Quarterly Economic Update

December 9, 2015

MACROECONOMIC COMMENTARY

Monetary Policy

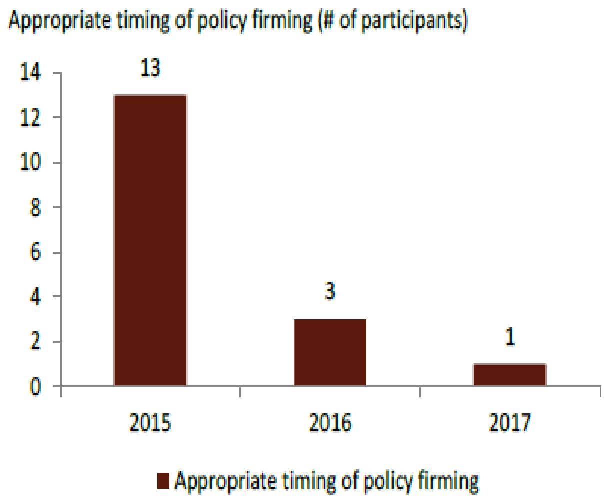
By Bobby Long

The September Federal Open Market Committee (FOMC) meeting passed with no change to policy as committee members expressed concern about potential downside risks to US economic activity and inflation due to weakness in Chinese and other emerging markets. Leading up to the September meeting, growth concerns in these emerging market economies contributed to increased volatility in financial markets, specifically a drop in equity prices, further appreciation of the dollar, and wider risk spreads. At one point, the September meeting had been anticipated as the possible beginning of a shift in policy that would lift the federal funds rate off the current zero bound range. With the increased market volatility and uncertainty around the ramifications of weaker growth outside the US, the odds of a rate increase had fallen leading up to the meeting. The September FOMC statement specifically cited that "recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term." In light of these concerns, the FOMC chose to hold the target range for the federal funds rate at the current 0 to ¼ percent.

The minutes from the September meeting revealed further discussion around participants' assessment of economic conditions, economic projections, and the factors that led to their decision that it was not yet appropriate to raise the federal funds rate. Members seemed to agree that economic activity, with the exception of net exports, was expanding at a moderate pace and expected to continue. Overall, members also seemed to agree that labor market conditions had substantially improved and the underutilization of labor resources had diminished. However, the degree to which the underutilization had diminished seemed to be somewhat debatable among some members. While most participants thought that the underutilization had been substantially reduced, some continued to highlight the low level of labor force participation and the higher number of part-time workers due to economic reasons as concerning. The lack of broad-based wage increases and labor compensation was also highlighted as a concern. As a whole, the minutes indicate a higher level of confidence in the progress towards the maximum employment part of their mandate. There seems to be less confidence and a wider range of views on their progress towards bringing inflation in line with levels seen as promoting price stability. While communicating that longer-term inflation expectations remain stable and confidence that inflation would gradually move towards the committee's 2 percent objective, several members expressed concerns that lower oil prices and the higher foreign exchange value of the dollar would continue to place downward pressure on inflation. The recent move lower in market-based measures of inflation compensation also left some members less confident in their inflation projections. The minutes state that most participants thought the conditions for policy firming had been met or would likely be met by the end of the year, but noted that some participants judged that the downside risks to the outlook for economic growth and inflation had increased. In her post meeting press conference, Federal Reserve Chair Janet Yellen acknowledged that "the recovery from the Great Recession has advanced sufficiently far and domestic spending appears sufficiently robust that an argument can be made for a rise in interest rates at this time," but went on to say that "in light of the heightened uncertainties abroad and a slightly softer expected path for inflation, the Committee judged it appropriate to wait for more evidence, including some further improvement in the labor market, to bolster its confidence that inflation will rise to 2 percent in the medium term."

The updated economic projections submitted by participants at the September meeting slightly lowered growth and inflation projections to reflect downward pressures from weaker foreign growth, lower commodity prices, and the stronger US dollar. As illustrated in the chart below, 13 participants viewed it appropriate to begin raising the federal funds target range before the end of 2015. This declined from 15 participants as of the June projections, but still represents a significant majority.

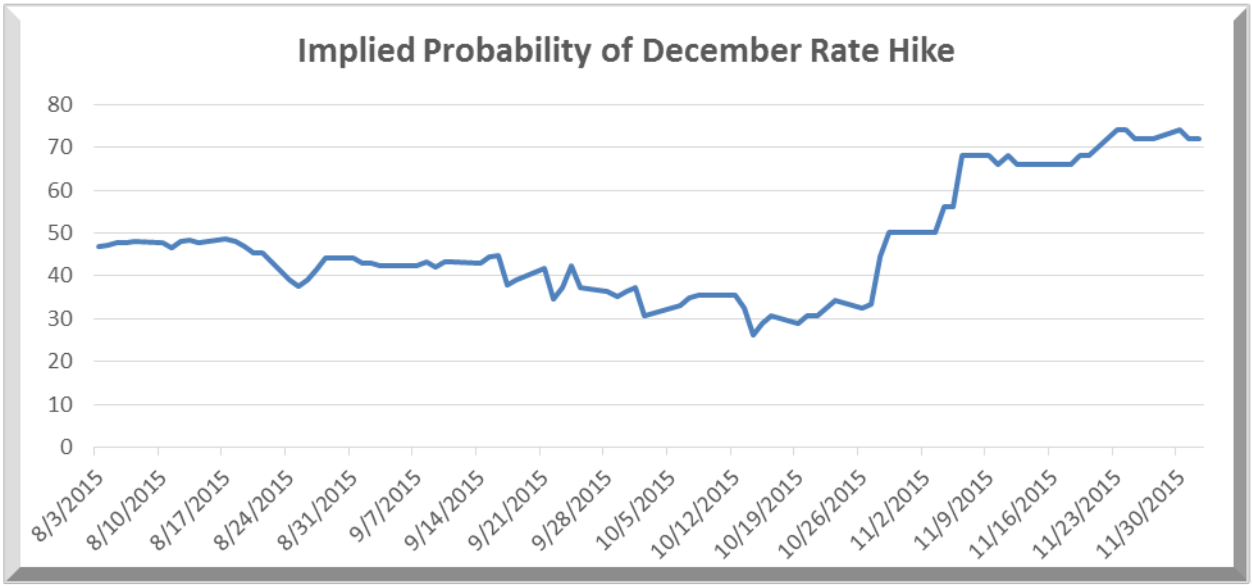
FOMC Forecasts	Median				
	2015	2016	2017	2018	Longer-run
Change in real GDP	2.1	2.3	2.2	2.0	2.0
June projection	1.9	2.5	2.3	-	2.0
Unemployment rate	5	4.8	4.8	4.8	4.9
June projection	5.3	5.1	5		5.0
PCE Inflation	0.4	1.7	1.9	2.0	2.0
June projection	0.7	1.8	2	-	2.0
Core PCE Inflation	1.4	1.7	1.9	2.0	-
June projection	1.3	1.8	2	-	-
Projected Policy Path					
Fed funds rate	0.4	1.4	2.6	3.4	3.5
June projection	0.6	1.6	2.9	-	3.8



Source: Haver Analytics, Renaissance Macro Research

The FOMC met again in October with no shift in policy and little change to guidance on the path of the federal funds rate. The FOMC's statement was a little more constructive on economic activity, while noting that the pace of job gains had slowed and market-based measures of inflation compensation had moved slightly lower. The FOMC did adjust their statement to communicate that a policy shift as early as the December meeting was on the table by changing the language from "In determining how long to maintain this target range," to "In determining *whether it will be appropriate to raise the target range at its next meeting*, the Committee will assess progress--both realized and expected--toward its objectives of maximum employment and 2 percent inflation." The October minutes show similar discussion regarding economic activity, labor markets, and inflation. They note some mixed views on the recent slower employment reports, but also note that cumulative conditions over the year had shown improvement towards their employment objectives. The minutes also indicate that most participants viewed the downside risks from weaker foreign economies and markets as having diminished. Some participants expressed various reasons why the FOMC should avoid delaying policy firming further, while others still pointed to downside risks that exist and the limited ability to provide additional accommodation should it be needed.

Communications from the FOMC and its members have been varied over the past few months and have left market participants confused at times. More recently, communications and conditions have increasingly pointed to an initial increase in the federal funds target at the December meeting. Since the October FOMC meeting, the implied probability of a December rate hike has moved sharply higher as shown in the chart below.

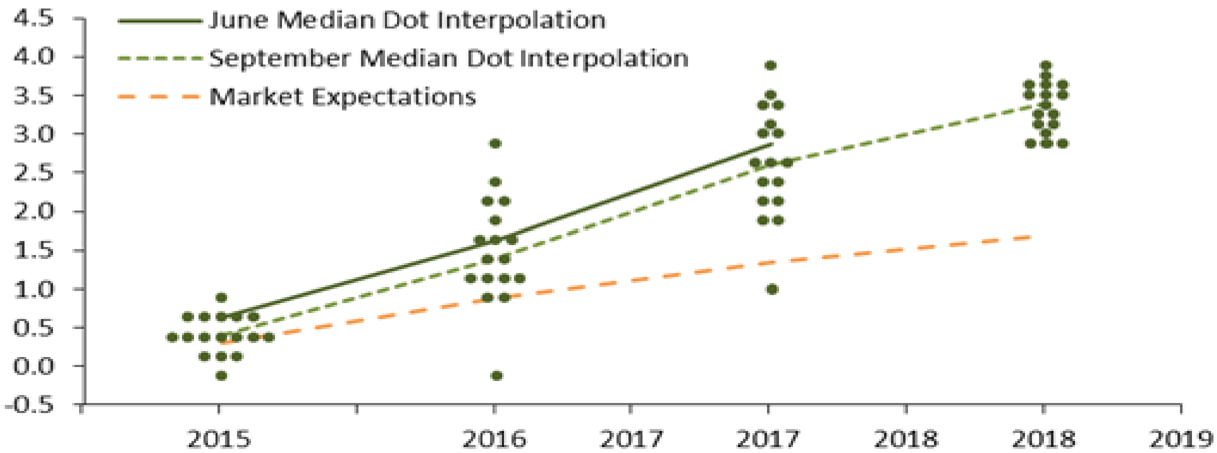


Source: Bloomberg

FOMC communications signal they want to move forward with an initial rate increase to get the federal funds target off the current zero bound range and they likely will in December barring a significant deterioration in labor conditions or some other major economic shock. There remains a greater degree of uncertainty on the inflation side of the equation, but this will likely influence the pace of rate increases going forward more than the initial increase. Yellen gave a speech at the Economic Club of Washington, D.C. on December 2nd and stated that "economic and financial information received since our October meeting has been consistent with our expectations of continued improvement in the labor market" and that this improvement "helps strengthen confidence that inflation will move back to our 2 percent objective over the medium term." With market expectations of a December rate hike rising, Yellen could have used this speech to talk expectations down but instead chose to communicate that conditions were continuing to move in a direction that would warrant a rate increase.

The chart on the following page shows the September projections for a rate increase before year end are widely supported, but the pace of tightening going forward is much more uncertain as represented by the dispersion of the dots. There also remains a wide diversion between the pace of tightening as indicated by the projections versus market expectations. While the median projections moved down at the September meeting, the gap relative market expectations is still pretty wide.

FOMC Projections for the Federal Funds Rate



Source: Cornerstone Macro, Federal Reserve and Bloomberg

The next FOMC meeting is December 15^{th}-16^{th}, so we will get a decision on an initial rate increase then and also get updated projections on the potential pace of tightening. Regardless of the decision to move forward with the initial rate increase, the projected path will likely shift down some. Yellen has repeatedly sought to communicate that the pace of tightening is more important than the initial timing of an increase and stressed that the committee prefers a gradual approach to tightening policy. In her recent speech to the Economic Club of Washington, D.C., she noted that "to delay the start of policy normalization for too long, we would likely end up having to tighten policy relatively abruptly to keep the economy from significantly overshooting both of our goals. Such an abrupt tightening would risk disrupting financial markets and perhaps even inadvertently push the economy into recession." As they move past the initial rate increase, their communication strategy on the expected path of rates will likely need to evolve and take greater importance going forward. While everything does seem to be pointing to a rate increase at the December meeting, as always the decision is data dependent and will consider a variety of incoming information leading up to the meeting, so stay tuned.

Fiscal Policy

By Michael McNair

Since at least 2010, there has been a widespread national debate about the proper role and direction of fiscal policy. Unfortunately, discussion on government spending is highly susceptible to turn from an economic conversation into a political debate. A policy recommendation is often immediately dismissed unless it fits with the individuals preconceived beliefs. In the Fiscal Policy Report, I have been adamant in my belief that fiscal policy in the US and in Europe has been far too restrictive and has stunted the economic recovery. I am fully aware that this belief is sacrilege to some who believe that government deficit spending is always evil. Therefore, I want to take the time to briefly explain my position and provide more insight into my views.

There has been a longstanding debate in economics between “supply-siders” and “demand-siders” over the appropriate role of fiscal policy. In overly simplistic terms, supply-siders believe that the production of goods and services are the most important factor in determining economic growth; therefore, the role of the government should be to promote policies that allow an increase in the savings rate in order to fund increased investment in capital and to lower barriers for the production of goods and services. In essence, they believe that it is a lack of productive capacity that limits economic growth.

Demand-siders (a version of this is Keynesian Economics) believe that it is a lack of demand, not supply, that limits economic growth. Demand-siders believe that when the economy is weak the role of the government should be to increase fiscal spending in order to stimulate demand.

Today, most economists, politicians, or individuals who are proponents of one side believe their policy prescriptions should be universally applied and are often opposed to the other’s policies. But as it turns out, there are economic conditions under which supply-side policies will be effective and demand-side policies will be ineffective and vice versa.

I will call the conditions under which supply-side policies will work the “Supply-Side world” and the conditions where demand-side policies will prevail will be called the “Keynesian world”.

Supply-Side World

The conditions under which supply-side policies will be most effective are when investment is being constrained by a lack of savings (investment is funded by savings). The best example of this Supply-Side world is the US during the 19th century. The US was a new and rapidly growing nation with a need for significant investment in infrastructure. However, the amount of profitable and productive investment far exceeded the domestic supply of savings. Therefore, US growth was dependent on the supply of excess savings from Britain to fund the needed investment. When British savings became constrained and the flow of capital to the US was choked off, such as in 1837, the US fell into a severe depression which resulted in widespread bank failures and defaults.

When investment is constrained by a lack of savings, government investment competes with the private sector for the finite amount of available savings. Thus, increases in government investment cause interest rates to rise in a phenomenon known as the crowding out effect. Because most supply-siders believe that the private sector is superior to the government in investing in productive projects, they believe that the government should reduce their spending to allow for more spending by the private sector.

Further, when an economy has low unemployment and is near full capacity utilization, as was often the case in the US during the 19th century, demand runs near the limits of the economy's ability to produce. As such, further increases in demand will not raise the output of the economy but only raise the PRICE of goods and services (i.e. create inflation).

During times when the economy is near full capacity, increased government spending will push demand above the capacity of the economy to produce at stable prices, leading to inflation and causing interest rates to rise. In this case, the government should cut spending and focus on supply-side policies that raise the domestic savings rate (which is the same as cutting consumption) and increase investment in production capacity.

Keynesian World

An economy that has recently fallen into a recession, due to a drop in private sector spending, is a typical example of an economy operating in a "Keynesian world". However, any economy where economic output is considerably below the full capacity of the economy to produce is considered to be operating in a Keynesian world. This "output gap" is defined as the gap between actual GDP and potential GDP, and we will refer to it as economic slack. An economy operating with significant economic slack is characterized by having low capacity utilization, high unemployment, and excess savings that drive down interest rates and inflation. This is clearly the current state of the economy, and **under these circumstances, the proper fiscal policy is for the government to increase the deficit to whatever level is necessary to bring the economy back to full employment.**

In a Keynesian world, the economy can produce far more than is currently being produced; thus, it is a lack of demand, not supply, that is constricting economic growth. Weak demand or economic slack occurs when fear, a banking crisis or some other shock cause the private sector to reduce their spending and raise their savings rate. At the individual level, if we save a portion of our income, we can spend more in the future. However, at the macro level, we cannot save by spending less. This is because total income in the economy is equal to the amount of spending in the economy (income = spending). Therefore, when the private sector attempts to save, it only causes total income to fall and paradoxically the economy has less money to spend in the future. In a Keynesian world where the economy is operating well below capacity, it is the role of the government to increase spending to offset reduced private sector spending and ensure that incomes do not fall.

There have been three main arguments made against increasing government deficits, and I will examine each claim to show why they do not apply to an economy operating in a Keynesian world.

Probably the most misguided critique of the large fiscal deficits run over the past few years is that government spending is crowding out private sector spending. This could not be further from the truth. Remember, that in a Supply-Side world, savings are constrained and the government must compete with the private sector for the limited capital available to fund investment. However, the Keynesian world is awash in savings because the private sector reduced consumption and is too reluctant to invest. The result of this excess savings is that interest rates drop and capital is forced into speculating on financial assets rather than investing in productive projects that can increase the productivity in the economy. The lack of consumption and investment from the private sector makes it imperative that the government fill the void and increase deficit spending. In fact, the US government is missing a golden opportunity to increase investment and upgrade the nation's failing infrastructure while interest rates are historically low.

Another common criticism of the large government budget deficits of the past several years is that it will cause US debt to rise to an unsustainable level. The flaw in this argument is that when the economy is operating below full capacity, government spending (or any spending for that matter) will have a significant multiplier effect, where every dollar spent will create well over a dollar of new income/GDP. So while debt increases, the income to service that debt increases at a far greater rate. I have commonly heard the claim that the government budget deficits run in the wake of the financial crisis are just borrowing from the future. However, this is a completely false statement, in so far as "borrowing from the future" implies that our future spending will be lower than it would have been if we didn't increase the deficit today. While our debt will be higher, our ability to service the debt will be greater because of the multiplier effect.

You are probably asking yourself, "If deficit spending is so good for the economy then why don't we just always run large deficits?"

The answer is that **government deficits will only increase economic wealth when the economy is operating below full capacity and there are ample idle resources, such as unemployed workers or unused factories, that can be brought on to meet the increased demand from government spending.** When actual GDP is near potential GDP, then any increase in spending from the government will be inflationary as it will only increase prices and not output.

A final concern with government deficit spending is that it will cause inflation. The truth is that all spending (public or private) can cause inflation if it causes demand to rise faster than the real capacity of the economy to produce it. The essential factor that determines if increased government spending will cause inflation is the amount of slack in the economy. If the government increases spending and the economy is operating well below full capacity, then output will rise but inflation will not.

Context is Everything

It is completely understandable for people to worry about growing deficits and monetary expansion because economic history is filled with examples of it leading to inflation and weak real economic growth. If you lived through the 1970s, then you have been well versed in the consequences of excessive government spending in an economy with little spare capacity, and it is natural that this lesson will cause people to form a perpetual fear of government deficits regardless of the economic circumstance.

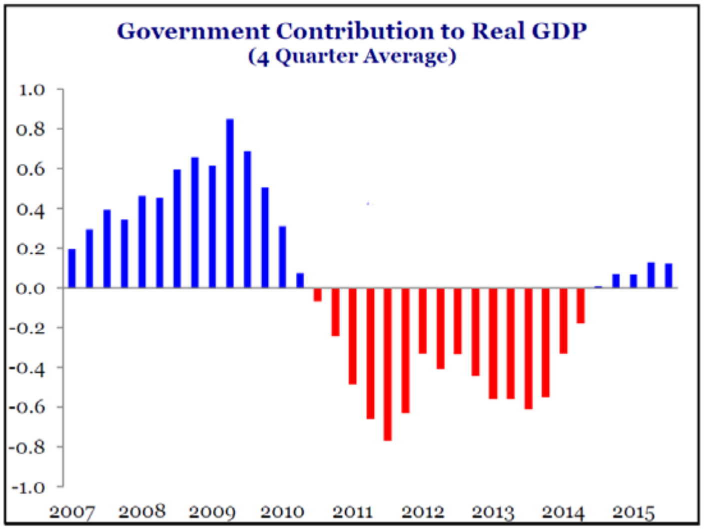
Similarly, anyone living during the 1930's will be well aware of the importance of stimulative fiscal and monetary policy in reviving the economy in the midst of a depression, and they will point to 1937 as a clear lesson in the negative consequences of tightening policy while there is still significant economic slack.
These experiences present us with seemingly conflicting advice, yet it is only when we place these lessons into the proper economic context that the inconsistency can be reconciled.

We must also not be confused by taking economic theory out of context. Politicians and mainstream media are especially susceptible to falling victim to this trap because their reading of economics is focused on finding economic literature that supports their political agenda.

Over the last few years, I have heard many commentators quoting monetarist economists, such as Friedrich Hayek, to extol the evils of the government deficits of the past few years. But these commentators are taking Hayek out of context when they use his advice for the supply-side world and apply it to the Keynesian world, where we currently live. Hayek, on the other hand, would never have made this mistake because he knew very well that in an economy awash in savings and operating below full employment, as we have been for years, then government spending will be stimulative and will not be inflationary.

The important point is that we have clearly been living in a Keynesian world for at least the last seven years, and when the economy is operating well below capacity, the government should run stimulative fiscal policy.

My criticism of US fiscal policy over the past few years is that the government engineered the largest fiscal drag in our nation's history at a time when we were experiencing the largest output gap in the post-war period. Fortunately, the fiscal drag has now turned into a slight stimulus, as government spending is no longer subtracting from economic growth for the first time since 2010.



Source: Strategas

The problem is that the slack in the US economy is less than it was 4 years ago. It is still appropriate to run simulative fiscal policy because there is still a wide output gap in the US economy, but it was far more important to do so in 2011 than it will be in 2016. My contention is that the position of fiscal policy should be determined by the condition of the economy and not based on the outcome of political battles in Washington.

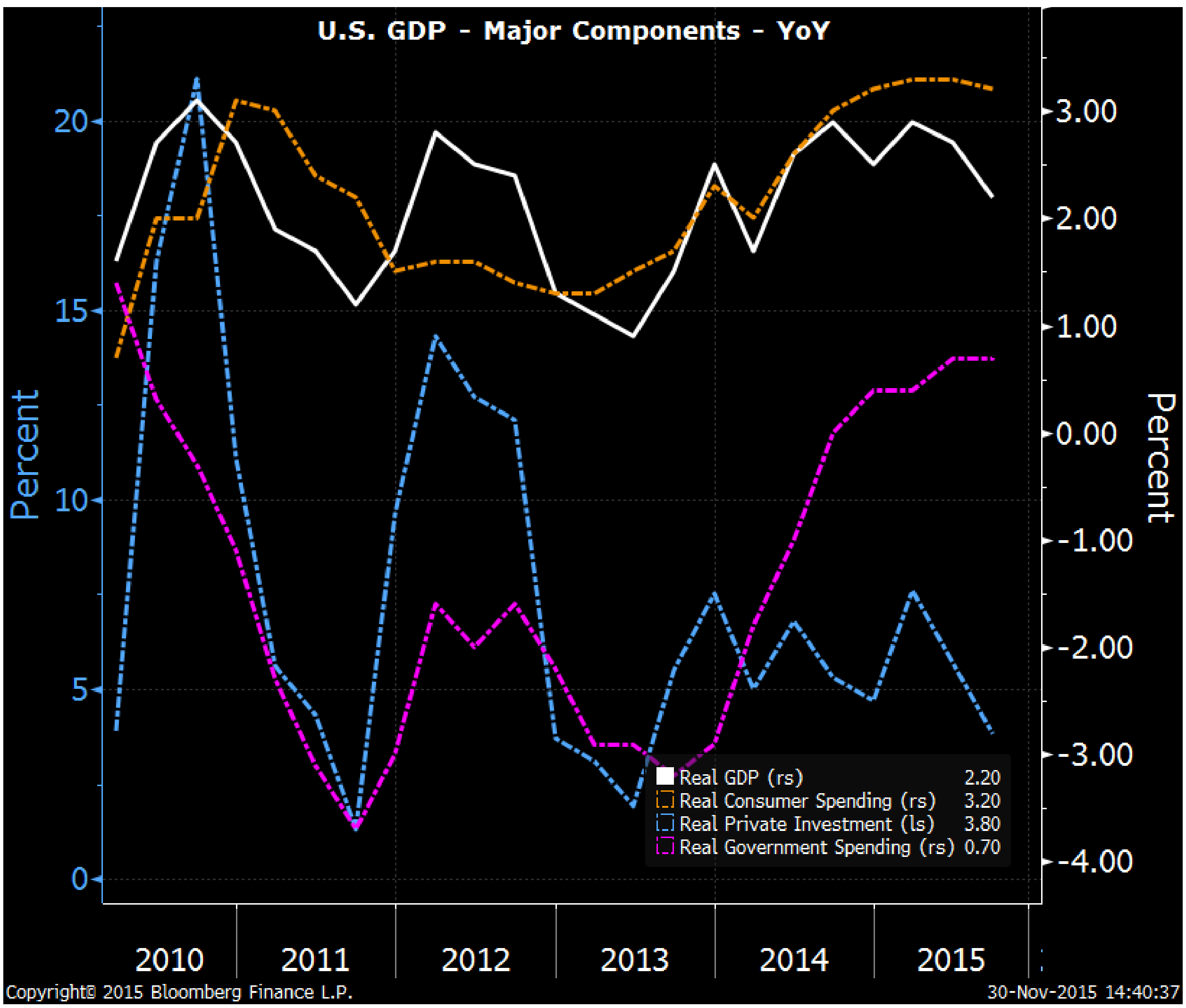
Economic Outlook

By Adam Rogers

Growth

The U.S. economy grew faster in 3Q 2015 than previously estimated, rising at a 2.1% annualized rate, up from the advanced survey of 1.5%. The upward revision overall came as a slight disappointment, with the composition painting a negative picture for Q4. The contribution from inventory growth, up from -1.44% to -.059%, was in line with expectations as we've already been given the September inventories data. These higher than expected inventories, while providing a boost (or less of a drag) to the 3Q report, are likely to weigh on 4Q, drawing out the inventory cycle. Minor downward revisions to consumer spending and a wider trade gap offset some of the positive effects of the inventory build.

Figure 1



Source: Bloomberg

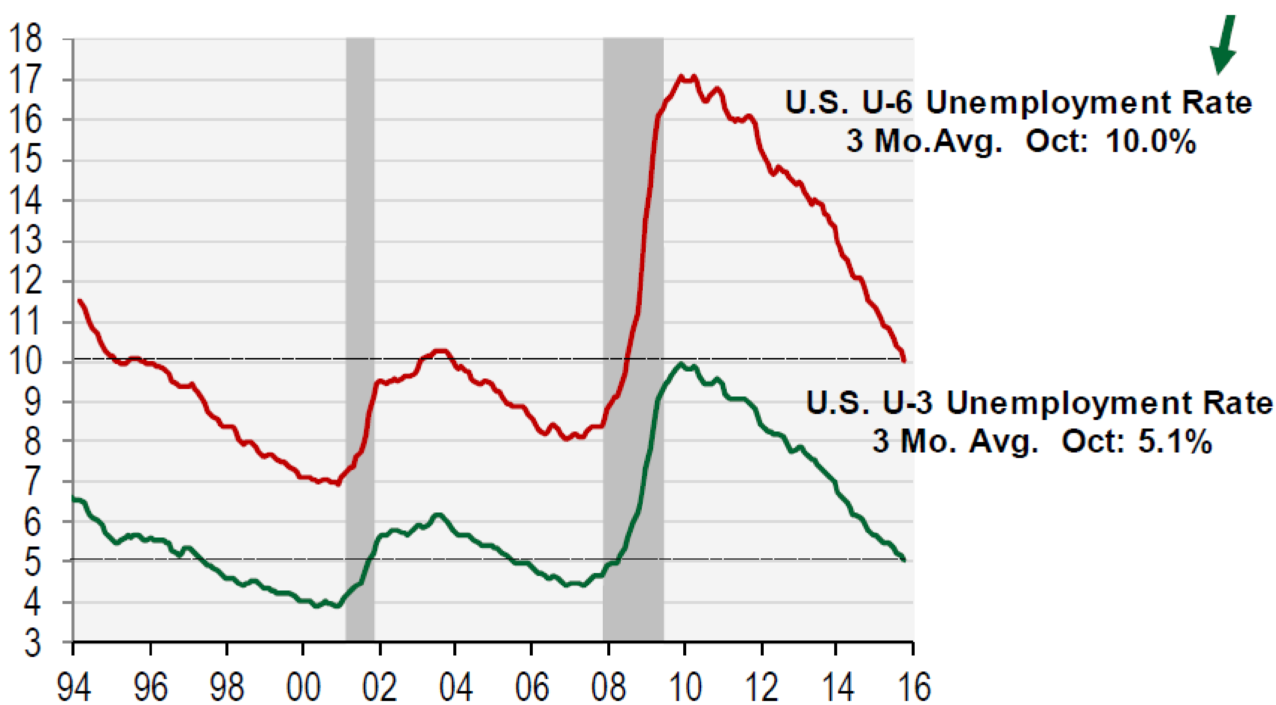
Employment

After the October jobs report, there is no question that the US labor force is back to work. The 271,000 jobs gained was the biggest of the year, surpassing estimates. Manufacturing jobs were flat, but 241,000 were added in the service sector and 31,000 contributed from construction. The unemployment rate has now dropped to an even 5%, its lowest reading since April 2008, and for the 12 months ending in October, average hourly earnings have increased 2.5%, the most in 6 years.

While we don't have the November Non-Farm payrolls data as of this writing, the similar ADP payroll number released on Dec 2nd, a good leading indicator of the NFP report, was another clear sign that the labor market continues to strengthen, with a headline of 217k jobs - above the consensus forecast of 190k and the highest in five months. October was also revised up to 196k from 182k. Last month the ADP underestimated NFP by 89k, much larger than normal and the current forecast for NFP stands at 200k. It's unlikely such a large underestimation will occur again, but the report was another encouraging signal.

As we have pointed out over the past year, wage gains are typically seen once the unemployment rate falls to these levels. And while that is certainly beginning to play out, so far the acceleration leaves a little to be desired. Looking at U6 unemployment provides some explanation as amidst all these job gains there has remained a fair level of *under*-employment, people working at reduced hours or wages. This too is moving in the right direction and we believe with U6 now below 10%, and the labor force stable, wage gains will continue accelerating.

Figure 2



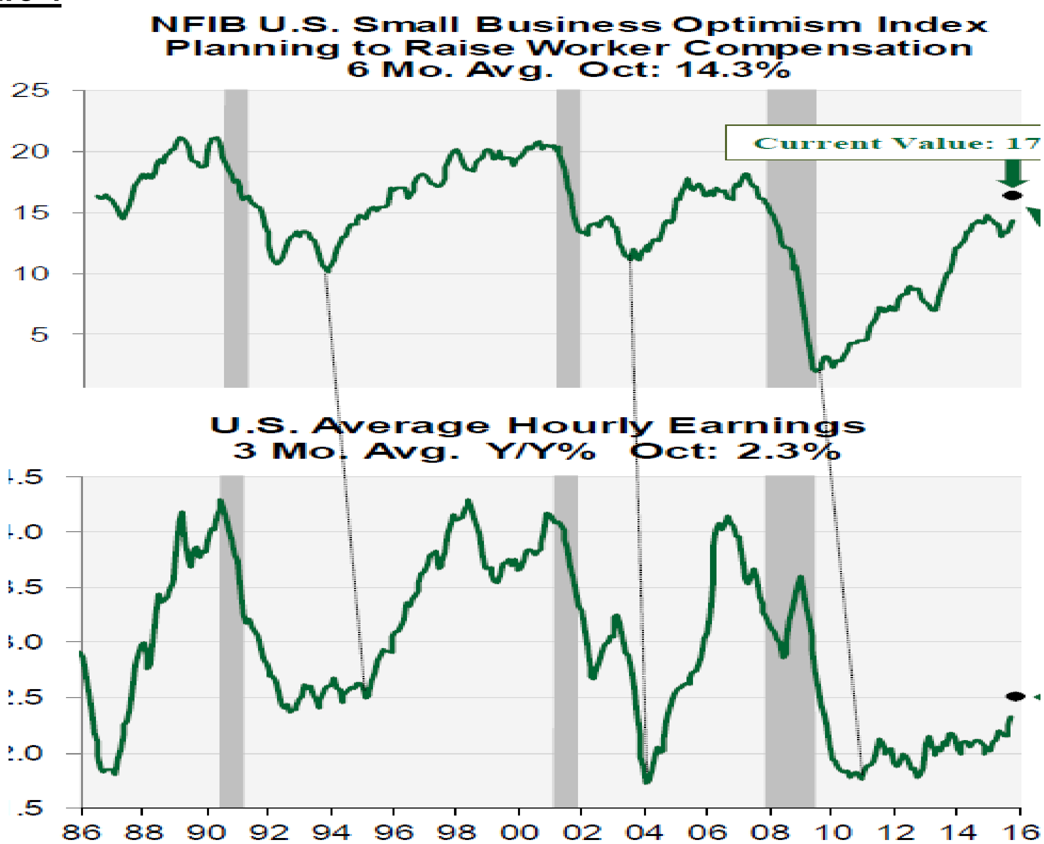
Source: Cornerstone Macro

Figure 3

Source: Bloomberg

Digging deeper, the NFIB's survey of compensation plans has increased sharply from its low, another sign of labor market strength.

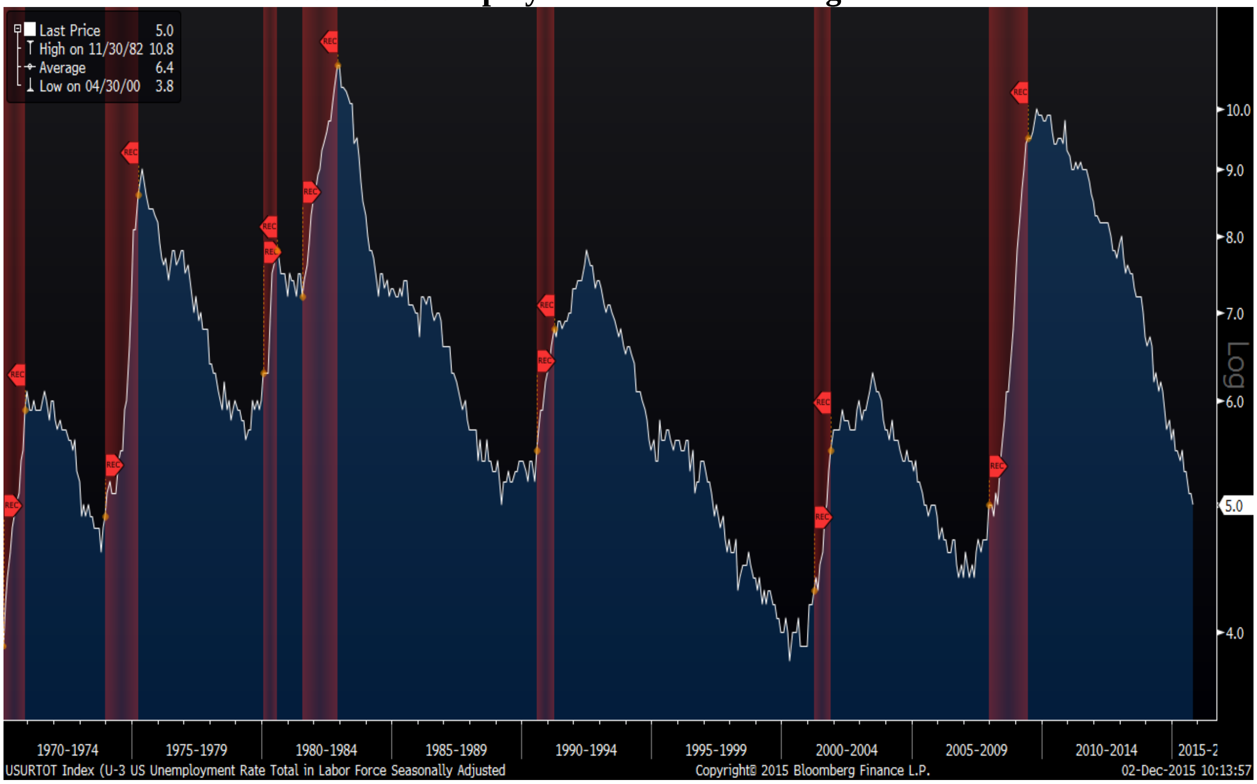
Figure 4



Source: Cornerstone Macro

Figure 5

Low Unemployment Rate Preceeding Recessions



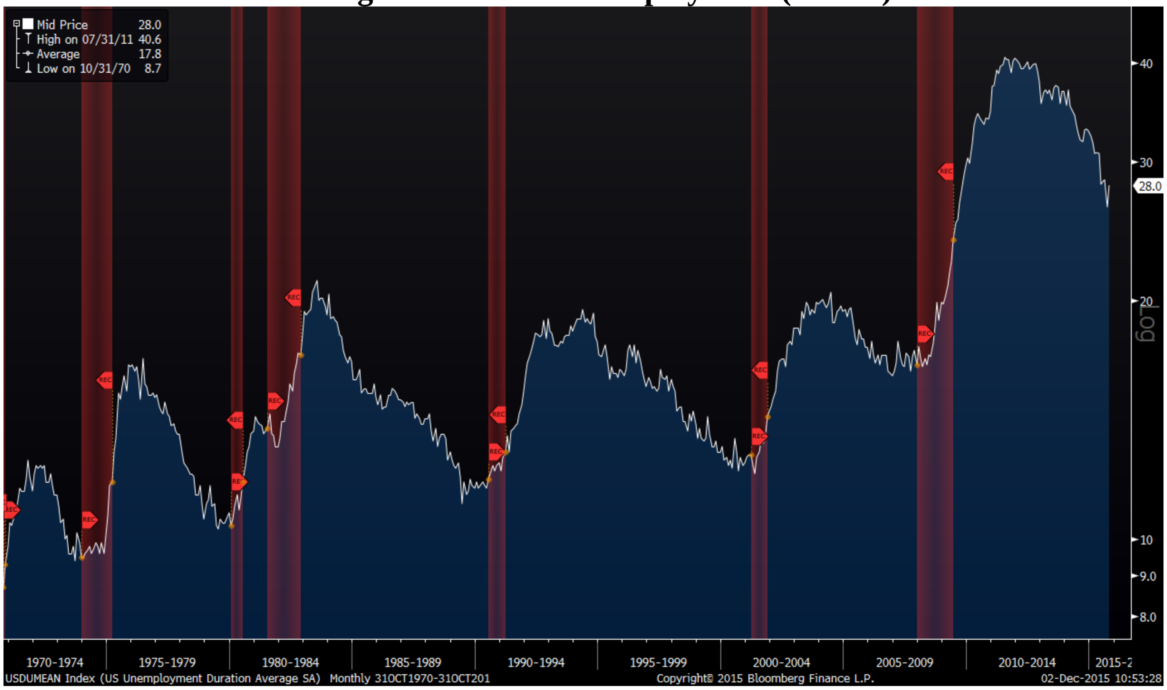
Source: Bloomberg

Some would point to the fact that low unemployment coupled with tightening Fed policy is late cycle activity and now is the time to be on your toes as a recession is immiment. We agree with the first part. Great job numbers and wage gains are good but indeed they are usually one of the last “goods” you get until things turn. Much of this, of course, is highly dependent on the Fed and what type of pause we see after liftoff. We disagree with the imminence of a recession as there are plenty of other late cycle indicators suggesting we still have time. We will lay out three of these indicators below.

1 - Duration of Unemployment

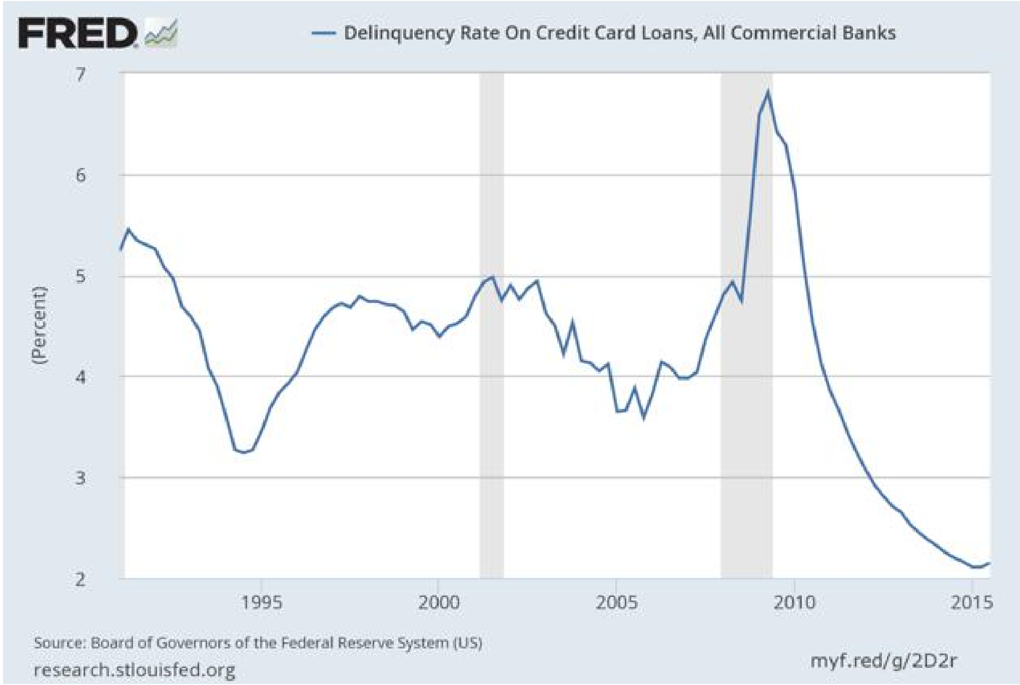
This refers to the length of time the unemployed have been looking for work. When the economy peaks this measure is usually somewhere in the neighborhood of 10 weeks and for decades never rose much above 20 weeks during the worst part of the cycle. The great recession was bad enough to push us all the way up to 39 weeks and while it has steadily improved from there, its current level of 28 weeks can hardly be called overheated. This suggests the labor market still has slack to work through and the good job gains we’ve had still haven’t brought us back to what you could call full employment.

Average Duration of Unemployment (Weeks)



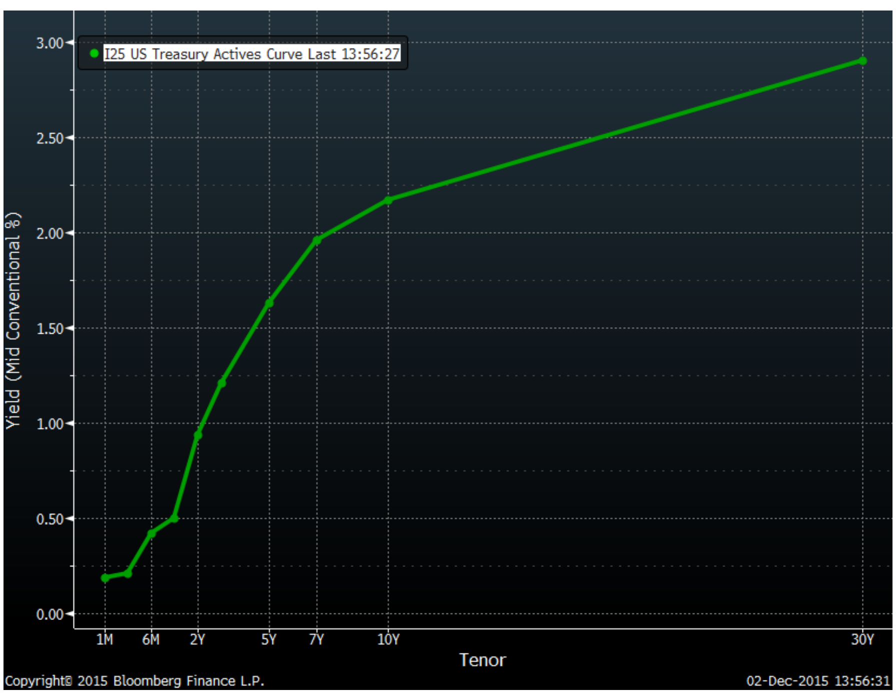
2 – Consumer Financials

The consumer is also not behaving in a fashion commensurate with economic tops. At tops we expect to see increasingly reckless use of debt or at least increasing amounts of debt. Households now in fact are still deleveraging and behaving much more responsibly.



3 – Positively Sloping Yield Curve

Put simply, a positively sloping yield curve signals normalcy with longer maturities having a higher yield than shorter maturities and generally indicates that interest rates are expected to be higher in the future. An inverted, or downward sloping curve is a reliable indicator of a recession.



Source: Bloomberg

Most of the late cycle indicators we look at show few signs of an immediate threat. The average duration of unemployment is improving but still well above normal levels. Consumer balance sheets are healthier than they've been in decades, and lending activity is improving but not overheated. The primary risk to the economy remains a policy mistake from the fed.

Interest Rates and Fixed Income Strategy

By Nick Prillaman

With respect to our September meeting, we discussed the volatility in yields as global factors like China's currency devaluation and crude oil's downward price trend affected rates. There was also much debate over the timing of the first interest rate hike as events in August caused various Wall Street entities to alter their expectations of an interest-rate hike from September to December.

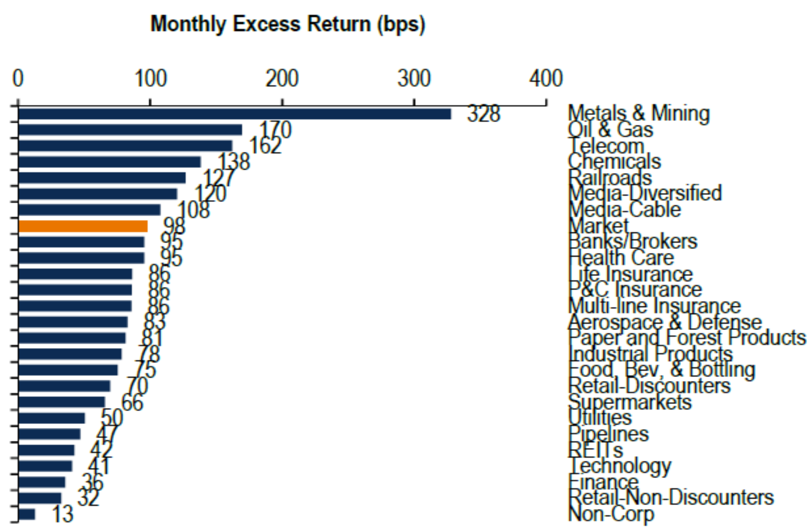
The month of September was a poor one for the riskier portions of the financial markets as the S&P 500 fell over 2%. BofA Merrill Lynch said "risk assets struggled in September as an FOMC statement that surprisingly directly highlighted concerns about global weakness spooked investors, with the Fed attempting – but failing – to walk a fine line between providing extended accommodations and spotlighting downside risks to the US economy." At their September 17th meeting, the Federal Reserve "reaffirmed its view that the current 0 to ¼ percent target range for the federal funds rate remains appropriate" while also saying "recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term." Treasury securities performed well in this environment with the 10-year bond rallying from 2.2179 percent to 2.0368 percent and the 5-year note moving from 1.5478 percent to 1.3572 percent. During this time, the 2s/10s curve flattened by 7 basis points (bps) which was consistent with the risk-off mentality among market participants.

In the realm of fixed income spread products, government-related securities posted mixed performance while company bonds were weak, especially in the lower-rated areas. The 30-year mortgage index experienced spread widening for the month of September as the spread over the 5-year Treasury went from 139 bps to 143 bps. The negative convexity characteristics of mortgage securities were not ideal in this falling rate environment. The Credit Suisse 3-5 Year Agency Index, however, did post strong spread movement as they narrowed from 14.50 bps to 7.30 bps. For the corporate bond market, September was a struggle "as uncertainty about global growth, Fed Policy and rising event risk weighed heavily on risk premiums" according to Wells Fargo. In the U.S. investment grade space, spreads widened by 10 bps with commodity-related names getting hurt the worst. Drillers and Metals and Mining were hit with the largest widening at 78 bps and 69 bps. The high yield market suffered the most as spreads jumped 90 bps. Chemical and Telecom names had the greatest adverse spread action with 209 bps and 181 bps of movement though Energy E&Ps had a worse total return than the Telecoms. Along the credit-ratings spectrum, CCC-rated credits had the poorest total return for September at -3.51 percent.

While the previous two months in the S&P 500 had been difficult for the investing community, October marked a strong turnaround in risk appetite as the S&P 500 surged 8.30 percent. The lower-than-expected payroll number in early October was a catalyst for the market move as expectations for the first interest-rate hike were pushed out per BofA Merrill Lynch. The Labor Department said 142,000 jobs were added in September which was below expectations. Wage pressures were absent in the report and the jobless rate remained stationary. BofA Merrill Lynch also said the European Central Bank provided additional fuel to the rally when it signaled its "willingness to increase support for its economy amid signs of tepid inflation and slowing global growth." Mario Draghi said "the bond purchases, originally due to end next September, will continue until the ECB sees a sustained increase in the inflation outlook" according to Bloomberg News. During this time, Treasury securities acted in their typical fashion of selling-off when risk assets perform well. The 10-year Treasury went from 2.03 percent to 2.14 percent while 2-year note rose from 62 bps to 72 bps. The 2s/10s curve was fairly stagnant for the month with only 1 bps of steepening.

Outside of Treasuries, most bonds posted strong relative gains as spreads compressed. The 30-year mortgage index versus the 5-year Treasury went from 143 bps to 131 bps as volatility declined. The Credit Suisse 3-5 Year Agency Index experienced some whipsaw movements as spreads went from 7.30 bps at the start of the month to 12 bps on October 2nd to 8.20 bps by the end. In terms of corporate issues, the high grade index tallied 54 bps of total return versus -36 bps for Treasuries. As one can see in the chart below, Metals & Mining posted superior excess returns of 328 bps with Oil & Gas generating the second best performance with 170 bps as "higher beta sectors outperformed" per BofA Merrill Lynch. New issuance of $102.7 billion was robust for October and was the seventh time this year that $100 billion in issuance was exceeded according to CreditSights. High yield corporates were among the best asset classes in monthly total return with a 2.73 percent gain. Bonds rated "BB" led the high yield space with a 3.34 percent total return.

Figure 4: October 2015 high grade sector excess return



Note: Based on Credit Strategy, not index, sectors.
Source: BofA Merrill Lynch Global Research

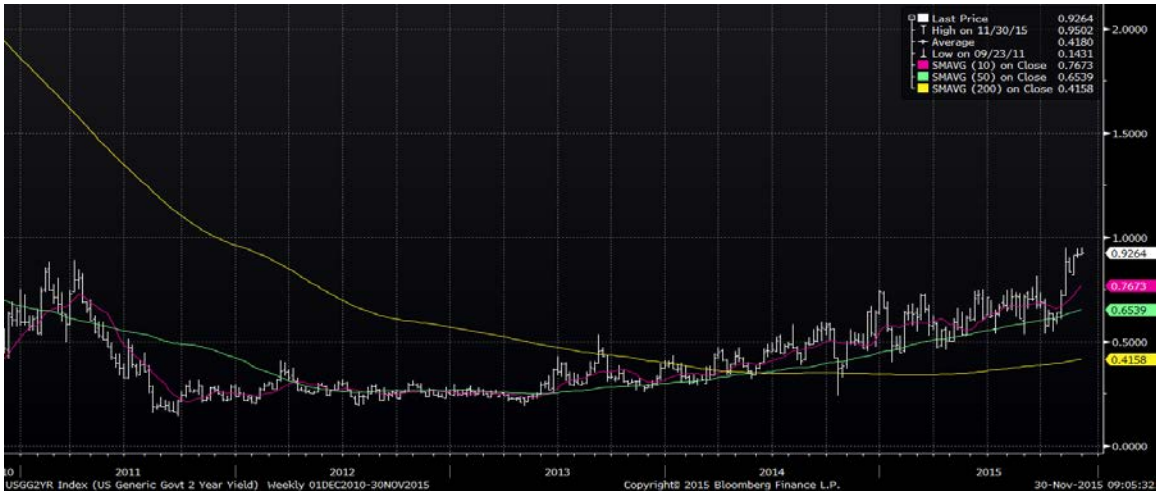
Source: BofA Merrill Lynch Global Research

The month of November saw two different phases. BofA Merrill Lynch said the first part was driven by "the surprisingly hawkish late October FOMC statement, subsequent hawkish commentary from a number of FOMC members including Chair Yellen, and a very strong October jobs report." The Labor Department said on November 6th that "total nonfarm payroll employment increased by 271,000 in

October." The New York Times felt that the number "suggested that economic growth had enough momentum to allow the central bank to begin its move away from the ultralow, crisis-level interest-rate policy it has been following for seven years" which raised the probability of a December interest rate hike. During this initial phase, Treasuries sold off sharply with the 5-year moving from 1.51 percent to a high of 1.77 percent while the 10-year went from 2.14 percent to a high of 2.37 percent. The S&P 500 sold off by 2.88 percent as investors fled riskier assets. The second part of the month was a reversal as oil prices stabilized at the expense of heightened geopolitical risk, according to BofA Merrill Lynch. Treasuries rallied in conjunction with higher stock prices. In the midst of all this volatility, the result was a much flatter Treasury curve by 14 bps. Also, investors raised their probability of an interest rate hike at the December meeting from 50% at the start of the month to 74% at the end per Bloomberg.

Spread products posted mixed returns while the market oscillated. The Credit Suisse Liquid US Agency 3-5 Year Index showed spreads surging higher from 8.20 bps to 17.40 bps in November. While this is not a dramatic move historically, it was large relative to its starting point. Mortgage spread performance was varied as the 30-year mortgage index rallied versus the 5-year Treasury while selling off versus the 10-year Treasury. Corporate bonds had significant divergences in returns as the overall high grade index tightened 4 bps to 162 bps with Media-Cable and Telecom leading the way with 81 bps in excess return. Metals and Mining and Pipelines posted the worst excess return at -415 bps and -133 bps. In high yield, the excess return was -2.24 percent which was the lowest among broad asset classes, according to BofA Merrill Lynch.

Various actions were taken over the recent time frame to improve RSA's investment positioning. In the Treasury portion of the portfolio, however, we made no strategic adjustments as opportunities were not readily forthcoming. We remained underweight versus the Barclays Aggregate while keeping a longer duration tilt to offset the underweight. Treasuries as an asset class will likely underperform spread products as the potential for the first interest rate hike of the cycle over the next couple months could derail the returns. As seen in the chart on the next page, the 2yr note yield has been rising for some time, but has popped even more recently in anticipation of higher rates. This move has caused the 2s/10s curve to flatten as the movement in the 10-year has been subdued. According to Bloomberg, the probabilities of a December hike is 74% and 69.2% for a January raise.



Source:Bloomberg

The chart shown below is the 30-year Treasury overlayed with a trend channel. The recent move higher in rates seems transitory as the long term trend is still clearly lower. With this in mind, we will look to add duration if a significant rise in yields occurs or to shed duration if yields fall to the lower end of the range.

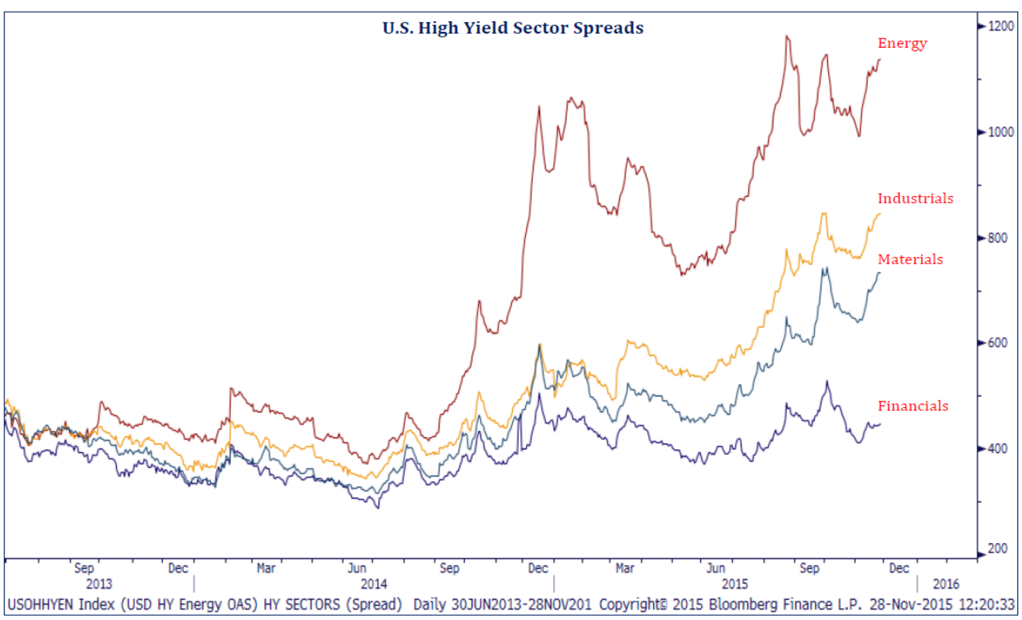
Source:Bloomberg

Activity in the agency portfolio consisted of replacing multiple called agency securities with various other agency debt offerings. One purchase was a 5-year FNMA bullet with a 2020 maturity which gave greater diversity among the various maturities in the agency portfolio while keeping the duration mostly neutral. Another was a 2021 Federal Farm Credit callable bond that provided a 20 bp pickup in yield versus similar agency bullets. This was also a fairly neutral trade in terms of duration. Additionally, a 2019 Federal Home Loan Bank callable note was purchased as it provided 22 bps of spread over Treasuries. For the foreseeable future, our view on agency spreads is that volatility will be largely uneventful. With the Credit Suisse Liquid US Agency 3-5 Index at 16.80 bps, there isn’t a lot upside for the agency sector from a spread perspective. Our duration is slightly long to benefit from any drop in interest rates. We are not planning any activity over the coming months beyond general maintenance trades.

In the mortgage space, we completed a prepayment reinvestment trade by buying a 15-year Fannie Mae 2.50 percent coupon which helped to increase our duration. The pool had a 5.656 year average life with a 2.26 percent yield. We will continue to reinvest prepayments in an effort to maintain our weighting in the overall portfolio. Among government-related fixed income securities, mortgages remain the go-to-product from a spread perspective. Relative to the 5-year Treasury, the 30-year mortgage index offers a 128.26 bp spread while the 15-year mortgage index offers a 56 bp spread. The 2.50 coupon 15-year mortgage appears to be best pool as it is longer on a duration basis than the Barclays Aggregate's mortgage index while also providing less extension risk than 30-year pools due to its 15-year maturity.

For corporate bonds, we participated in a number of new issues. One example was the new 10-year MetLife note which came at 125 bps over the equivalent Treasury security. This purchase enabled us to invest funds in a stable company after an increase in interest rates. Another purchase was the new 10-year Dr Pepper Snapple Group bond issue which priced at 130 bps over the 10-year Treasury. Other new issues deals that we participated in were Microsoft, Stryker, Goldman Sachs, and HP Enterprise. Beyond new bond offerings, we took part in a tender offer for our Hewlett Packard 2016 notes as the tender price was deemed attractive. We have a positive future perspective in investment grade corporate bonds as the 163 bps in spread according to Goldman Sachs is more attractive than other fixed income products. With rates staying historically low even with the prospect of upcoming interest rate hikes, the extra spread over Treasuries will help this asset class outperform. In the high yield segment, the 638 bps of spread per Goldman Sachs is compelling though it is too early to call the turn in spreads. If one looks at the chart of the various high yield sectors below, it looks as if the energy, industrials, and materials portions could continue their trends higher. This is not a positive and one should tread lightly until a catalyst occurs to change the direction like a bottoming in oil prices.

HY SPREADS CONTINUE TO LEAK WIDER



-Strategas Research Partners

Domestic Equity Strategy

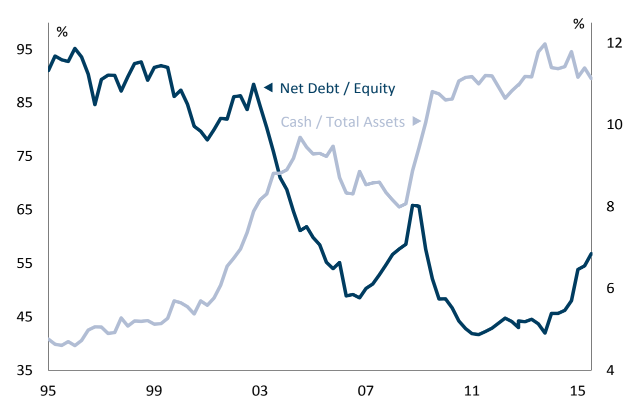
By Allan Carr

Around the time of our last update in early September, the market was in the midst of digesting the implications of the Chinese government's devaluing the Yuan. The S&P 500 closed at 2104 the day prior to China's devaluation announcement on August 11 and on December 1 it closed at 2103. So if you were long the market during that period you are exactly where you were roughly four months ago. However, the period in between (especially if you are a pension fund with a September 30 fiscal end) was a roller coaster of uncertainty and volatility. In a 32 day trading window from late August to early October, the average absolute daily move in the S&P 500 was 1.37%. There were 5 days in that span where the market was down over -2% and a five day stretch where the market was down roughly -10.6%. The ten worst days in that 32 day trading period were a cumulative (-22%), while the ten best days were a cumulative 18.5%.

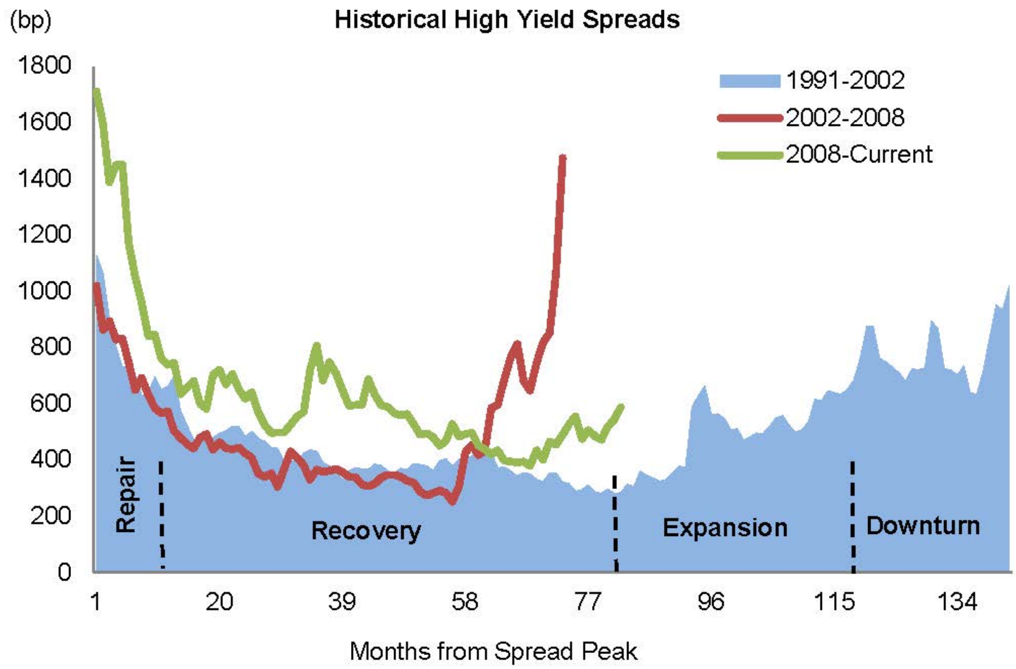
We are now nearly seven years into the current bull market with the S&P 500 up nearly 250% inclusive of dividends. Focus is shifting to what is in store for 2016 with the market slightly positive for 2015 and just 1.5% off the all-time high set back in May. Markets have settled down from the August/September scare and look better both domestically and abroad. Emerging markets CDS have come in, and global growth fears have lessened. It may be a commonly held view, but the base case scenario continues to be the slow and steady grind higher in the recovery/expansion that we have seen in previous years. As we have stated before, it's not that the base case is extremely compelling, but rather the low probability of the bear case happening that keeps us constructive.

Bull markets and business cycles do not just randomly end. They typically end when a recession is imminent. The usual warning signs of recession are not currently present. The yield curve is positively sloped, inflation is in check, and both the consumer and corporate America are in good shape-so a credit event seems unlikely. You can refer to the Economic Outlook piece in this update for some data and charts showing the strength of the consumer. On the corporate side, companies continue to be diligent in their use of capital and have done a remarkable job in repairing balance sheets post crisis as evidenced in the chart below from RBC.

Corporate Leverage and Cash Levels



Even though the current cycle is longer in duration than the historical average, given the slow and steady pace of improvement and lack of recessionary warning signs, we see it continuing. The chart below from Morgan Stanley shows the current credit cycle compared to the previous two.



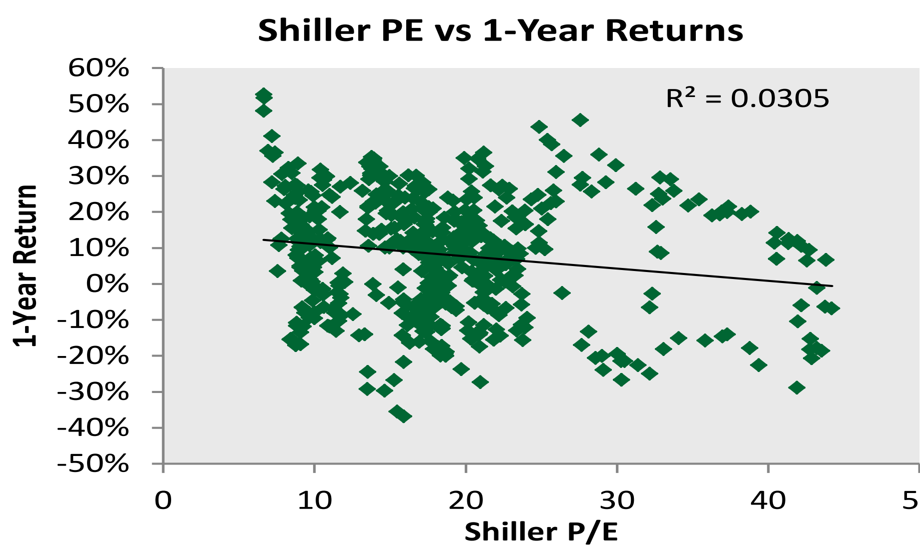
While we have seen High Yields spreads inch higher, it is mostly attributable to the commodity/energy related sectors. While not a positive, it seems most of the damage has been done, and if we see a stabilization in commodity prices or possibly a rebound, credit risk should remain contained.

The common bearish arguments seem to be China derailing, the Fed tightening, and earnings/valuation domestically. China data has improved recently-hopefully this continues and the lagged effect of stimulus is working. Uncertainty over Fed action has weighed on the markets for years. It appears, barring something unforeseen, they will raise the funds rate at the December 16 meeting. We welcome this move as we see it as one less distraction: it's time to rip the band-aid off. The reasons that usually spook markets when the Fed tightens are inflation and growth overheating, neither of which are a concern at the moment. The Fed is simply getting off the zero bound we've been on since 2008.

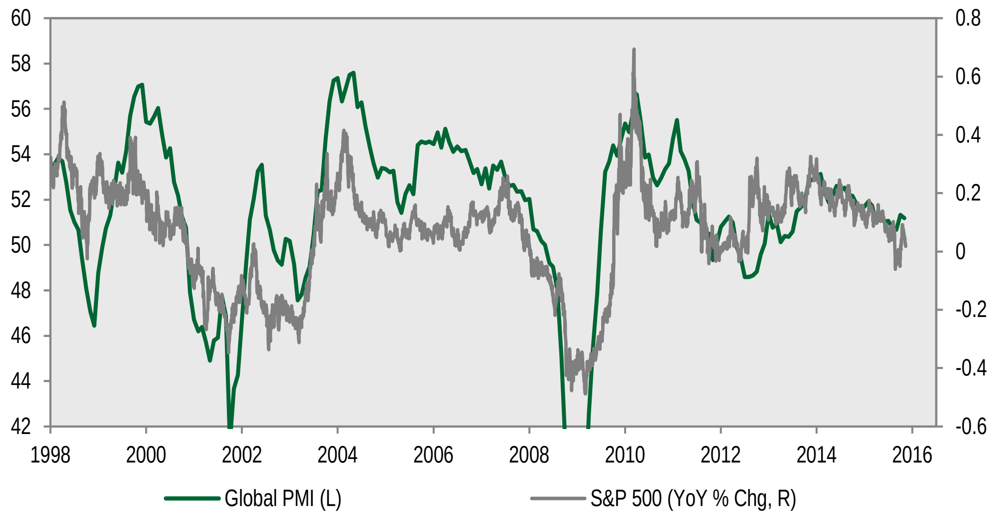
There is an over-simplified belief that rate hikes are bad for the stock market. At some point they do eventually weigh on valuations, but it usually takes multiple hikes and time for the tightening to work. In fact, historically the first rate hike has been a good omen for stocks. In the last seven tightening cycles, the 12 month return of the market after the first rate hike has been positive 6 out of 7 times with an average return of 11.64%. All signs point to this being a slow and methodical tightening by the Fed with futures not expecting another hike until June of next year at the earliest.

There have also been worries over an earnings slowdown. S&P earnings are going to be only marginally higher than 2014, with the overwhelming drag coming from the dramatic earnings shortfall in the energy complex and to a smaller degree the strong move in the dollar. While the drop in commodity prices hits producers immediately, there is a lag when the consumer gets the benefits of the lower prices. Ex-energy, earnings are up a respectable 6%, and looking to 2016, the negative drag to earnings from energy and the dollar are mostly out of the way.

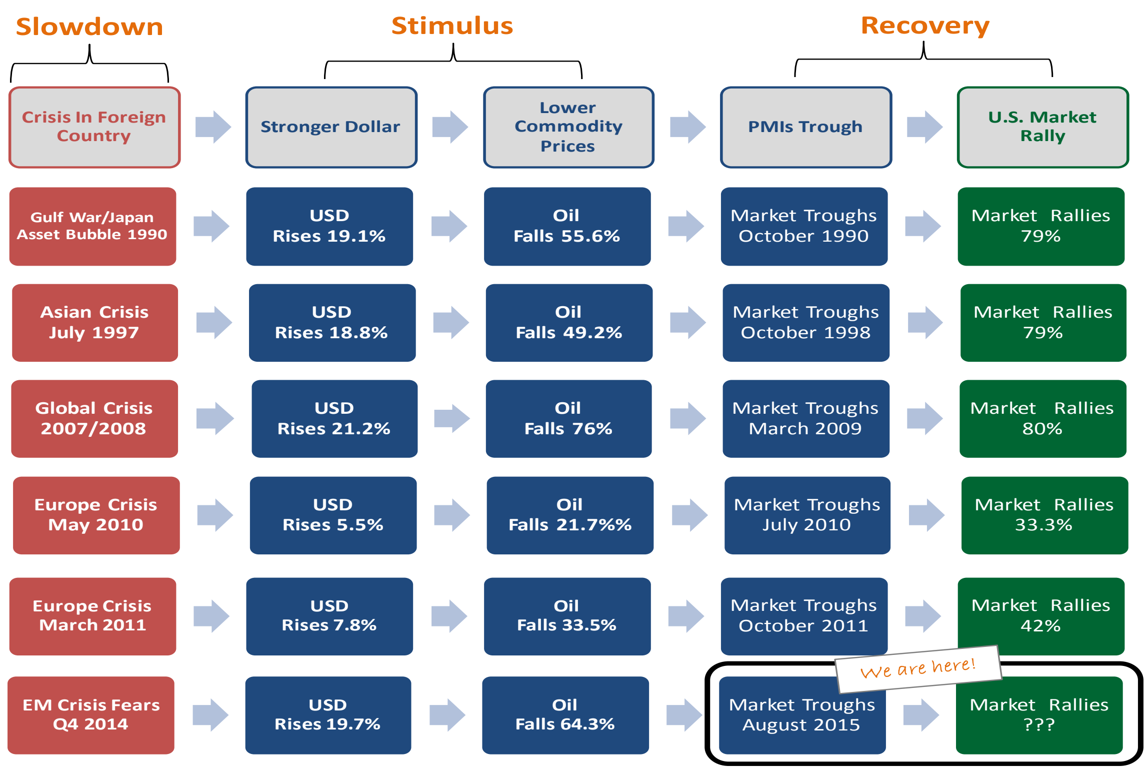
Another contentious debate on the market is with the P/E multiple. We are slightly above long term P/E averages, but we've pointed out in many previous updates that multiples do not necessarily mean reversion quickly. More often than not, they tend to trend for some time. In a low rate, low inflation environment, we do not think further multiple expansion is impossible as some seem to indicate. We've seen several headlines using phrases such as "dangerously expensive" and we simply do not see that being the case at 16.5x. Furthermore, trying to guess what the market will do next year based on today's P/E has been a futile exercise as shown in the chart below. As you can see, the P/E today has virtually no statistical significance in explaining what the market will do over the next 12 months. (chart compliments of Cornerstone with data from 1955-2014)



One of the lone bullish voices in the market has been Cornerstone Macro. The crux of their call is that the markets follow the business cycle/world economy and leading indicators point to a rebound. A large part of the rally in the markets in October was due to Chinese PMI data as well as the Global PMI reading. Cornerstone believes that the bounce in the Global PMI was a bottoming, which would mark an inflection point in markets. The following chart shows the strong relationship between Global PMI and S&P 500 returns:



Simply put, if the world economy has bottomed this would lead to lower risk, better sentiment, better growth, better earnings, etc. This should in turn lead to higher stock prices. Along the same lines, we found the following Cornerstone comparison chart interesting with all the attention given to energy prices, the dollar, and the market.



This is a theme and series we will monitor closely, as it is an out of consensus call with a strong historical correlation to back it. It is too early to tell, but if their call is right, we are well positioned.

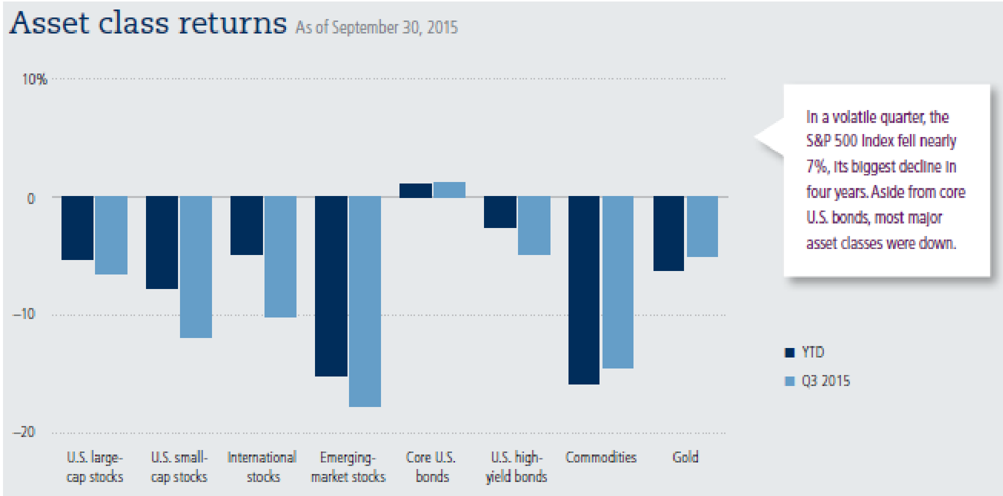
In sum, we remain constructive on the equity markets as we do not see signs of a recession. With EPS growth expected to be 7% or so for 2016, we would need modest multiple expansion to get to a double digit return. A possible source of multiple expansion could be the long awaited return of the retail investor. However, retail investors continue to pull money out of US equity funds with last week's $4B outflow bringing the year to date total to a record $143B. That is more outflows than we saw in 2008.

As far as activity, we took advantage of the sharp move higher to start our fiscal year to put on three tranches of equity linked notes. The market rose nearly 10% from September 30 to November 3 and we felt the need to try and capture some of that performance in an economical way without giving away more potential upside with 11 months left in our fiscal year. We structured all three notes with 5% downside protection and 1.5x levered returns up to a specified cap. The blended cap of the three notes would give us upside participation to near the 2340 level on the S&P which would be nearly a 22% return for the fiscal year. We feel these notes give us a good balance of risk/reward in an environment where returns aren't expected to be outsized to the downside or upside. If the market is down, we get protection on the first 5%. If the market is up low to mid-single digits, we get 1.5x the return (ex: market up 5%, we are up 7.5%). And if the markets were to increase more than 22%, which we do not think is likely, we only have roughly 7.5-8% of our S&P 500 Index fund exposure tied to the notes.

International Equity Strategy

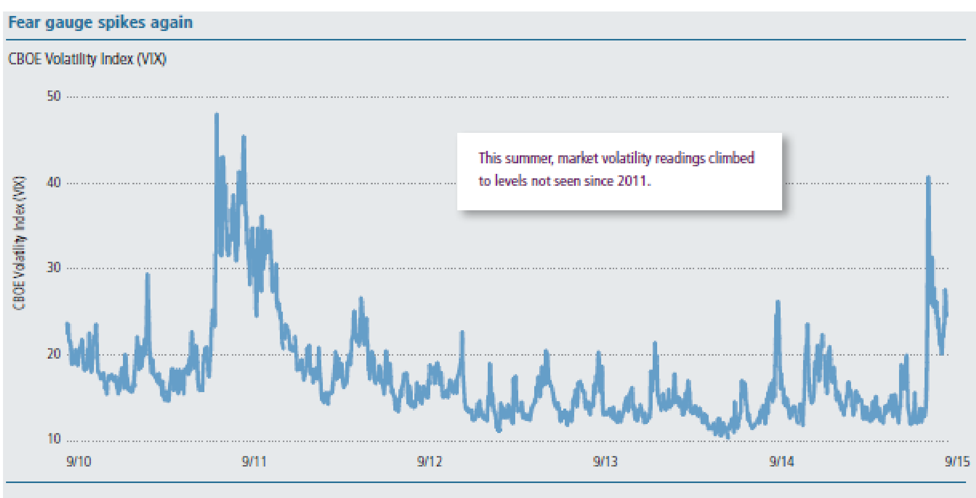
By Steve Lambdin

The third quarter of 2015 proved to be a difficult time to be in the global equity markets. For most markets, this was the worst quarter in over four years and served to wipe out the bulk of investors' gains thus far in 2015. The selloff was sparked by fresh concerns over a slowing Chinese economy, the sudden and largest devaluation of the Chinese Yuan in almost two decades, continued uncertainty surrounding U.S. monetary policy, and the persistent worries over future corporate earnings. Emerging market equities were hit extremely hard as many depend on a strong Chinese economy and commodity cycle to perform well. The initial response by the Chinese government and the People's Bank of China (PBOC) was rather tepid at best, and resulted in further equity market selling as investors were surprised by this response. Finally, decisive actions were taken in late August to stabilize the situation and investors seemed to welcome this. As a result of this disarray in the global equity markets, the U.S. Fed postponed its September rate hike until markets calm down a bit from the severe volatility we witnessed in late summer. In Europe, the European Central Bank (ECB) responded with further quantitative easing actions and remained prepared to do more if this was necessary, as Germany remains exposed with its large export driven economy. As one would expect, global interest rates fell in response to what was happening in China. However, even as growth slows in China, the benefits of lower commodity prices, especially oil, provide a nice benefit and should provide some help with weak growth around the globe. Japanese equities struggled with the upheaval in China, and could push this region back into recessionary territory as conditions here remain delicate with its recovery. We still remain in the camp that China's growth is slowing, but is not collapsing, as it continues along its long road to transition its economy to more of a domestic focus. The PBOC has plenty of leeway to take monetary policy actions to support growth and provide stability to the region, which should propel a bit of confidence to investors. In the end, the U.S. remains the single most important component of the global economy and this economy still looks decent as we move forward. On the geo-political front, things are very busy as the recent terrorist attacks in France remind us all of how dangerous these groups are, which could put pressure on world equity markets at any time.

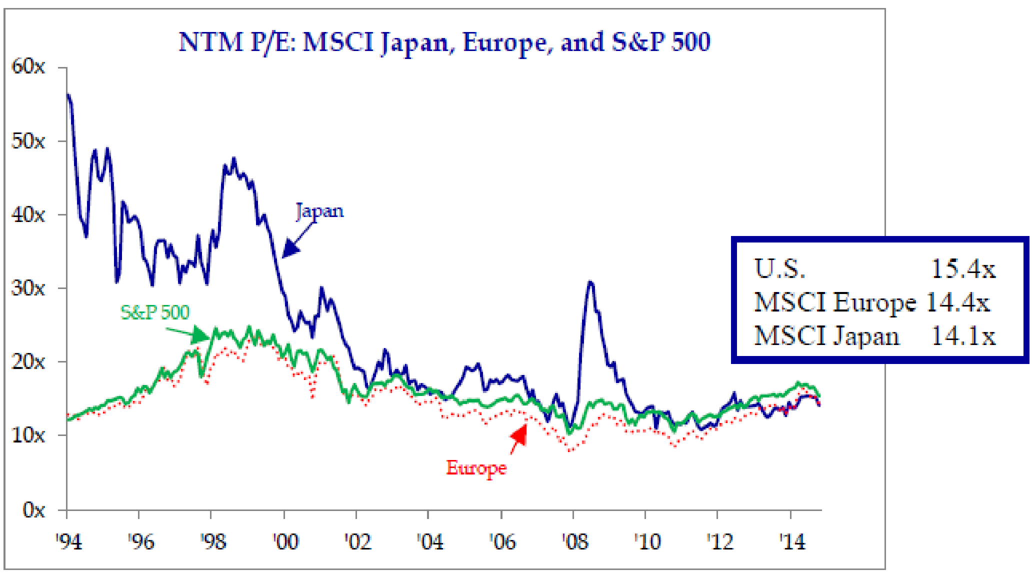


Source: John Hancock Investments; Morningstar Direct

The MSCI EAFE Index (net dividend) and the MSCI Emerging Markets Index returned -10.23% and -17.90% respectively during the third quarter of 2015 vs. -6.44% for the S&P 500 Index. This was the worst quarterly return for global equities in the last few years, as investors sought to dispose of riskier assets from the fallout in China. The U.S. dollar was not much of a factor in returns in the quarter, as it was nearly flat against the euro, rose +3.4% against the British pound, and fell -1.7% against the Japanese yen. The European region wound up being "the best house in a bad neighborhood", as this region fell a bit less than the Pacific region, with its larger exposure to China. From an economic sector standpoint, the safer havens of utilities, staples, and discretionary stocks were relatively stronger, while energy, basic materials, and industrials were the weakest. The commodity markets fell to fresh lows this cycle in response to potential economic weakness, as copper was near $2 and crude oil pushed back down to the lower $40's level.



Thus far into the fourth quarter of 2015, the global equity markets have staged a nice relief rally. Further fears of a growing slowdown in China have faded somewhat and recent rhetoric surrounding the potential initial U.S. fed rate hike in December has given investors a bit more clarity at the present time with these high profile issues. In addition, the potential for further devaluation of the Chinese currency seems to be fading as well. Large cap global as well as emerging market equities have posted gains through the end of November, just two months into our new fiscal year. Whether these gains can hold up and grow even further remains anyone's guess, but we do believe most regions of the global economy could post better economic growth in 2016 vs. 2015, with China being the only exception. We see this as a positive backdrop and a catalyst going forward. However, we should remain mindful that things can change in a hurry, especially in today's environment. All eyes will be on the U.S. Fed and the other central banks in December as these actions could set the tone of the markets going forward.



Source: Strategas

Asia Update

Coming as little surprise, the MSCI Pacific region was the worst performing region in the MSCI EAFE Index during the third quarter of 2015, falling -13.2% in USD terms. The equity markets in Hong Kong, Singapore, and Australia were very weak as the fallout from China was simply too much to overcome in the period. In fact, we saw no region in the Pacific that posted anything close to a positive return in the period. The dependence on the Chinese economy is critical for this region, as weakness in China gets propelled to other countries quite quickly. However, we believe once investors begin to accept that the new "normal" is a gradually slowing Chinese economy going forward, then we should see some level of stabilization and confidence come back into many of these markets. In fact, we are beginning to see this unfold recently. We are expecting further stimulus actions in Japan, which should help push Japan's recent economic weakness out of the picture. At this point, as we see new measures to combat China's economic problems being announced, we expect to see better equity markets across the region in the near term, but nonetheless, news flow out of China will dictate the direction of equity markets over the next few months.

Market Performance

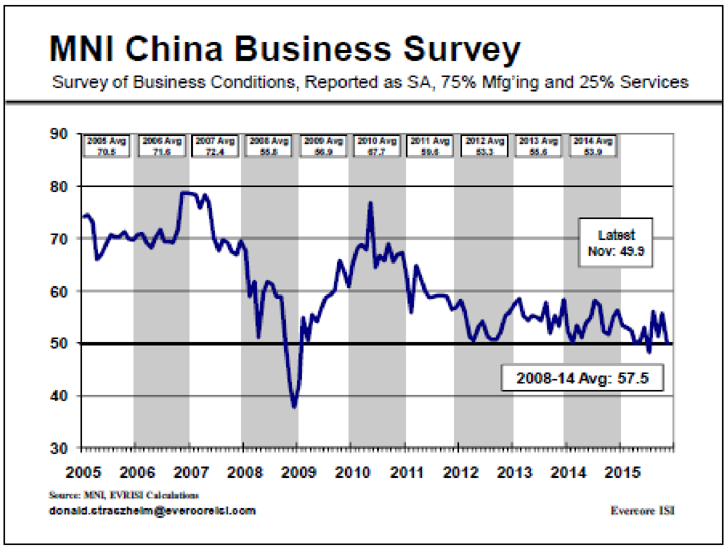
Data as of: 30-Sep-2015

Index Name	QTD % Change	YTD % Change	One Year % Change
MSCI Philippines	-10.34	-6.35	-5.73
MSCI Japan	-11.80	0.21	-2.22
MSCI Korea	-11.82	-11.45	-18.44
MSCI Pacific	-13.21	-5.54	-7.51
MSCI Australia	-15.33	-18.11	-21.08
MSCI Hong Kong	-16.16	-6.18	-3.27
MSCI Taiwan	-16.95	-12.79	-11.31
MSCI Singapore	-19.48	-21.06	-21.42
MSCI China	-22.71	-11.39	-5.04

Source: Factset

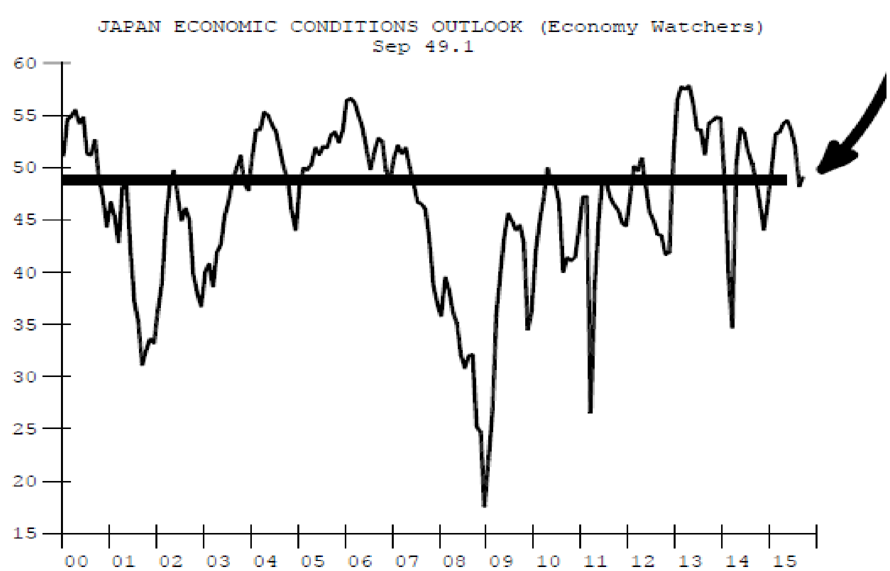
In a bit of a surprise for most, the Chinese economy continued to remain stable in the third quarter of 2015 as gross domestic product (GDP) in China rose +6.9% from the year earlier period, which again exceeded most economists' estimates. Even though growth is more resilient than expected, it still remains the slowest rate of growth since the great recession six years ago. Strength in the services sector helped to reduce the drag from the manufacturing and exports sector. Many see the growth in the services sector as key to the government's goal of transforming the economy away from external sources of growth to more internally focused. As the services sector of the economy continues to grow at a good pace, this will provide a bit of a cushion against a sharper fall in the economy here and take the pressure off industrial production and fixed asset investment providing the bulk of growth. At this point, the official government target of +7% growth in 2015 is not completely unrealistic and very much within reach. No doubt the PBOC's five interest rate cuts over the last year and recent targeted stimulus actions toward the property and automobile sectors by the government are helping on the margin. Industrial production rose +5.7% in September, while fixed asset growth continued to slow to +10.3% in the first nine months of 2015, which is the slowest pace of growth in nearly 16 years.

Exports fell -1.1% in September from the year earlier period, which wound up being much better than what we saw in July and August. No doubt the recent currency devaluation is helping on this front. Retail sales continue to be a bright spot in the Chinese economy and were up +10.9% in September, the fastest pace in several months. Inflation remained very low recently as consumer prices rose only +1.3% in October from a year earlier, declining from the previous months as falling food and energy prices work their way into the economy. This should open the door for further interest rate cuts sometime in the near future which could also serve as a positive catalyst for this economy. At this point, we continue to see a measured softening in this economy going forward which should result in a soft landing scenario in this region.



Source: Evercore ISI

The Japanese economy, without too much fanfare, officially entered into another recession in the third quarter of 2015 as GDP fell -.8% from the year earlier period, which was a little weaker than many had expected. This came as little surprise as the Chinese economic situation was too much to overcome in the period. Japanese companies wound up cutting back on spending and production in response to these developments. Business investment fell by -1.3% in the quarter, which subtracted -.2% from growth. In addition, inventories subtracted another -.5% from growth in the quarter as well. Exports continue to struggle and were reported down -2.1% year over year in October. There was simply too much global economic turmoil over the last several months as weakness prevailed. Industrial production posted its third consecutive decline in October as output fell -1.4% from the year earlier period. However, indicators are pointing to better readings ahead, which will be a key variable in clawing out of the current recession. Small business confidence did not really improve much lately and was reported at 48.7 in October. We still believe we will see improvement in this data point as the economy exits the recession. Consumer confidence continues to be tough, falling to 40.6 in September from slightly higher levels in the summer. Perhaps we will see this improve as business confidence comes back. Core prices were flat in November from the year earlier, which breaks the negative trend over the last few months. The labor market remains relatively tight as the October unemployment rate fell to 3.1%, a 20 year low as labor force participation continues to shrink. In addition, the jobs-to-applicant ratio improved to 1.24. This should begin to put solid pressure on wages going forward. We expect to see the current mild recession end fairly soon as some economic readings are expected to get better over the next few months. With this in mind and coupled with more central bank stimulus, we would expect to see a decent equity market climate. Of course, this is all dependent on a China situation not getting any worse.



Source: Evercore ISI

Europe Update

The Eurozone economy continues to slug around in a slow growth trajectory and living off of the whims of the quantitative easing program being implemented by the ECB. President Draghi remains firm that even more aggressive stimulus measures may be necessary should the economy take a dive southward over the near term. Banks do seem more inclined to lend, which is good for economic growth. However, as commodity prices continue to fall and growth remains rather low, investors remain watchful toward deflationary pressures. The MSCI European Index (ex. U.K.) posted a loss of -8.1% in USD for the third quarter, as the German equity market was particularly weak from the fallout of the growth concerns in China. This is not surprising since Germany is a large exporting country and has more exposure than most other countries in the Eurozone to the Chinese economy. When something like this happens in China, there seems to be few places to hide. As we take a look out going forward, we do see the potential for better growth ahead in 2016 in the Eurozone as the ECB continues to spur the region. Lower energy costs will help the consumer as this works through the economy and labor markets should continue to mend, but at a very slow pace.

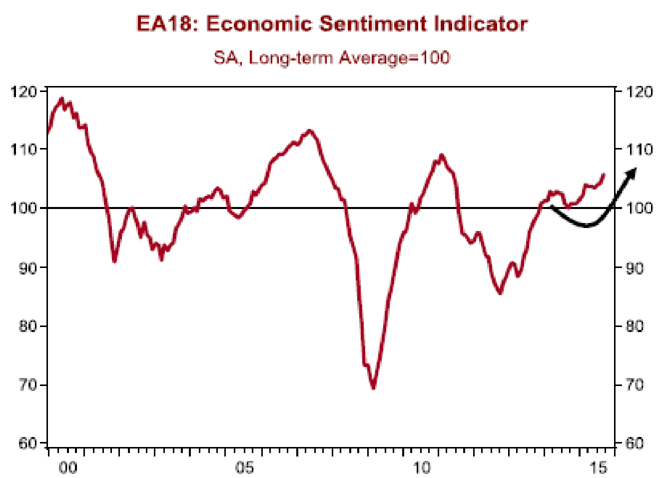
Market Performance

Data as of: 30-Sep-2015

Index Name	QTD % Change	YTD % Change	One Year % Change
MSCI Italy	-4.36	4.73	-9.32
MSCI France	-6.45	-1.75	-7.70
MSCI Switzerland	-6.97	-1.57	-3.77
MSCI Europe ex UK	-8.08	-3.79	-8.03
MSCI Netherlands	-8.90	-1.74	-2.01
MSCI United Kingdom	-10.02	-8.23	-12.12
MSCI Germany	-10.89	-8.90	-9.26
MSCI Spain	-11.12	-13.44	-20.55

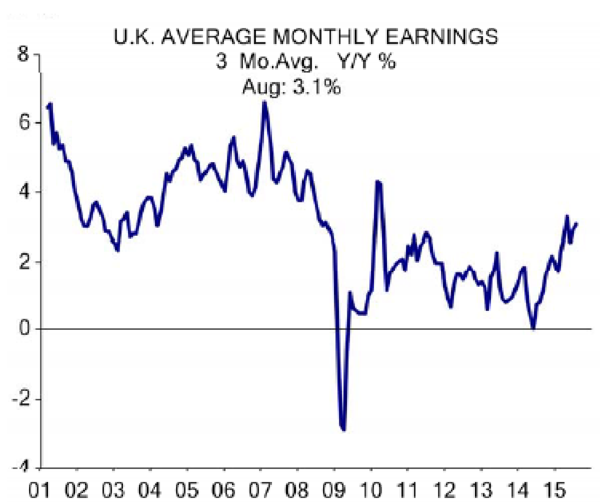
Source: Factset

Third quarter GDP rose +.3% from the previous quarter, or +1.6% from the year earlier period, which is just a tad slower than the previous quarter and slightly below expectations. The German economy remained stable in the period as growth was right in line with overall growth in the region, while the French and Italian economies were a bit stronger than what many had expected. With growth still slow, this should give the ECB an opportunity to cut deposit rates and expand its quantitative easing program in order to foster more growth at its December meeting should it choose to do so. This should be welcomed news by investors as downside risks are still very much in play in the region. Industrial production actually held up better than expected in the third quarter and was reported up +1.8% from the year earlier, a stronger pace than the previous quarter. We view this as fairly positive, in light of weakness in Germany, as other countries picked up the slack and exceeded expectations. The index of executive and consumer sentiment continued to get better, reaching 106.1 in November, which is near a five year high. Many believe this is a good indication of a better business climate over the next few months. Retail sales seem to have been stable lately, as sales were up approximately +2.5% on a year over year basis in the third quarter, a slight increase from the previous quarter. While still cautious, this is moving in the right direction and this could be better going forward. Inflation still remains almost non-existent as core consumer prices only rose +1.1% in October from a year earlier. Again, as we have mentioned before, the real risk to the region is if a deflationary scenario develops. However, we still do not see this happening as the ECB remains vigilant to avoid this from transpiring. The employment situation continues to forge steady progress as the October unemployment rate was reported at 10.7%, marginally better than a few months earlier. We expect to see continued improvement in this statistic in 2016, which will help provide a better foundation for the Eurozone economy.



Source: European Commission; Strategas

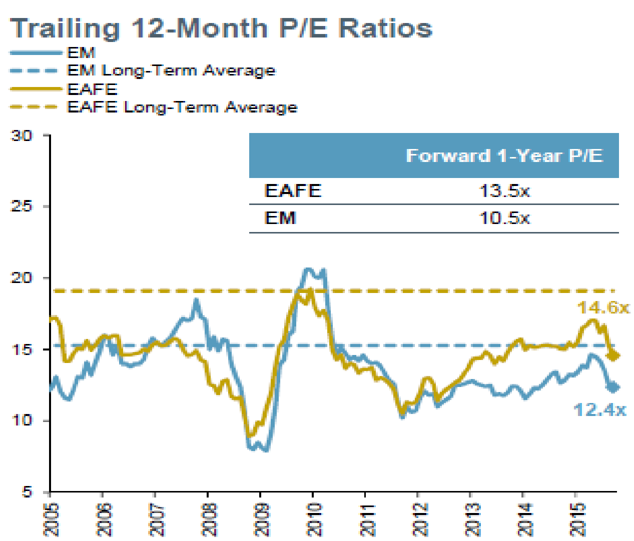
The U.K. economy continued its pattern of consistent growth in the third quarter of 2015, even as headwinds are beginning to hit the region. However, we do not expect these headwinds to derail the longest stretch of growth this region has produced since the financial crisis ended seven years ago. GDP grew by +.5% in the quarter from the previous quarter, or +2.3% from the year earlier period. This growth was just a bit weaker than what many economists had expected, but fairly good when considering the turmoil hitting China and the rest of the emerging markets during the period. Construction shrank by -2.2% in the quarter, which was the most in three years, while manufacturing slipped by -.3% in the period as well. In addition, net trade took off -1.5% off of reported GDP, which is the most in 18 years. As has been the case lately, the business services sector continued to be the growth driver and was reported up +3.1% year-over-year in the third quarter. Retail sales have been a little erratic from month to month lately as October sales were down -.9% in October from a robust +1.5% in September. However, on a year over year basis, retail sales were up +3.0 in October. Swiftly changing weather patterns and the timing of key sporting events in the U.K. are making this statistic rather hard to predict lately, but we feel good about future trends. Consistent with other parts of the world, inflation seems almost non-existent at the moment, as October CPI was up only +.1% from a month earlier, or +1.1% year over year. The continuing fall in commodity prices, especially crude oil, are serving to keep a lid on any inflation at the moment. At its November meeting, the Monetary Policy Committee (MPC) kept interest rates at a record low of .50% and its bond purchase target remained at 375 billion pounds, just as it has for an extended period of time. As with the U.S. Fed, we should start to see the MPC raise interest rates sometime over the next several months, provided we don't see an unexpected growth scare in the region or China does not have a hard landing that would affect the rest of the world. The employment situation has stabilized somewhat lately, as the unemployment fell to 5.3% in third quarter. Also, employment rose by 177,000 in the three month period ending in September to a record employment of 31.21 million workers. Wages are also continuing to grow, rising to the +3.0% level on a year-over-year basis in September. Overall, the employment situation looks solid at the moment and should remain so as we enter 2016. At this time, we expect the U.K. economy to remain steady as we have probably passed the period of peak growth in the region even as this economy appears to have decent fundamentals as we head into 2016. We are optimistic this will transpire into higher equity markets over the next few months.



Source: Evercore ISI

Emerging Markets

Emerging market equities faced an enormous amount of headwinds in the third quarter of 2015 and posted one of the worst quarterly returns in recent memory. We saw losses in every major emerging market sector. The commodity cycle, which is very important to many of the emerging market countries, remains extremely challenging at present as many commodities remain at or very near 52 week lows. This has caused several of the currencies to plunge relative to the U.S. dollar. In fact, the Brazilian Real plunged to historic lows against the U.S. dollar recently. The MSCI EM Index (net) fell -17.90% in U.S. dollar terms in the third quarter of 2015, which brings the one year return to -19.3%. Unfortunately, China has cast a heavy shadow on this asset class and rising interest rates in the U.S. will not help much at the onset. However, over the long term, there is still plenty of good things happening in these markets and some of these equity markets will realize this at some point. We still see the best opportunities lying away from dependence on the commodity cycle at the present time in addition to "self-help" stories based on some type of structural reforms going on inside the country. We still remain cautious toward commodities in general and need to see these markets digest higher U.S. interest rates in order to get more confident in the outlook here. However, we will get more involved if we see another significant downward movement in these equities as we keep a long term perspective in mind.



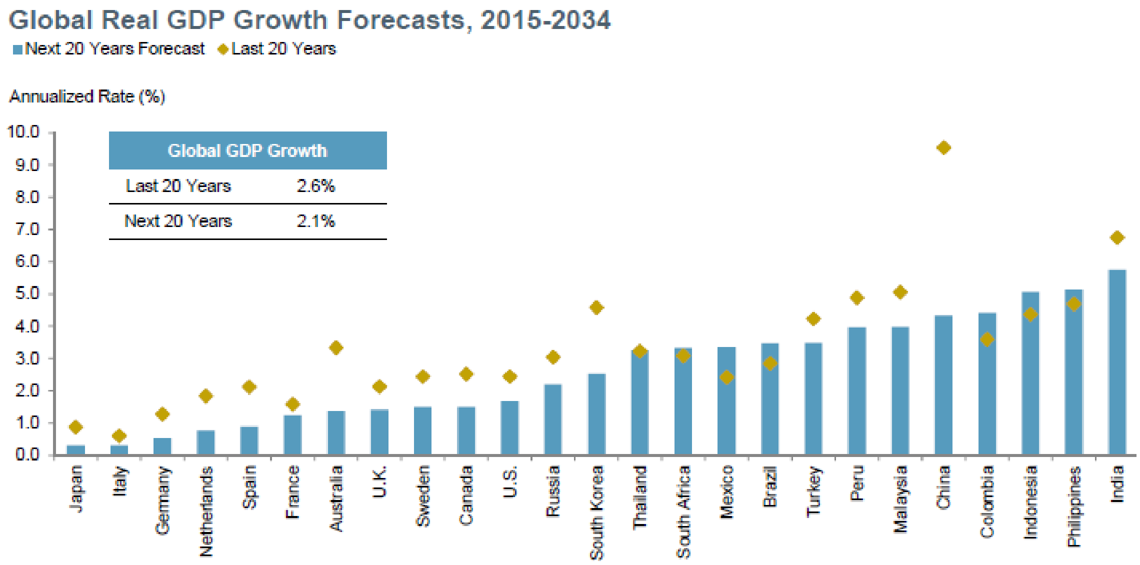
Source: Fidelity Investments Q4 2015 Market Update

International Equity Activity/Strategy

As we move into the late stages of 2015 and early 2016, the slowing growth of the Chinese economy and fresh geo-political concerns from the recent terrorist attacks in France remain fresh in most investors' minds. In addition, the impending change in U.S. monetary policy presents some additional level of risk for most. These issues look to set the course for world equity markets over the near term. This seems to be a rather harsh headwind especially for the emerging markets as prospects for continued U.S. dollar strength will continue. However, things do not appear this bleak for the more developed markets around the globe. Economic activity in Europe should continue to improve at a slow pace as the tailwind from lower commodity prices pushes through the economy. Also, the ECB still remains on target with its accommodative monetary policies to foster further growth in the region. Credit conditions continue to improve as lending activity gets better on the margin, which is vital to growth in the region. The Japanese economy still seems rather inconsistent lately, as the economy moved back into recessionary territory recently. However, we don't expect this to last much longer as structural reforms and monetary policy from the Bank of Japan (BOJ) should bring confidence back into the economy. Companies in Japan are focusing more on capital efficiency measures and shareholders returns, which brings more confidence to investors and should be good for the equity markets. As far as China goes, investors should begin to get comfortable with the long term slowing of this economy at some point. As this happens, perhaps volatility in the equity markets will be reduced, which should bring a bit of comfort to most. This is our base case for this region and only time will tell if this develops. The U.S. economy remains just marginally weaker than we would like to see, but should post growth in 2016 that is higher than 2015. The consumer looks fairly strong here, housing remains decent, and auto production is healthy. Outside of this, it seems we are in a very slight industrial recession at the moment, but we don't expect this to be too bad. So all in all, the global economy looks set to accelerate as we leave 2015 with the only exception being in the emerging markets, as headwinds remain difficult over the near term.

We have not added any monies to our global equity portfolios since our last addition in late August. We expect to continue to sell put options on the Emerging Markets Index (EEM) at prices below the current price of the security in an effort to buy some exposure into the emerging markets index if the market turns further down from here. However, we don't expect to be too aggressive at this point until the outlook improves from here. In addition, we have sold some call options on EEM at strike prices well above the current price of EEM in an effort to take advantage of premiums in the marketplace in the current state of heightened equity volatility. Premiums for doing these strategies still look attractive in the current low interest rate environment.

Our current allocation to Emerging Market equities is approximately 1.50% of total assets and approximately 11.1% for MSCI EAFE equities, which still remains below peer group averages. *(Charts provided by Factset, Evercore ISI, Fidelity Investments, European Commission, Strategas, Federal Reserve Bank of St. Louis, Morningstar Direct, John Hancock Asset Management)*



Source: Fidelity Investments Q4 2015 Market Update