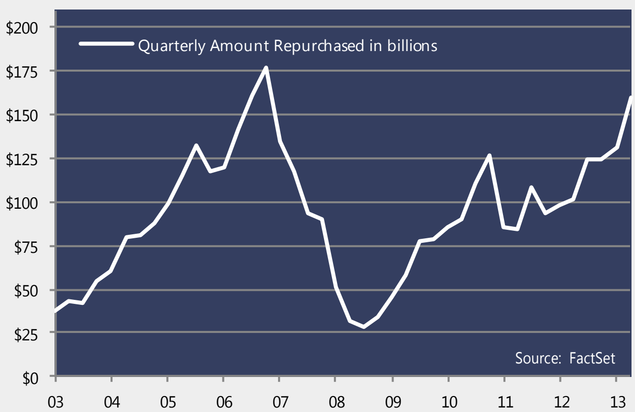
second quarter 2014

INVESTMENT *perspective*

Although economic fundamentals remain sluggish and margin pressures are developing, which will likely place near term earnings estimates at risk, the U.S. equity market continued to advance during the second quarter. The equity markets are being driven by low interest rates, compressed credit spreads, generous borrowing terms, and increasing investor appetite for fixed income product. These generous credit conditions provide corporations the opportunity to finance share repurchases and mergers that are pushing equity markets higher despite investor skepticism concerning the sustainability of the bull market.

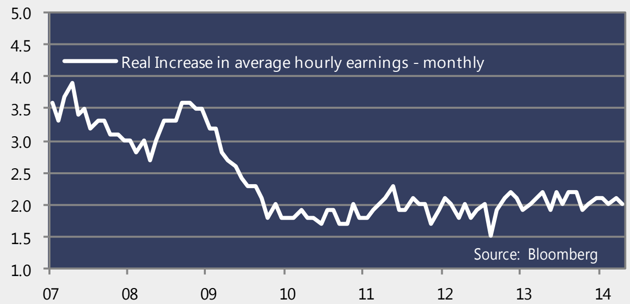
Corporate Share Repurchases (3/31/07 to 3/31/14, quarterly)



While we are of the opinion "real" interest rates cannot increase materially and, therefore, credit markets will remain supportive of equity values for several more years, we believe we are nearing a turning point in the current equity bull market. We would not be surprised by an increase in volatility as U.S. inflationary pressures are accelerating for non-discretionary items and Global Central banks are no longer on a synchronized path of monetary easing.

In general, we believe the market is discounting continued modest improvement in earnings growth and an inflationary environment where deflationary risks are modestly higher than inflationary risks. While the scenario is plausible, it is not our base case scenario. Inflationary pressures are building in non-discretionary items (e.g. housing/rent, food, energy, and healthcare) which is placing increased pressure on real consumer spending as wage gains remain sluggish.

Wage Gains (3/31/07 to 6/30/14, monthly)



The increase in near term inflationary measures has the potential to call into question the Federal Reserve's flexibility as to how soon they will need to raise interest rates and at what pace rates may need to rise. Given the current level of margin debt in equity and fixed income markets, this change in inflationary expectations and the Federal Reserve's monetary policy flexibility may increase the volatility in interest rates resulting in corrections in the equity and fixed income markets.

Margin Debt (1/31/00 to 5/31/14, monthly)

Even without a broader equity market correction, we expect market breadth to continue to narrow. Not only will the inflationary pressures noted above begin to impact margins, so will several years of underinvestment in IT infrastructure, property, plant and equipment. Companies can no longer rely on a recovery in consumption, lower interest rates, share repurchases, and deferred capital expenditures to drive earnings growth. Going forward, companies will be required to increase capital expenditures, research and development expenses, and other operating costs in order to sustain or grow earnings. If revenue growth does not accelerate from here, all of these actions will suppress margins in the near term.

over...

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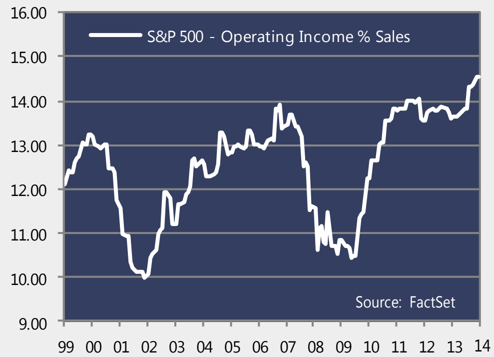
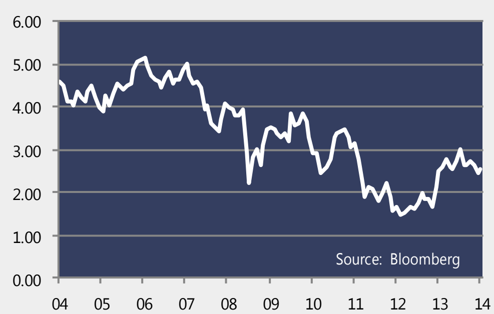
Corporate Profit Margin
(7/30/99 to 6/30/14, monthly)



Despite the potential for a near term correction in equity markets, we expect the credit market to remain supportive of equity values over the medium term and will welcome any correction as an opportunity to make attractive investments. While the nature of the bull market is changing there are still individual stocks that will perform well despite the increasing market headwinds. This positive outlook continues to be stock-specific and not reflective of opportunities in specific industries or regions of the world.

Throughout the quarter, bond yields trended lower, with the Ten-Year Treasury trading in the 2.50% to 3.00% range. We expect yields to move back toward the 3.00% level during the second half of 2014. Within client fixed income portfolios, we have maintained a shorter than benchmark duration but have held a material overweight to corporate bonds. While the shorter duration was a slight negative during the quarter, the corporate bond exposure aided performance and thus the strategy performed in-line with the Barclay's Aggregate index over the quarter. While we have begun to opportunistically reduce our corporate bond allocations due to valuations, we remain positive on the overall strength of corporate credit quality.

10-Year Treasury Yield
(6/30/04 to 6/30/14, monthly)



The municipal bond market benefited from the rally in the Treasury market, along with a combination of low new issuance and continued steady demand from investors for tax-free income. While the headlines in the tax-free arena have been dominated by difficulties in Puerto Rico, which was downgraded once again, this event has had minimal impact on the Investment Grade Municipal market. Improving tax revenues are allowing towns, cities and states to accelerate hiring. This rapidly improving financial situation is particularly evident in states like Texas, where natural resource driven growth has led to increased employment, rising property values and tax sources being restored to pre-recession levels.