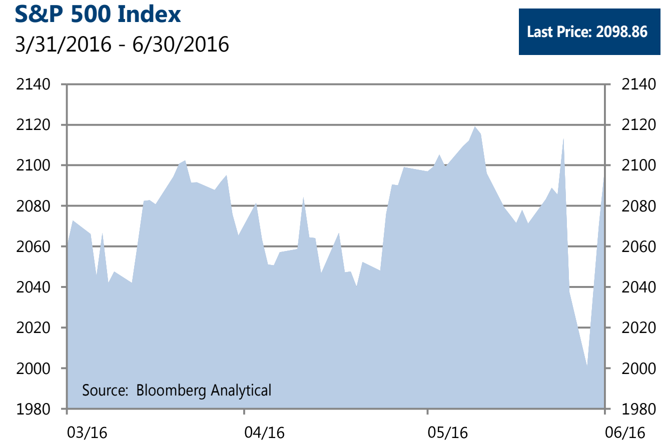
During the second quarter of 2016 equity markets traded in a tight range as market participants anxiously awaited the United Kingdom's vote to remain in the European Union and for the release of economic data that would confirm or refute the weak May payroll data, which indicated a slowing labor market. The United Kingdom's vote to leave the European Union shocked markets creating an immediate sell off in U.S. risk assets. The sell-off was short lived as foreign central bankers were quick to indicate additional monetary stimulus would be forth coming and as the dramatic decline in U.S. Treasury rates provided further support to U.S. equity markets. Despite the stronger dollar and deteriorating international fundamentals, the S&P 500 and Russell 2000 indices appreciated approximately 2.45% and 3.79% including dividends, respectively during the quarter **(Chart 1)**.

CHART 1
S&P 500 Index
3/31/2016 - 6/30/2016



Equity markets were able to modestly appreciate by further expanding earnings multiples during the quarter despite declining earnings expectations and deteriorating international economic conditions. We believe the incremental multiple expansion was driven by an easing of monetary conditions domestically, the indication of additional monetary stimulus by foreign central banks, and by foreign investors increasing their portfolio allocation to U.S. equities post the United Kingdom's vote to leave the European Union. Appreciation in equity markets is always welcome, but we would prefer that it is driven by an improvement in company fundamentals rather than by stimulus from central bankers and by foreign investors fleeing the risks in their local equity markets.

As it relates to corporate fundamentals, we expect the current corporate earnings recession to moderate in coming quarters, but we do not expect it to end. With corporate margins near all time highs, labor markets tight, and benefit costs on the rise we do not believe top line growth will be sufficient to prevent margin pressure. With monetary stimulus nearly exhausted, we believe fiscal stimulus will be necessary not only in the United States but internationally so that the macro imbalances can continue to adjust without creating excessive volatility. We would expect any fiscal stimulus to benefit the middle class directly at the expense of capital providers and creditors. We remain hopeful that such stimulus will include much needed corporate tax reform which should have a material positive impact on U.S. equity markets and our domestic corporations' global competitive position.

As it relates to the intermediate to long-term outlook, we believe we are entering the final stages of rebalancing the liquidity/leverage bubble that has been accumulating in our financial markets for several decades. While the financial crisis was effective at eliminating the excesses within our regulated banking systems, it pushed imbalances into the unregulated financial system and accentuated the imbalances that exist in international markets.

As a result of these imbalances, we do not believe interest rates can move higher on a "real" basis and in fact would expect our U.S. 10-year Treasury rate to fall below 1% unless we see global coordinated fiscal stimulus. While low rates are welcomed by debtors, we have remained at low rates for such an extended period of time that the negative impact on capital formation and increased savings is starting to outweigh any benefit of low rates. As such, low rates are becoming an unwelcome deflationary force.

In addition to expecting further rate declines absent global coordinated fiscal policy, we expect the Chinese to further devalue their currency. China is likely to experience a normal banking crisis/recapitalization that has occurred throughout history post a credit binge. The key is that the necessary adjustments occur over many years as opposed to a swift +20% decline in their currency. We believe uncontrolled Chinese currency devaluation would have a material negative impact on global trade and risk assets with far reaching implications both monetarily and politically. The Chinese are working to control

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the devaluation such that it occurs over a number of years and the resulting global deflationary pressures are moderate and not disruptive to economic activity. Our concern is that the recent increases in defaults that are occurring within China's banking systems have the potential to move faster than policymakers and markets are currently prepared to respond. While the credit excesses within the Chinese banking system are a significant threat to the global economy, the potential exists for domestic Chinese consumption to increase in order to rebalance their economy. It will be important to monitor this transition over the coming quarters.

As the nature of the market continues to change there are still individual stocks that will perform well over the medium term despite the increasing market headwinds. Our outlook has become more balanced, stock-specific, and not reflective of opportunities in specific industries, regions of the world, or broader market indices.

The fixed income market volatility continued in the second quarter as economic data weakened both globally and in the U.S. and the Brexit vote created a significant flight to safety into government securities **(Chart 2 and Chart 3)**. High quality corporate bonds were well bid, as the low yield levels on government bonds pushed "yield hungry" investors into this sector. Risk premiums on corporate bonds narrowed eleven basis points in the quarter. Long duration securities outperformed in the quarter with the U.S. 30-year Treasury returning 7.3% and it is now up 16.9% year to date.

CHART 2
U.S. 10-Year Treasury Yield
12/31/2015 - 6/30/2016

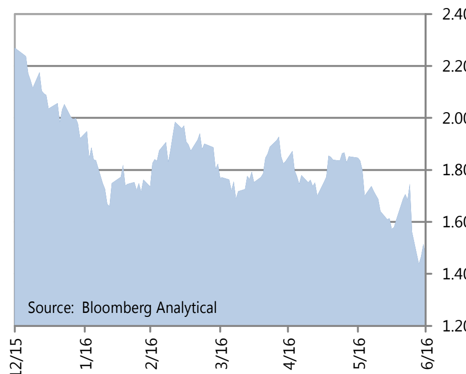
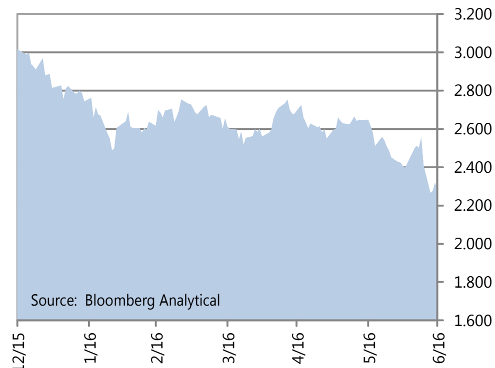


CHART 3
U.S. 30-Year Treasury Yield
12/31/2015 - 6/30/2016



Even though corporate credit metrics have likely peaked, they remain healthy at levels above historical averages and we continue to believe this is the most attractive sector within the investment grade universe. With mergers and acquisition activity slowing, but still a significant credit risk, we will remain selective in both the sectors and the individual companies we invest in.

The municipal markets handled the negative news of the eventual Puerto Rico debt default, the largest municipal default in history, with few side effects. With the State of Texas 10-year AA-rated bonds at 1.60%, the yield to maturity is 20 basis points cheaper than the U.S. 10-year Treasury, and on a taxable equivalent basis that is a 2.46% yield. Although absolute yield levels are low, on a relative basis high quality municipal bonds are extremely attractive.