

Third Quarter 2016

Quarter Highlights

- Total returns for major asset classes were positive during the quarter, with equity gains generally strongly so
- Market performance generally was more favorable among our Portfolio tilts, with international value and small-cap equities faring particularly well
- Fixed income returns reflected broadly stable interest rate trends against the unchanged backdrop of historically low yields
- Trends in corporate earnings provided little support for equity market valuations, which generally expanded over the three-month period
- Market anxieties we could surmise were narrow and not heavily impactful
 - “Brexit” presented challenges at the start of the quarter, but quickly faded from view
 - Monetary policy continued to support equity markets, even as policy uncertainty fostered heightened market volatility
 - U.S. electioneering seemed to intensify market skittishness, though not the extent that is more normal for this part of the presidential cycle

Themes in Review

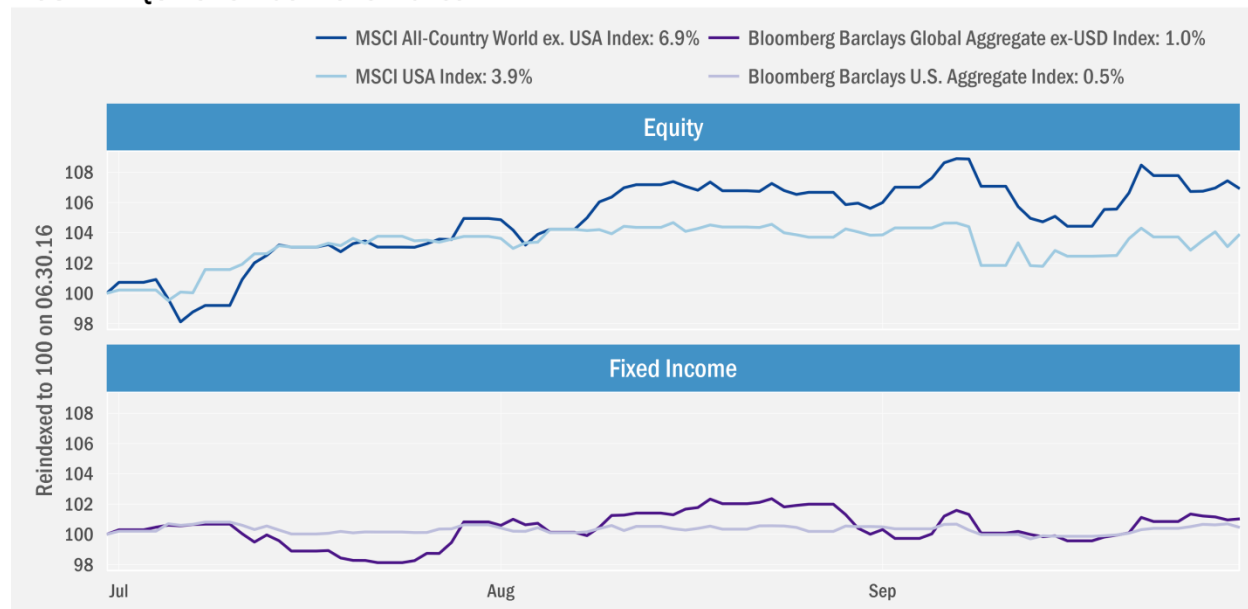
Capital markets entered the third quarter of 2016 recovering from the turmoil impelled by the United Kingdom’s surprise vote to depart from the European Union. Nonetheless, as we show in Figure 1, equity markets generally saw reasonably strong gains in the third quarter, with fixed income markets generally tracing a path to green as well. Helped that fears of “Brexit” contagion quickly subsided, as broader hopes of further accommodation from global central banks and twinkles of light among various global and regional macroeconomic indicators instilled greater calm. Monetary policy followed through on those hopes, generally speaking, while trends in macroeconomic data provided a generally stable to modestly positive backdrop for equity markets to retain a positive bent. This, despite continued weakness in corporate profits, which intensified the upward pressure on equity valuations.

Broad-Market Performance

Detailed in Figure 2, after bouncing about during the prior three months, global equity markets saw healthy gains in the third quarter, with the MSCI All-Country World Index rising 5.3%¹. Domestic stocks trailed that tally, turning in a 3.9% gain as other Developed Markets (up 6.4%) and Emerging Markets (up 9.0%) led the charge. International small-cap and value stocks outperformed the broader indexes, rising 7.9% and 7.8% respectively. Indeed, International small-cap value stocks saw a particularly robust gain, jumping 8.8% quarter-on-quarter. These latest trends help relieve some of the relative underperformance of value stocks outside of the U.S. have seen over the past 12 months, owing much to a relatively tough fourth quarter of 2015.

Fixed income market returns were less remarkable over the quarter, which should not necessarily be surprising given the broader interest rate backdrop. Returns for domestic bonds were range-bound for much of the quarter, eventually settling to a 0.5% gain for the three-month period. Meantime, global non-U.S. dollar-denominated bonds were more volatile, at one point showing a loss of near 2% only to show a gain of more than 2% a month later, then dropping back to flat and subsequently close the quarter up 1.0%.

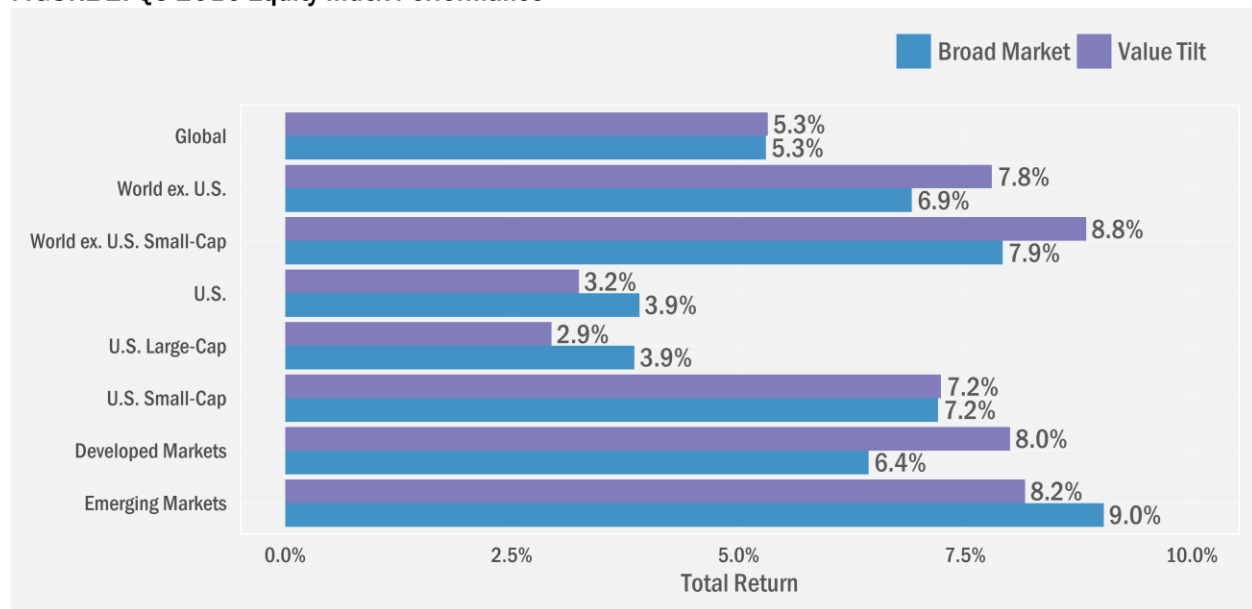
FIGURE 1: Q3 2016 Index Performance



From 06.30.16 to 09.30.16. Past performance is not indicative of future results. One cannot directly invest in an index. Index performance does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

¹ Including a detailed list and explanation of this and other indexes we use to represent various asset classes, please see additional important information regarding indexes at the end of this report.

FIGURE 2: Q3 2016 Equity Index Performance



From 06.30.16 to 09.30.16. Past performance is not indicative of future results. One cannot directly invest in an index. Index performance does not reflect the expenses associated with the management of an actual portfolio. Please see additional important information regarding indexes at the end of this report. SOURCE: SRCM using data from Bloomberg

Portfolio Positioning

Maintaining a stance sustained since the beginning of the year, our Portfolios retained the following broad themes during the quarter:

Global Equity Allocations

The Portfolios are overweight the domestic equity market, based on its size relative to international equity markets (i.e. non-U.S.; “global” includes the U.S.). This overweight reflects the Investment Team’s favor of domestic equity familiarity and relative stability. Out Portfolios also maintain a moderately higher exposure to domestic small-cap equities. This tilt toward (read: greater emphasis upon) smaller-company stocks, reflects our desire to maintain portfolio exposures understood to be indicative of longer-term relative outperformance. In addition to the “size” factor, our Portfolios similarly tilt toward equities that are relatively undervalued and more profitable, versus their peers. These tilts emphasize the “value” and “profitability” factors, which also are seen to have been indicative of stronger relative long-term performance among stocks.

Outside of the U.S., our exposures favor developed markets over emerging markets in a manner mostly reflective of their regional relative capitalization weights. Outside of the United States, too, the funds we own in our Portfolios as a group emphasize size, value and profitability among their underlying holdings.

Global Fixed Income Allocations

Generally speaking, the focus of our fixed income allocations is to modulate overall portfolio risk as we seek to cushion the impacts of equity market volatility. Within the fixed income space, our Portfolios deemphasize international developed-market fixed income in favor of a U.S. focus. Further, versus broader-market aggregates (e.g. the Bloomberg Barclays U.S. Aggregate Bond Index), the Portfolios shift toward credit (corporate) exposures, away from government bonds, including U.S. Treasuries, and securitized bonds (e.g. mortgage-backed securities), while including inflation-protected bonds. We maintain a level of aggregate duration, which measures the Portfolios' sensitivity to changes in interest rates, much lower than the benchmark, though the yield still is moderately higher than that of the benchmark (mostly due to the overweight to credit).

Current Quarter Outlook

Fortune-telling aside, we will remind readers that the newsier items (e.g. the U.S. election) are nearly always influencing the returns of our investments over the short term. Conversely, headline-making events TV anchors so breathlessly cover rarely impact the broader economy or corporate fundamentals and therefore are not materially impactful to investment returns over time. At least not in any directly discernable way. The race for the White House is a fine example. While much often is made of the importance of the Office of the President to capital markets, little from any individual's decision can be seen to have had an enduringly broad impact on market returns.

Closer to top-of-mind for the Investment Team is the nature of the evolution of corporate fundamentals (revenue, earnings and such). It would seem domestic corporations long ago wrung as much from their costs as they could. Top-line (revenue) and earnings per share growth have been negative since last summer for U.S. large company stocks (as represented by members of the S&P 500). And though we place very little confidence in Wall Street analysts to predict the future, their present expectations, according to financial data provider Bloomberg, are in for yet another decline in aggregate earnings per share for the index. As fundamentals have lagged the gains in equity indexes, valuations have risen as well. That may mean that we as investors presently are paying more the same amount of future growth, leaving us with the potentially uncomfortable feeling the future returns may lag historical experience.

Though we continue to believe market characteristics such as historically stretched global equity valuations will pressure investors to enhance portfolio diversification and instill additional "safety" among allocations, we think the tone of monetary policy will remain generally supportive of "riskier" investments through year end. Still, we expect markets to remain a bit on edge, on account of U.S. election unpredictability and European banking sector instability, along with central bank inconsistency and broader monetary policy uncertainty.

Maintaining our Discipline

Critically, though we maintain relatively cautious views on equity market valuations, we dare not suggest that any manner of discomfort would ever see us exiting the markets or otherwise attempting to shift between equity and fixed income as a result. Rather, our discipline is founded on the belief that our clients

are best served with portfolios that remain fully invested at target allocations appropriate for their overall ability to tolerate investment risk. In following, over the long term the primary drivers of portfolio total return should prove our approaches to enhance overall diversification through our target allocations while emphasizing those characteristics, like size and value, that can be seen to have improved long-term portfolio returns.

Short-term market shifts can be unnerving if we let them. Easy to preach, though not always so easy for all to practice, we should try to avoid letting near-term market emotions—whether euphoric or despairing—drive our own. Instead, we can gain comfort by being aware of, but otherwise mostly ignoring noisy day-to-day and even week-to-week market fluctuations, confident in the knowledge that most “breaking news” events are lost to history as our perspectives expand through time.

That basic view in tow, we will continue to favor those features in our Portfolios that we believe have the propensity to lead to outperformance in the fullness of time: 1) enhanced diversification, versus global market capitalization-based weights, and 2) reasonable tilts among and within equity asset classes to size, value and profitability factors. Atop that foundation, we will maintain a suite of portfolios suitable to a range of risk tolerance levels, with the intention of being able to serve the investment needs of a diverse group of clientele presently and as their investment needs evolve in the future.

Important Information

Investing involves risks. Past performance is not indicative of future results.

One cannot invest directly in an index. Index performance does not reflect the expenses associated with the management of an actual portfolio.

Asset classes and their respective indexes mentioned in this report include the following:

International (global non-U.S. dollar-denominated) fixed income: The Bloomberg Barclays Global Aggregate Index is a multi-currency benchmark that measures global investment grade debt and includes fixed-rate treasury, government-related, corporate and securitized bonds from developed and emerging markets issuers while excluding U.S. dollar-denominated debt.

Domestic (U.S.) fixed income: The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market.

Global equity: The MSCI ACWI Index captures large- and mid-cap representation across 23 Developed Markets and 23 Emerging Markets countries. The index covers approximately 85% of the global investable equity opportunity set.

International equity: The MSCI ACWI ex. USA Index captures large- and mid-cap representation across 22 Developed Markets countries and 23 Emerging Markets countries. The index covers approximately 85% of the global equity opportunity set outside the U.S.

International small-cap equity: The MSCI ACWI ex. USA Small Cap Index captures small cap representation across 22 Developed Markets countries (excluding the U.S.) and 23 Emerging Markets countries. The index covers approximately 14% of the global equity opportunity set outside the U.S.

International value equity: The MSCI ACWI ex. USA Value Index captures large- and mid-cap securities exhibiting overall value style characteristics across 22 Developed and 23 Emerging Markets countries. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. The index targets 50% coverage of the free float-adjusted market capitalization of the MSCI ACWI ex. USA Index.

International small-cap value equity: The MSCI ACWI ex. USA Small Cap Value Index captures small-cap securities exhibiting overall value style characteristics across 23 Developed Markets countries and 23 Emerging Markets countries. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. The index targets 14% coverage of the free float-adjusted market capitalization in each country.

Emerging markets (EM) equity: The MSCI Emerging Markets Index captures large- and mid-cap representation across 23 Emerging Markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

Domestic (U.S.) large-cap equity: The S&P 500 Index represents 500 U.S. companies and captures approximately 80% coverage of available market capitalization.

Domestic (U.S.) small-cap equity: The S&P SmallCap 600 Index represents 600 U.S. small-cap companies that meet investability and financial viability criteria.

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