Creating Opportunities

Quarterly Market Outlook

After the COVID-19 pandemic halted economic activity at an unprecedented speed, policymakers responded with extraordinary monetary and fiscal support measures, leading to an equally dramatic recovery in the second quarter.

The continuation of the recovery will depend largely on how economies reopen as risks of renewed infection waves, policy effectiveness and any long term damage to the economy will be the most prevalent headwinds.

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Quarterly Capital Markets Review and Outlook

U.S. Economic Outlook

- Economic data released in the second quarter suggests the economy's recovery began as state lockdown measures eased. BBVA USA Research expects the recovery will take an "incomplete V" shape, meaning it will be slower than anticipated and could be impacted by a second wave of new cases.
- The labor market will be important to watch in the coming months to gain insight on the magnitude and length of the current recovery. The U.S. economy added 4.8 million jobs in June on top of the 2.7 million jobs added in May.
- The Federal Reserve has indicated it is committed to do whatever it can to support the economy. If necessary, the Fed could continue to expand its balance sheet, already at $7 trillion, or provide more guidance about the future direction of interest rates.

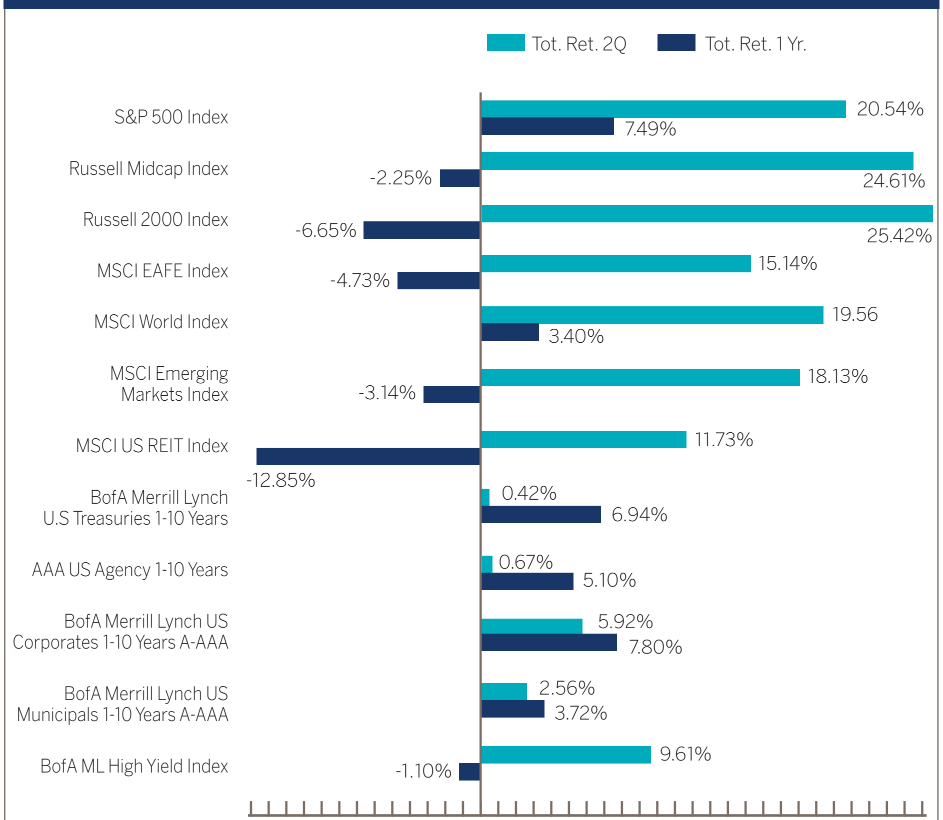
Equity Outlook

- The Second Quarter was the best quarter for the S&P 500 since 1998, increasing by 20.5%. For the Dow Jones Industrial Average, it was the best quarter since 1987, with a return of 18.5%. Meanwhile the tech-heavy NASDAQ lead the way with 30.9%. Internationally, both the MSCI EAFE (developed international) and MSCI EM (emerging markets) indices had double digit returns, but lagged compared to domestic markets.
- As we enter into the Second Quarter earnings season, investors will learn a lot about the initial impact of shutdowns on corporate results. While Wall Street analysts are doing their very best to predict those results, we are likely to see actual numbers vastly different than expectations.
- While the quarter saw a broader section of the market do well, diversification in general has not helped returns halfway through the year. Anything outside of large, technology-based businesses has struggled.

Fixed Income Outlook

- In the second quarter of 2020, the U.S. fixed income markets recovered from the volatility in March. It appears the height of the recent move, the highest risk premiums, and widest credit spreads occurred on March 20th.
- After hitting their widest point in late March, credit spreads saw a dramatic recovery throughout the second quarter. The Fed helped stabilize the investment grade corporate credit market by creating a buying program, primarily in the one to five-year part of the curve. Meanwhile the high yield sector had its best quarter in a decade and saw returns of over 10%.
- The municipal bond market experienced a strong rally in the second quarter of 2020 as attractive yields brought investors into the asset class. Increased government intervention, strong investor demand for tax-free income, and limited new issue supply pushed municipal yields lower during the quarter.

Total Returns - 2Q20 and 1 Year



Source Bloomberg

Economic Outlook

Activity Restart

The Covid-19 pandemic undoubtedly created a combination of supply and demand shocks to the U.S. economy, deteriorating economic growth in the first quarter. In the first quarter of 2020, the economy declined at an annualized rate of 5.0% – the first time since the Financial Crisis. However, economic data released in the second quarter suggests the economy's recovery began as state lockdown measures eased. BBVA USA Research expects the recovery will take an "incomplete V" shape, meaning it will be slower than anticipated and could be impacted by a second wave of new cases. The duration and magnitude of the recovery, however, remains highly uncertain and strongly tied to the government's ability to contain the virus or the development of a vaccine. Members of the Federal Reserve have expressed similar sentiments – the U.S. is in for a slow and uncertain recovery. Philadelphia Fed President Patrick Harker expects the recovery is likely to look like "a swoosh, written with a very shaky hand."

Amid the economic lockdown, industrial production, which measures activity at factories, mines, and utilities, hit a low of -12.7% in April. However, activity picked up in the second half of the second quarter as factories reopened. In June, industrial production rose a seasonally adjusted 5.4% up from 1.4% in May. Much of the recovery in June was attributed to the 7.2% gain in the manufacturing sector, the largest component of industrial production. Despite the gains in May and June, industrial production fell at an annualized rate of 42.6% in the second quarter, the largest quarterly decrease since World War II.

Manufacturing purchasing manager indices (PMIs) paint a similar story. While there is certainly still weakness in the manufacturing sector, two separate surveys suggest the sector may be poised for recovery. In June, IHS Markit reported its manufacturing PMI rose to 49.8 from 39.8 in May and its low of 36.1 in April. The Institute for Supply Management's (ISM) PMI expanded in June at 52.6, a stark rebound from the index's reading of 43.1 in May and 41.5 in April. Readings above

The U.S. Economy at a Glance

Factor	2020 Low	2020 High	June 30, 2020
Monthly Nonfarm Payroll Gains	-20,537,000	4,800,000	4,800,000
Unemployment Rate	3.5%	14.7%	11.1%
ISM Manufacturing Production Index (above 50 indicates expansion)	41.5	52.6	52.6
ISM Non-Manufacturing Production Index (above 50 indicates expansion)	41.8	57.3	57.1
Annualized Housing Starts	891,000	1,599,000	1,186,000
U.S. Euro-to-Dollar Exchange Rate	1.07	1.14	1.12
Conference Board Consumer Confidence Index	86.6	131.6	98.1
Inflation (PCE, year-over-year)	1.0%	1.8%	*
Price of Oil/Barrel – West Texas Intermediate (WTI)	-$37.63	$63.27	$39.27

Source: Bloomberg Professional Terminal®, as of 07/21/2020
Figures as of release date, not accounting for revisions. *Data released on 07/31/2020

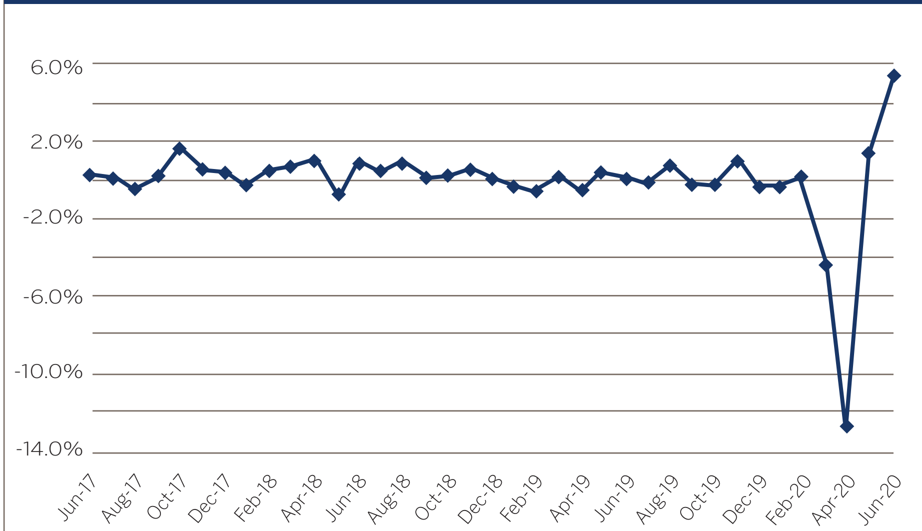
Economic Outlook continued

50 indicate expansion, while readings below 50 indicate contraction. Survey respondents have recently indicated demand has stabilized, evident by the strongest monthly gain in new orders since the start of ISM's index. Similarly, the easing of stay-at-home orders has allowed manufacturers to reduce the number of layoffs to its workforce. Both factors caused an uptick in business sentiment, which could bode well for employment and business spending. Due to the recent uptick in the new coronavirus cases possibly triggering a reclosure of factories, it isn't clear if the recovery is sustainable.

The Fed Beige Book, a compilation of business anecdotes, suggests that while recent business activity shows significant improvement, it may not be sustainable. Optimism remains muted as businesses remain uncertain about the future and hesitant to rehire workers given the continued "health and safety concerns" around the virus. Moreover, there were also talks of a new round of layoffs as the federal government's Paycheck Protection Program nears its end.

This sentiment is a particular concern for the service sector, which accounts for roughly two-thirds of the U.S. economy. As states began to ease lockdown restrictions, activity in the service sector began to pick up. IHS's services PMI rose to 47.9 in June from 37.5 in May. While these number still represent a contraction, it is a notably a significant improvement from the low of 26.7 in April, the height of the lockdowns. However, the recent resurgence in cases could undo the gains made in the sector as many states have already announced new restrictions on restaurants and bars in June.

U.S. Industrial Production MoM



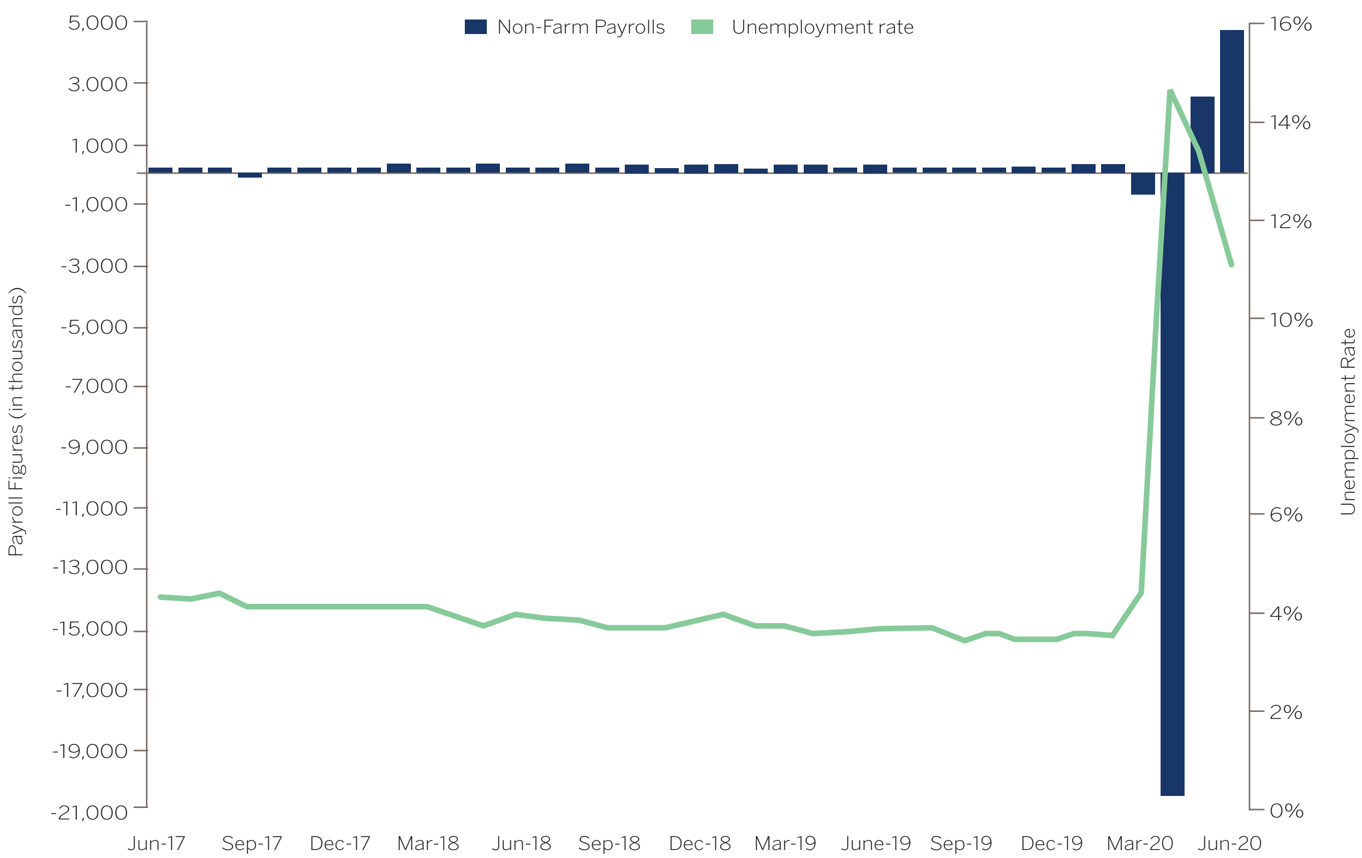
Line chart measures month-over-month change of US Industrial Production figures, from June 2017 - June 2020. Sources: Bloomberg Professional Terminal®, Federal Reserve

Consumer spending, the primary driver of growth in the U.S. economy, is experiencing a similar trend. Spending was bottlenecked as consumers abided by social distancing and lockdown measures. As restrictions were rolled back and government stimulus measures, such as enhanced unemployment insurance and household stimulus payments, were implemented, retail spending bounced back. After plunging 14.7% in April, retail sales jumped 18.2% in May – the biggest gain since the Commerce Department began tracking the data. In June, retail sales rose to $524.3 billion or an increase of 7.5%, nearly back to pre-pandemic levels. Spending was largely attributed to big ticket items such as furniture and autos, but sales also picked up significantly on visits to restaurants and bars and gasoline. Meanwhile in June, spending at both grocery stores and online retailers declined from a month earlier. We could begin to see consumer spending weaken if layoffs resume due to dialed-back state openings and consumers' incomes take a hit.

Consumer prices, gauged by the consumer price index, rose in June to an annualized rate of 0.6% after declining for the past three months. A large part of the gain in June was attributed to the rise in gasoline prices, which were hit hard by the coronavirus pandemic. Core CPI, which extracts the volatile food and

Economic Outlook continued

Nonfarm Payrolls & Unemployment Rate



The chart above shows increases/decreases in non-farm payrolls (in blue) since June 2017. The green line represents the change in the unemployment rate during same time period. Source Bloomberg Professional Terminal ®

energy prices, rose to an annualized rate of 1.2%. The snap back in prices implies the risk of deflation has declined, though it is unlikely we'll see a significant spike in prices anytime soon. BBVA USA Research expects inflationary prices to remain muted for the rest of 2020.

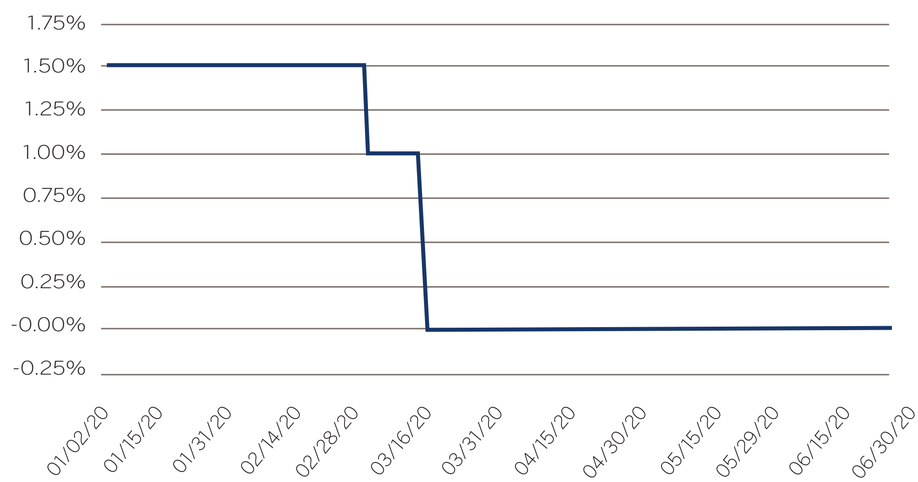
The labor market will be important to watch in the coming months to gain insight on the magnitude and length of the current recovery. The U.S. economy added 4.8 million jobs in June on top of the 2.7 million jobs added in May. According to the Labor Department, these gains only reflect a partial recovery of the 22.2 million jobs lost in March and April. Moreover, we've seen a continued increase in permanent job losses which increased 588,000 to 2.9 million in June. The overall unemployment rate, however, declined to 11.1% from 13.3% in May, after hitting the record high in April at 14.7%. BBVA USA Research expects the unemployment rate to converge to 8.6% by the end of 2020. Recent initial jobless claim numbers, representing new applications for unemployment benefits, have been at least 1 million for the past 17 weeks, which could stall the recovery in the labor market.

Economic Outlook continued

The Federal Reserve has indicated it is committed to do whatever it can to support the economy. The Fed already cut its short-term interest rate to 0.00%, launched numerous credit facilities, and ramped up its bond buying program. If necessary, the Fed could continue to expand its balance sheet, already at $7 trillion, or provide more guidance about the future direction of interest rates. Various members of the Fed, however, have indicated that despite the "unprecedented monetary and fiscal stimulus," more fiscal stimulus is needed to navigate the fallout from the coronavirus. Recently, Treasury Secretary Steven Mnuchin indicated the Trump administration is working with the Senate to pass a new bill for coronavirus-related economic aid by the end of July as enhanced unemployment benefits near expiration.

While economic activity has shown signs of recovery following the rollback of social distancing measures in May and June, risks to the downside remain elevated as the number of coronavirus cases in the U.S. continue to rise. BBVA USA Research anticipates U.S. GDP will decline to 5.1% in 2020.

Federal Funds Target Rate - Lower Bound



Source: Bloomberg

Equity Outlook

Real Resilience?

**"It's like déjà vu all over again."
– Yogi Berra**

Yogi Berra was known as much for his "Yogi-isms" as he was for his hall of fame baseball career. Like his coach, Casey Stengel and his "Stengelese", he had a knack for unintentional witticisms and a unique and humorous way of crafting the English language leaving many befuddled. However, sometimes those malapropisms actually added to the sentiment in a way that accuracy of speaking might not have otherwise captured.

Halfway through the year, the world feels defined by struggle and contradiction. While we have watched Northeastern states begin to emerge from their battle against COVID-19, many of the Sun Belt states have seen a reversal of fortunes. On a global scale, new cases continue to set all-time records, while places hit hardest cautiously try to return to normal. Even our national pastime, which should be celebrating its halfway point with the All-Star Game, is still struggling just to get the season started. However, Mr. Market spent the second quarter acting as if all was right in the world, and the best was yet to come.

Market Returns

	QTD	1 Year	3 Year	5 Year	10 Year
S&P 500	20.54%	7.49%	10.71%	10.71%	13.97%
Dow Jones	18.51%	-0.54%	9.07%	10.59%	12.97%
Nasdaq	30.95%	27.05%	19.18%	16.42%	18.34%
MSCI EAFE	15.15%	-4.63%	1.38%	2.63%	6.31%
MSCI EM	18.14%	-3.11%	2.23%	3.24%	3.63%

Source: Bloomberg

"You can observe a lot by just watching." – Yogi Berra

Despite the uncertainty, the Second Quarter was the best quarter for the S&P 500 since 1998, increasing by 20.5%. For the Dow Jones Industrial Average, it was the best quarter since 1987, with a return of 18.5%. Consistent with recent trends, a handful of companies drove those returns. While we saw some life from value names at times during the quarter, familiar names such as Facebook, Amazon, Apple, etc. resoundingly led markets higher. Of the broad indices, the tech-heavy NASDAQ lead all with a gaudy 30.9% return.

While the quarter saw a broader section of the market do well, diversification in general has not helped returns halfway through the year. Anything outside of large, technology-based businesses has struggled. The bifurcation is easily observed when comparing the returns of the Russell large cap growth and value indices. Growth stocks are now up year-to-date (YTD) over 9.8%, while value companies are down 16.3%. While a diversified global equity portfolio posted a very good return of 19.4% for the quarter, the year-to-date return of -6.0% lags the S&P 500.

While some areas of the market had very strong quarters, their returns year-to-date remain fairly depressed. MLPs, which were easily the best performing major asset class, were up over 50.1% but remain down 35.7% for the year. Small companies also were top performers as the Russell 2000 came in at up 25.4%, but year-to-date returns are a negative 13.0%, a return of almost 10% behind the S&P 500.

Internationally, the story was similar. Both the MSCI EAFE (developed international) and MSCI EM (emerging markets) indices had double digit returns, but lagged the domestic markets. Year to date, developed international stocks are down -11.0% and emerging market names performed slightly better with a -9.7% return. With Europe beginning to emerge from a devastating shutdown, the region is cautiously attempting to return to normal but remains far from achieving that goal. With the virus rapidly increasing in Latin America, places like Brazil seem

Equity Outlook continued

P/E Ratios and Earnings/Share across U. S. Large, Mid, and Small Caps, and Developed and Emerging Countries					
	P/E RATIOS			EARNINGS	
Market Cap	Trailing P/E	10yr Med P/E	Forward P/E	Trailing (Historic) EPS ($)	LTG EPS 3-5 Yr (%)
Domestic Indices					
S&P 500 INDEX	21.81	18.19	24.90	142.13	8.60
Russell Midcap Index	23.71	21.44	31.41	90.48	7.82
Russell 2000 Index	68.27	39.65	181.73	21.11	8.86
International Indices					
MSCI EAFE	18.97	17.40	19.67	93.85	5.64
MSCI EM	16.38	13.22	15.76	60.74	5.41

Source: Bloomberg

on the front end of the curve and have a long way to go. The one bright spot is China, which makes up about a third of the emerging markets index. The country continues to report very limited impact from the virus and outside sources, like mobility data, seem to support that position.

"There comes a time in every man's life, and I've had plenty of them." – Casey Stengel

This little gem of Stengelese might appropriately paint a picture of all the ups and downs we've had the past few months. Often, we have seen events which initially appeared as inflection points and magnitude. However, this quarter should help define our situation a little better.

As we enter into the Second Quarter earnings season, investors will learn a lot about the initial impact of shutdowns on corporate results. While Wall Street analysts are doing their very best to predict those results, we are likely to see actual numbers vastly different than expectations. As of writing this update, according to Factset, expectations are for earnings results of -43.9%. If results come in at this level, it will be the worst quarter since Q4 2008 (-69.1%). This latest projection is a far cry from the -13.6% for the Second Quarter analysts were expecting as of March 31.

Wall Street expectations always have a level of inaccuracy, however, uncertainty going into this quarter is elevated. While analysts talk with company leadership and do their best to model out expectations, even those leaders appear uncomfortable setting expectations. For this quarter, only 49 companies in the S&P 500 bothered to issue guidance. This is important because as we get results, stocks are likely to see meaningful shifts in price once this data is released. Even more, the earnings calls will begin to paint a clearer picture of the challenges these companies are facing and their ability to navigate them.

"You better cut the pizza in four pieces because I'm not hungry enough to eat six." – Yogi Berra

The value of an item is only as much as a buyer is willing to spend at a given point in time. That number can vary wildly depending on the availability of information. Stocks are not removed from this condition and the availability of information helps define the efficiency of these markets. When information is not available or when there is an asymmetry of information, stocks can trade at

Equity Outlook continued

otherwise unreasonable prices. Yogi maybe adds a different factor - incorrect processing of accurate information.

With the uncertainty surrounding almost every input, investors face extreme difficulty in making smart decisions. Based on what the street expects for earnings, stocks look expensive. The forward P/E of the S&P 500 ended the quarter at 24.9x as compared to the 25-year average of 17.4x. This current valuation is at a level not seen since the end of the tech-bubble in the early 2000s. However, this process of valuation relies heavily on the accuracy of earnings expectations we referenced earlier. If we average long-term historical earnings in an effort to remove the inherent fallacy of projections and use Robert Shiller's cyclically adjusted P/E (CAPE), the market is trading at 29.0x. At that level it is also unusually elevated, but we were higher near the end of 2018.

The current valuation concerns are not exclusive to U.S. Large Cap companies. Small Cap companies appear to trade at astronomical levels, despite a double-digit negative return for the year. With the strong quarter, the forward P/E comes in at astounding 182.9x earnings! When PE ratios are this absurd, it indicates many small cap companies have earnings that are negative or approaching zero. This can happen in times of stress. Keep in mind the long-term P/E average comes in at 26.3x. If someone is simply investing in areas of the market which have underperformed, they may find themselves buying this group of stocks at what appears as historically high prices.

Where does this leave us? You can assume this disconnect can't last – either the price of the market should decline or earnings will come in well ahead of current estimates. Nevertheless, there is certainly one other factor at play – monetary policy. With the aggressive actions taken by the Fed to ward off disaster, we are once again dealing with all-time low interest rates. We are also dealing with low and declining inflation expectations. These factors should warrant higher multiples. The question is what is too high?

"When you come to the fork in the road, take it." – Yogi Berra

While Robert Frost may have rolled over in his grave at that quote, we seem to have come to several forks over the past few months. Different areas of our country have taken different paths, but there are all intertwined and we will likely all end up at the same destination – wherever that may be. Although Second Quarter corporate results will matter, much of our expectations for market returns will hinge on the impact of COVID-19. Globally, countries are all on very different paths. However, the interconnectivity of our planet makes those experiences meaningful to all nations. We've seen this play out in the U.S. as much of the Tri-State area dealt with the initial brunt of infections, but the rest of the country saw milder exposure. This trend has now reversed as infections in other regions have significantly increased.

With this event, the economic picture remains importantly tied to these trends and governmental policies in response. Increasing lockdowns over time will inevitably result in stickier unemployment. This one factor of employment will ultimately dictate how our economy fares. Various levels of the government have the unenviable position of balancing public wellness with economic disaster. While we hope for a perfect solution, it is unlikely that any one course of action will emerge as the clear choice. We will continue to see starts and stops along the path, and missteps will likely remain as common as beneficial actions. Despite this environment, good companies will continue to improve and be in position to prosper as we eventually do conquer this challenge.

"Never, ever bet against America." – Warren Buffett

The Oracle of Omaha has a frankness of words not entirely dissimilar to those baseballisms in his ability to make complex ideas simple. His clear-eyed view is one which has unequivocally reaped a record of demonstrated success. While we warned earlier this year not to extrapolate extreme market emotions, Mr. Buffett also reminds us we have faced many similar or worse challenges in our nation's history. While the road was not easy, our ability to withstand adversity and prosper has been our hallmark. During Berkshire Hathaway's recent shareholder meeting,

Equity Outlook continued

Mr. Buffett spoke of the many crises we've seen over the past 244 years, but more importantly he illustrated how we've succeeded. While this crisis is far from over, and market volatility is almost certain, history suggests we will get through this and will likely come out a stronger and more prosperous society. In that scenario, stocks will almost certainly provide the best return for investors. Until we get through this, we will continue to position our portfolio with diversified, high quality assets capable of weathering the current storm.

Fixed Income Outlook

What Used to be Unprecedented Could Become Conventional

Overview

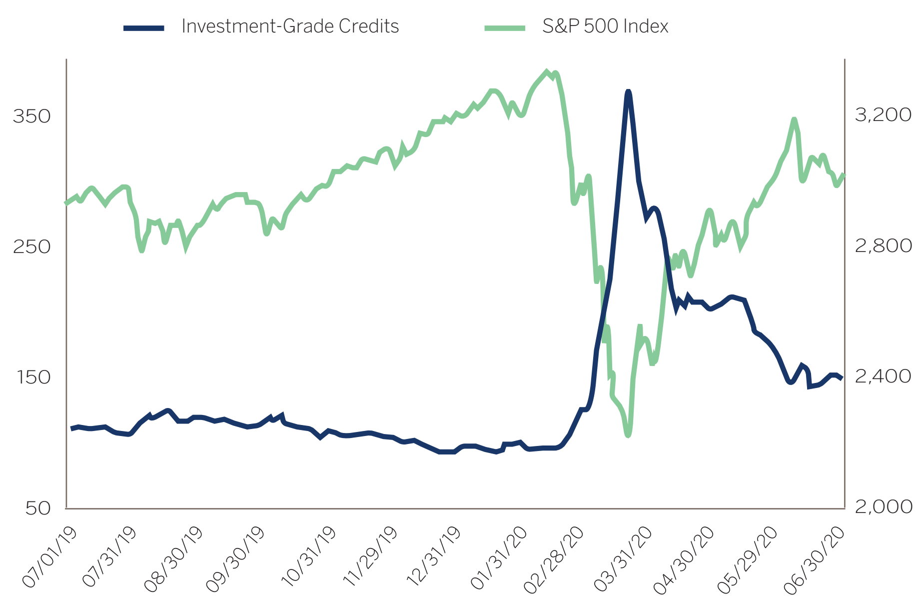
In the second quarter of 2020, the US. fixed income markets recovered from the volatility in March. It appears the height of the recent move, the highest risk premiums, and widest credit spreads occurred on March 20th. As the Federal Reserve began massive liquidity injections and credit backstops, investors had enough confidence in the credit markets to provide stability. In addition to the Fed, Congress provided fiscal stimulus to help offset the unprecedented government-mandated shutdowns of most state economies due to the outbreak of the coronavirus.

It is important to remember the equity markets hit an all-time high on February 19, the economy was solid, and unemployment in virtually all demographic groups was at multi decade lows. The damage to the economy from coronavirus is almost beyond comprehension. The U.S. economy contracted 5.0% annualized in the first quarter, the first contraction since the fourth quarter of 2008. Over forty million Americans have filed for some type of employment assistance. Personal and business bankruptcies are expected to soar.

The initial reactions by state and local governments was to issue shelter in place orders, close most non-essential businesses, and ban any type of commercial or recreational gathering. The shutdown was effective, but at an enormous damage to the economy. Governments began reopening their economies as quickly as their health situation allowed. The reopenings have created a second wave of infections in the South and West, and governments are experimenting with various rules and regulations trying to limit the spread of the virus and that are expected to create the least amount of damage to their economies.

The credit markets snapped back from the declines of March, and outperformed government bonds in the second quarter. The two year U.S. Treasury note has traded around 0.20%. The ten year U.S. Treasury note has traded mostly between 0.60% and 0.80%. 1-10-year US Treasuries returned 0.42% in the first quarter. 1-10 year high grade corporate bonds, those rated A3/A- or better, returned 5.93%. 1-10-year investment grade corporate bonds, those rated

1 Year Credit/Equity Trends



*The lines represent the relationship between the average option-adjusted spread levels of the Barclays US Corporate High Yield Bond Index and the price levels of the S&P 500 Index from July 1, 2019 - June 30, 2020.

Source: Bloomberg

Fixed Income Outlook continued

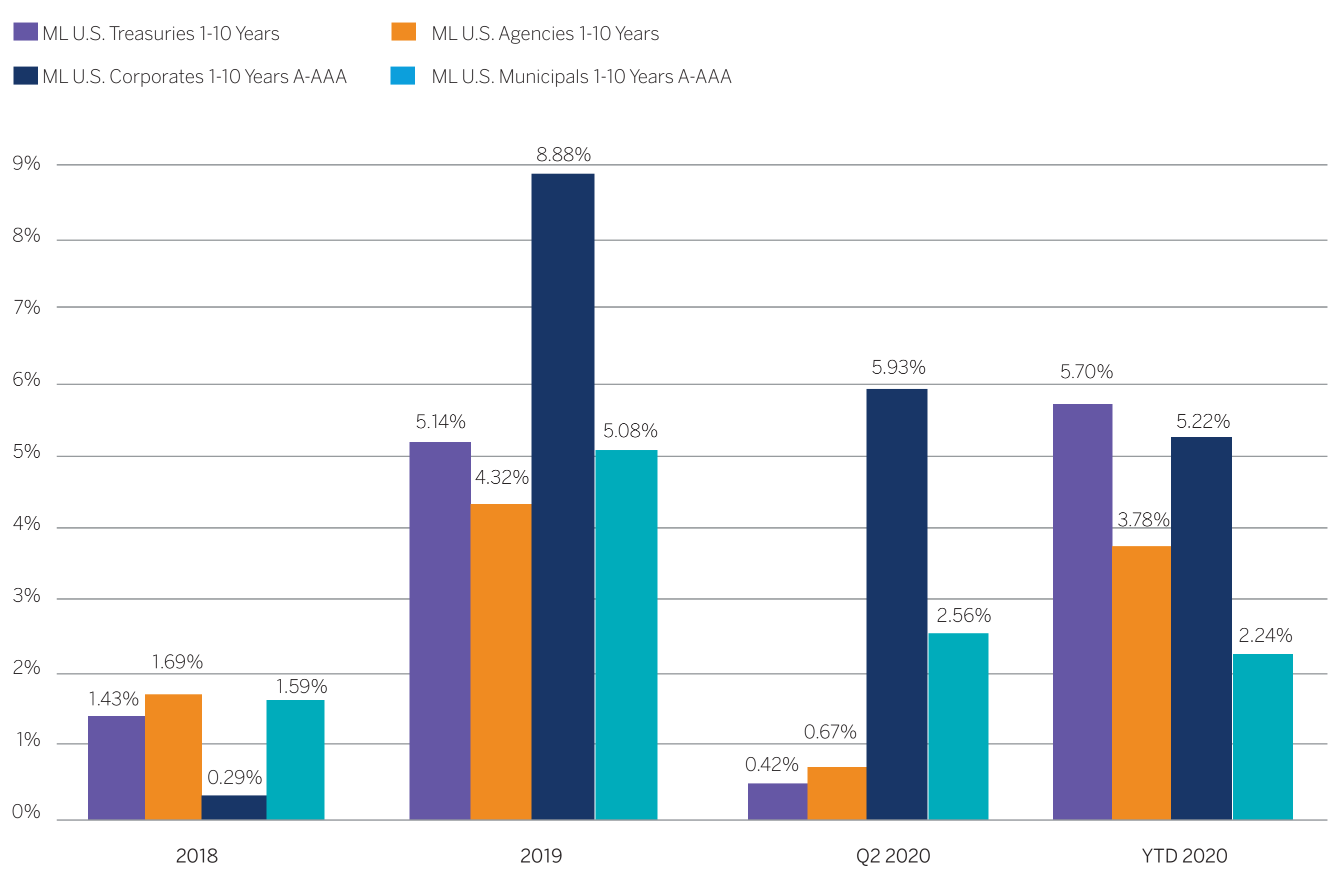
Baa3/BBB- or higher, returned 7.88%. 1-10-year high yield bonds, those rated below Baa3/BBB-, returned 9.13%.

Going forward, the bond market will try to determine the level that the economy can grow and still allow economic activity to be slowed enough to slow the spread of the virus. The credit markets are expected to be stable with the massive Fed support solidly in place. The Fed has indicated that stimulus and support will stay as long as needed. Interest rates are not expected to rise dramatically, as the Fed is expected to be active in keeping them low to support the recovery. As the summer progresses, the November Presidential election will become another unknown to the outlook.

Credit Markets

The second quarter was one of massive corporate debt supply. At quarter end, investment grade new supply had already crossed the $1 trillion mark, nearly double last year's pace and almost matching the record supply of $1.3 trillion set back in 2017. Even with the extremely heavy supply calendar, demand for new issues has remained strong with almost every deal being several times oversubscribed. Expectations are for new supply to slow down in the second half of 2020 and should be in line with the numbers seen in the second half of last year.

Asset Class Returns



Source: Bloomberg

Fixed Income Outlook continued

After hitting their widest point in late March, credit spreads saw a dramatic recovery throughout the second quarter. The Fed helped stabilize the investment grade corporate credit market by creating a buying program, primarily in the one to five-year part of the curve. The gradual reopening of the economy throughout the second quarter also calmed market nerves, and by the end of June, credit spreads returned to the pre-shutdown levels of early March. After reaching a high of +373 basis on March 23, the Barclays Investment Grade Index closed out June at +150 basis points. A significant improvement, but still shy of the +90-100 basis point range seen at the beginning of 2020. Going forward, credit spreads should generally continue on the path to recovery, though a second Covid wave in the fall and a reclosure of the economy would put negative pressure on credits.

The high yield sector had its best quarter in a decade and saw returns of over 10%. Recovering commodities prices, especially in the oil market which pushed past the $40 per barrel mark, helped lift the Barclays High Yield Index to a close at +624 basis points on June 30 after reaching as high as +1100 basis points in late March. While the recovery in high yield bonds has been dramatic, spreads still remain at about double where they started the year.

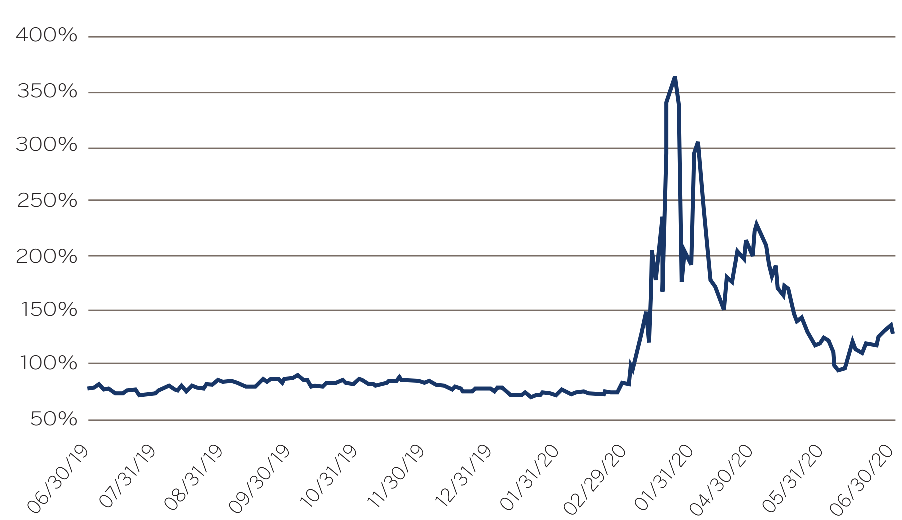
Municipal Market

The municipal bond market experienced a strong rally in the second quarter of 2020 as attractive yields brought investors into the asset class. Increased government intervention, strong investor demand for tax-free income, and limited new issue supply pushed municipal yields lower during the quarter.

Municipal bond yields followed the Treasury market lower in anticipation that the Federal Reserve will keep rates low for an extended period of time. The yield on the 10-year AAA General Obligation bonds hit its high for the quarter on April 2nd and finished the quarter 98 basis points lower at 0.85%. At the same time, the yield on the 5-year AAA General Obligation bond dropped 96 basis points to end the quarter at 0.45%. This decline in rates produced a quarterly return of 2.56% on the ICE BofAML 1-10 Year AAA-A Municipal Index and was the highest quarterly return since the third quarter of 2009.

The positive returns were driven by the Federal Reserve announcing the Municipal Liquidity Facility in April to help with the cash crunch facing State and Local Governments by buying short-term debt sold to cover revenue shortfalls caused by the pandemic. Also contributing to the decline in municipal yields was the limited new issue supply. Second quarter new issue supply, at $74.6 billion, was 6.5% lower than the same period in 2019. The limited new issue supply and steady investor demand contributed to lower yields and tighter spreads. The high-yield

10-Year BVAL AAA Muni Yield % of Treasury Yield



Source: Bloomberg Professional Terminal®

Fixed Income Outlook continued

municipal sector also performed well as lower yields pushed investors to take on more risk.

As stability starts to return to the market, municipal credits are adjusting to new levels and assessing the impact of slowing tax revenues on municipal credits. High-grade credits have been in strong demand and spreads have compressed. The market is experiencing a bottom-up credit rally as investors take on more risk to achieve their yield targets. New issue supply is expected to remain lower than average. At the same time, increased demand from summer reinvestment coupled with positive flows into the asset class provides supportive technical for the next few months.

We look to position portfolios with a neutral duration while focusing on the 1 to 10-year part of the yield curve. We prefer high-grade municipal revenue credits rated AA-AAA with dedicated revenue streams as a hedge against a slower economy. High-grade State and Local General Obligation credits provide a strong foundation to portfolios while callable bonds could offer value for their higher yield and shorter duration. As we move closer to the November elections, the increased talk of potential higher taxes should increase investor demand for tax-free bonds. Any backup in rates should be viewed as an entry point for adding municipal bonds to a portfolio or a buying opportunity for existing holdings.

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This material contains forward looking statements and projections. There are no guarantees that these results will be achieved.

Investing involves risk including the potential loss of principal. There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment. No investment strategy, such as asset allocation, can guarantee a profit or protect against loss in periods of declining values. Past performance is no guarantee of future results. Please note that individual situations can vary. Therefore, the information presented here should only be relied upon when coordinated with individual professional advice.

Indexes are unmanaged and investors are not able to invest directly into any index.

International investing involves special risks not present with U.S. investments due to factors such as increased volatility, currency fluctuation, and differences in auditing and other financial standards. These risks can be accentuated in emerging markets.

Investments in stocks of small companies involve additional risks. Smaller companies typically have a higher risk of failure, and are not as well established as larger blue-chip companies. Historically, smaller-company stocks have experienced a greater degree of market volatility than the overall market average.

Equity investments tend to be volatile and do not involve the guarantees associated with holding a bond to maturity.

In general, the bond market is volatile as prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

Fixed income investments are subject to various risks including changes in interest rates, credit quality, inflation risk, market valuations, prepayments, corporate events, tax ramifications and other factors.

The investor should note that vehicles that invest in lower-rated debt securities (commonly referred to as junk bonds) involve additional risks because of the lower credit quality of the securities in the portfolio. The investor should be aware of the possible higher level of volatility, and increased risk of default.

Municipal bond offerings are subject to availability and change in price. If sold prior to maturity, municipal bonds may be subject to market and interest risk. An issuer may default on payment of the principal or interest of a bond. Bond values will decline as interest rates rise. Depending upon the municipal bond offered, alternative minimum tax and state/local taxes could apply.

The price of commodities is subject to substantial price fluctuations of short periods of time and may be affected by unpredictable international monetary and political policies. The market for commodities is widely unregulated and concentrated investing may lead to higher price volatility.

Investments in real estate have various risks including possible lack of liquidity and devaluation based on adverse economic and regulatory changes.

Other Sources: Bloomberg; California.gov; Russell.com; First page index returns are calculated on a total return basis using the following indexes: S&P 500 (SPX), MSCI World (MXWO), MSCI Emerging Markets (MXEF), BofA Merrill Lynch U.S. Treasuries 1-10 years, BofA Merrill Lynch U.S. Agencies 1-10 years, BofA Merrill Lynch U.S. Corporates 1-10 years A-AAA, BofA Merrill Lynch U.S. Municipals 1-10 years A-AAA, Russell Top 200 Index, Russell 1000 Index, Russell Midcap Index, Russell 2500 Index, Russell 2000 Index, Credit Suisse High Yield Index (CSHY), MSCI U.S. REIT Index (RMZ Index).