Back to Basics

After two successive years of strong returns for the S&P 500 index and lackluster returns for broadly diversified portfolios, many investors are questioning the promised benefits of portfolio diversification and asset allocation. Here is a not-so representative sample of recent headlines on this topic:

Diversification Means Always Having To Say You're Sorry – Forbes
Is Diversification Dead? – Barclays Wealth Management
Is Skill Dead? – Grantham, Mayo, von Otterloo
Is Modern Portfolio Theory Dead? – iSectors
Is Asset Allocation Really Dead? – Wells Fargo Private Bank
Lessons Learned in 2014 – Bernstein Global Management
When Diversification Feels Like %$#@ – The Reformed Broker
Rumors of the Death of Diversification are Greatly Exaggerated … Again – Wells Fargo Investment Institute

To help readers gauge whether these tools are no longer effective, we will start by going over the key precepts of asset allocation and diversification, which underpin our own approach to portfolio management. Next, we will examine why investors are dissatisfied with their recent performance and review some factors that may have contributed to these outcomes. Through this process, we hope to derive some conclusions that will be helpful to readers as they assess the performance of their own portfolios.

Investment Philosophy

Irrespective of the specific investment objective, our investment philosophy has three overarching goals - preserve clients' capital, maintain long-term purchasing power and minimize portfolio risk through diversification. To accomplish these goals, we use asset allocation to combine investments from different asset categories into diversified portfolios that reflect each client's specified preferences and objectives. This process, also called portfolio construction, is designed to deliver better risk-adjusted returns by combining a mix of risky assets to reduce the overall portfolio risk and/or enhance its return potential.

Asset Allocation

Asset allocation is the broad mix of stocks, bonds and other assets that comprise an investment portfolio. Investment programs that utilize asset allocation are largely based on a seminal 1986 study by Brinson, Hood and Beebower. The study looked at investment returns for a group of 91 pension plans and concluded that 92% of the variability of the returns was due simply to asset allocation. The study indicated that security selection and market timing accounted for only 6% and 2%, respectively. Coming at a time when investment managers spent most of their time on security selection, these conclusions were somewhat controversial, but they had a revolutionary impact on the investment management industry. Asset allocation has since been adopted across the investment industry and is now used as the framework for portfolio construction for clients. (Brinson, Hood and Beebower, Determinants of Portfolio Performance, Financial Analysts Journal, Jul-Aug 1986).

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Since the Brinson study was first published, its findings were questioned, challenged and eventually validated by other market participants. For instance, a follow-up analysis by Ibbotson Associates in 1999 examined data for 58 pension funds and it too concluded that asset allocation is a primary driver of portfolio performance. The Ibbotson study found that asset allocation accounted for 86% of the overall return for the best performing funds and 113% of the overall return for the worst performing funds, signifying that poor decisions on security selection and timing were a net detractor to performance in the latter portfolios.

Aside from showing that active management can positively or negatively impact portfolio returns, the Ibbotson study made some key points that we now take for granted: Market timing is difficult, if not impossible, to pull off successfully; investors need to be in the market continuously to capture the expected returns, and expenses and fees strongly influence long-term investment returns. (Ibbotson Associates, Does Asset Allocation Policy Explain 40%, 90% or 100% of Performance?, Financial Analysts Journal, Jan-Feb 2000).

Diversification

Diversification is a key tenet of modern portfolio theory. By spreading bets across a broader mix of assets, investors can benefit from exposure to the categories that do well, and limit their vulnerability to categories that perform badly. It is important to note that by definition, a broadly diversified portfolio will include some asset categories that are either underperforming or out of favor. The diversified portfolio is therefore likely to underperform a less-diversified portfolio that only (or mainly) holds the asset class currently in favor.

In 2013 and again in 2014, the S&P 500 index delivered outsized gains for US large cap stocks and handily outperformed most other markets. By comparison, diversified portfolios delivered lower returns in both years, leading investors to question whether diversification still made sense. For an explanation, we can turn to behavioral finance. Studies show that investors use their domestic market as the frame of reference for evaluating investment performance. For instance, when the S&P 500 underperforms other asset classes, diversification generates better outcomes and investors are happy with the outcome. However, when the S&P 500 outperforms other asset classes, investors perceive that diversification is working against them.

Next, let's look at why the S&P 500 index performed so well in 2013 and 2014 relative to other world equity markets:

1. Starting in 2009, the US Federal Reserve was quick to implement various stimulus programs that provided massive amounts of liquidity to the economy. Arguably, these actions were the biggest reason why the US economy was further along in its recovery than other economies that were slower to act during the crisis.

2. By keeping interest rates near zero for an extended period, the Federal Reserve enabled banks to rebuild their balances sheets and borrowers to benefit from cheap credit, which aided the recovery process.

3. By keeping rates low, the Fed hoped to force investors to reduce their cash holdings and put the money to work in other markets, such as stocks and real estate, thereby providing a boost to the economy from the wealth effect on consumer spending.

4. Investors facing economic and political turmoil in their home countries continued to look to the US as a safe haven. With cash and bond yields at historically low levels, much of this money eventually found its way to the US stock market.

5. The US now has access to vast resources of cheap domestic energy and is close to energy self-sufficiency. This has provided a significant cost advantage to the manufacturing and industrial sector. Additionally, the US trade deficit shrank as energy imports declined.

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Chart 1. Investment Leadership in Equities

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
34.0%	32.1%	39.4%	-36.8%	78.5%	26.7%	1.5%	18.2%	36.8%	13.2%
13.5%	26.3%	11.2%	-37.6%	34.4%	18.9%	-2.5%	17.9%	33.1%	7.1%
8.1%	16.2%	5.8%	-43.4%	31.8%	16.1%	-12.1%	17.3%	22.8%	-2.2%
6.3%	15.5%	1.4%	-53.3%	28.4%	7.8%	-18.4%	16.4%	-2.6%	-4.9%

US Large Cap Equities
Emerging Market Equities
US Small/Mid Cap Equities
Non-US Developed Market Equities

Source: Is Diversification Dead? Barclays Wealth Management, February 2015

Investors expect 2015 to be another banner year for the US economy with GDP forecast to grow at 3% or better. It remains to be seen whether that will translate to another year of outsized gains for US markets. First quarter returns for the S&P 500 have lagged those for Europe, Japan and other markets that underperformed in the last two years, a sign of markets' tendency towards mean reversion.

We see further evidence of mean reversion in Chart 1 above. Over the last ten years, US large cap stocks were the top equity class for two years, and the bottom performer for four years. Conversely, emerging market equities, the top performer in five of the ten years, have delivered very poor returns in the last couple of years.

From a portfolio construction standpoint, it is not enough to look at one asset class in isolation. We need to see how equities have performed, both in relation to one another, and also in relation to other asset classes. For this, we turn to the Chart 2 on the following page, which shows the relative performance of 14 asset categories, annually over the last twelve calendar years and into the first quarter of 2015.

This chart highlights that return distributions are somewhat unpredictable and that performance leadership varies greatly over time. The chart also provides some evidence for mean reversion, where the top performing category in a given period is prone to underperform in following periods. However, the persistent performance of MLPs and commodities suggests strong evidence for trend persistence, where a winning/losing strategy in one period continues to outperform/underperform in subsequent periods.

The overall impact of portfolio diversification can be seen in Chart 3, which compares the cumulative returns on various single asset classes versus a diversified portfolio over a 15-year period. Emerging market equities (green) posted the highest cumulative returns to investors, but they also exhibited the greatest volatility. The second best returns came from a diversified portfolio holding a mix of US large cap stocks, developed international equities, emerging market equities, investment grade bonds, commodities and hedge funds (blue). All the other portfolios provided lower returns and higher volatility than the broadly diversified portfolio. With the possible exception of the most aggressive investors, we believe most investors would view the broadly diversified portfolio as their preferred option.

Note that the cumulative returns for US large cap stocks (dashed line) trail those of the diversified or balanced portfolio (blue), as well as the stand-alone returns for investment grade bonds (brown), hedge funds (grey), commodities (black) and emerging market equities (green). To the extent that much of the current debate over portfolio diversification was triggered by the strong performance of the S&P 500 index in 2013 and 2014, it is clear that investing solely in US large cap stocks would have generated inferior returns and the diversified portfolio did considerably better over this period.

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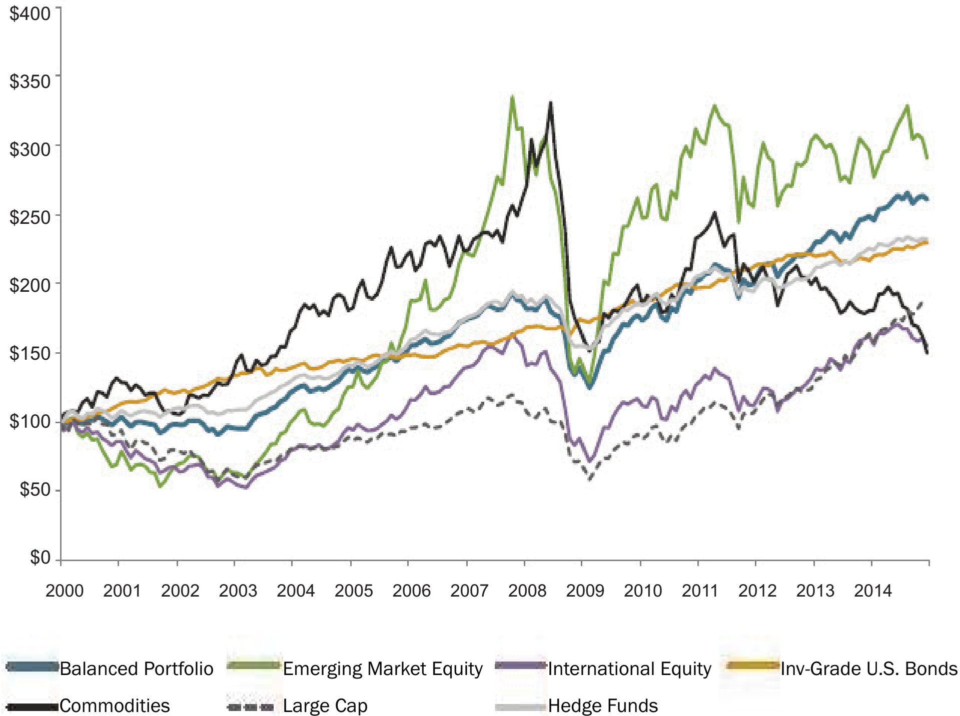
Chart 2. Historical Asset Returns

Jan 2003 to Mar 2015

HPM PARTNERS

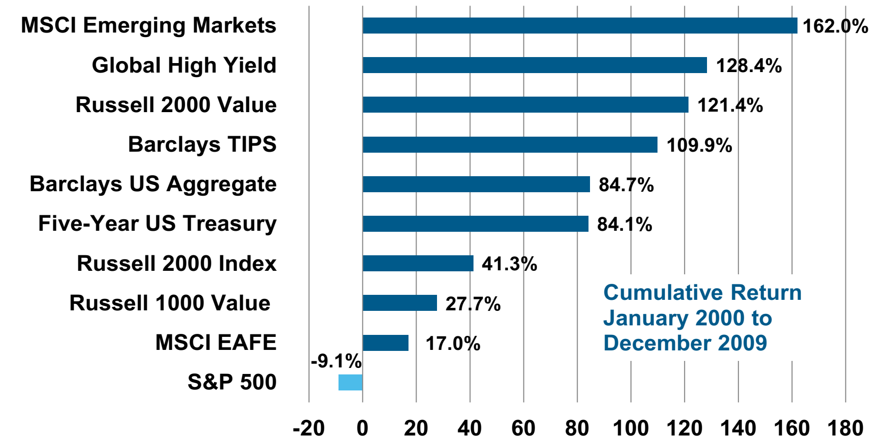
Source: Principles of Investing Success, The Vanguard Group, April 2014 with FactSet updates

Chart 3. Cumulative Returns
(Jan 2000 to Dec 2014)



Source: Rumors of the Death of Diversification Greatly Exaggerated...Again, Wells Fargo Investment Institute, Feb 2015

Chart 4. Lost Decade – Cumulative Returns
Jan 2000 to Dec 2009



Source: Asset Allocation Special Report, Morgan Stanley, March 2015

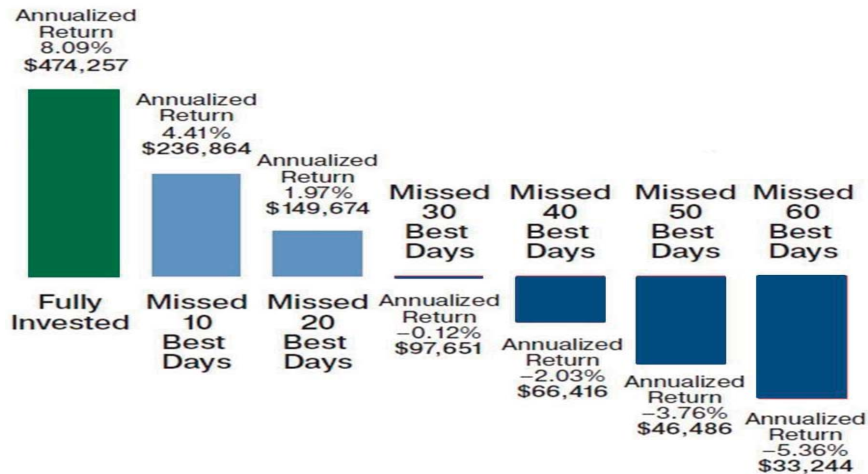
Additional justification for diversification comes from Chart 4, which compares how some other asset categories performed during the so-called lost decade for US stocks in the 2000s, when the S&P 500 posted negative cumulative returns over a full 10-year cycle. Investors were well served by having these other asset classes in the portfolio.

We see elements of mean reversion at work in subsequent years. Emerging market equities, the top performing asset class in the last decade, have delivered sub-par returns this decade, while US large cap stocks, the laggards of the 2000s, rebounded to deliver strong returns. Investors who sold US equities after a period of extended underperformance, or who bought emerging markets equities following a lengthy run of outperformance, saw their returns suffer in subsequent years.

This highlights three additional ingredients that are crucial for investment success – discipline, patience and staying in the market. As illustrated in Chart 5 on the following page, being out of the market on the critical days that drive market returns can have a huge impact on investor returns.

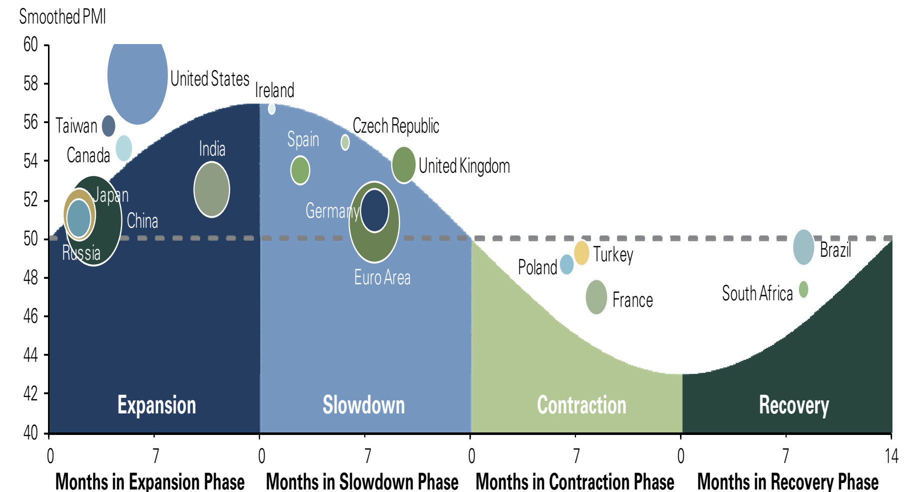
In summary, we believe diversification remains a highly desirable tool for investors to both manage risk and achieve their desired goals. While US large cap equity portfolios and simple 60/40 portfolios have outperformed highly

Chart 5. Impact of Being Out of the Market



Source: Oppenheimer Funds, April 2015

Chart 6. Global Phasing of the Economic Cycle



Source: Divergent Paths, Divergent Opportunities, Goldman Sachs Asset Management, September 2014

diversified portfolios in recent years, this was partly due to exceptional market conditions in the aftermath of the global financial crisis. Broadly diversified portfolios have delivered consistent returns over long periods, with considerably reduced volatility. When compounded over extended periods, the combination of consistent returns and reduced volatility enabled diversified portfolios to deliver superior returns.

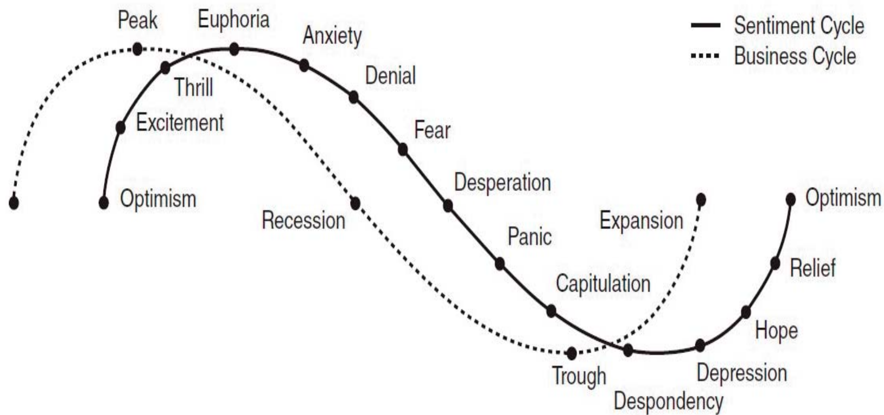
The Economic Cycle and Effect on Investor Behavior

Countries at different points in the economic cycle provide varied opportunities for investors at any given time. Exposure to global markets enables investors to benefit from diversification at three levels – country, economic cycle and currency (see Chart 6).

In his pioneering book, "The General Theory of Employment, Interest and Money", John Maynard Keynes used the term "animal spirits" to describe consumer confidence, one of the essential elements of economic prosperity. Economists have long assumed that humans are rational in pursuit of their economic interests. Keynes acknowledged that human behavior is driven more by intuition and emotion and economic decisions can be greatly influenced by irrationality and behavioral factors.

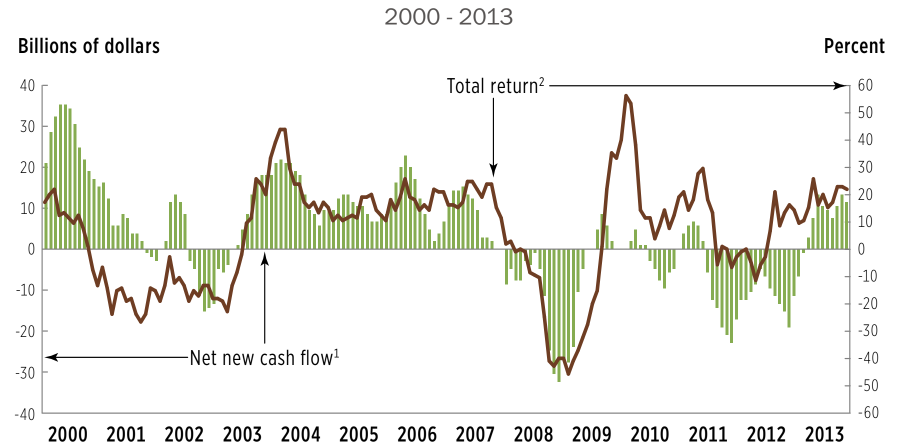
We see this point illustrated in Chart 7 on the following page, which demonstrates how closely investor sentiment tracks the economic cycle. When consumers feel economic conditions are good, investor sentiment rises; when conditions are felt to be bad or worsening, sentiment falls. In fact, we should be seeing the opposite behavior. In one of most well-known quotes, legendary investor Warren Buffet attributes his legendary success to contrarianism, as in

Chart 7. Investor Sentiment and the Economic Cycle



Source: Advising the Behavioral Investor, Gerstein Fisher Research Paper, October 2013

Chart 8. Correlation of Equity Cash Flows to Market Returns
2000 - 2013



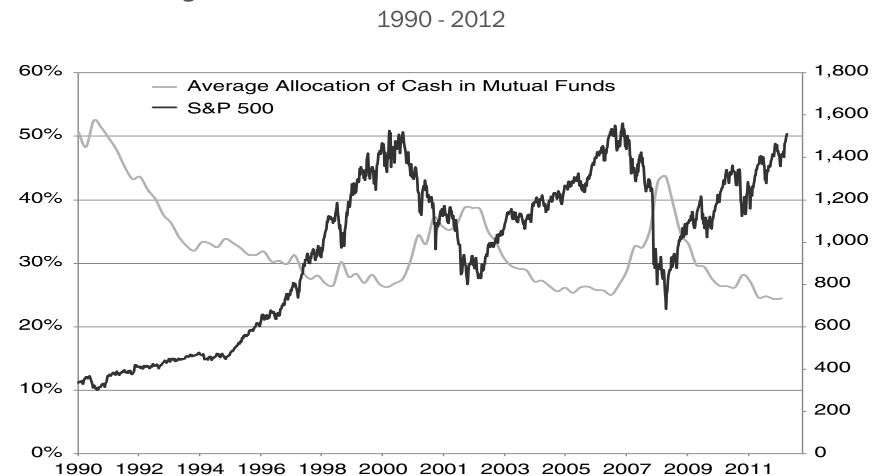
Source: 2014 Investment Company Fact Book, Investment Company Institute

"we simply attempt to be fearful when others are greedy and greedy when others are fearful". Clearly, the vast majority of investors have not taken this advice to heart, which would explain why so few have garnered Buffet's level of success in investing.

And as we see in Chart 8 from the mutual fund trade association, inflows into equity mutual funds are highly correlated to market returns. Flows rise when market returns are rising and fall when market returns decline, suggesting that investors' decisions are often based on emotional reactions to news about markets rising or falling.

For further proof, we turn to Chart 9, which maps average cash positions in mutual funds to movements in the S&P 500 index. It confirms that investors tend to be most aggressive (holding least cash) when markets are peaking and at their most risky, and most conservative (holding most cash) when markets are at troughs and offer the greatest opportunity.

Chart 9. Average Cash Allocations of US Mutual Fund Owners vs. S&P 500 Index
1990 - 2012



Source: Advising the Behavioral Investor, Gerstein Fisher Research Paper, October 2013

Looking at other aspects of investor behavior, studies show that investors tend to be impatient. They are too quick to make portfolio changes and often do not give managers sufficient time to prove themselves, or for their strategy to come to fruition. In so doing, investors regularly buy high (i.e. when managers are popular and have posted good returns) and sell low (when managers have underperformed and are out of favor). As a result, an individual investor's returns for a given investment are often inferior to the manager's returns for the strategy.

Manager Performance

In recent years, despite the fact that investment managers have access to more information and tools than ever before, we have seen a growing trend for the majority of active managers to underperform their benchmark, particularly in years when markets are very strong. Does this mean that active management is a failure, or that managers are any less competent or less skilled than in the past? We don't think so, but we believe several factors are working against active managers today:

1. Market information is universally accessible, diminishing any information advantage enjoyed by managers and making it much harder for individual managers to uncover and act on unique insights that are not shared by other participants in the market.

2. The investment business has become more professionalized over the last 30 to 40 years and the average quality of managers has risen to the point where there is less differentiation amongst managers and firms in terms of skills, education or access to information. As the playing field has leveled, it is more difficult for individual managers or firms to distinguish themselves from the crowd.

3. Equity market correlations are rising, due to the huge growth of derivatives trading, rising numbers of hedge funds, explosive growth of high frequency trading programs and growing proliferation of exchange traded funds. Together, these factors have contributed to higher correlations within US, developed international and emerging markets equities, making it far more difficult for active managers to generate alpha, or returns in excess of the market.

4. Correlations soared during the global financial crisis as risk on-risk off trading patterns dominated markets overwhelmed by systematic concerns. With conditions normalizing, we see below that correlations are receding, setting the stage for managers to generate returns from more differentiated opportunities and for investors to resume seeing benefits from international diversification (see Chart 10 on the following page).

5. Dispersions of equity returns have been falling to new lows. As shown in Chart 11, the lower the dispersion of returns, the lower the opportunity for managers with differentiated views to outperform the broader market, and hence, the greater the likelihood that active managers will underperform their benchmark.

With correlations high and dispersions low, even the most skilled managers have difficulty generating returns or keeping up with the broader markets. As market conditions continue to normalize, we expect correlations to subside and dispersions to rise, providing active managers more opportunities to generate outperformance through unique themes or ideas. Furthermore, market volatility is at historically low levels due to the impact of policy actions such as quantitative easing that have suppressed normal market conditions. As markets adjust to the ongoing withdrawal of liquidity from the economy, we expect active managers to resume their role of providing downside protection within portfolios.

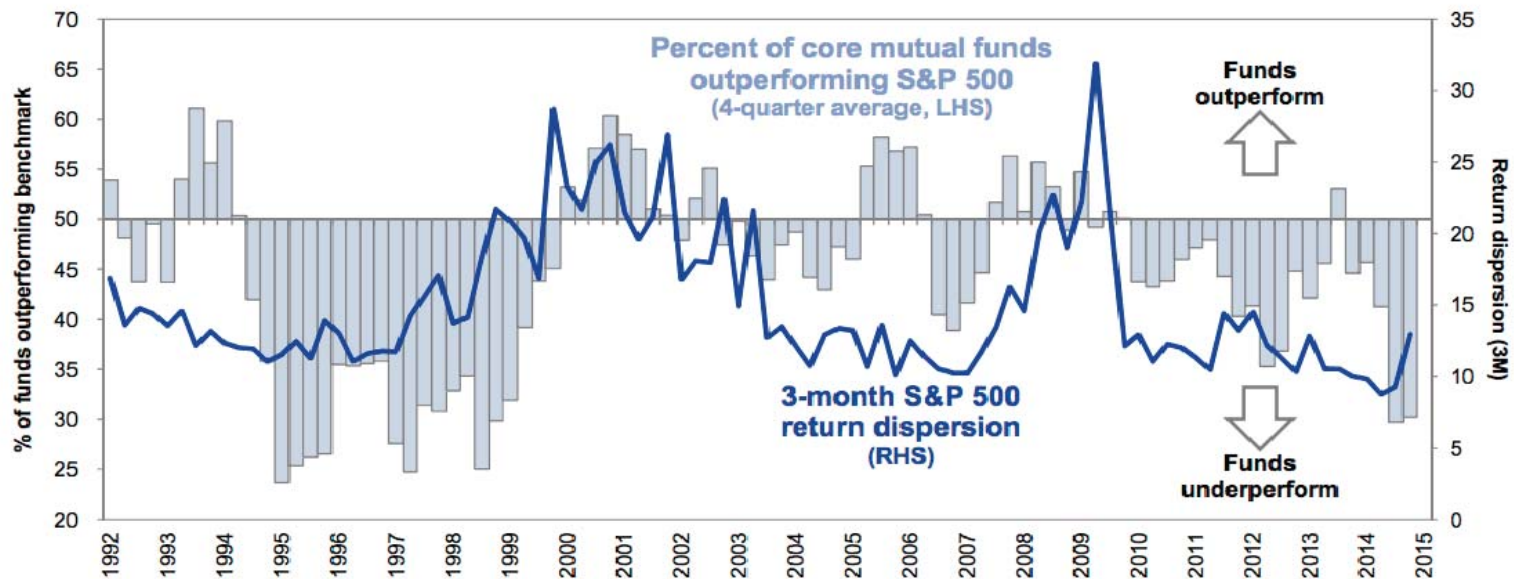
Research Affiliates, a well-known quantitative investment firm, has released an interesting study on manager performance. In the entire universe of mutual funds, only three funds have outperformed the broader market by 2% or more compounded over the 1970 to 2014 period. More importantly, Research Affiliates found that even these three stellar managers were on the equivalent

Chart 10. Inter-Market Equity Correlations
2000 - 2013

Year	ACWI ex USA vs	EM	EAFE	Brazil	Germany	Japan	AC Asia Pacific ex Japan	Europe	UK	Mexico	Korea
2010	0.95	0.91	0.94	0.88	0.79	0.77	0.88	0.92	0.92	0.83	0.78
2011	0.96	0.85	0.91	0.78	0.83	0.43	0.86	0.92	0.96	0.72	0.65
2012	0.87	0.79	0.85	0.78	0.85	0.70	0.79	0.83	0.80	0.53	0.81
2013	0.81	0.59	0.83	0.45	0.75	0.38	0.58	0.86	0.84	0.71	0.22

Source: Current Hedging: The Importance of Managing Currency Exposure, Deutsche Asset & Wealth Management, August 2014

Chart 11. Dispersion and Manager Outperformance



Source: Portfolio Strategy Research, Goldman Sachs, March 30, 2015

of a watch list for underperformance for an average of 61 quarters out of 176, including an average of 21 straight quarters of underperformance. The study points out even Warren Buffet would have been on watch for longer than four years, despite his stellar long-term record. (Hiring Good Managers Is Hard, Research Affiliates, November 2014).

A broader study by Vanguard Investors of all actively managed US equity funds found that between January 1998 and December 2012, 97% of successful managers underperformed their respective benchmark in at least five of the years and that two-thirds of them experienced at least three consecutive years of underperformance. (The Bumpy Road to Outperformance, Vanguard Investors, July 2013).

Thus, it is almost certain that investors will frequently face the issue of manager underperformance. As mentioned earlier, behavioral finance studies show that investors are very quick to switch from the underperforming manager to one who outperformed in the most recent period. In doing so, investors will very likely obtain subpar returns from both managers as there is a very good chance the underperforming manager will rebound in the following period, while the outperforming manager will underperform subsequently.

Successful investing requires a strong degree of contrarianism. Since consensus views are largely reflected in security prices, managers have to be willing to bet against their peers in order to generate outperformance. And even if the manager's contrarian thesis is correct, it may take some time for the idea to play out and be ultimately rewarded by the market. If the manager is being measured on short term performance, he/she may not have enough time for the investment to come to fruition before he/she is terminated for underperformance. And, as the Research Affiliates study points out, even the most successful investment managers are likely to underperform for appreciable lengths of time. In this respect, contrarian bets can be viewed as analogous to shorting markets, which "can remain irrational longer than investors can remain solvent", a quote attributed to Keynes, who reputedly outperformed the stock market by 8% annually, placing him in the pantheon of all-time great investors. (M. O'Brien, JM Keynes was the Warren Buffet of His Day, The Atlantic, 4.3.2012)

Conclusions

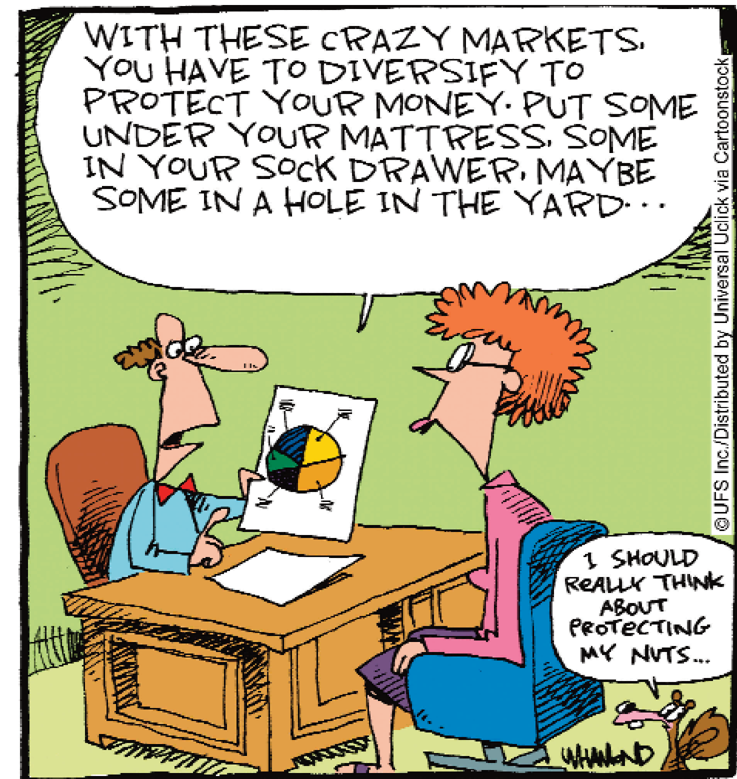
Unquestionably, the last few years have been a challenging time for investment managers. The global financial crisis was arguably the most difficult period in their careers. Since then, extraordinary policy actions have suppressed normal market conditions and subverted historical relationships between asset classes, making it extremely difficult for active managers to generate outperformance. As a result, the majority of active managers have underperformed the broad market indices, prompting investors to question the value of active management.

US investors with global portfolios have been hurt by the combination of a strong dollar and exposure to weaker markets. The strong dollar has made international comparisons challenging when returns are translated back to dollars, while strong performance from US large cap stocks was offset by lower returns on small cap and international stocks. Returns were further diluted by lower returns on bonds and hedge funds, along with negative returns from commodities. Taken together, these factors have caused US investors to question the value-added of diversifying into non-US equities and other asset classes. We have demonstrated market leadership can vary greatly over time and that markets have a strong tendency toward mean reversion. Today's leaders are liable to be tomorrow's laggards and vice versa.

We have also spent some time reviewing behavioral factors that drive the actions of managers and investors. Both are human and subject to the same foibles and emotions that drive them to make decisions detrimental to their longer term goals. As we have shown, discipline, patience and time in the market are also key ingredients for investment success. A better understanding of these issues

may help both parties work together better when faced with adversity or challenging conditions.

Finally, we hope this analysis has demonstrated that asset allocation and diversification remain fundamental precepts of successful investing, both to manage risk and to maximize return potential. As investors have experienced in the last couple of years, diversified portfolios are almost sure to underperform concentrated or single asset portfolios over short time frames and in periods of rising markets. Nonetheless, there is clear evidence that diversified portfolios are likely to do much better in the long run due to the combined impact of reduced volatility and the compounding of steadier returns over extended periods.



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First Quarter Performance Summary

Asset Class	Benchmark	1Q15 Return	YTD Return	Performance Summary
Domestic Gov't / Agency	BC U.S. Gov't & Related 5-7	1.91	1.91	The yield curve flattened in Q1 as short-term rates rose relative to intermediate and long-term rates. Continued strong demand from foreign investors seeking safety and higher yields buoyed flows. The long end of the curve predominantly drove returns. Q1 saw considerable volatility in the benchmark 10-yr Treasury, which rose from 1.64% in January to 1.94% by quarter-end.
Domestic Tax-Exempt	BC Municipal Bond 5-Year	0.76	0.76	Inconsistent economic data and shifting assessments of future monetary policy heightened Q1 volatility. Strong investor demand led to exceptional inflows into municipal bond funds, while supply was boosted by a resurgence of new issuance, as municipalities moved to lock in low rates ahead of any Fed rate hikes.
TIPS	BC TIPS	1.42	1.42	TIPS breakeven rates fell to 1.76% in Q1, reflecting inflation expectations well below the Fed's 2% target and the impact of falling energy prices. Demand for TIPS rose significantly late in the quarter, as concerns over global disinflation receded.
Investment-Grade Debt	BC Inv. Grade Intermediate	1.89	1.89	Investment grade debt continued its 2014 rally into 2015, generating solid returns in Q1. Issuance remained strong, with corporations taking advantage of low rates to refinance existing debt and issue new debt prior to any move on rates by the Fed. MBS saw significant selling pressure early in Q1, but recovered as the expected wave of prepayments failed to materialize.
High-Yield Debt	BC High-Yield Intermediate	2.36	2.36	Despite signs of softness in the U.S. economy, high yield bonds benefited from the continuing fall in energy prices. Attractive spreads, low default rates and robust M&A activity drove strong performance across the sector. Demand remained strong from yield-seeking investors.
Global Bonds	Citi World Gov't Bond Index (Hedged)	2.04	2.04	Interest rates on developed market sovereign bonds have fallen to historic lows following the implementation of bond purchases by the ECB in March, ongoing quantitative easing in Japan and continued easing in other markets. DM bonds remain unattractive for dollar investors due to low rates and weak FX rates relative to the dollar.
Emerging-Markets Debt	Morningstar EM Composite Bond Index	2.01	2.01	Dollar-denominated EM debt participated in the Q1 bond rally, driven by low inflation and accommodative monetary policy around the globe. Local currency EM bond returns were again hurt by the strong dollar and the prospects of a US rate hike. Russia recaptured some of the steep losses from Q4 2014 but this was offset by the downgrading of Petrobras amid a corruption scandal.
Large-Cap Equity	S&P 500	0.95	0.95	Sector returns trailed those for DM and EM equities. The strong dollar, falling oil prices and mixed economic data weighed heavily on investor sentiment, as did concerns over the slowing economy and the impact of rising rates. Companies in Growth sectors such as Healthcare and Consumer Discretionary were favored over value companies in Energy, Utilities and Finance.

First Quarter Performance Summary (Continued)

Asset Class	Benchmark	1Q15 Return	YTD Return	Performance Summary
Small/Mid-Cap Equity	Russell 2000	4.32	4.32	U.S. small/mid-cap equities outperformed large-cap stocks as companies with lower exposure to foreign markets avoided the negative impact of the strong dollar on translating overseas revenues and profits. Hopes for Fed "patience" on raising rates provided a further boost to small and mid caps, which are more exposed to credit than large caps. The tech-heavy NASDAQ retraced the 5,000 level for the first time in 15 years.
International Equity	MSCI EAFE	4.88	4.88	EAFE was the top performing major equity market in Q1, reflecting the benefit of highly accommodative monetary policy by DM central banks. Large and small companies participated equally in the rally. As in the US, growth was favored over value. Currency hedging helped to further boost returns for U.S. investors.
Emerging-Markets Equity	MSCI EM	2.24	2.24	Despite concerns of a looming credit crisis in some emerging market countries, Q1 returns benefitted from export growth and the beneficial effect of lower energy import prices. Asia generated solid returns, EMEA posted modest gains and LatAm posted further losses. Among the majors, Brazil dropped 15%, Russia rebounded 18%, China A-shares rose 18% and India gained 5%. Valuations remain attractive but currency uncertainty remains a concern for US investors.
Real Estate	DJ Composite REIT Index	2.96	2.96	REIT returns were buoyed by rising commercial property valuations and increased transaction activity across all property sectors except CBD office markets. The housing market showed signs of continued recovery, with rising prices and falling inventories.
Commodities	DJ UBS Commodity Index	(5.94)	(5.94)	Commodities endured another difficult quarter. Oil prices fell further, as crude stockpiles reached decade-high levels in the face of weak global demand. Prices for other commodities stabilized, albeit at weak levels in response to muted demand from slow global growth.
Private Equity	S&P Listed Private Equity	4.78	4.78	Buyouts reached their highest levels since Q3 2007. High valuations helped realized returns, but hampered deal flow and fund raising activity. Compared to Q4, deal flow fell 26% to $101B, while capital raised fell 38% to $38B. Valuation multiples declined in Q1, indicating growing investor concerns over excessively high valuations.
Hedge Funds	HFRX Global Hedge Fund Index	2.06	2.06	Hedge funds posted their best quarterly performance since Q3 2011. Macro, event-driven, relative value and equity hedged strategies delivered strong returns. Across the board, strategies benefited from rising volatility, falling correlations and rising dispersions in Q1, mainly in anticipation of rate tightening in the US.
Cash	Citi 3-month T-bill	0.01	0.01	Cash yields continue to remain at historical lows as a result of muted inflation.

Source: FactSet; Data as of 3/31/2015

First Quarter Market Summary

					Annualized			
		2014	1Q15	YTD	1-Year	3-Year	5-Year	10-Year
US Equity Benchmarks	**Price**							
Dow Jones Industrial	17,776.12	10.04	0.33	0.33	10.57	13.18	13.23	8.17
Nasdaq Index Composite	4,900.89	14.75	3.79	3.79	18.12	18.11	16.72	10.46
S&P 500	2,067.89	13.69	0.95	0.95	12.73	16.11	14.47	8.01
Russell 1000 (Large Cap)	2,224.02	13.24	1.59	1.59	12.73	16.45	14.73	8.34
Russell 1000 Growth	657.54	13.05	3.84	3.84	16.09	16.34	15.63	9.36
Russell 1000 Value	626.61	13.45	(0.72)	(0.72)	9.33	16.44	13.75	7.21
Russell Mid Cap	4,420.67	13.22	3.95	3.95	13.68	18.10	16.16	10.02
Russell Mid Cap Growth	1,694.95	11.90	5.38	5.38	15.56	17.41	16.43	10.19
Russell Mid Cap Value	4,420.67	14.75	2.42	2.42	11.70	18.60	15.84	9.61
Russell 2000 (Small Cap)	3,113.45	4.89	4.32	4.32	8.21	16.27	14.57	8.82
Russell 2000 Growth	4,668.34	5.60	6.63	6.63	12.06	17.74	16.58	10.02
Russell 2000 Value	5,624.95	4.22	1.98	1.98	4.43	14.79	12.54	7.53
S&P GICS Sectors	**Weight**							
Consumer Discretionary	12.6%	9.68	4.80	4.80	18.26	20.68	20.11	10.25
Consumer Staples	9.7%	15.98	0.99	0.99	16.53	15.74	15.00	10.76
Energy Sector	8.0%	(7.78)	(2.85)	(2.85)	(11.11)	4.11	8.00	7.41
Financials	16.2%	15.20	(2.05)	(2.05)	9.97	17.33	10.53	0.58
Health Care	14.9%	25.34	6.53	6.53	26.19	26.86	20.09	11.41
Industrials	10.4%	9.83	(0.86)	(0.86)	8.73	16.65	14.51	7.88
Information Technology	19.7%	20.12	0.57	0.57	18.11	13.62	14.55	9.77
Materials	3.2%	6.91	0.99	0.99	4.97	11.93	10.82	7.55
Telecommunication Services	2.3%	2.99	1.54	1.54	4.09	10.55	12.75	7.54
Utilities	3.0%	28.98	(5.17)	(5.17)	11.09	12.55	12.95	8.48
Global Equity Benchmarks	**Price**							
MSCI World Index	1,331.35	4.94	2.31	2.31	6.03	12.19	10.01	6.39
MSCI AC World x-USA	341.95	(3.87)	3.49	3.49	(1.01)	6.40	4.82	5.46
MSCI EAFE	1,086.75	(4.90)	4.88	4.88	(0.92)	9.02	6.16	4.95
MSCI EAFE Growth	985.95	(4.43)	5.85	5.85	1.05	8.96	6.99	5.60
MSCI EAFE Value	2,090.02	(5.39)	3.89	3.89	(2.90)	9.03	5.27	4.23
MSCI Emerging Markets	50,568.06	(2.19)	2.24	2.24	0.44	0.31	1.75	8.48
MSCI BRIC	558.85	(2.85)	3.55	3.55	3.61	(0.77)	(1.43)	9.99
MSCI Japan	948.79	(4.02)	10.21	10.21	12.06	9.36	5.87	3.54

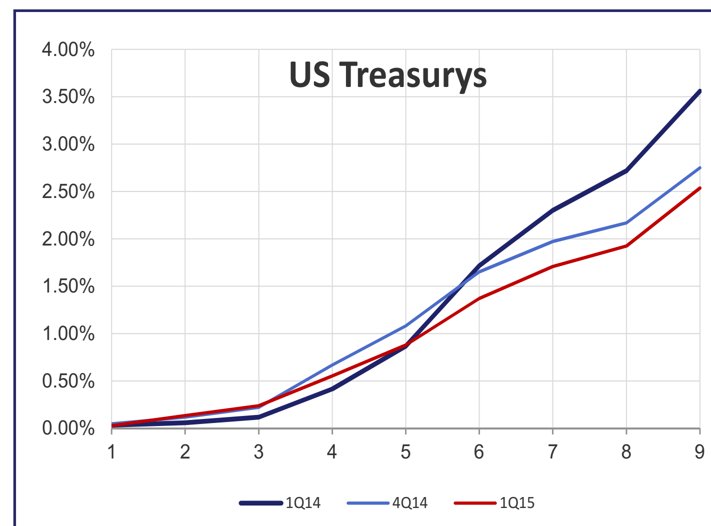
Global Equity Valuation Summary	4Q14	1Q15	QoQ
S&P 500			
Price	2,058.90	2,067.89	8.99
Trailing P/E	17.12	17.43	0.31
Est P/E	16.23	16.75	0.53
Trailing 12m Earnings	120.26	118.66	-1.60
Est Forward 12m Earnings	126.89	123.77	-3.12
Implied 1yr Earnings Growth	5.51%	4.31%	-1.2%
Russell Mid Cap			
Price	4,268.89	4,420.67	151.78
Trailing P/E	21.30	22.15	0.85
Est P/E	17.84	18.80	0.95
Trailing 12m Earnings	200.42	199.61	-0.81
Est Forward 12m Earnings	239.22	235.88	-3.34
Implied 1yr Earnings Growth	19.36%	18.17%	-1.2%
Russell 2000			
Price	2,993.97	3,113.45	119.48
Trailing P/E	36.16	34.20	-1.96
Est P/E	21.88	24.01	2.13
Trailing 12m Earnings	82.80	91.04	8.24
Est Forward 12m Earnings	136.83	130.79	-6.04
Implied 1yr Earnings Growth	65.26%	43.66%	-21.6%
MSCI EAFE			
Price	986.85	1,086.75	99.90
Trailing P/E	15.33	16.50	1.17
Est P/E	14.17	15.89	1.72
Trailing 12m Earnings	115.74	112.05	-3.69
Est Forward 12m Earnings	125.25	116.66	-8.59
Implied 1yr Earnings Growth	8.21%	4.11%	-4.1%
MSCI EM			
Price	48,361.14	50,568.06	2,206.92
Trailing P/E	12.23	13.11	0.88
Est P/E	11.02	11.94	0.93
Trailing 12m Earnings	78.20	74.34	-3.85
Est Forward 12m Earnings	86.80	81.82	-4.98
Implied 1yr Earnings Growth	11.00%	10.06%	-0.9%

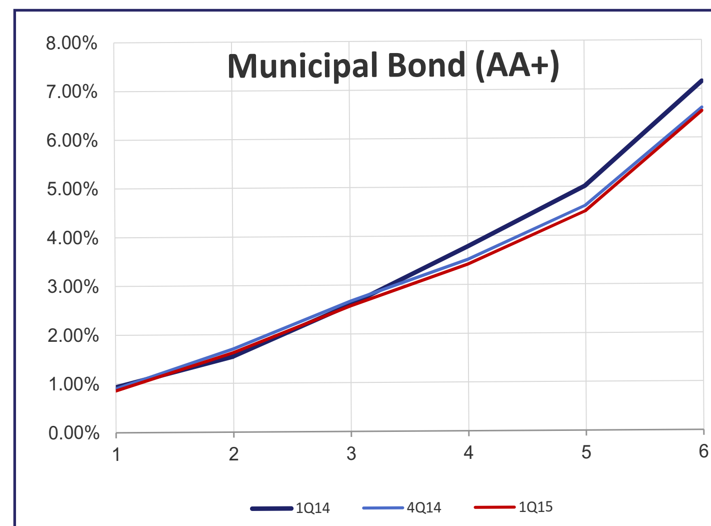
Source: FactSet; Data as of 3/31/2015

First Quarter Market Summary (Continued)

		2014	1Q15	YTD	Annualized 1-Year	3-Year	5-Year	10-Year
Interest Rates	**Yield**							
Prime Rate	3.25	3.25	0.79	0.79	3.25	3.25	3.25	4.61
3m Treasury Bill	0.03	0.03	0.00	0.00	0.02	0.05	0.06	1.35
US LIBOR 3m	0.27	0.23	0.06	0.06	0.24	0.29	0.32	1.85
US Treasury 3m	0.88	0.88	0.24	0.24	0.93	0.65	0.70	2.03
US Treasury 10yr	1.92	2.53	0.48	0.48	2.33	2.21	2.44	3.26
US Treasury 30yr	2.54	3.34	0.62	0.62	3.06	3.19	3.47	4.00
Fixed Income	**Price**							
Citi 3-month T-bill	622.61	0.03	0.01	0.01	0.03	0.05	0.07	1.41
BC U.S. Gov't & Related 5-7	105.28	5.36	1.91	1.91	5.29	3.15	4.97	5.74
BC Municipal Bond 5-Year	113.59	3.19	0.76	0.76	2.95	2.38	3.44	4.17
BC TIPS	107.83	3.64	1.42	1.42	3.11	0.63	4.29	4.55
BC Investment Grade Intermediate	105.71	4.35	1.89	1.89	4.51	4.07	5.24	5.34
BC High Yield Intermediate	99.82	1.85	2.36	2.36	1.39	7.10	8.22	7.87
Citi World Gov't Bond Index	794.78	8.35	2.04	2.04	8.31	4.80	4.54	4.69
JP Morgan EMBI Global Diversified	712.63	7.43	2.01	2.01	5.65	5.37	7.10	8.11
Real Estate	**Price**							
Dow Jones Composite REIT Index	251.70	22.02	2.96	2.96	16.58	8.71	9.89	3.14
FTSE EPRA/NAREIT Europe	1,909.26	9.47	6.01	6.01	9.58	15.65	11.00	5.07
Commodities								
Bloomberg Commodity Index	98.12	(17.01)	(5.94)	(5.94)	(27.04)	(11.52)	(5.71)	(3.56)
Energy	52.00	(39.34)	(8.20)	(8.20)	(46.56)	(17.31)	(15.33)	(16.88)
Agriculturals	57.27	(9.22)	(8.82)	(8.82)	(28.96)	(10.58)	0.27	0.06
Livestock	34.25	11.56	(9.78)	(9.78)	(13.51)	(0.42)	(1.19)	(6.50)
Softs	42.08	(10.10)	(13.70)	(13.70)	(36.07)	(20.01)	(4.65)	(4.70)
Industrial Metals	117.17	(6.87)	(5.32)	(5.32)	(7.62)	(10.17)	(8.64)	2.24
Precious Metals	166.09	(6.71)	1.30	1.30	(10.35)	(13.80)	0.26	9.53
Private Equity / Hedge Funds								
S&P Listed Private Equity Index		(3.61)	4.78	4.78	(1.24)	14.98	10.18	
HFRX Global Hedge Fund Index		(0.58)	2.06	2.06	0.36	2.81	1.12	1.01
Currencies	**Price**							
ICE Dollar Index	98.38	12.80	8.98	8.98	22.81	7.58	3.95	1.59
Euro / US Dollar	1.07	(12.18)	(11.24)	(11.24)	(22.08)	(6.92)	(4.52)	(1.89)
Pound / US Dollar	1.48	(5.86)	(4.79)	(4.79)	(10.96)	(2.42)	(0.43)	(2.38)
US Dollar / Yen	119.93	14.07	0.03	0.03	16.45	13.37	5.12	1.15

Source: FactSet; Data as of 3/31/2015





Source: FactSet, HPM Partners. Reflects 5-year tenor, broad composite and generic returns.

Municipal bond yields are shown on a comparable, adjusted basis using a 35% tax rate.

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