August 2015

SOL CAPITAL MANAGEMENT COMPANY

CLIENT INVESTMENT LETTER

Financial Markets Performance

Inside this issue:

The world's financial markets posted lackluster results in the second quarter of 2015 amid rising volatility. On a global basis, equity performance was relatively flat, and returns were negative across much of the fixed income market. Over the first half of 2015, the S&P 500 Index gained a modest 1.2%, while the Barclays Capital U.S. Aggregate Bond Index was negative 0.1% during the same period. International stocks, especially in developed markets, have led the markets, rising 4.0% through June 30, as measured by the MSCI All Country ex-U.S. Index; see Exhibit 1. In diversified portfolios, the relatively strong performance of international equities has helped offset the weak returns of the broad U.S. stock and bond markets through June 30.

Equities

In the United States, small caps modestly outperformed large caps in the second quarter. At the same time, growth stocks have significantly outperformed value stocks over the past six and twelve months, driven by strength in the health care (especially biotechnology) and technology sectors. Financials also did well in the second quarter, due in part to major banks settling lawsuits related to the financial crisis. Thus, they do not have to set aside as much cash for legal expenses, improving their profit prospects going forward. REITs and utilities lost ground over the same period, as rising bond yields made their dividend yields look less attractive. Among international stock markets, China and Japan were notable gainers, while Germany and India lagged.

Year-to-date through June 30, international stock market performance has been healthy. Japanese and European equities led the way, helped by corporate reforms (Japan) and signs of an economic turnaround fueled by quantitative easing (Europe). The performance of emerging markets has been mixed, with Chinese and Russian shares rallying strongly and Latin America continuing to face economic challenges.

Fixed Income

Volatility in the global fixed income markets picked up in May and June after European Central Bank (ECB) President Mario Draghi declared

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that the ECB's bond-buying program was helping the region's economy. For many investors, his comments substantially shortened the timetable for when the ECB would start raising interest rates. Consequently, yields increased across developed economies, sending prices of government and investment-grade bonds lower. In the United States, the move in longer-term Treasury securities was significant, with 10- and 30-year issues returning -3.0% and -10.4%, respectively. High yield bonds held up relatively well, as they are typically less sensitive to interest rate movements than investment-grade bonds. Emerging market debt was also resilient to the spike in developed market yields.

" ... relatively strong performance of international equities has helped offset the weak returns of the broad U.S. stock and bond markets ... "

Exhibit 1

Total Return* for Selected Equity, Fixed Income, and Hedge Fund Indices

	2nd Quarter (3/31/15 to 6/30/15)	Year-to-Date *(12/31/14 to 6/30/15)*
Major Equity Indices	**%**	**%**
S&P 500 Index	0.3	1.2
Russell 3000 Index (Total US market)	0.1	1.9
Russell 2000 Index	0.4	4.8
MSCI All Country Ex-US Index (Net)	0.5	4.0
MSCI EAFE International Index (Net)	0.6	5.5
MSCI Emerging Markets (Net)	0.7	3.0
Source: Bloomberg, MSCI		
Major Fixed Income and Hedge Fund Indices	**%**	**%**
Barclays Capital US Aggregate Bond Index	(1.7)	(0.1)
Barclays Capital US Government/Credit Index	(2.1)	(0.3)
Merrill Lynch 1-3 year U.S. Broad Market	0.2	0.7
Merrill Lynch US High Yield BB-B Bond Index	0.0	2.7
JPMorgan Non-US Global Bond Index (GBI) Hedged	(3.2)	(1.0)
JP Morgan EMBI Global Index in USD (Emerging markets)	(0.3)	1.8
HFRX Equal Weighted Strategies Index (Hedge Funds)	(0.4)	1.5
Source: Bloomberg, MSCI, PIMCO, HFRI		

* *Includes price appreciation plus dividends and/or interest.*

Key Events

Until the last few weeks of June, global equities were on track to post stronger quarterly gains. However, volatility related to developments in China, Greece, and the oil markets reduced second quarter returns to less than 1% for major stock market indices. This volatility continued into July.

Selloff in China

Between their June 12 peak and July 8 trough, shares of mainland Chinese companies trading on the Shanghai Stock Exchange fell more than 31%. It is worth noting at this point that the overwhelming majority of the investment products we use for exposure to Chinese equities invest via the Hong Kong market, not the mainland markets; see below.

The pullback in mainland equities was triggered by concerns about high valuations and negative sentiment that coincided with a heavy supply of initial public offerings (IPOs) coming to market. The decline in prices prompted margin calls, as most mainland investors use a high amount of leverage in the market, which led to further selling. Shanghai-traded stocks recovered approximately 6% by July 30, as government intervention helped restore investor confidence. While the volatility in China's stock market has been substantial, so have the longer-term gains. Shanghai shares are still up 16% year-to-date and 71% over the past 12 months, as of July 30.

Volatility in China is expected to increase as the financial sector becomes a more critical part of the nation's economy. However, the mainland markets are not yet integrated enough with the overall economy for the recent selloff to materially impact the rate of growth or consumer spending. Currently, the financial sector represents less than 10% of China's GDP and only 7% of its population is invested in equities. We also believe that the risk of any social unrest resulting from near-term portfolio losses is low.

Stocks of mainland Chinese companies trading in Hong Kong experienced much less volatility, falling 13% from June 12 through July 8. Gains have also been more subdued, with Hong Kong-traded shares rebounding 4.2% by July 30. Through the same date, shares in Hong Kong are up 6% year-to-date and up 2% over the past 12 months. The varying performance reflects the different characteristics of the mainland and Hong Kong markets; see Exhibit 2.

"... mainland markets are not yet integrated enough with the overall economy for the recent selloff to materially impact the rate of growth or consumer spending."

Financial Markets Performance Cont.

Exhibit 2

Chinese Stocks: Mainland vs. Hong Kong Market*

	Mainland	Hong Kong
Market capitalization	$6.8 trillion	$4.8 trillion
Number of companies	2,800	1,800
Ownership	80% retail investors	Mostly institutional investors
Foreign participation	Low; capped at 3%	High
Transparency and governance	Below Average	Good
Valuation**	54x	14x

Source: Matthews International Capital Management; data as of 07/10/15.

**The mainland market is represented by the Shanghai Composite Index; the Hong Kong Market is represented by the Hang Seng Composite Index.*

*** Valuation is measured by the median forward price-to-earnings ratio.*

http://matthewsasia.com/perspectives-on-asia/asia-weekly/article-958/default.fs

The Greek Debt Crisis

Near the end of the second quarter, a breakdown in negotiations between Greece and its international creditors left the country on the brink of default and heightened concerns that it might be forced out of the eurozone (“Grexit”). Ultimately, an agreement aimed at resolving Greece's debt crisis and keeping the country in the euro was reached in July. While there is still the potential for a Grexit down the road, the risk is now less immediate.

The talks between Greece and its creditors had investors on edge—not because of worries that Greece's debt crisis could spark economic contagion, but because of the implications a new rescue plan would have for other debt-laden eurozone countries. Investors were particularly concerned that lenient terms for Greece might strengthen the popularity of anti-austerity opposition parties in Italy and Spain. In the end, the agreement reached in July included tighter budgetary constraints than those previously offered to the Greek government in June, which Greek citizens rejected in a snap referendum.

While the debt crisis has already taken a massive toll on the Greek economy and will likely continue to suppress local growth for an extended period, its broader effects should be negligible outside of the country. Greece makes up a small and shrinking percentage of the eurozone, global economies, and eq-

“While the debt crisis has already taken a massive toll on the Greek economy ...its broader effects should be negligible outside of the country.”

Financial Markets Performance Cont.

uity markets. The exposure of private banks and bondholders to Greek debt has dropped substantially; see **Appendix A.**

Oil Price Movements

Following a dramatic decline from June 2014 through March of this year, oil prices surged more than 25% in the early part of the second quarter and held steady over the remainder of the period. However, market uncertainty related to the volatility in Chinese equities, as well as the prospects of and subsequent nuclear deal with Iran, pushed crude prices 15% lower during the first two weeks of July.

The agreement with Iran, if ratified by the U.S. Congress, will lift sanctions on Iran's oil sector, unlocking additional supply into the market. That said, the short-term supply impact should be limited, since it is likely that Iranian oil will be slow to come online, and will represent only a small fraction of global crude production; see **Appendix B.** Additionally, China and India have been continuous consumers of Iranian oil, which has kept Iran on the list of top oil exporters despite the United States and European Union ceasing all purchases in 2010 and 2012, respectively.

Global Economic Outlook

United States

U.S. economic activity picked up in the second quarter, expanding at an annualized 2.3%, following upwardly-revised 0.6% growth in the first quarter. These numbers put the United States on track for GDP growth of nearly 2.5% in 2015; see Exhibit 3.

Unemployment dropped in June, but the decrease was partly due to a decline in labor force participation. Nonetheless, employers added 223,000 jobs during the month, a pace of job creation consistent with the three-month average. In addition, housing data remains strong, with building permits and home sales continuing to climb.

Developed International

In Europe, quantitative easing is already having a positive effect on the region's economy, as evidenced by increasing GDP forecasts and rising loan growth. Simultaneously, lower oil prices and the weak euro are supporting exports and corporate earnings. While all components of domestic demand are still showing modest improvement, consumer spending

"In Europe, quantitative easing is already having a positive effect on the region's economy, as evidenced by increasing GDP forecasts and rising loan growth."

Global Economic Outlook Cont.

“ … China is still expected to post a healthy growth rate in 2015 and beyond.”

remains soft due to high unemployment.

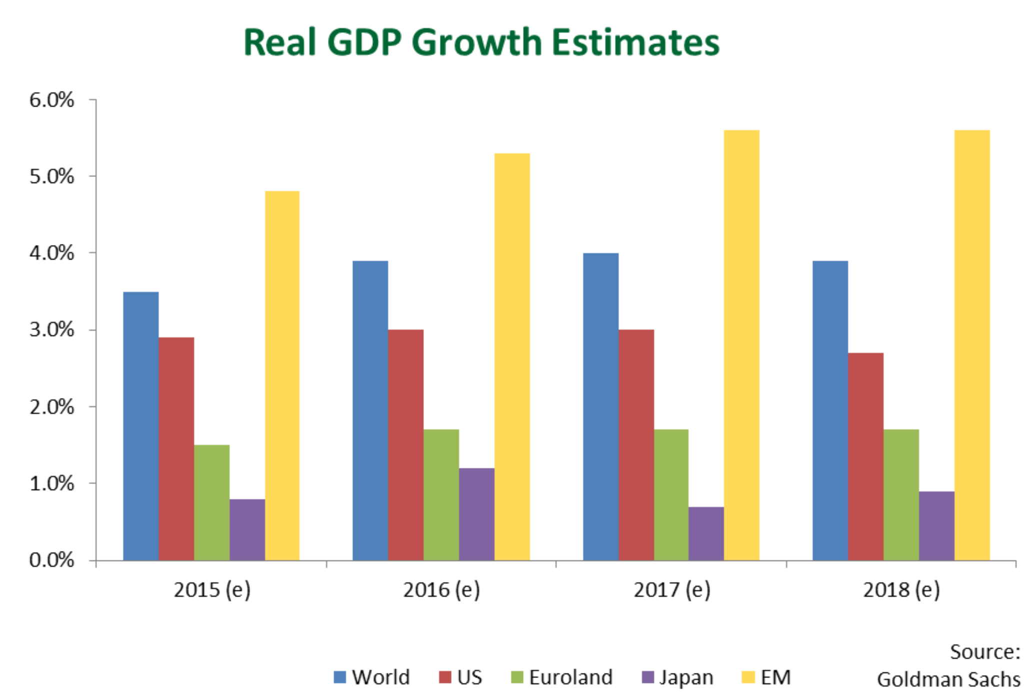
Like Europe, Japan is benefiting from lower oil prices, easy monetary policy, and a weak currency. In addition, the unemployment rate has fallen to 3.3%, which could put upward pressure on wages and boost domestic consumption. Furthermore, the delay in a second national sales tax increase is yet another tailwind for consumption.

Emerging Markets

Chinese growth continues to slow as the government orchestrates the country's long-term transition from a production-based to a consumer-based economy. However, China is still expected to post a healthy growth rate in 2015 and beyond. The property market has been recovering in recent months (see Appendix C), and consumption remains strong, accounting for 60% of China's GDP growth in the first half of 2015, the largest percentage in six years.

Elsewhere in emerging markets, the South Korean and Taiwanese economies appear to be slowing, and Russia's economy remains weak. In Latin America, Brazil continues to deal with rising inflation and slowing economic activity, although depreciation in

Exhibit 3



Source: Goldman Sachs

Global Economic Outlook Cont.

the Brazilian real could benefit exporters. Despite these challenges, emerging economies are still performing much better than developed economies. India, in particular, is a bright spot, where lower oil prices could help the country's economy grow faster than China's this year, as is expected.

Investment Strategy

Equities

Broadly speaking, we think U.S. equities are fairly valued because corporate earnings continue to climb with the market. In fact, forecasts suggest that earnings may climb even higher in the coming quarters (see **Appendix D**), which could pave the way for further stock market gains, although a strong dollar could be a headwind. We believe that pockets of the U.S. stock market are overvalued, including the IPO market, the biotechnology industry, and certain areas of the technology sector. U.S. equities should also continue to benefit from dividend increases, share buybacks, and M&A activity as companies look for ways to put idle cash to work to create shareholder value.

International stocks look more attractively valued than their U.S. counterparts, despite having outperformed the broad U.S. market in the first half of the year. Moreover, lower currencies and accommodative monetary policies around the world should contribute to growing corporate earnings. Valuations in a number of emerging markets are also particularly compelling, as is the long-term demographic picture. Nevertheless, while we are finding more opportunities in international equities relative to U.S. equities, we believe international equities could experience more volatility and therefore we are selectively increasing exposure, where appropriate.

Fixed Income

Although the bond market still looks expensive, an allocation to bonds remains a core component of a well-diversified portfolio, lowering risk and providing income. To minimize volatility and downside risk, we continue to tilt portfolios toward short duration securities. When interest rates rose in the second quarter, this strategy benefited performance.

As investors await the Federal Reserve's first rate hike since 2006, we expect increased volatility across the fixed income market. However, price movements in shorter duration bonds are generally less than

"International stocks look more attractively valued than their U.S. counterparts..."

" ... we continue to tilt portfolios toward short duration securities."

Investment Strategy Cont.

those with higher durations, and are quicker to recover. Low yields overseas and the need for pension plans to match long-term liabilities with long-term assets could lend support to the U.S. bond market, even as short-term rates begin to rise.

In Closing

"When short-term volatility picks up, it is important to keep a long-term view."

In the months ahead, we believe the markets will remain volatile as U.S. equities become even more fairly valued, international markets continue to recover, and all eyes remain on the Fed. Even when the Fed begins to hike, interest rates will still be very low by historical standards. Nonetheless, we believe the uncertain timing of the Fed's next move will impact market psychology, resulting in higher levels of short-term volatility. Investors are divided on when the central bank will act, and every time there is discussion of a delay or an advance, the markets become unusually volatile. We expect this to continue.

When short-term volatility picks up, it is important to keep a long-term view. Rather than listening to the "noise," we believe you will be better served by concentrating on your long-term goals. We also continue to diversify portfolios by asset class, geographic market, asset size, and investment style. As always, we remained focused on helping you achieve those goals, within your risk profile, and funding your future liquidity needs.

Thank you for the trust you have placed in us, and please call us at 301.881.3727 with any questions or concerns about your portfolio.

Sincerely,

The SOL Capital Management Team

Appendices

Appendix A

Low Potential for Economic Social Contagion From a "Grexit"

Greece's portion of the global economy and markets is small and shrinking

Greece	Pre-Crisis	Latest	Change
Share of global economy	0.32%	0.26%	-18.4%
Share of MSCI ACWI	0.07%	0.03%	-50.8%
Decrease in Market Cap of MSCI Greece ($bn)	$ 26,602	$ 13,084	-50.8%
Private Foreign Bank exposure to Greece ($bn)	$ 310	$ 47	-84.9%
Private Bondholder exposure to Greece ($bn)	$ 265	$ 43	-83.7%

Source: International Monetary Fund World Economic Outlook, MSCI, Bank for International Settlements, Barclays Research, EOTM: "The Grecian Formula: the Greek 'No' vote and what it means for investors in Europe," J.P. Morgan Asset Management.

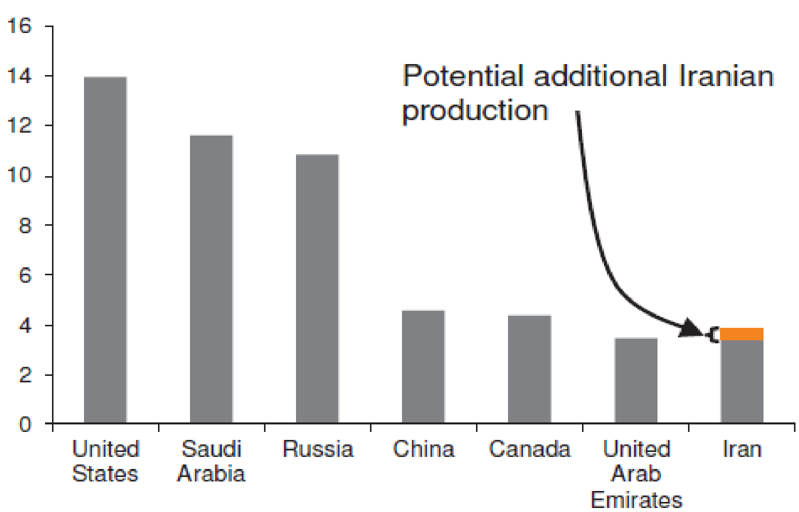
Source: Weekly Market Recap, July 13, **J.P. Morgan Asset Management**, *page 1*

"Greece makes up a small and shrinking percentage of the eurozone, global economies, and equity markets."

Appendix B

Despite Sanctions, Iran Remains a Top Oil Producer

Top petroleum producers, million barrels/day, 2014



Source: EIA, J.P. Morgan Asset Management.

Source: Weekly Market Recap, July 20, **J.P. Morgan Asset Management**, *page 1*

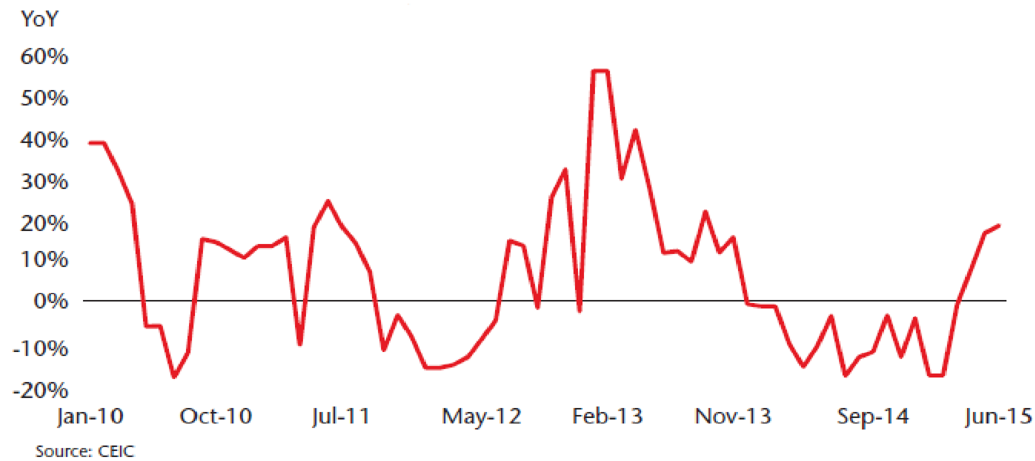
"...Iranian oil will be slow to come online, and will represent only a small fraction of global crude production."

Appendices Cont.

> **"The property market has been recovering in recent months."**

Appendix C

China's Recovering Property Market
Growth Rate of New Home Sales (Year Over Year) by Square Meter

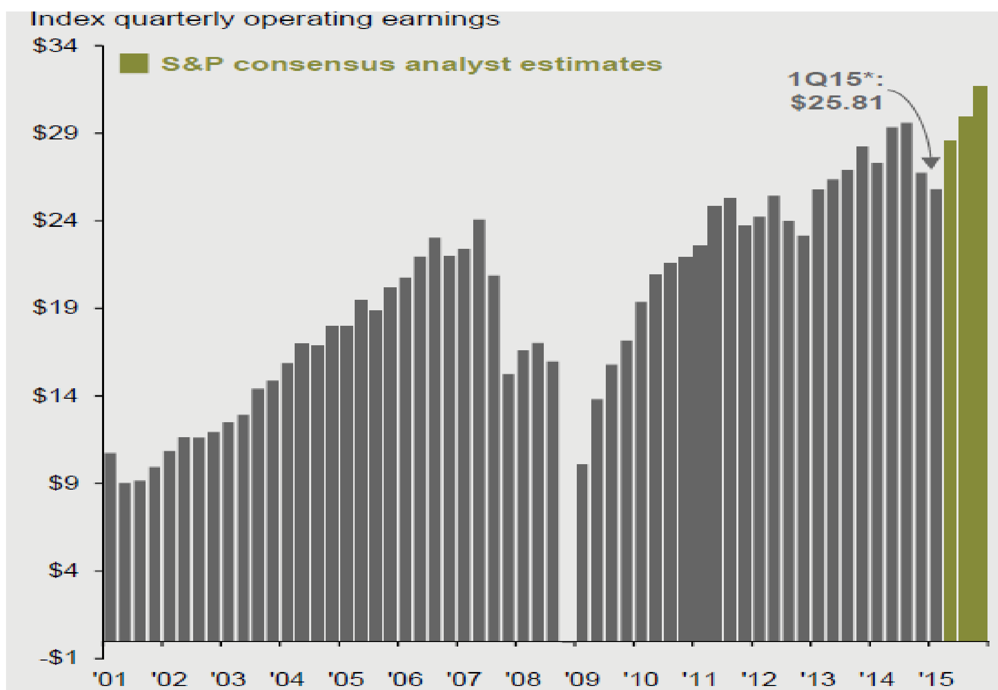


Source: Sinology, July 15, **Matthews Asia**, *page 2*

> **"...Corporate earnings continue to climb with the market."**

Appendix D

S&P 500 Earnings Per Share



*Source: BEA, Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management. EPS levels are based on operating earnings per share. *Most recently available data is 1Q15, which is a Standard & Poor's estimate. Future earnings estimates are Standard & Poor's consensus analyst expectations. Past performance is not indicative of future returns. Guide to the Markets – U.S. Data are as of June 30, 2015.*

Source: Guide to the Markets 3Q 2015, **J.P. Morgan Asset Management**, page 7