

Inside this issue:

Financial
Markets
Performance 2

Global Economic
Outlook 5

Investment
Strategy 8

In Closing 9

Appendices 10

If you left for vacation on January 1 and returned after June 30, you would have been pleased to see the markets' year-to-date (YTD) results, and could be forgiven for assuming the progression was smooth and steady. However, if you were watching the markets, you know we experienced two bouts of extreme volatility in the first half of 2016: one early in the year and another in late June.

A large sell-off in the first quarter that reached its bottom on February 11 was driven by slowing global growth, plummeting oil prices, and the prospect of further monetary tightening in the U.S. In the second quarter, financial markets generally performed well, but endured another turbulent ride. Investors were again besieged by uncertainty regarding the true health of the U.S. economy, the potential for additional interest rate hikes by the Federal Reserve, an ongoing slowdown in China, and the UK's "Brexit" referendum on its membership in the European Union (EU). The referendum's result shocked politicians, investors, and analysts around the globe as the British public narrowly voted to

withdraw from the EU. In the wake of the vote, global equity markets witnessed the "largest losses over a two-day period" in history¹. However, despite the brief panic, for those investors who stayed the course, portfolios recovered and surpassed pre-Brexit highs by the end of the next trading week.

In our view, economic fundamentals did not warrant the dramatic volatility in equity and fixed income prices, or the major moves in oil prices that occurred in the first half of the year. We believe the volatility was exacerbated by the excessive use of derivative securities by certain types of fund managers and traders. Nevertheless, as uncomfortable as volatility feels—especially the very high levels of volatility witnessed immediately after Brexit—it is a normal part of the investment experience, serving as an excellent reminder of the importance of adhering to your long-term asset allocation in all market environments. Investors who maintained their targeted portfolio exposures throughout the recent market turmoil have been rewarded for staying the course.

¹Richard Skaggs, CFA. "Equity Market Review and Outlook." Q2 2016. Loomis, Sayles & Company, L.P.

Financial Markets Performance

Equities

The S&P 500 Index returned 2.5% for the quarter, bringing its YTD increase through June 30 to 3.8% (see [Exhibit 1](#)). Large-cap U.S. equities were supported by a rally in oil prices, continued accommodative monetary policy, and a slightly weaker dollar (see [Appendix A](#)).

Additionally, stock prices of high-quality companies —with strong balance sheets better able to increase dividend payouts and share repurchases— stood out among peers.

Reversing a multi-year trend, value stocks outperformed growth stocks across all capitalizations for the

“The S&P 500 Index returned 2.5% the first quarter, bringing its YTD increase through June 30 to 3.8% (see Exhibit 1).”

Exhibit 1		
Total Return* for Selected Equity, Fixed Income, and Hedge Fund Indices		
	2nd Quarter	Six Months
	03/31/2016 to 06/30/16	12/31/15 to 06/30/16
Major Equity Indices	%	%
S&P 500 Index	2.5	3.8
Russell 3000 Index (Total US market)	2.6	3.6
Russell 2000 Index (Small Companies)	3.8	2.2
MSCI All Country ACWI Ex-US Index (Net)	(0.6)	(1.0)
MSCI EAFE (Developed International) Index (Net)	(1.5)	(4.4)
MSCI Emerging Markets Index (Net)	0.7	6.4
MSCI ACWI Commodity Producers Index (Net)	10.8	20.2
<i>Source: Bloomberg, MSCI</i>		
Major Fixed Income and Hedge Fund Indices	%	%
Barclays Capital US Aggregate Bond Index	2.2	5.3
Barclays Capital US Government/Credit Index	2.7	6.2
Merrill Lynch 1-3 Year U.S. Broad Market Index	0.7	1.6
Merrill Lynch US High Yield BB-B Bond Index	4.6	7.9
JPMorgan Non-US Global Bond Index (GBI) Hedged	3.3	7.7
JP Morgan EMBI Global Index in USD (Emerging Markets)	5.4	10.9
HFRX Equal Weighted Strategies Index (Hedge Funds)	1.6	0.2
<i>Source: Bloomberg, MSCI, PIMCO</i>		

* Includes price appreciation plus dividends and/or interest.

Financial Markets Performance Cont.

quarter and YTD. Energy and commodity stocks rebounded strongly from recent lows, while high dividend-yielding sectors, such as utilities and telecom performed very well. Stocks of financial companies lagged, as falling interest rates continued to hinder their growth prospects.

The second quarter also saw a divergence of performance on a more micro level. Returns within sectors were widely dispersed. In health care, large dividend-paying stocks gained ground, while smaller biotech stocks were hard hit. Within the small-cap space, returns were highly dependent on relative market cap. The S&P SmallCap 600 Index (representing relatively larger stocks within the small-cap space) closed out the first half of 2016 at 6.2% versus the 2.2% return of the Russell 2000 Index (representing relatively smaller stocks within the small-cap space).²

Outside the United States, performance was mixed. European shares, impacted by the Brexit vote and a weakening euro, fell 2.7% in U.S. dollar terms during the quarter and 5.1% for the year. Japanese equities, despite increasing 1.0% in Q2, declined 5.6% for the year, as a stronger yen has been inhibiting growth in what is largely an export-driven

economy. Despite ongoing economic weakness in China, emerging markets fared better than their developed market counterparts. Emerging market equities rose 0.7% for the quarter and 6.4% for the year, having been buoyed by a recovery in commodity prices, as well as early signs of progress toward much needed policy reform in Latin America.

After the quarter ended, global equities continued their upward run as immediate concerns surrounding Brexit faded and a “risk-on” atmosphere returned to markets. By July 31, the S&P 500 Index was up 7.7% for the year, developed market equities (as measured by the MSCI EAFE Index) had returned to positive territory, and the MSCI Emerging Markets Index was up 11.8%.

Fixed Income

Low growth and inflation estimates in developed markets fueled investors’ race toward the relatively attractive yields of U.S. Treasuries. Furthermore, as it became clear that the Fed would not be overly aggressive in tightening monetary policy, investors took on more duration

(Continued on page 4)

“By July 31, the S&P 500 Index was up 7.7% for the year, developed market equities (as measured by the MSCI EAFE Index) had returned to positive territory, and the MSCI Emerging Markets Index was up 11.8%.”

² “Small-cap” is a classification generally given to companies with market capitalizations below USD 2 billion. The S&P Small-Cap 600 Index has a median market cap of USD 977 million versus the Russell 2000 Index with a median market cap of USD 695 million.

Financial Markets Performance Cont.

(Continued from page 3)

“Investors chasing higher yields by taking on substantially more credit risk were handsomely rewarded.”

risk, further weighing down long-term yields. In fact, given increasing demand from investors and the unprecedented amount of quantitative easing from the European Central Bank (ECB) and the Bank of Japan, longer-term German and Japanese sovereign yields were pushed into negative territory for the first time in history.

During the quarter, the Barclays U.S. Aggregate Bond Index advanced 2.2% and was up 5.3% YTD through June 30. Declining long-term Treasury yields, coupled with generally solid company fundamentals, benefited the U.S. corporate bond market, where performance was strong across credit qualities. The Barclays U.S. Corporate Investment Grade Index rose 3.6%, led by a 4.3% return in BBB-rated issues (the lowest quality tier in the Index). Prices of short duration bonds also rose, as reflected by the Merrill Lynch 1-3 year Index, which increased 0.7% for the quarter and 1.6% for the year through June 30.

In developed markets, government bonds performed especially well, despite the fact that many issues offered negative yields. European corporates, while slightly restrained by their lower average durations,

also delivered positive returns, especially in light of the ECB’s initiation of its corporate bond purchase program.

U.S. high yield debt continued its robust recovery and, as of June 30, had brought 12-month returns into positive territory. Investors chasing higher yields by taking on substantially more credit risk were handsomely rewarded. CCC-rated bonds (one rating above default) returned 11.8% in the second quarter alone, nearly triple the returns of higher quality BB-rated notes. Returns on high yield issues in Europe were positive but trailed the returns of investment-grade bonds, limited by the uncertainty surrounding the Brexit referendum. Emerging market debt also saw strong performance last quarter as commodity prices rebounded and the U.S. dollar’s strength moderated.

July also saw continued advances in global fixed income markets. The Barclays U.S. Aggregate Bond Index was up 6.0% YTD through July 31, while the “risk-on” environment benefited high yield and emerging market debt, whose respective benchmarks were up 10.5% and 12.6% for the same period.³

³ As measured by the Merrill Lynch U.S. High Yield BB-B Bond Index and the JP Morgan EMBI Global Index in USD, respectively.

Global Economic Outlook

Globalization has been the mantra of free market economies for the last several decades. However, in recent years, it has come under political fire in many developed economies, as certain segments of the population do not believe they have benefited from free trade and migration. Despite unprecedented actions by central banks in an effort to stimulate the global economy, wages and job growth remain stagnant for the lower- and middle classes, income inequality continues to rise, and efforts to further integrate economies have stalled (see [Appendix B](#)). This came to a head in the UK's June 23 referendum.

The British public voted 52% to 48% to leave the European Union, an outcome most around the world did not expect. Britain's departure from the bloc is expected to be a long and complex negotiation. In fact, policymakers are already divided on when the process should even begin. At this point, the true effects of Brexit are not entirely certain, but will be felt most acutely in the UK, whose Eurozone exports comprise roughly half of its total exports (see [Appendix C](#)). The remaining EU economies may face increased downside risk as a result, but we do

not expect Brexit to derail the continent's economic expansion; in contrast, the Eurozone exports less than one-tenth of its total exports to the UK. Meanwhile, the U.S., emerging markets, and the global economy as a whole should be relatively insulated from Brexit's economic fallout (see [Appendix D](#)).

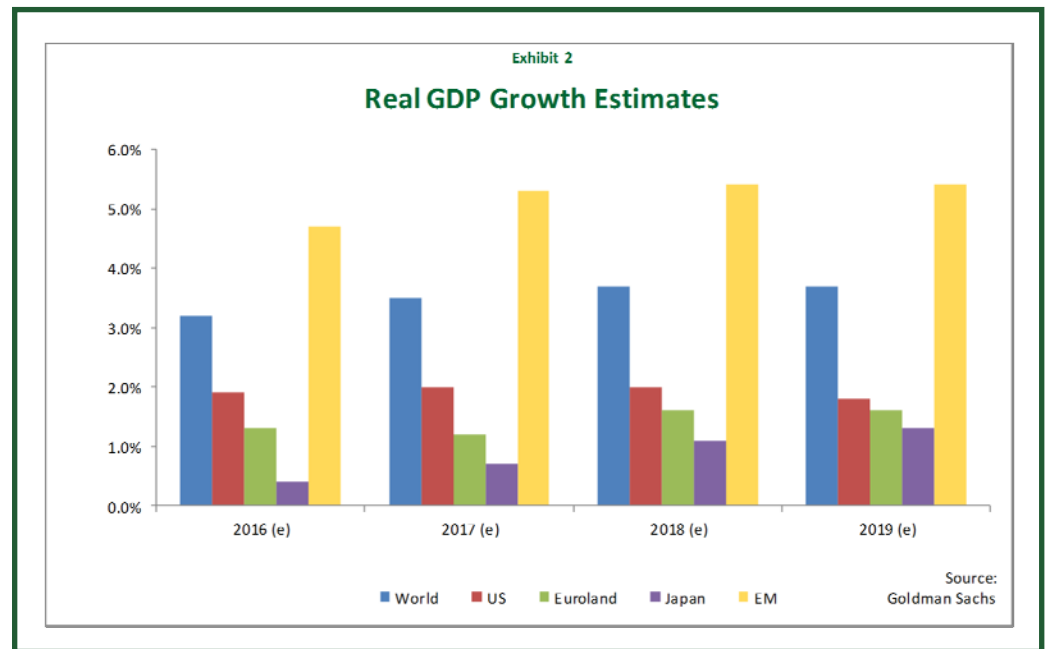
In the run-up to the vote and since then, the British pound has fallen markedly against the dollar, yen, and euro. While a weaker currency will benefit the country's exporters (assuming favorable trade terms remain in place or are agreed upon), the UK currently faces its largest current account deficit in recent history (see [Appendix E](#)). This means more expensive imports pushing up inflation, coupled with a stalling economy amid heightened uncertainty could produce a "stagflationary" environment, similar to what the U.S. experienced in the 1970s.⁴ In the interim, markets will be focused on how successful UK politicians are in negotiating favorable future trade agreements with the EU. Until then, we anticipate business sentiment and investment in the UK to remain subdued.

“The British public voted 52% to 48% to leave the European Union, an outcome most around the world did not expect.”

⁴ Stagflation is the combination of persistent, high inflation, high unemployment, and stagnant demand in a country's economy.

Global Economic Outlook Cont.

“...the U.S. economy continues to show signs of mid- to late-cycle expansion, but we believe it still has the capacity to expand at reasonable rates (see Exhibit 2).”



United States

Economic growth in the U.S. cooled slightly in the second quarter, expanding at an annualized 1.2% rate. Strong consumer spending more than compensated for a slump in capital expenditure driven by tightening bank lending standards for businesses. A weaker-than-expected jobs report in May, along with the impending Brexit referendum convinced the Fed to keep rates unchanged in June. However, a much stronger jobs report in June, as well as solid growth in sales and wages all point to more inflationary pressure in the economy, meaning rates could still be increased later this year (see [Appendix F](#)).

Overall, the U.S. economy continues to show signs of mid- to late-cycle expansion, but we believe it still has

the capacity to expand at reasonable rates (see Exhibit 2). The transition from mid- to late-cycle expansion is typically punctuated by an uptick in inflation indicators, especially commodities. Up to this point, these indicators have been restrained. However, if today's relatively low prices persist, U.S. oil producers may continue to reduce output, meaning inflation could pick up as oil prices stabilize and rise from current low levels (see [Appendix G](#)).

Europe and Japan

The Eurozone grew at its fastest pace in a year, spurred mostly by improving household consumption and investment. This modest, but encouraging expansion appeared to weather the Brexit storm, as both manufacturing indicators and consumer sentiment in the Eurozone

Global Economic Outlook Cont.

increased in July. Furthermore, the political and economic uncertainty unleashed in the UK in the wake of Brexit appears to have, at least for the moment, halted the progress of other “Euro-sceptic” movements on the continent. For example, in the Spanish parliamentary elections held just after the referendum, the left-wing, anti-establishment *Podemos* party—which was expected to do well—saw disappointing results.

The growth outlook is less favorable in Japan, where domestic consumption remains weak. Sluggish wage growth and rising social insurance payments are reducing consumers' disposable incomes, and, as life expectancy rises, people are choosing to spend less to ensure they do not outlive their savings. In addition, the yen has been appreciating since late last year, which is negatively affecting Japanese exporters. Finally, Japan is vulnerable to slowing growth in China, which is its largest export market. As the Chinese economy stabilizes at lower, more mature growth rates, Japan's economy will be also be impacted.

However, the economic challenges do not mean that investors should avoid these regions. There are sectors and companies that remain attractive to investors in this environment. In Europe for example, multinational exporters are benefiting from a historically weak euro, as well as their globally-diversified source of revenue. Meanwhile in Japan,

high savings rates have presented growth opportunities for financial service firms advising clients on how to invest their wealth.

Emerging Markets

A number of emerging markets have benefited from the recent recovery in commodity prices, but fiscal deficits remain a concern. China, India, and Mexico have seen real interest rates rise, domestic consumption slow, and currencies depreciate substantially in recent months. While this will slow growth forecasts, the situation should help improve current account imbalances in the near-term.

The weaker renminbi in China, which has fallen 1.6% against a strong, post-Brexit U.S. dollar, should help ease monetary policy and support domestic growth. Policymakers' efforts to stabilize the economy, including government spending on infrastructure projects, appear to be working, and the second-quarter 6.7% GDP growth matched that of the first quarter. Nevertheless, while China's trade with Europe (including the UK) totals only 18% of GDP, contagion risk from a potential, but unlikely, slowdown in the European economy remains; however, analysts have not yet revised their forecasts for Chinese GDP in the wake of Brexit.⁵

“A number of emerging markets have benefited from the recent recovery in commodity prices, but fiscal deficits remain a concern.”

⁵“The great China debates (IV): Brexit – the good, the bad, and the uncertain.” 11 July 2016. *The Goldman Sachs Group, Inc.*

Investment Strategy

Fixed Income

We continue to underweight fixed income, wherever appropriate, as the asset class has, in our view, become overvalued. The current low yields on longer-term U.S. Treasuries, which are primarily the result of continuing demand from foreign investors, are not reasonable for an economy at full employment and expecting a pick-up in inflation. At these levels, investors are not being offered meaningful compensation for the increased risk of buying, long-term debt versus short-term financing (see [Appendix H](#)). Nevertheless, for certain investors, an allocation to fixed income is still warranted to dampen overall portfolio volatility and/or meet liquidity needs. In most accounts with a fixed income allocation, we maintain sizeable exposure to high-quality, short duration bond funds.

The new reality of negative interest rates presents another uncharted risk to fixed income investors. Effectively, negative interest rates result in the lender paying the borrower to take their money. The financial system will need to address a number of operational issues, as well as any unintended economic consequences that could result. Modeling and valuing fixed income securities could become more difficult, leading to further uncertainty and volatility in the market.

Equities

On a global basis, we believe equity markets are more attractively valued than fixed income markets. We continue to diversify broadly and thoughtfully across equities, but maintain a modest tilt to international stocks. European equities are more attractive from a valuation perspective, but may be subject to more volatility as the Brexit negotiations get under way. Despite a strong rally since the beginning of the year, we still find emerging market equities to be undervalued, and in the near-term could be *less* vulnerable to uncertainty given increased headline risk in Europe (see [Appendix I](#)). Furthermore, headwinds facing the region have eased and long-term demographic trends remain favorable.

In aggregate, the U.S. market appears fully valued, but has pockets and sectors that are both over- and undervalued. Despite their outperformance so far this year, we still view value stocks as an attractive opportunity for investors. Currently, the U.S. equity managers that we utilize are focused on taking advantage of bouts of volatility to purchase high-quality stocks at less-expensive entry points.

It is important to note that the divergence in equity returns by market capitalization, style, sector, and geography witnessed this year creates opportunities for active managers to add value. Contrast this to an environment in which returns for different types of stocks are very similar, thus leaving limited opportunity for active managers to generate returns that exceed the returns of the market indices.

“At these levels, investors are not being offered meaningful compensation for the increased risk of buying, long-term debt versus short-term financing (see Appendix H).”

In Closing

Volatility is an integral component of investing, but the magnitude we witnessed in the first half of 2016 was higher than normal. In these periods of rapid corrections and recoveries, we urge clients to remain focused on long-term (five-, ten-, thirty-year) goals rather than short-term (one year or less) fluctuations in asset prices. To quote one of the managers of the funds we utilize, Dimensional Fund Advisors, “Long-term investors recognize that risks and uncertainty are ever present in markets...However, it is difficult to know when good outcomes will materialize in the future. By attempting to time the right moment to invest or redeem, one risks not enjoying the potential benefits of such materializations. Many of those who exit the markets miss the recoveries. What we have often seen in the past is that investors who remained in well-diversified portfolios were rewarded over time.”⁶

Risks remain and we do not expect volatility to subside in the near term. In addition to continued geopolitical concerns in Europe, the Middle East, and Asia, investors should expect a bumpy ride in the lead-up to the U.S. general election in November, and as the details of a post-Brexit UK-EU relationship become clearer. However, it is important to remember that what best protects an investor from the risk of permanent loss of capital is broad diversification, discipline, and patience.

As always, we remain focused on helping you reach your long-term investment objectives, within your risk profile, and funding your future liquidity requirements. We invite you to call us at 301.881.3727 if you have any questions or concerns about your portfolio.

Sincerely,

The SOL Capital Management Team

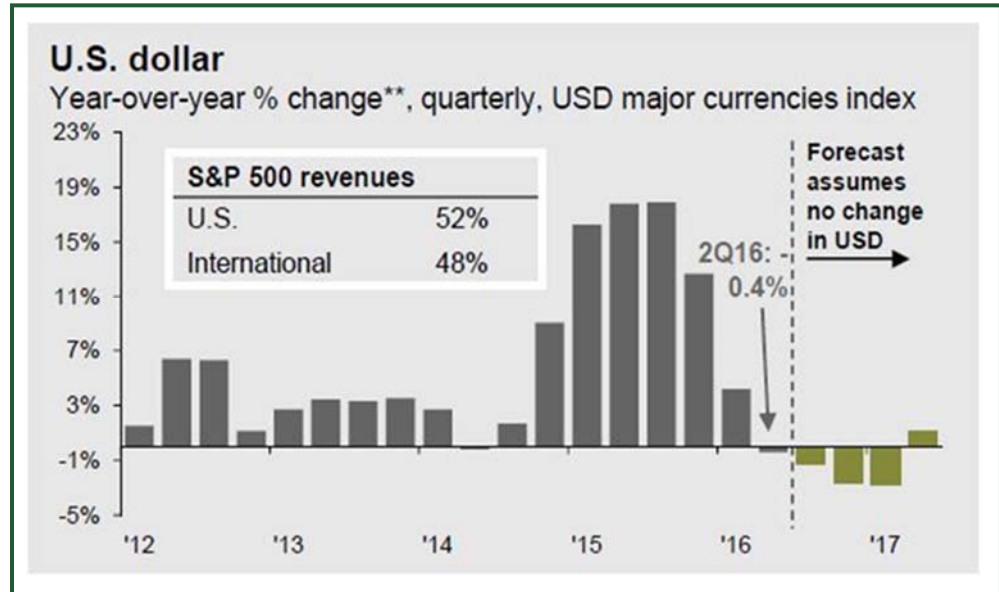
“...it is important to remember that what best protects an investor from the risk of permanent loss of capital is broad diversification, discipline, and patience.”

⁶“UK’s EU Referendum Result”, *Dimensional Fund Advisors L.P.*, 24 June 2016

Appendices

Appendix A

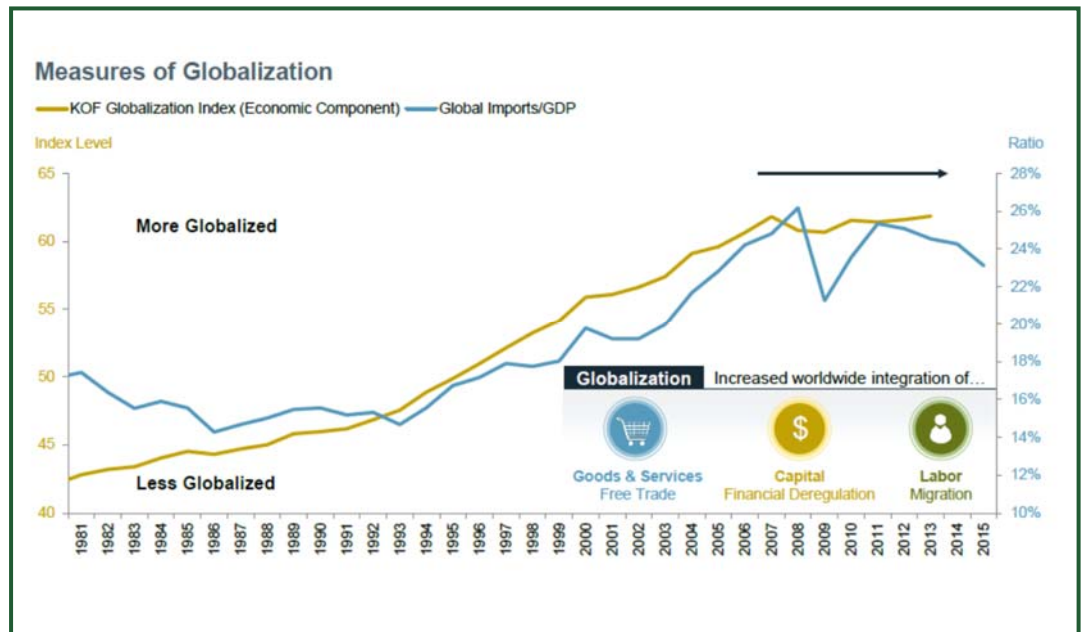
Depreciating Dollar



Source: Guide to the Markets – U.S. Data are as of June 30, 2016. J.P. Morgan Asset Management, page 7

Appendix B

Economic Globalization Has Stalled

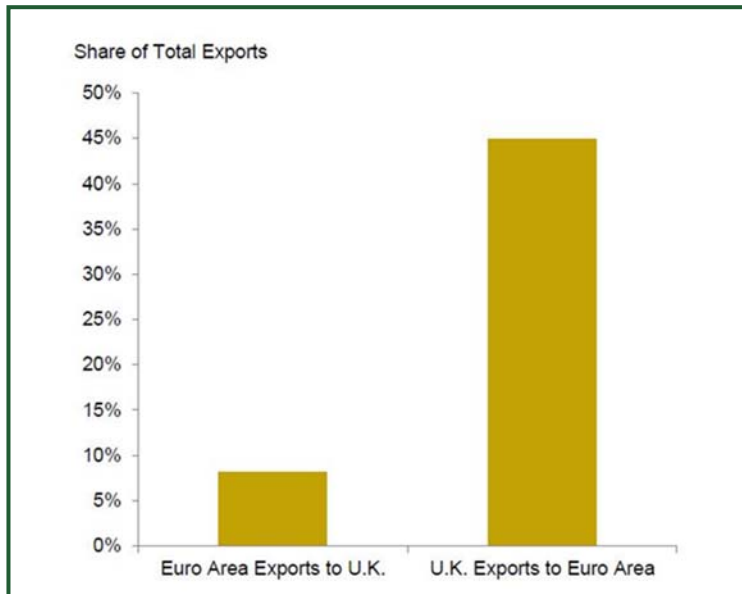


Source: Third Quarter 2016 Market Update, Fidelity Investments, page 9

Appendices Cont.

Appendix C

U.K. and Eurozone Trade



Source: *Third Quarter 2016 Market Update, Fidelity Investments, page 10*

Appendix D

Changing Growth Estimates

GDP Estimates (%)	2016	2017	2018	2019
UK before Brexit	2.2	2.1	2.3	2.3
UK after Brexit	1.5	0.2	1.3	2.2
Eurozone before Brexit	1.4	1.5	1.6	1.6
Eurozone after Brexit	1.3	1.2	1.6	1.6
Japan before Brexit	0.5	0.7	0.7	1.4
Japan after Brexit	0.4	0.7	1.1	1.3
U.S. before Brexit	1.8	2.2	2.0	1.8
U.S. after Brexit	1.9	2.0	2.0	1.8
Emerging Markets before Brexit	4.6	5.3	5.5	5.5
Emerging Markets after Brexit	4.7	5.3	5.4	5.4
World before Brexit	3.2	3.5	3.7	3.7
World after Brexit	3.2	3.6	3.7	3.8

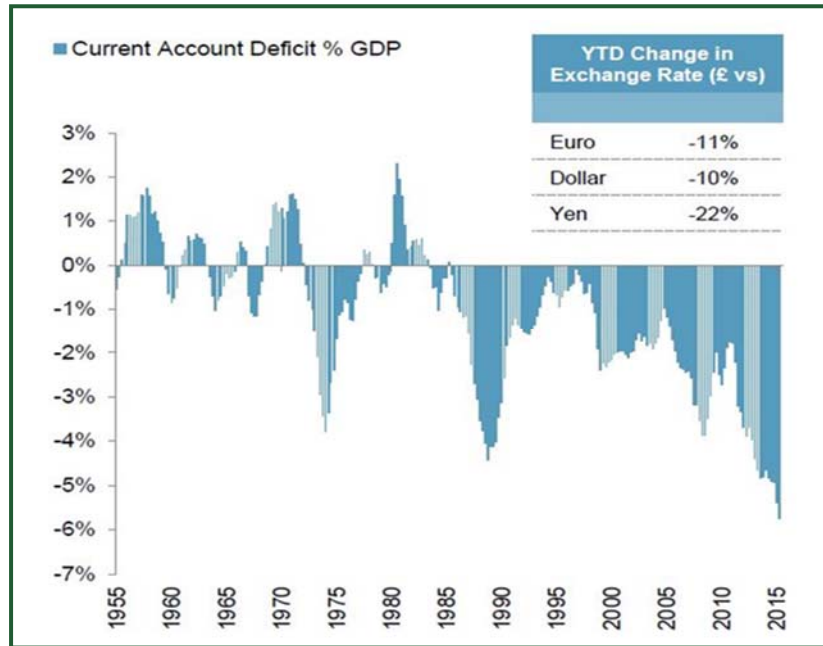
Note: "Before Brexit" signifies GDP estimates as of Q1 2016. "After Brexit" signifies GDP estimates as of Q2 2016.

Source: **Goldman Sachs Asset Management**

Appendices Cont.

Appendix E

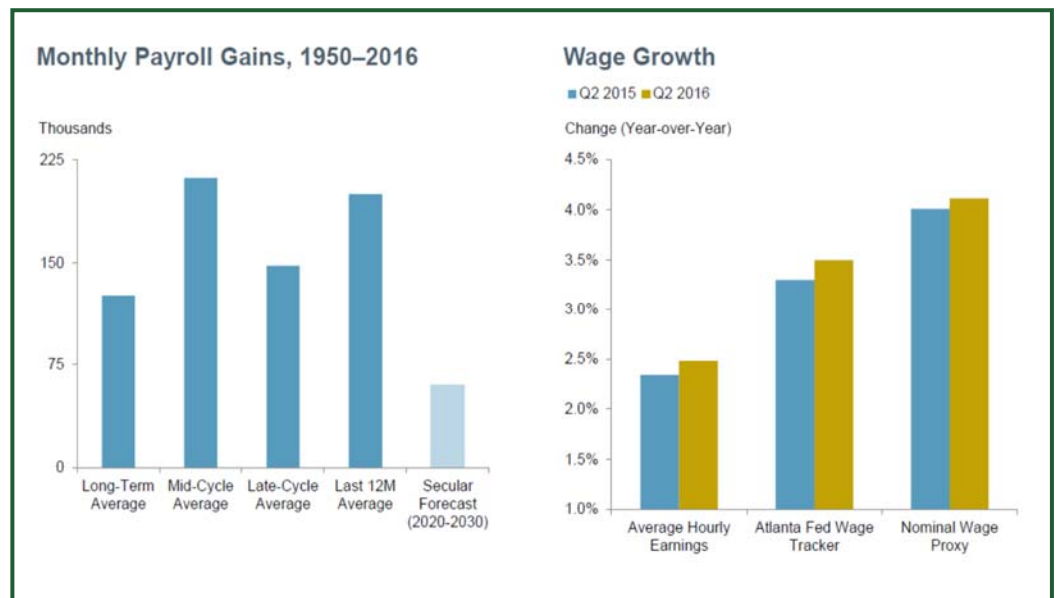
U.K. Current Account Deficit



Source: Third Quarter 2016 Quarterly Market Update, *Fidelity Investments*, page 10

Appendix F

Rising Employment and Wages Support U.S. Consumer

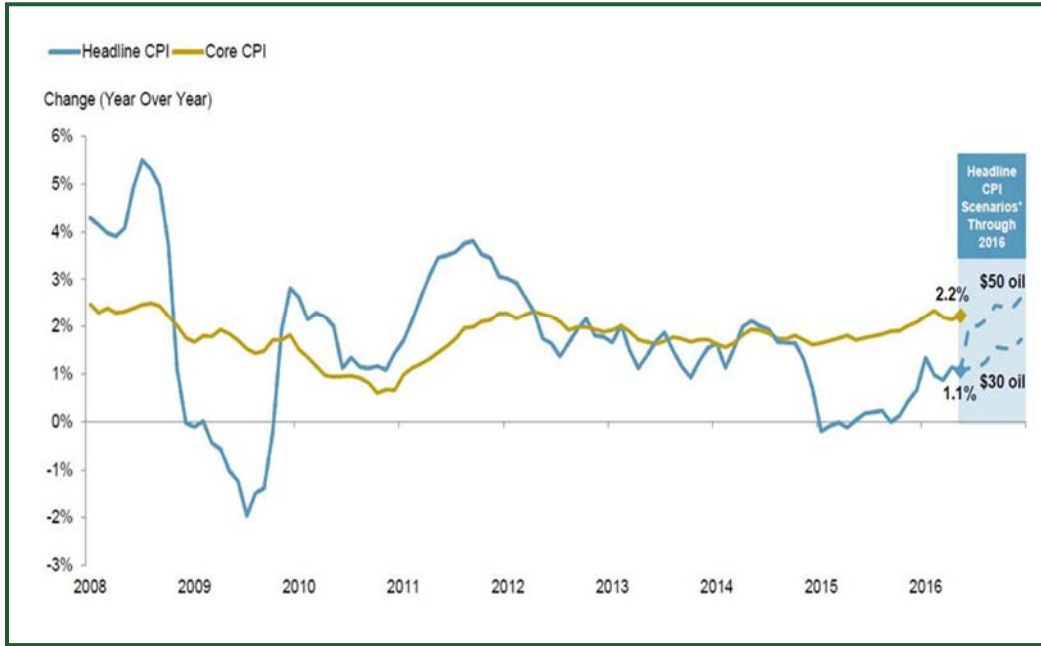


Source: Third Quarter 2016 Market Update, *Fidelity Investments*, page 19

Appendices Cont.

Appendix G

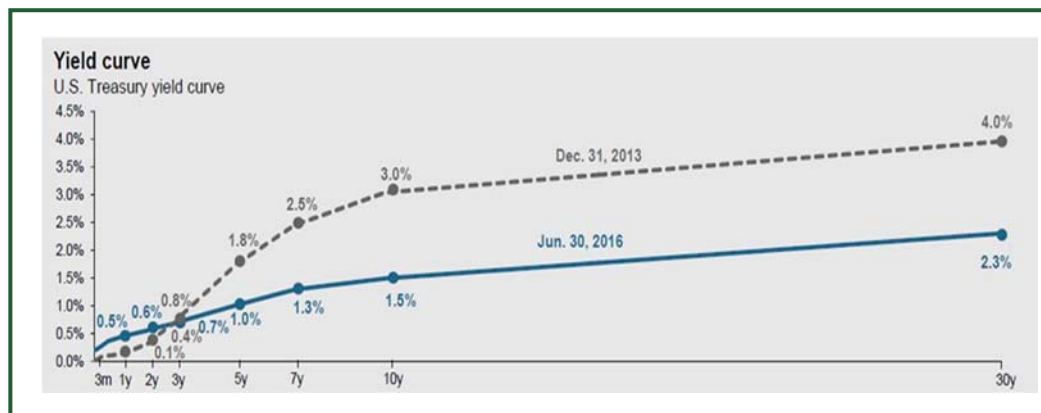
U.S. Inflation: The Base Effect



Source: Third Quarter 2016 Market Update, *Fidelity Investments*, page 22

Appendix H

Shape of the Yield Curve

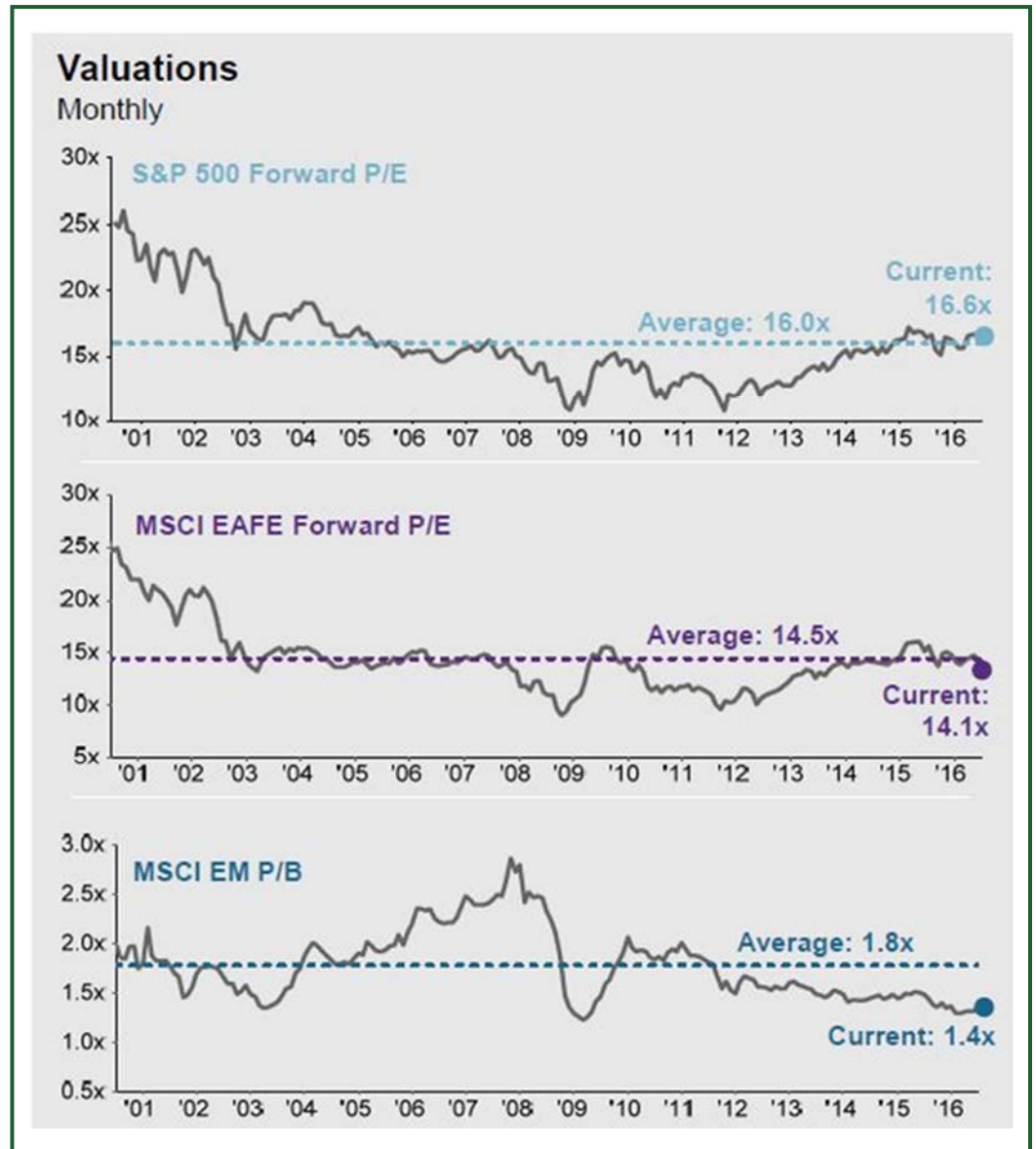


Source: Guide to the Markets 3Q 2016, *J.P. Morgan Asset Management*, page 34

Appendices Cont.

Appendix I

Equity Market Valuations



Source: Guide to the Markets 3Q 2016, J.P. Morgan Asset Management, page 44

Disclaimers

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by SOL Capital Management Company), made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from SOL Capital Management Company. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. SOL Capital Management Company is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice. A copy of the SOL Capital Management Company's current written disclosure statement discussing our advisory services and fees is available upon request. If you are a SOL Capital Management Company client, please remember to contact SOL Capital Management Company, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services.

SOL CAPITAL MANAGEMENT
111 Rockville Pike, Suite 750
Rockville, MD 20850
Phone: 301.881.3727

3 Columbus Circle, Suite 2120
New York, NY 10019
Phone: 212.710.4698

www.sol-capital.com

E-mail: sol@sol-capital.com

