

Global Economic and Financial Markets Summary

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The world's financial markets delivered mixed performance in the second quarter. US equities advanced, with the S&P 500 Index gaining 2.9%. In contrast, returns were negative for major international stock market indices and nearly every sector of fixed income. The weakness in these asset classes was concentrated in the second half of the quarter when there was a broad sell-off in the global markets. However, the markets started to recover in late June and continued to rally into July.

The quarter started on a positive note, with equity and fixed income prices climbing higher in April. The markets subsequently retreated in response to comments made by Federal Reserve Chairman Ben Bernanke. In May, Chairman Bernanke stated that if the US economy continued to improve, the Fed could decide to begin scaling back its monthly \$85 billion bond purchases at one of its next meetings. He reiterated these remarks in June and said that the central bank could end its bond-buying program entirely by mid-2014, provided the economy performed as expected.

Chairman Bernanke's comments triggered widespread selling in the global financial markets, as the timetable he presented for reversing monetary stimulus was sooner than many investors anticipated. Much of the selling was related to the unwinding of speculative positions in higher-yielding equity and debt securities that were funded with inexpensive US dollars. Once security prices started to fall, individual

investors began liquidating mutual fund holdings, and fund managers were forced to sell positions to meet redemptions, depressing prices further. Slowing economic growth and tighter monetary policy in China also contributed to the selling pressure.

We believe the markets overreacted to Chairman Bernanke's remarks. With the US economy in its fifth year of recovery, it seems logical that the central bank might soon taper the significant amount of stimulus it has been providing the economy. Furthermore, Chairman Bernanke said that any tapering would be gradual and that the Fed would not raise interest rates until unemployment fell to 6.5%. Near quarter-end, Fed officials tried to assure investors that their actions would be based on economic data rather than a particular timetable. These statements helped the markets regain their footing.

In terms of global macroeconomics, the US economy remains on a path of modest growth. The euro zone economy is stabilizing, growth in Japan is positive, and emerging economies are slowing, but still expanding at healthy rates. Leading economic indicators for approximately two-thirds of the world's largest economies have risen over the past six months; see [Appendix A](#). This suggests that the global economy is poised to continue to grow at a moderate pace.

Financial Markets Performance

Equities

Prices of US equities climbed higher in the second quarter, with gains across all major styles and capitalization segments. Within the US equity market, value stocks outpaced growth stocks, and the Russell 2000 Small Cap Index outperformed the large-cap S&P 500 Index; see Exhibit 1. Most sectors within the S&P 500 Index generated positive returns. Financials and consumer discretionary led the way, boosted by the recovery in the housing market and overall US economic expansion. The utilities sector, a traditionally high dividend

paying sector, performed the worst during the quarter. Rising bond yields caused stock dividend yields to appear relatively less attractive.

Equities in developed international markets were down slightly, but remain positive year-to-date. Within the developed world, the performance of European stocks was flat for the quarter, while losses throughout much of the Pacific region overshadowed strong results in Japan. Emerging market equities struggled due to several factors, including inflationary pressures and slowing economic growth in the “BRIC” countries of Brazil, Russia, India, and China.

“...US equities climbed higher in the second quarter...”

“Equities in developed international markets were down slightly...”

“Emerging market equities struggled due to several factors...”

Exhibit 1		
Total Return* for Selected Equity, Fixed Income, and Hedge Fund Indices		
	2nd Quarter (3/31/13 to 6/30/13)	Year to Date (12/31/12 to 06/30/13)
Major Equity Indices		%
S&P 500 Index	2.9	13.8
Russell 3000 Index (Total US market)	2.7	14.1
Russell 2000 Index	3.1	15.9
MSCI All Country Ex-US Index (Net)	-3.1	0.0
MSCI EAFE International Index (Net)	-1.0	4.1
MSCI Emerging Markets (Net)	-8.1	-9.6
<i>Source: Bloomberg, MSCI</i>		
Major Fixed Income and Hedge Fund Indices		%
Barclays Capital US Aggregate Bond Index	-2.3	-2.4
Barclays Capital U.S. Credit Index	-2.5	-2.7
Merrill Lynch US High Yield BB-B Bond Index	-1.6	0.7
JPMorgan Non-US Global Hedged Index	-1.4	-0.1
JP Morgan EMBI Global Index in USD (Emerging markets)	-6.1	-8.2
HFRX Equal Weighted Strategies Index (Hedge Funds)	0.8	3.4
<i>Source: Bloomberg, MSCI, PIMCO</i>		

* Includes price appreciation plus dividends and/or interest.

Financial Markets Performance Cont.

Fixed Income

Interest rates rose after Federal Reserve Chairman Ben Bernanke suggested that the Fed may begin to slow the pace of its monthly bond purchases. As interest rates (which move inversely with bond prices) increased, most bond sectors generated negative returns during the quarter. Interest-rate sensitive issues, such as Treasury Inflation-Protected Securities (TIPS) and long-dated US

Treasuries, were the largest detractors. Emerging market debt and other credit-sensitive sectors were especially weak, as rising market volatility and diminished liquidity caused credit spreads to widen (credit spreads are the difference in yields between credit-sensitive instruments and similar-maturity Treasuries.) Following the losses during the quarter, the convertible, high-yield, and floating-rate sectors of the bond market were the only sectors with positive returns year-to-date.

Global Economic Outlook

United States

The US economy has been resilient despite January tax increases and government spending cuts that began in March. During the first quarter of 2013, GDP grew at a 1.8% annual rate, and we expect a similar growth rate for the full year; see [Exhibit 2](#). The negative effects of fiscal tightening are being countered by positive trends in the private sector.

Housing has been a key contributor to private sector growth. A key index of home prices posted a record monthly increase in April, and in May, sales of new homes rose to their highest level in almost five years. While existing home sales have been robust and construction activity accelerates, foreclosures have been declining, thereby limiting the supply of homes available on the market. Further, housing affordability remains near

record highs even as mortgage rates have risen above their unsustainable record lows; see [Appendix B](#).

Other sectors of the economy have also been improving. This includes rising orders for capital equipment, recovering auto sales levels (unseen since before the financial crisis), and a 5.7% increase in overall retail sales for the year through June. Against the backdrop of a strengthening economy, employers have been adding to their payrolls, and importantly, confidence among consumers and businesses has been rising – all of which bolsters consumer spending, job creation, and capital investment in the months ahead.

Europe

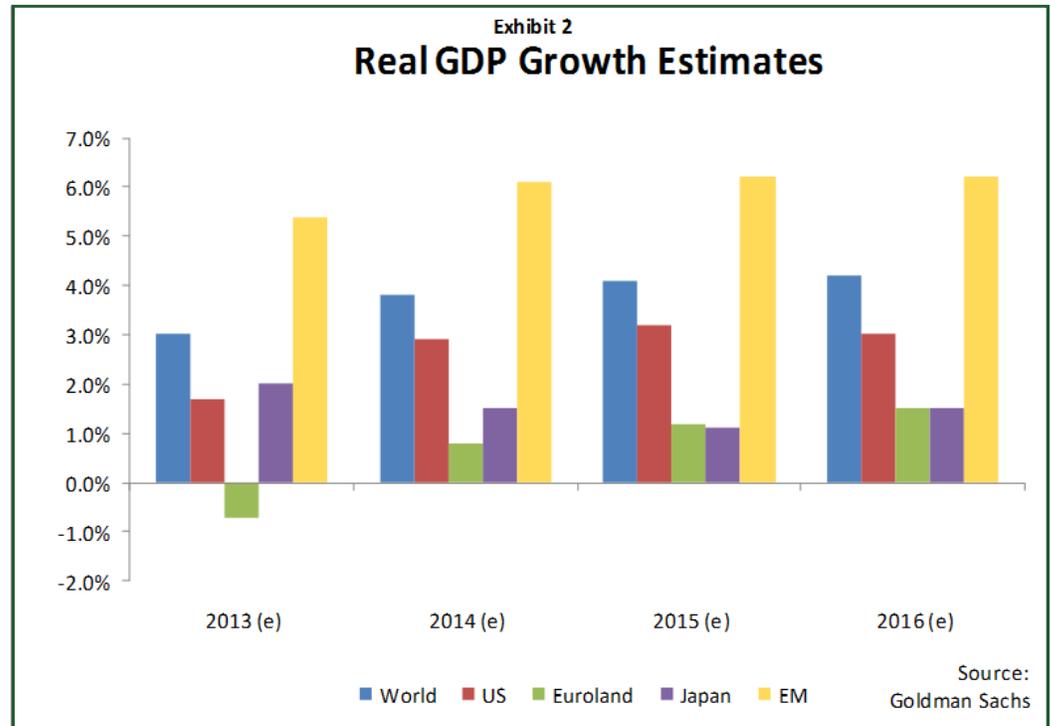
The euro zone remains in recession; however, the economy is stabilizing. Manufacturing output has

“During the first quarter of 2013, GDP grew at a 1.8% annual rate, and we expect a similar growth rate for the full year.”

(Continued on page 4)

Global Economic Outlook Cont.

“The Japanese economy grew at an annual rate of 3.5% in the first quarter of 2013, boosted by pro-growth policies of Prime Minister Shinzo Abe, who took office in December.”



(Continued from page 3)

been rising for the past several months (see [Appendix C](#)), and touched a 16-month high in June, led by strength in the peripheral countries of Italy and Spain. The European Central Bank cut interest rates in May, and governments across the periphery are shoring up their finances, reducing the need for external borrowing, and easing stress in the debt markets. While austerity measures continue to weigh on growth, the fiscal drag should fade in the second half of the year. The euro zone still faces numerous challenges, particularly as policymakers try to agree on a plan to oversee the region’s banks. However, the worst of the recession appears to have passed.

Japan

The Japanese economy grew at an annual rate of 3.5% in the first quarter of 2013, boosted by pro-growth policies of Prime Minister Shinzo Abe, who took office in December. Japan has been taking bold steps under his leadership to end deflation which has crippled economic growth for two decades. As part of these initiatives, the Bank of Japan launched an unprecedented monetary easing program in April designed to achieve 2% inflation within two years. Under the program, the Bank of Japan will purchase \$70 billion of Japanese government bonds each month. This is extremely aggressive specially considering the size of Japan’s and the US monetary easing programs in relation to the sizes of their respective economies: (1) the Fed is

Global Economic Outlook Cont.

buying only \$15 billion more US Treasury and mortgage-backed securities a month than Japan, while (2) the US economy is nearly three times larger than the Japanese economy; see [Appendix D](#). It remains to be seen whether Japan's new policies will put its economy on a path of sustainable growth. One major impediment is the country's substantial public debt, which is more than 200% of GDP. In addition, Japan's aging population may have little appetite for continued low yields on top of rising inflation.

demand for exports, declining personal income growth, and the government's efforts to rein in the "shadow banking" industry (i.e., the network of non-bank lenders that are subject to limited regulatory oversight). Despite the slowdown, China's economy remains strong, with GDP rising 7.5% in the second quarter from a year ago. Furthermore, we think China is taking appropriate steps to promote long-term economic stability. For example, beyond trying to curb shadow banking, the government is working to transition the economy away from growth driven by exports and investments towards a more sustainable growth driven by domestic consumer demand.

"...we think China is taking appropriate steps to promote long-term economic stability."

Emerging Markets

Economic growth in China slowed in the first half of 2013 amid softer

Investment Strategy

Equities

With the tailwind of a strengthening economy, US corporate profits should continue to improve, albeit at a more moderate pace. In addition, high cash balances should allow companies to continue returning capital to shareholders in the form of dividends and buybacks; see [Appendix E](#). As a result, we believe the risk-return profile of stocks remains attractive, despite this year's gains in the equity market and the recent erosion of the income advantage that stocks have had over bonds (e.g., bond yields increased, while dividend yields decreased). Our outlook is also positive

for international equities, as valuations in both developed and emerging markets continue to be below long-term averages.

In light of these factors, we are maintaining, and in some cases increasing global equity exposure as appropriate. We continue to invest in special opportunities, such as housing-related companies, natural gas and other commodity companies, and technology companies. That said, we see the potential for more volatility in the market and are therefore paying close attention to clients' investment and liquidity needs in constructing and rebalancing their portfolios.

Investment Strategy Cont.

Fixed Income

Even with the increase in yields this quarter, bond yields remain exceptionally low, providing limited opportunity for price appreciation. Nonetheless, fixed income plays an important role in a balanced portfolio because it generates a steady stream of income, and because its low, and sometimes negative correlation to equities can mitigate downside volatility in the stock market. We believe intermediate and longer duration Treasury securities are currently

overvalued, and that the high-yield bond market is fairly valued. As a result, we continue tilting our fixed-income exposure toward lower-duration securities and opportunistic strategies. We believe these investments will have relatively limited downside risk in a rising interest rate environment, can reduce equity market volatility, and provide liquidity.

“...fixed income plays an important role in a balanced portfolio...” “...its low, and sometimes negative correlation to equities can mitigate downside volatility in the stock market.”

In Closing

We are optimistic that the US and international equity markets have the potential to generate positive returns over the next few months. Leading economic indicators are rising around the world, led by the United States, Japan, and other developed economies. Corporations have favorable earnings prospects, and equity valuations appear attractive to reasonable. Interest rates could continue rising as they return toward their long-run averages, but fixed-income allocations bring valuable diversification benefits to portfolios.

Consistent with our belief in broad diversification, portfolios are diversified by asset class, geographic market, asset size, and investment

style. In addition, we continue to thoughtfully rebalance portfolios, while being mindful of the geopolitical and macroeconomic environment.

As always, our focus remains on meeting your long-term investment goals, while considering your risk profile and future liquidity needs. Please call us at 301.881.3727 with any question or concerns about your portfolio, and thank you for the opportunity to manage your assets.

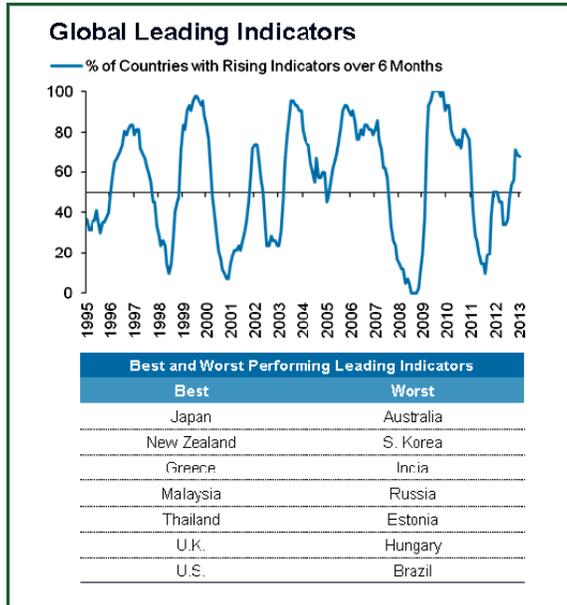
Sincerely,

The SOL Capital Management Team

Please note that past performance is neither an indication nor a guarantee of future returns and that diversification does not ensure profits or guarantee against a loss.

Appendices

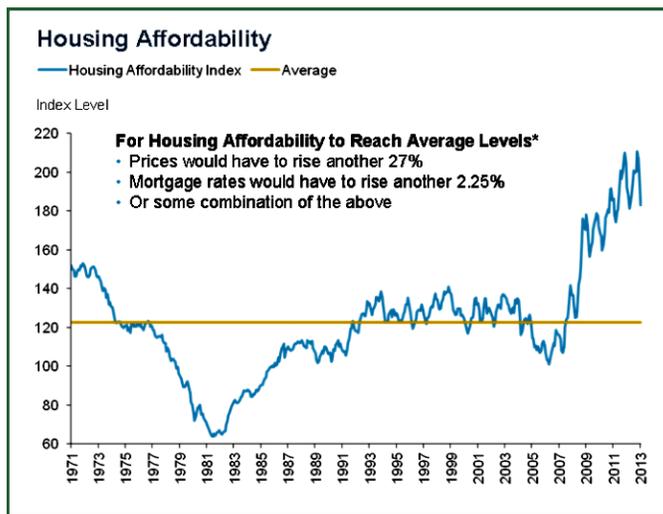
Appendix A Global Leading Indicators



Percentage of world's 37 largest economies with rising Leading Economic Indicators. Source: Organization for Economic Cooperation and Development (OECD), Foundation for International Business and Economic Research, Haver Analytics, Fidelity Investments (AART) through 4/30/13.

Source: "CMMSG Weekly Market Update" *Review of AART's Quarterly Market Update*, Fidelity Investments, page 4

Appendix B Housing Affordability



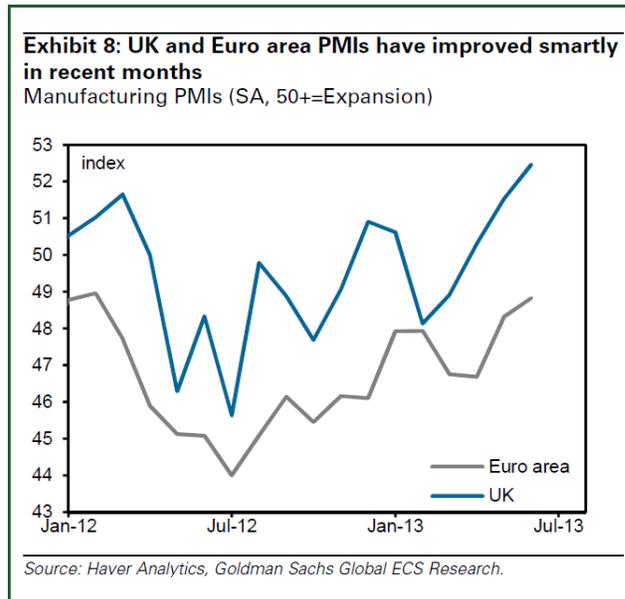
* Housing affordability sensitivities based on FMR estimates as of 6/21/13. Housing affordability data as of 4/30/13. Source: National Association of Realtors.

Source: "Housing Affordability," *Third Quarter 2013 Quarterly Market Update*, Fidelity Investments, page 19

Appendices Cont.

Appendix C

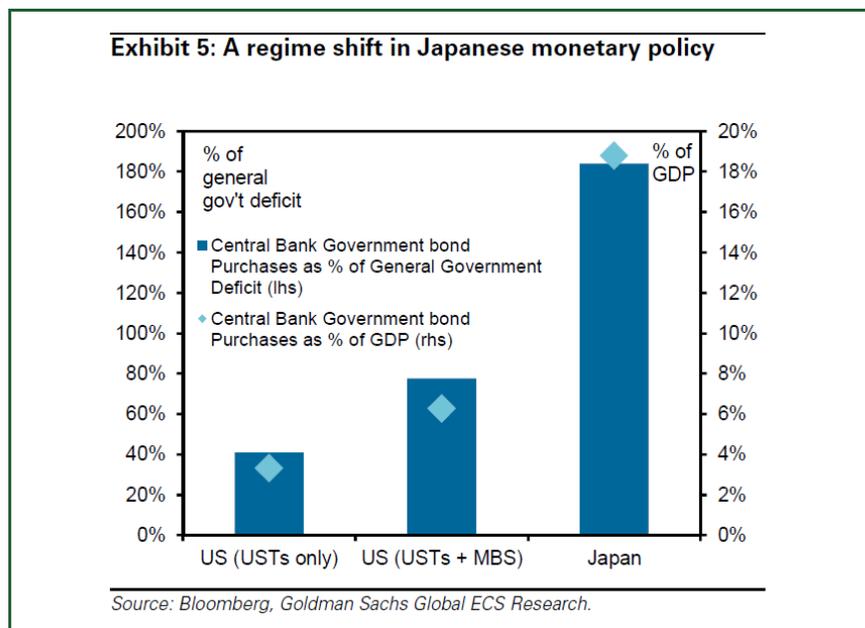
An Upward Trend in European Manufacturing Activity



Source: *Global Economics Weekly*, Goldman Sachs, July 3, 2013, page 7

Appendix D

The Bank of Japan's Aggressive Bond-Buying Program

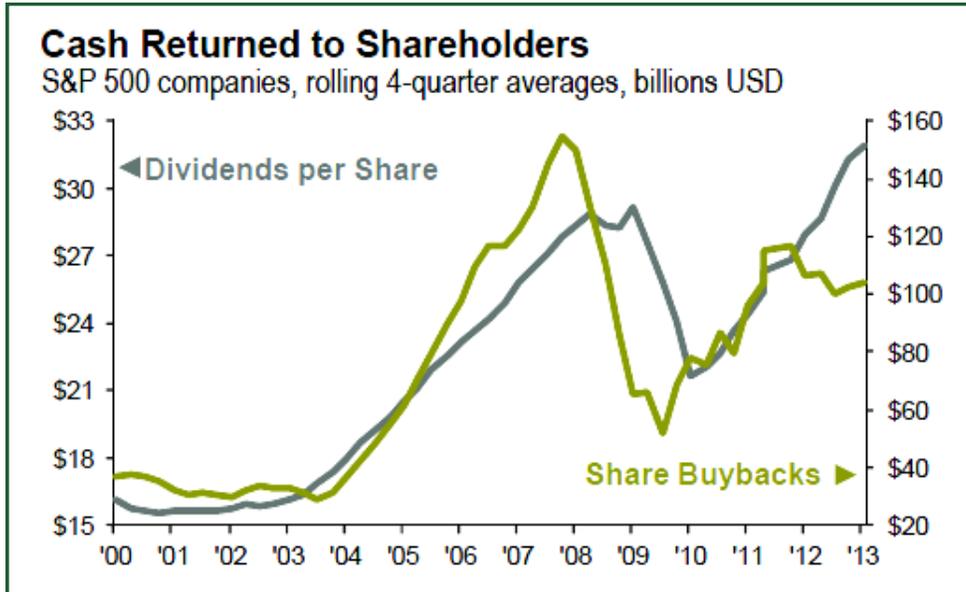


Source: *Global Economics Weekly*, Goldman Sachs, July 3, 2013, page 5

Appendices Cont.

Appendix E

Cash Returned to Shareholders



Source: Standard & Poor's, FactSet, J.P. Morgan Asset Management.

Source: "Cash Returned to Shareholders," *Guide to the Markets 3Q 2013*, J.P. Morgan Asset Management, page 14

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