CURRENT MARKET ENVIRONMENT

The S&P 500 entered a correction yesterday, and investors are speculating as to the primary causes, with the main culprits being falling oil prices, the fall in the Chinese Yuan, and the decline in Chinese equity markets prompted by misguided governmental oversight. The global market downdraft has actually changed the market sentiment for the first time since the "Great Recession", from "let's buy on the dip", to "sell on any rise". Investor outlook has changed because any of the aforementioned factors can singularly or in combination cause a slowdown in global economic growth. Here is our viewpoint regarding each factor.

I. OIL PRICES

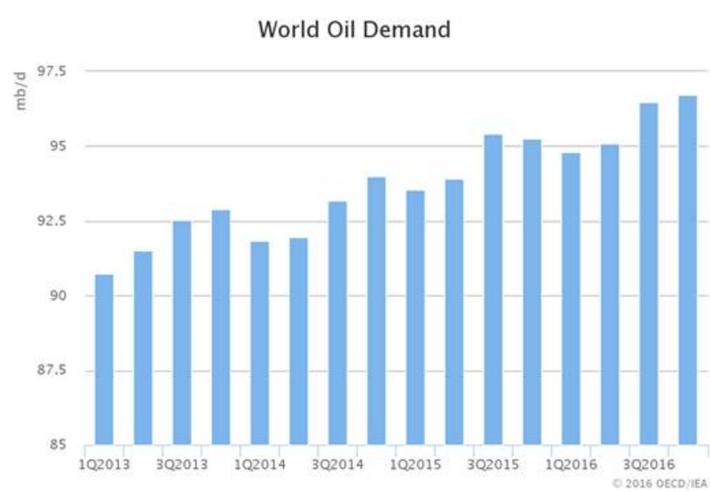
The continued decline in oil prices should have helped to lower costs throughout the global economy and helped to foster economic growth. This has not occurred because the drop in oil prices is not **demand driven** (demand has remained rather steady by historical standards - it is just not growing at the robust pace seen in years past due to muted economic growth) but rather is **supply driven,** due to a price war between the Middle East and everyone else, particularly the U.S.

- Oil prices have actually been falling since mid-2014, and have led to a reduction in capital spending in the U.S. and other countries from the energy industry as prices have fallen.

- Lower prices have caused 30 small to mid-sized U.S. energy companies to file for bankruptcy totaling $13 billion in debt. Another $39 billion of energy related debt may be at risk of default, which, coupled with the already defaulted $13 billion, accounts for 15% of public energy debt outstanding.

- Large oil companies such as BP are already laying off thousands of employees in their exploration and production businesses, and similar cuts may be seen in the U.S., Russia, Venezuela, and Brazil. This is a global employment issue, which the already muted global economic recovery can ill afford.

- Global demand for oil continues to increase, per the chart to the right (source: IEA). We believe once the supply side of the equation is stabilized, the demand side will help move oil prices higher.



II. THE CHINA EFFECT

Growth in China is slowing, but at a moderate pace, which is to be expected from an economy that has grown to over $10 trillion. As the Chinese economy grows at an expected rate of 6.6% in 2016, its slowdown is being caused primarily by the loss of China's low cost labor advantage, and its shift from a manufacturing to a services and consumer-driven economy. This is a slow and arduous process which market strategists believe may take five to ten years. The slowdown raises other questions:

- The China slowdown may negatively affect growth not only in Asia, but also in developed market countries that do a great deal of export business with China, including South Korea, Japan and Germany.

- The slowdown may cause a capital flight out of China as investors seek safer opportunities, robbing China of the needed capital to help maintain economic growth as well as support an economy that is heavily in debt on a country and corporate basis.

The decline in the Chinese Yuan also worried investors, as it too could prompt a capital flight out of the country, and cause a currency war. This could lead to continued declines in global currencies relative to the U.S. Dollar, increase rising deficits seen by individual countries, and increase the cost of goods (inflation) which would have a negative effect on consumers.

The combination of these concerns have caused a reset in equity market valuations. In the U.S. the S&P 500 is now trading closer to 15X forward earnings and Europe is closer to 14X. These are far cheaper valuations than seen in June of 2015. We believe the uncertainty in oil prices, the Chinese Yuan and Chinese economic growth will limit asset returns during the first half of 2016. This is also coupled with uncertainty regarding the political picture in the U.S., as well as its interest rate policy (Fed officials had forecast up to five potential rate hikes this year).

SUMMARY: NO CHANGES TO CURRENT ASSET ALLOCATION

We believe as the economy and currency settles down in China, and as government officials gain a better grasp of how to handle their issues and communicate their true intentions, China should stabilize. In the energy/oil sector, the OPEC meeting in June will help to determine output levels going forward, as OPEC will be able to assess the changes in production from Iran (which is expected to go on line within the next month or so) and the U.S. due to a reshaping of the fracking landscape. By this time, the U.S. will have been through several Democratic and Republican primaries - once the lead candidates are identified, geo-political uncertainty regarding the U.S. political landscape should dissipate. Throughout the many market corrections we have seen over the decades, large and swift downdrafts in market price create investment opportunities. As we believe in investing as valuations for good and quality assets become cheap, we recommend that clients remain with their existing overall asset allocation and stay the course.