CENTURION
ASSET MANAGEMENT

Market Insight – 2015 Mid-year Review and Outlook

While economic data suggested the second quarter of 2015 was an improvement over the first quarter, the period was rather lackluster for domestic equity investors, and somewhat poor for bond investors. Through July and the beginning of August, the financial markets have provided both opportunity and anxiety as volatility has increased. While entering the last six weeks of the third quarter, we will try to answer in this commentary many investor questions regarding opposing forces that shaped the markets, and provide our view for the back half of 2015 and beyond.

Economic and Market Summary

The U.S. economy fell short of expectations in Q1, furthering a pattern of weakness during four of the last five Q1s. Following that pattern, the economy has appeared to have rebounded during the second quarter, and should show signs of continuing to grow through the end of the year. Our outlook beyond Q2 remains unchanged and confident that we will hit our 2015 target GDP growth rate of 2.4%, a modest rate of growth, and in-line with expectations for a slowly improving economy. We feel this slow pace provides a backdrop that will deter Fed action.

Small and large company stock indexes performed in a virtual dead heat in the second quarter, while year-to-date small companies have provided four times the return of large companies. Growth has significantly outperformed Value over the last 12 months, but it was almost even between the two over the last 3 months. Among international sectors, Developed Markets stocks are outperforming Emerging Markets stocks, and non U.S. small cap stocks have been the best performing style, with a year-to-date return of 10.4% through June 30.

Among bonds, each of the following broad categories have struggled mightily over the past three months, and have negative returns thus far in 2015: investment-grade bonds, U.S. corporate bonds, and long-term government bonds. The only seemingly bright spot this year has been high-yield (one of CAM's overweights) with a return of 2.5%. With this type of performance from the fixed income markets, we continue to favor equities over bonds.

Asset Category	Q2 2015 (%)	Year-to-Date (%)	Asset Category	Q2 2015 (%)	Year-to-Date (%)
U.S. Large- Cap Stocks	0.3	1.2	Investment-Grade Bonds	-1.7	-0.1
U.S Mid-Cap Stocks	-1.5	2.4	U.S. Corporate Bonds	-2.9	-0.08
U.S. Small- Cap Stocks	0.4	4.8	Long Government and Credit Bonds	-7.6	-4.5
Non-U.S. Developed- Country Stocks	0.8	5.9	High-Yield Bonds	0.0	2.5
Emerging-Market Stocks	0.8	3.1	Emerging-Market Bonds	-0.3	1.8
Real Estate Stocks	-9.1	-5.4	Gold	-1.3	-2.9

Past performances is no guarantee of future results. It is not possible to invest directly in an index. Represented by: Commodities- Bloomberg Commodity Index; Emerging- Market Bonds- JP Morgan EMBI Global Index; Emerging- Market stocks- MSCI EM Index; Gold- Gold Bullion, LBMA PM Fix; High Yield Bonds- Bank of America Merrill Lynch (BofA ML) High Yield Bond Index; Investment- Grade Bonds- Barclays U.S. Aggregate Bond Index; Non- U.S. Developed- Country Stocks- MSCI EAFE Index; Non- U.S. Small- Cap Stocks- MSCI EAFE Small- Cap Index; Real Estate Stocks- FTSE NAREIT Equity Index; U.S. Corporate Bonds- Barclays U.S. Credit Index; U.S. Large- Cap Stocks- S&P 500 Index; U.S. Mid- Cap Stocks- Russell Midcap Index; U.S. Small- Cap Stocks- Russell 2000 Index; U.S. Treasury Bonds- Barclays U.S. Treasury Index. Source: Bloomberg Finance L.P., Haver Analytics, Fidelity Investments (AART), as of 6/30/15.

Over the last six weeks, July 1 – August 14th, domestic large cap equities as measured by the S&P 500 index have grown only 1.34%, while small caps are flat at 0.0% as measured by the Russell 2000 index. Styles have had diverged, with growth out performing value 5.75% to -0.89% (Russell 3000 Growth index, Russell 3000 Value index). The most widely known market indicator, the Dow Jones Industrial Average, has a negative return of -2.33% thus far this year. All of this data, which has changed meaningfully since June 30, provides a backdrop for investor's new trepidation.

Mid-year Reflections and Second-half Expectations

At just past the midpoint of the year, we find ourselves entering a fairly volatile period. considering headlines regarding the Greek bailout and Chinese currency devaluation, and the flow of economic data, we see the market volatility as opportunity. As we evaluate influences on the markets, we conclude out short and long term outlooks from earlier this

year should mostly stay intact. In most cases, our predictions have become reality, and the themes we have held for several years are still relevant. Let us specify those themes and further solidify our position regarding equities, fixed income securities, and the economy.

Equity Securities: We remain positive concerning domestic equites in 2015. The factors that we have focused on that lead us to this position are still meaningful, even with the recent negative performance. It is our belief that U.S. economic improvement, or faltering, will impact stock performance over the next few years. Many market pundits fundamentally believe there is a link, as do we, but others feel there is a disconnect between economic growth and stock market performance. Our industry colleagues at Goldman Sachs have recently written about their position that strong economic growth forecasts are not a predictor of stock market performance[i]. While we do not believe a 1 + 1 = 2 absolute relationship exists, we note that the recovery period since 2009 has provided, and will continue to provide, solid returns for investors. Since 2010, Large Cap stocks (S&P 500 index 5 year growth, 6/30/2015) have returned on average 14.89% annually. As we know, during that period we have experienced economic improvement in the U.S. at a steady pace. The support is there in the economic data, and the market continues to move higher.

The performance of stocks within the past 5 years and over the next 5 years is not solely attributable and predictable based upon economic performance or growth rate outlooks. However, **in the current market cycle we feel there exists a fundamental connection between economic output and consumption, as measured and predicted by economic reports, that greatly impacts the investing behaviors of institutions and individuals, and thus the performance of the financial markets.**

It is odd to us that Goldman would take a counter view point to this type of thesis, but perhaps they are hedging their position. For example, the closing line of the Goldman article states, “Therefore, particularly in emerging markets, we may very well own stocks in countries where we do not have a favorable macroeconomic view.” If that is the case, then I would define their approach as speculation, or as high risk vs reward investing. Perhaps they are choosing to short economic factors while going long stocks in their book, but we do not know if that is the case. Our focus is a bit different, and is directed toward finding companies, styles, and sectors where there exists economic support for investing. Getting it right is hard enough, why make it more difficult by trying to invest in a security where the surrounding macro-economic influences are negative? We subscribe to finding value investments, with reduced risks.

This leads to our continued theme that steady economic growth in a low interest environment will exist for the next few years and provide support for us to conclude equities will continue to do well absolutely, and on a relative basis, to fixed income securities. Corporate earnings under a favorable interest rate environment and mid-level capex spending, are factors that exist today, while individual consumer debt, consumer confidence, and delinquencies reports, are strong as well. Thus, as we have stated previously, barring major global event shocks (terrorism, etc.) we see a continued rise in equity markets. Investor trepidation over short-term shocks will happen, but if the fundamentals are there from a supportive economic story, we can only conclude good performance for stocks.

Fixed Income Securities: As we have mentioned, save for High Yield bonds, the fixed income market has been poor thus far this year. Rising interest rates in the second quarter took away the gains in bonds in the first quarter. Longer dated bonds performed the worst, so our call earlier this year to remain fairly short in duration for bonds portfolios was on target.

While the Greek debt drama has been interesting to watch, the impact to U.S. investors is not meaningful to the overall picture. Eurozone bonds are holding-up in the midst of the trouble, but the outside influence of Chinese market issues may cause a more serious review of the global bond market. Normally, a problem such as Greece, or the Chinese stock market decline, brings forth a flight to quality scenario that helps bond prices, however, US investors seem to be more fixated on the probability of Fed maneuvers. The potential for the Fed to raise rates has been debated for some time, but during the second quarter Janet Yellen re-affirmed the Fed’s willingness to raise the federal funds rate later this year. She referred to this process as the beginning of the normalization of monetary policy.

With that backdrop, we feel it is still the right call to position investors in High Yield (HY). We made our case over the past few years on why we expect High Yield to outperform most other sectors. The HY sector has a much lower correlation to

interest rates than investment-grade bonds, can provide attractive equity-like returns, and are dependent upon economic conditions. If we are saying the economic environment is improving, all be it at a modest pace, then as interest rates rise HY should provide a mid-level stepping point for investors who do not see the value in remaining in high quality investment grade bonds (think price declines), and are unwilling to have all of their liquid capital in the stock market. This is favorable for more dollars to flow into the high yield market and cause a continued lift in those securities.

Conclusions: As we move into the second half of 2015, the debate and hand wringing over the US Fed's decision on interest rates appears to be the focus of most of the financial press. That is to say, we do not have many fundamental issues with the performance of domestic companies, as earnings seasons continue to confirm the health of these companies. "Don't fight the tape," is an expression heard when the market is rising and does not look like it will soon slow down. At this time, we like to say "Don't over think it," and prefer to stick with the basics of noticing the strength of US stocks on an absolute and relative basis over other assets. We are investors, choosing to deploy personal and institutional capital in areas that have value with decipherable risks in order to obtain a client's particular objective. As such, it is still a time to be long equities.

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[i] Goldman Sachs, "Expectations Versus Reality": Fundamental Equity Research Team, 3rd Quarter 2015