ECONOMY: As US Strengthens, Global Economy Slows

September gave a picture of a U.S. economy that is enjoying a strong expansion with solid job growth, low inflation & interest rates, and rising profits. All this suggests a resilient economy with underlying momentum moving into the fourth quarter.

**Q2 GDP Revised Upwards**
Q2 GDP growth was revised up from 4.2% to 4.6%. The revision showed a pick up in business investment, manufacturing, and exports. The update raised the year over year growth rate to 2.6%.

**Consumer Confidence Falls Sharply**
The Conference Board Consumer Confidence survey fell from 93.4 in August to 86 in September. “Consumer confidence retreated in September after four consecutive months of improvement. A less positive assessment of the current job market, most likely due to the recent softening in growth, was the sole reason for the decline in consumers’ assessment of present-day conditions. Looking ahead, consumers were less confident about the short-term outlook for the economy and labor market, and somewhat mixed regarding their future earnings potential. All told, consumers expect economic growth to ease in the months ahead.”

**Fed Watch**
Minutes from the Federal Reserve’s September policy meeting show central bankers remain determined to take a cautious approach towards raising interest rates and normalizing monetary policy as the economy continues its slow, gradual recovery. Economic activity, according to the minutes, continues to expand “at a moderate pace,” but not fast enough to hasten a decision to raise rates. The consensus among members of the policy-setting Federal Open Markets Committee is that rates will start to gradually move higher in mid-2015, according to the minutes.

**Reports on Business**
According to the Institute for Supply Management (ISM), economic activity in the manufacturing sector expanded for the 16th consecutive month in September. Comments continued to reflect a positive business outlook, while noting some labor shortages and concern over geopolitical unrest. The non-manufacturing sector grew in September for the 56th consecutive month. Respondents continue to be optimistic about business conditions and the direction of the economy.

**Labor Market Strength Continues**
Nonfarm payrolls jumped from an upwardly revised 180,000 gain in August to a 248,000 surge of new jobs in September. July and August payrolls were also revised up by 69,000 leading to healthy trend growth averaging 245,000 new jobs per month over six months. The U.S. unemployment rate fell to 5.9% in September, dropping below 6% for the first time in more than 6 years.

**Return of the Strong Dollar**
The U.S. dollar was rising against almost all major currencies, during September and the third quarter, due to the improving economic and employment picture domestically. The trade-weighted dollar hit its highest level since early May 2009.

**ECB Eases Further**
The ECB has set itself on an easing path as ECB President Draghi announced the long delayed asset purchase plan. The ECB will buy asset-backed securities in both the primary and secondary markets. The goal is to take these obligations off bank balance sheets, and encourage them to securitize new and existing loans, thus spurring needed economic activity.

**Brazil in Recession?**
Technically, the economy has contracted for the past two quarters, generally accepted standards for a recession. Although year over year growth still stands at 1.4%, a continued slow growth trend, could be a harbinger of things to come if the global economy worsens.
GLOBAL EQUITIES: An Ugly End to Q3

TOUGH MONTH DOMESTICALLY
Stocks reached new highs in mid-September, but losses later in the month erased those gains. Stocks rallied early in the month amidst good economic data and news that the Fed’s interest rate policy remained unchanged. However, political turmoil overseas and weaker global economic conditions sent stocks lower for the month.

VOLATILITY RISES
The CBOE Volatility Index, or VIX as it is commonly known, spiked in September. The index rose 32% to close end September at 16.31 (rising further in October to almost 25). The index had traded at relatively low levels for most of 2014, illustrating a lack of “fear” with most investors. Consider this – earlier in the year there were 42 consecutive days without a 1% move in the S&P 500. Since the bottom of the financial crisis, there have been 9 pullbacks in the S&P 500 averaging 7%. In addition, there have been 4 instances where the market corrected 10% or more (the last being from April to June 2012). At the same time, stocks have advanced 180% over this period. Quite simply, markets do not go straight up.

OVERSEAS GROWTH CONCERNS
Developed international markets posted steep losses in September. European markets were lower as weak inflation data pushed the euro to a two year low versus the U.S. dollar. Economic growth within the region was also a major concern as the economies of Germany and Italy contracted, while growth in France was flat.

EMERGING MARKETS RECOVERY FALTERS
Emerging market stocks fell in September after seven straight months of gains. Brazilian stocks fell 19.2%, as polls showed a greater chance the current administration wins reelection in October, dampening speculation for a new government and more market-friendly policies. Separately, Moody’s cut its credit outlook on Brazil to negative. Russian stocks were also hit hard, falling 19.6% as investors continued to shun Russian assets in response to the ongoing Ukraine crisis and ensuing sanctions. The ruble repeatedly fell to record lows, triggering reports that Russia was considering capital controls if net outflows rise significantly.
Bill Gross Resigns
The big news in the fixed income market in September was the sudden departure of Bill Gross from PIMCO. This is a situation we have and will continue to monitor closely due to our institutional partnership with PIMCO. We have been in constant contact with our PIMCO representatives and had a lengthy discussion about this subject in our most recent Investment Committee meeting. We have decided to hold tight currently and continue to evaluate the situation, a position held by many larger institutional pension funds. While we anticipate that PIMCO will lose assets due to Mr. Gross’s departure, there remains a depth of talent at the firm. We will continue to keep you informed on any decisions we make regarding our positions with PIMCO.

Bonds Fall Marginally
The Barclays Global ex U.S. and the U.S. Aggregate indices fell 4.3% and 0.7% respectively in September as yields on U.S. 10-year Treasuries rose from 2.3% to 2.5%. As global economic prospects fell and the Fed edged closer pulling its easy money policy, yields on corporate credit and emerging sovereign bonds rose too. Despite this, the yield on the U.S. 10-year Treasury is down from the beginning of the year when it was at 3%.

Shouldn’t Yields Be Rising?
Faster growth after the weather related first quarter slump brought growing expectations of Fed tightening and higher yields. Thus far, that has not been the case. Some of the reasons include:
- Global economic growth is weak and the recovery in Europe is struggling.
- Geopolitical uncertainty in the Ukraine and Middle East drive flights to safety in U.S. Treasuries.
- Rising capital requirements for financial institutions boost demand for safe, liquid assets.
- Easy monetary policies abroad have made U.S. Treasury yields attractive on a relative basis.
- Continued expectations of easy global monetary policies inhibit a broad rise in interest rates.

### Fixed Income: Bill Gross to Janus

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<thead>
<tr>
<th>TAXABLE FIXED INCOME</th>
<th>TAX EXEMPT FIXED INCOME</th>
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<tr>
<td><strong>DOMESTIC</strong></td>
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<tr>
<td>Barclays US T-Bills</td>
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<td>Barclays US TIPS</td>
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<td>Barclays High Yield Muni</td>
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Barclays Municipal 7 Yr
Barclays Municipal 10 Yr
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Barclays Municipal VA
Barclays High Yield Muni

Barclays Municipal 0.1%
Barclays Municipal 0.0%
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**ALTERNATIVES: Real Assets Not Spared**

**GLOBAL MACRO STEALS THE SHOW**
Overall, hedge fund performance for September was relatively flat considering the losses in global equity markets. One bright spot was the HFRX Macro index which posted a gain of 1.5%. This was the indices fifth consecutive month of gains and the best monthly gain since 2009. The HFRX Macro Index had positive contributions from discretionary currency, fixed income and emerging markets strategies, as well as exposure to Japan, the U.S. and Europe.

**COMMODITY SLUMP CONTINUES**
Commodities extended declines in September on strong supply and low inflation expectations. Declines were led by oil, silver, platinum and gold, while agricultural commodity declines were led by wheat, soybeans and corn.

**REAL ASSETS FINALLY RETREAT**
REITs lost ground in September against the backdrop of a weakened broader market. This may also be attributed to investor concerns regarding interest rate risk and the uptick in the 10-year Treasury note yield. For the month of September, yields on 10-year notes rose 0.2%. REITs, which rely heavily on the debt markets, have fallen as interest rates have ticked up in anticipation of the Federal Reserve ending its bond-buying program