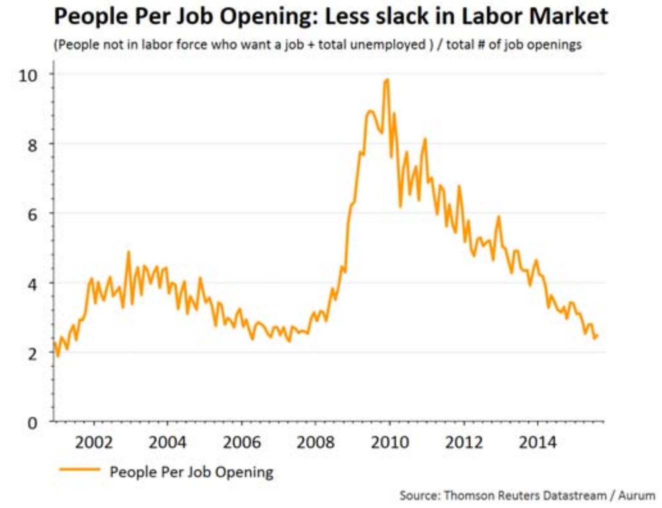
Strategy Newsletter
4th Quarter 2015

- Healthy economic conditions at home with emerging markets feeling pain.
- U.S. markets lead the way while Europe looks less attractive.
- High yield bonds were crushed while the wait for the Fed continues.
- What do we think about commodities?

Economy

The media headlines warning of a recession after a correction in equity markets may be due to the post-traumatic stress of 2008. The economic data releases do not show stress in the real economy, and if anything, indicate strength. This is especially true when examing the state of the all-important U.S. consumer and the factors which drive it.

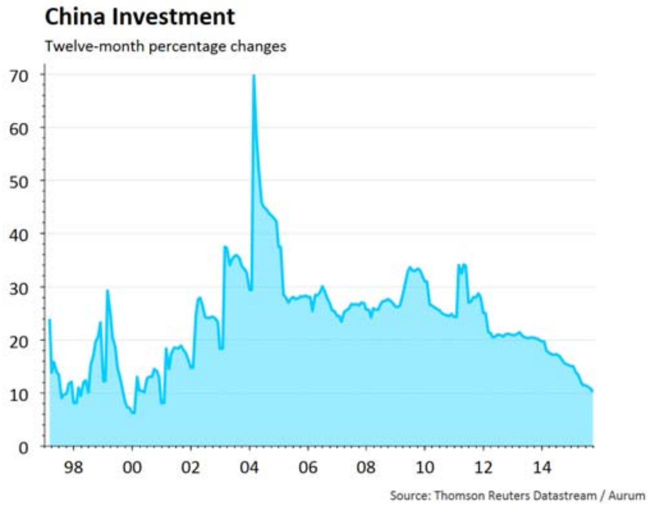
For example, debt service ratios are at the lowest levels in 35 years and the unemployment rate is at 5%. The year-over-year changes in labor markets slowed slightly yet remain in expansionary territory.



At the depth of the '08 recession, there were ten people unemployed for every job opening. Today, there are only about two (and this is less than a year ago).

The corporate sector has record profits (outside of the energy and materials sectors). Share buybacks continue, though investment does remain lower than prefered. While we do not doubt there will be a recession in the future, the data does not align with recessionary conditions today.

As we stated last quarter though, abroad is a different story. China's official data showed third quarter growth at a 6.9% annual rate, the lowest since the global financial crisis (though most believe the true numbers to be much less).



While the rebalancing from an investment led economy to a consumer based society continues, investment still accounts for 44% of Gross Domestic Product. This fell to 10% annual rate, much lower than the nearly 30% rate last decade.

Even though a lower currency peg, a drop in bank reserve requirements, and programs to stimulate consumption all came about in the last quarter, more likely needs to be done. There is still room for a drop in interest rates and unleashing the $3 trillion reserve balance, which could provide relief to China and the rest of the emerging market countries.

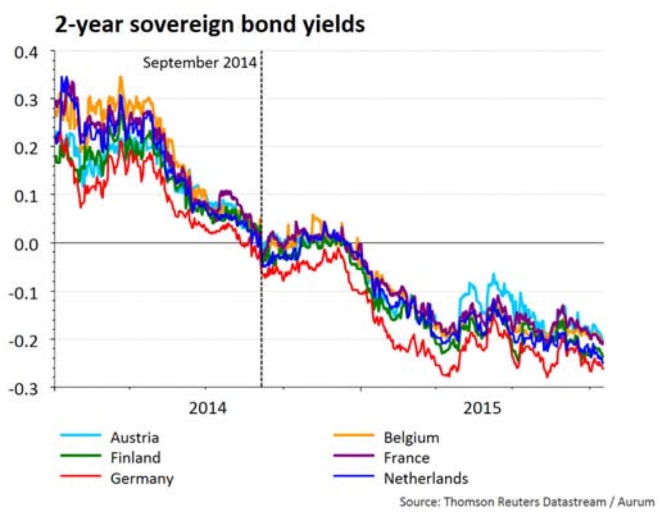
AURUM

Equity

The U.S. outperformed international markets for this quarter after lagging through the first half of 2015. Growth beat out value across the board while large outperformed small and mids.

US Equity	3Q 2015
Large Cap Stock	
Dow Jones Industrial Average	-6.98%
S&P 500	-6.44%
Small & Mid Cap Stock	
Russell Mid Cap	-8.01%
Russell 2000	-11.92%
Style Indices	
Russell 3000 Value	-8.59%
Russell 3000 Growth	-5.93%
International Equity	**3Q 2015**
MSCI EAFE	-10.19%
MSCI EAFE Value	-11.71%
MSCI EAFE Growth	-8.69%
MSCI Europe	-8.66%
MSCI Japan	-11.70%
MSCI Emerging Markets	-17.78%

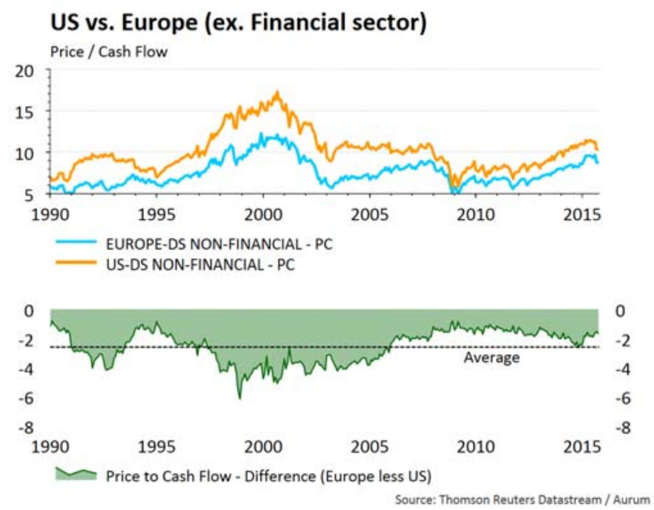
Quantitative easing boosting the economy along with a delay in Europe's recovery compared to the U.S. led investors to believe in a European rebound. There has been improvement in the earnings for the economy (excluding the Energy sector, of course, due to the crash in oil prices). Today, yields across most of Europe are negative from bonds with maturities less than 5 years.



For U.S. dollar-based investors, the MSCI EAFE Index peaked in mid-2014 and entered a bear market (peak to trough decline of 20%) this past quarter. This was driven partially by currency deprecation due to the Euro and Yen falling against the U.S. dollar.

Despite this, the Morningstar mutual fund & ETF category with the highest inflows is the Foreign Large Blend, which holds the majority of its assets in Europe. In addition, the Europe Stock category received $32 billion in new flows year-to-date, when just a year ago it had $57 billion in total assets.

Local share prices did not depreciate nearly as much. This leaves Europe's discount to the U.S. at less than the historical average on a price-to-cash flow basis (below) and on other valuation measures.



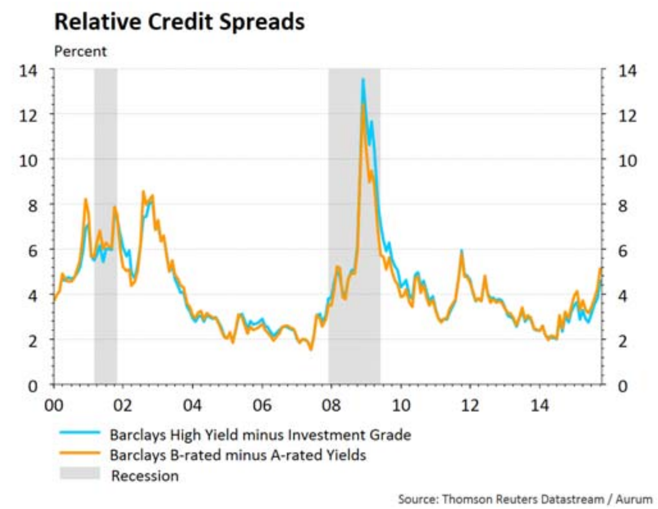
Currencies were the biggest detractor when it comes to emerging market performance this year. Despite this, we continue to like the prospects of emerging markets on a go-forward basis due to the valuation discount, particularly compared to U.S. small cap stocks. We are becoming less enthusiastic with European stocks for the opposite reason. Several of our bottom-up stock picking managers with tremendous long-term track records hold above aveage cash levels due to the dearth of attractive opportunities. Though it gets less headline attention, Japan is an area of favor in portfolios.

Fixed Income

Quality bonds rallied on the back of lower interest rates during the quarter and served as a safe-haven to the sell-off in global equities. Low quality credit related assets traded down.

Fixed Income	3Q 2015
Barclays U.S. Aggregate Bond	1.23%
Barclays Corporate Inv. Grade	0.82%
Barclays High Yield Bond	-4.86%
Barclays Global ex. U.S. Tres.	1.37%
Barclays Municipal Bond	1.66%

Driven by the sell-off in the energy sector, credit spreads (the difference between the yield on corporate bonds and comparable risk-free Treasury yield) widened during the quarter.

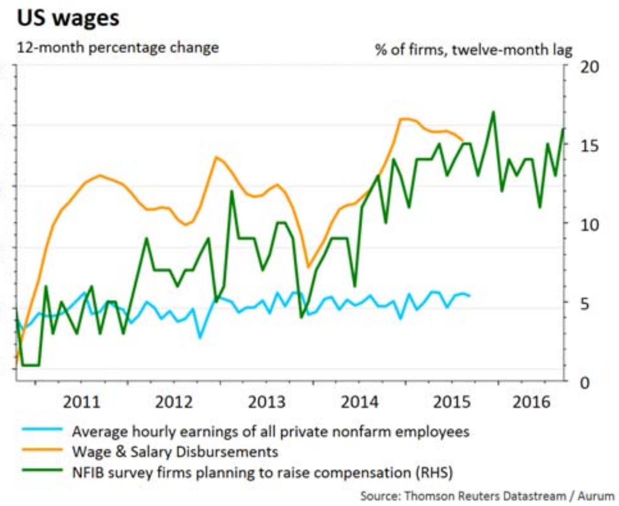


Because many argue that Treasury yields are artificially depressed, we show the spread difference between High Yield (or non-investment grade bonds) and Investment Grade bonds in the *turquoise line*. The chart also shows the difference between B-rated (high yield) bonds and A-rated (investment grade) bonds in the *orange line*.

Because the fundamental picture for energy remains so unclear, our fixed income managers are not making large allocation changes to the most beaten up sector. Still, excluding energy (which is being punished for overinvestment over the last decade), credit assets look attractively priced. This is especially true when examining valuations compared to non-recessionary periods. On the whole, our managers still favor higher quality structured credit assets such as mortgage-backed securities and asset-backed securities (such as those backing airplane leases).

The question at the forefront is, “When will the Federal Reserve raise interest rates?” It perpetually seems to be six months away. In September, most Fed watchers predicted that it would happen. However, inflationary measures such as the main one watched by Fed governors, the Personal Consumption Expdenditures Index, came in at 1.3% versus the 2.0% policy goal.

The data that could push inflation target towards the target is wages. According to the latest Fed Beige Book, “Labor markets tightened in most Districts, with some reports of labor shortages – particulary for skilled workers.” We see companies sight rising labor costs in earnings reports and increases throughout regions of the country.



The average hourly earnings data shows growth only around 2%, consistent with the last five years. Still, wage and salary disbursement data pierced a 5% annual growth rate, consistent with the National Federation of Independent Small Businesses plans to raise compensation over the next twelve months.

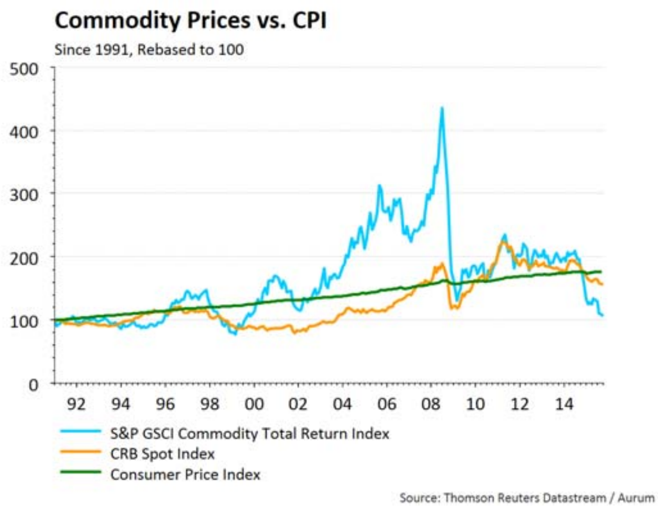
The Aurum Asset Allocation Frameworks maintain fixed income allocations near strategic targets.

Alternative Investments

REITs found a bid after falling for two consecutive quarters, while hedge funds fell with risk assets and TIPS dropped on lower inflation expectations.

Alternative Assets	3Q 2015
HFRI Hedge Fund of Funds	-3.28%
Dow Global Select REIT	1.30%
Barclays TIPS	-1.15%

One of the questions we often receive is regarding commodities and the attractiveness, especially in light of the over 50% sell off this past year. Where did this originate? In the mid-2000s, investment consultants back-tested commodities and found that the negative correlation provided great benefits to portfolios and recommended allocaitons of 5-8%.



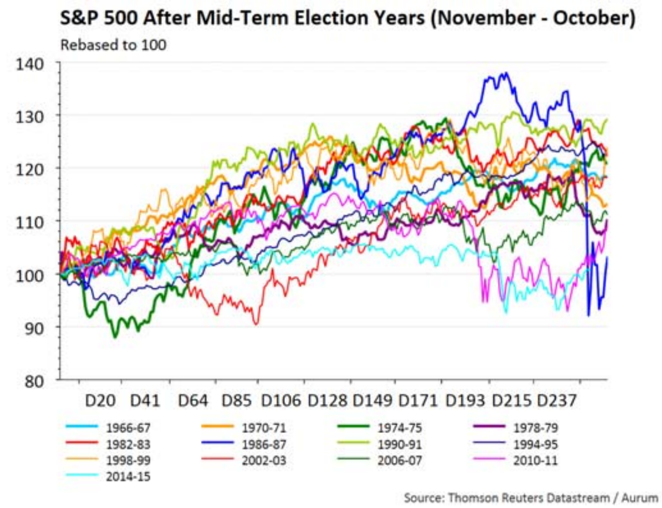
We have seen studies that show commodities provide a negative real (inflation-ajdusted return) over the past 200 years. The last 25 years maintained this trend as the Consumer Price Index (CPI) outpaced the two major commoditiy indices.

We prefer a trendfollowing approach to commodities, allowing managers to buy when an uptrend is evident or sell short when there is a defined downtrend.

Diversified alternative strategies maintain the bulk of our alternative allocation with multiple hedge fund strategies actively managing risk and seeking asymmetric opportunities.

Conclusion

If stock levels hold here through the end of October, it will mark the 13th consecutive positive 3rd year of the Presidential cycle.



This would be the lowest return ever at just below 1%. The Presidential election cycle kicked off earlier than anyone would like and the debt ceiling debate later in the fourth quarter could still throw a wrinkle into a year-end rally. Geopolitics, as always, remains a risk factor from the Middle East. We continue to monitor these and the evolving opportunity set across asset classes.

Aurum Asset Allocation Frameworks

	Income		Conservative		Moderate		Growth		Aggressive	
	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical
Equity	0%	0%	20%	20%	35%	35%	50%	50%	70%	72%
U.S. Equity	0%	0%	12%	8%	20%	14%	30%	22%	42%	35%
Int'l - Develop. Markets	0%	0%	6%	6%	12%	12%	16%	16%	21%	21%
Int'l - Emerg. Markets	0%	0%	2%	6%	3%	9%	4%	12%	7%	16%
Fixed Income	65%	60%	45%	42%	30%	30%	17%	18%	10%	10%
U.S. Fixed Income	56%	57%	39%	39%	26%	27%	15%	15%	7%	8%
Global Fixed Income	9%	1%	6%	1%	4%	1%	2%	1%	3%	1%
Alternative Invest.	25%	28%	28%	28%	30%	28%	30%	28%	19%	18%
Diversified Strategies	19%	28%	22%	28%	24%	28%	24%	28%	15%	18%
Real Estate & REITs	2%	0%	2%	0%	3%	0%	3%	0%	4%	0%
Inflation-Indexed Sec.	4%	0%	4%	0%	3%	0%	3%	0%	0%	0%
Cash/Equivalents	10%	12%	7%	10%	5%	7%	3%	4%	1%	1%
U.S. Dollar	10%	12%	7%	10%	5%	7%	3%	4%	1%	1%

The risk designations are relative only to the five Strategic Allocation targets and do not represent comparisons with any other investment or risk of the overall strategies.

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