Market Insight

Third Quarter 2014

Stocks Post Another Winning Quarter

1 Q3 2014 at a Glance

Sector	Q3 2014
GDP*	3.0%
S&P 500 Index	1.1%
Barclays U.S. Aggregate Bond Index	0.17%
Bloomberg Commodity Index	-11.8%

Source: LPL Financial Research, FactSet, Bloomberg 09/30/14

*Bloomberg consensus as of September 30, 2014

Figures for S&P 500, Barclays Aggregate, and Bloomberg Commodity Index are total returns from 09/30/14–09/30/14.

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment. Past performance is no guarantee of future results.

A Look Forward

We expect U.S. economic growth to exit 2014 at a run rate of economic growth of 3%, supported by improving business spending, the elimination of the drag from fiscal policy, and improving global growth.

Our forecast for the stock market in 2014 remains for 10–15% returns, based on a continuation of the 5–10% earnings growth experienced during the first half of the year and still reasonable valuations, especially when considering low interest rates and low inflation.

Strong performance in 2014 has left the bond market richly valued in our view. We do not believe the yield compensates investors for the interest rate risk, and we expect stronger global growth and higher inflation to lift yields over the balance of the year, weighing on bond market returns.

For more insight into our forecasts, please see our *Mid-Year Outlook 2014: The Investor's Almanac* and recent YouTube video, "Market Outlook Update: Fall 2014."

- **U.S. economy continues to rebound from the tough winter.** After severe winter weather caused significant disruptions to economic activity during the first quarter, the U.S. economy rebounded solidly during the second quarter of 2014 and the first two months of the third quarter. Based on gross domestic product (GDP) data from the Bureau of Economic Analysis (BEA), the U.S. economy grew at a more than 4% annualized pace during the second quarter of 2014; it is on track to grow at a 3%-plus annualized rate during the third quarter, based on Bloomberg-tracked consensus of economic forecasters, as of September 30, 2014.
- **Stocks posted their seventh consecutive positive quarter despite uncertain geopolitical landscape.** The S&P 500 returned 1.1% during the third quarter of 2014, bringing an impressive streak of consecutive positive quarters to seven. The quarterly gain brings the return for the year to 8.6% (as of September 30, 2014). Third quarter gains, though modest, came despite plenty of conflicts overseas to worry about. Support for stocks came primarily from the fundamentals, i.e., corporate profits supported by stronger U.S. economic growth.
- **Few places to hide in commodities downdraft.** The Bloomberg Commodity Index experienced its worst quarter since 2008, returning -11.8% due in large part to excess supply in select energy and agriculture sectors. The quarterly losses brought year-to-date performance into negative territory, with nearly half of the weakness attributable to corn, wheat, and soybeans amid improving weather conditions across the Americas that resulted in record crop yields. Crude oil struggled despite geopolitical headlines.
- **Bond market performance slowed.** Bond market performance slowed in the third quarter of 2014 after a very strong first half as the Barclay's Aggregate Bond Index returned just 0.2% during the quarter. Longer-term and higher-quality bond sectors performed best during the quarter, benefiting from the slight drop in long-term yields, while the most economically sensitive sectors and those most closely tied to the hotspots overseas, such as unhedged foreign bonds and emerging markets (EM) debt, suffered losses. Interest rates bounced around but stayed low, as the 10-year Treasury yield started and ended the quarter right around 2.5%.

The economic forecasts set forth in the presentation may not develop as predicted.

Please note: All return figures are as of September 30, 2014 unless otherwise stated.

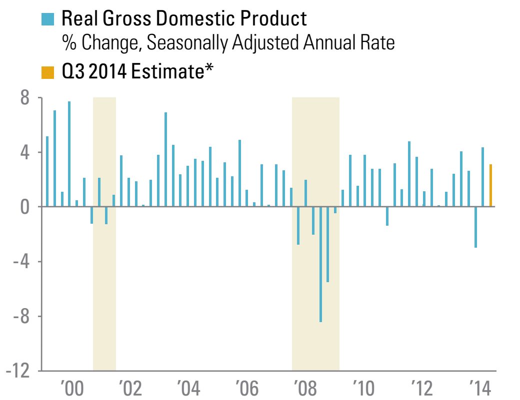
LPL Financial

U.S. Economy Continues to Rebound from the Tough Winter

After severe winter weather caused significant disruptions to economic activity during the first quarter, the U.S. economy rebounded solidly during the second quarter of 2014 and the first two months of the third quarter. Based on GDP data from the U.S. government, the U.S. economy grew at a more than 4% annualized pace during the second quarter of 2014; it is on track to grow at a 3%-plus annualized rate during the third quarter, based on Bloomberg-tracked consensus of economic forecasters, as of September 30, 2014 [Figure 2]. This pace (or slightly better) is confirmed by our analysis of all available data from the U.S. government that feed the GDP calculation as of quarter end. Five months of solid economic data provide significant evidence that the economic contraction during the first quarter was virtually all weather related.

We believe the current "run rate" for the U.S. economy is near our 3% growth expectation for the full year. The improving economy is consistent with the Federal Reserve's (Fed) Beige Book, essentially a "window on Main Street," which has provided evidence that the U.S. economy has rebounded solidly from the rough winter (the Beige Book is the Fed's qualitative assessment of economic, business, and banking conditions in each of the Fed's 12 regions). Manufacturing surveys of purchasing managers (from the Institute for Supply Management [ISM]) tell the same story.

2 U.S. Economy Stages Solid Rebound from Winter Contraction



Source: LPL Financial Research, Bureau of Economic Analysis, Haver Analytics 09/30/14

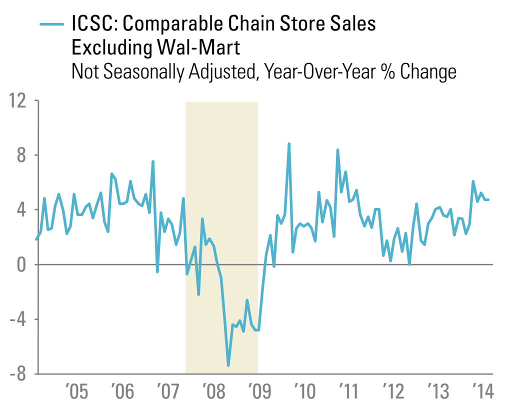
Shaded areas indicate recession.

*Reflects Q3 2014 Bloomberg-tracked consensus of economic forecasters at 3.0%.

Steadily Improving Job Market Supporting Consumer Spending

As the U.S. economy has improved in recent months, so has consumer spending—and an improving job market is a key reason why. The consumer spending component of GDP rose at a 2.5% annualized rate during the second quarter (the year-over-year growth rate was similar), and it is tracking toward a faster pace in the third quarter at over 3%, based on data through July and August. Retail sales are growing at a faster clip at more than 4% year over year, having enjoyed a solid back-to-school selling season [Figure 3].

3 Steady Gains in Retail Sales and Solid Back-to-School Shopping Season



Source: LPL Financial Research, ICSC, Haver Analytics 09/30/14

Shaded areas indicate recession.

The International Council of Shopping Centers (ICSC) is a global trade association of the shopping center industry.

Based on the employment data of the BEA, the U.S. economy has added an average of over 200,000 jobs during the past seven months, and the unemployment rate has fallen from 6.7% in March, when the weather started to improve, to 5.9% in September 2014. Jobs gains have translated into modest but steady gains in wages. Wealth effects from gains in stock portfolios and home prices, lower energy prices, and improving availability of credit have also helped consumers.

Inflation Remains Well Contained

Better growth during the spring and summer months has contributed to a slight pickup in inflation, but it remains well within the Fed's comfort zone. This suggests the Fed can pursue its plan to end quantitative easing (QE) in October 2014 and likely begin to raise interest rates sometime in 2015 as Fed Chair Janet Yellen and the Federal Open Market Committee (FOMC) have signaled. The latest reading on inflation for August as measured by the Fed's preferred measure of inflation—the personal consumption deflator excluding food and energy—rose just 1.5% from a year ago, well below the Fed's 2% target. The biggest potential inflation driver, wage growth, has only accelerated slightly and remains modest. The numerous indicators of job market tightness that are monitored by Chair Yellen are showing a fair amount of slack, suggesting little upward pressure on wages, while excess manufacturing capacity has helped contain manufacturing costs.

Business Spending Growing at a Solid Pace and Accelerating

Healthy cash balances, low borrowing costs, healthy credit markets, and improved business confidence (partly due to less policy uncertainty in Washington) have all contributed to a strong rebound in business spending since the slow start to the year. Shipments of nondefense capital goods excluding aircraft, a proxy for business capital spending that feeds directly into GDP, rose 8% year over year in July and August 2014. That strong growth followed a solid increase in business spending during the second quarter when nonresidential fixed investment (part of GDP) rose at a 10% annualized pace, rebounding sharply from the modest 1.6% increase during the weather-impacted first quarter.

Recent Data Suggest Slow Growth in Europe May Be Slowing Further

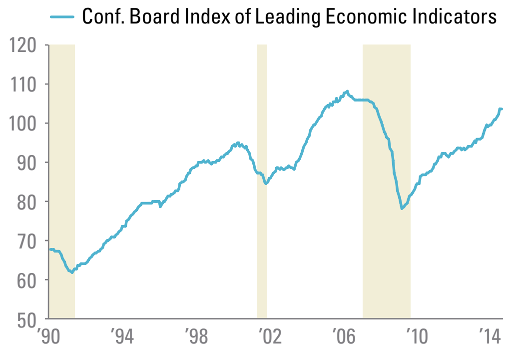
Economic growth in the Eurozone is lackluster, and recent data suggest growth may be slowing further. Bloomberg-tracked consensus estimates of Eurozone GDP are at 1% for 2014, but the latest forward-looking data suggest there may be downside risk to that forecast. Meanwhile, the Eurozone's energy dependence on Russia and Ukraine, including infrastructure, and structural impediments to the flow of credit, increase the risk of a return to recession, while inflation has fallen to dangerously low levels — in August 2014, Eurozone inflation was 0.3%. The European Central Bank (ECB) responded to the disappointing growth and the risk of deflation (falling prices that can be difficult to reverse) by further cutting interest rates, including a negative deposit rate, and launching an asset-backed securities (ABS) purchase plan. These actions and ECB rhetoric have led many to expect outright QE in the Eurozone at some point, which has contributed to the downward pressure on European bond yields.

Mixed Picture Economically for Emerging Markets

Emerging markets (EM) economies are generally in better shape than they were earlier this year when the reduction in Fed stimulus and problems funding trade deficits bubbled over. Growth continues to far outpace that in developed markets overall (Bloomberg-tracked consensus GDP growth in 2014 for the BRICs [Brazil, Russia, India, and China] that represent most of EM is 5.1% versus global growth of 2.5%), though the progress in some emerging economies in recent months has been uneven. The biggest emerging economy, China, has been growing at a 7.5% pace based on the latest official data (second quarter 2014) consistent with the Chinese government's target. And many central banks, including China's, have been in stimulus mode to varying degrees, either reducing interest rates or introducing fiscal policies to stimulate their economies.

But the risk of a potential property bubble in China remains a concern among many. Russia is a big trouble spot in the emerging world as the United States and European Union ratchet up sanctions against Russian economic and financial interests. The upcoming election in Brazil amid

4 Leading Economic Indicators Continue to Suggest Very Low Probability of Recession

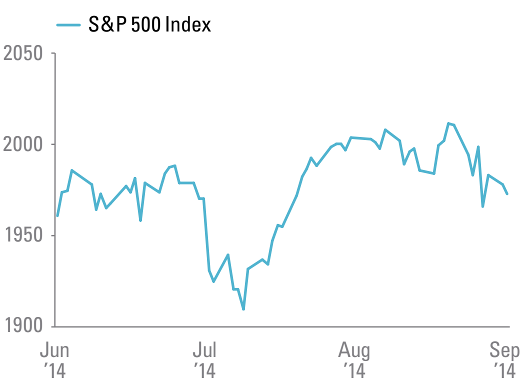


Source: LPL Financial Research, Bloomberg, Conference Board 09/30/14

Shaded areas indicate recession.

The Index of Leading Economic Indicators (LEI) is an economic variable, such as private-sector wages, that tends to show the direction of future economic activity.

5 Another Positive Quarter for Stocks Brings with It Some Volatility



Source: LPL Financial Research, FactSet 09/30/14

The S&P 500 Index is an unmanaged index, which cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment. Past performance is no guarantee of future results.

slowing growth and high inflation has created economic uncertainty. So while growth in EM has been fairly steady and ahead of the developed world overall, the economic backdrop is mixed.

Brief Look Ahead: Leading Indicators Continue to Suggest Very Low Likelihood of Recession

The Index of Leading Economic Indicators (LEI)—compiled by the Conference Board, a private sector think tank—is comprised of 10 primarily fundamental economic indicators and is designed to predict the future path of the economy with a lead time of between 6 and 12 months. When the year-over-year rate of change in the LEI turns negative and begins to fall, a recession has historically followed by anywhere from 0 to 14 months. The year-over-year increase in the LEI of 6.8% in August 2014 [Figure 4], supported by better economic growth and less policy uncertainty in Washington, suggests a less than 5% probability of recession over the next 12 months. We agree with the LEI's signal that the U.S. economy is in the middle of an expansionary cycle that began in mid-2009.

Stocks Posted Their Seventh Consecutive Positive Quarter Despite Uncertain Geopolitical Landscape

The S&P 500 returned 1.1% during the third quarter of 2014, bringing an impressive streak of consecutive positive quarters to seven. The quarterly gain brings the return for the year to 8.6% (as of September 30, 2014). The current bull market, which is about midway through its sixth year as of the end of the third quarter, has now produced a cumulative 225% return, or 23% average annual return.

Third quarter gains, though modest, came despite plenty of conflicts overseas to worry about, including U.S.-led airstrikes on the Islamic State in Syria and unrest in Iraq, Russia's incursion into Ukraine and resulting sanctions, intense fighting in Gaza between Israel and Hamas, and, more recently, pro-democracy protests in Hong Kong. These events, along with fears of slower global growth—in Europe in particular—and high stock valuations, drove some volatility but still only led to a maximum drawdown in the S&P 500 of 3.9% during the quarter (from July 24, 2014 to August 7, 2014) [Figure 5].

Support for the stock market came primarily from the fundamentals, i.e., corporate profits. Profits have driven stock market gains throughout 2014, supported by stronger U.S. economic growth and a very efficient corporate America that has kept profit margins high. We believe the S&P 500 reported earnings may exceed high-single-digit consensus estimates based on the third quarter results of 2014, following a 10% year-over-year gain during the second quarter of 2014 (according to Thomson Reuters's estimates). Meanwhile, although the Fed is pulling in the reins on its stimulus in terms of ending QE, short-term interest rates are still pegged effectively at zero, providing support for the economy and encouraging investors to shift from low-yielding bonds to stocks.

6 Healthcare and Technology Topped Q3 2014 Sector Rankings

S&P Sector Performance, Ranked by Third Quarter Returns

Sector	Q3 2014 (%)	YTD (%)
Healthcare	5.5	16.6
Technology	4.8	14.1
Telecom	3.1	7.5
Financials	2.3	7.4
Consumer Staples	2.0	7.2
S&P 500	**1.1**	**8.3**
Consumer Discretionary	0.3	0.9
Materials	0.2	8.9
Industrials	-1.1	2.9
Utilities	-4.0	14.0
Energy	-8.6	3.2

Source: LPL Financial Research, FactSet 09/30/14

The 10 S&P 500 Global Industry Classification Standards (GICS) indexes are unmananged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment. Past performance is no guarantee of future results.

Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

The asset classes are represented by the 10 S&P 500 Global Industry Classification Standard (GICS) indexes.

Cyclical sectors are economically sensitive and typically have stronger performance as economic and market conditions improve.

Defensive sectors typically are less economically sensitive and tend to perform relatively better in more challenging economic and market environments.

7 Very Difficult Quarter for U.S. Small Cap and International Equities

Asset Class	Q3 2014 (%)	YTD (%)
U.S. Growth	0.9	6.9
U.S. Large Cap	0.7	8.0
U.S. Value	-0.9	7.0
U.S. Mid Cap	-1.7	6.9
Emerging Markets	-3.4	2.8
Developed Foreign	-5.8	-1.0
U.S. Small Cap	-7.4	-4.4

Source: LPL Financial Research, FactSet 09/30/14

Based on Russell 1000, Russell 3000 Growth and Value Indexes, Russell 2000, MSCI EAFE, MSCI Emerging Markets Index

Total returns from 01/01/14–09/30/14.

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Falling Bond Yields Helped Support Defensive Sectors

Seven of 10 equity sectors produced gains during the third quarter, with defensive sectors generally faring better than the more cyclical (economically sensitive) sectors [Figure 6]. Healthcare was the top performer and remained the top performer for the year (as of September 30, 2014). Strength was driven by biotech, which is benefiting from robust new drug developments and acquisitions.

Technology and financials outperformed among cyclical sectors. Technology benefited from improving business spending, some favorable product cycles, and attractive valuations. The financials sector was buoyed by capital markets, which benefited from merger and initial public offering (IPO) activity, and banks, which benefited from the improving economy and a pickup in loan demand.

On the other end of the spectrum, the sharp drop in oil prices drove the energy sector down by 8% during the third quarter, well behind the next biggest laggard: utilities (-4%). Energy sector declines, following the sector's market-leading gains during the second quarter, were concentrated in the exploration, production, and services areas, which have significant energy price sensitivity. Natural gas prices also fell. Utilities, which gave back some of the sector's strong first half 2014 gains, were hurt by rich valuations and rising rate fears, the same factors that have hurt real estate investment trusts (REITs), which lost 2.5% during the quarter (based on the FTSE NAREIT Equity REITs Index).

For the year, consumer discretionary remains the biggest laggard with a modest year-to-date gain. Most of the sector's underperformance came during the first quarter when severe weather took its toll on consumer spending, though rich valuations have held the sector back this year.

Continued Weakness Brought Small Caps Near Correction Territory

S&P 500 or Russell 3000 Index performance during the third quarter of 2014 was not much of a story given the modest gains for stocks. But small cap performance was, as the Russell 2000 Index lost 7.4% during the quarter. Small caps have been hurt by valuation concerns with price-to-earnings ratios (PE) for small cap stocks above their long-term historical averages. Small caps are more cyclical than large caps, which likely also played a role in the underperformance—as did the slight increase in stock market volatility, which tends to hurt small caps more than large. Weakness came despite generally positive fundamentals for small caps including solid U.S. economic growth, healthy credit markets, solid earnings growth, and an active merger-and-acquisition environment. For the year, mid and large cap performance is similar, in the 7–8% range, while small caps are down about 5%, based on the Russell indexes [Figure 7].

Growth and Value In-Line in Q2

Growth outperformed value during the third quarter to bring the two styles even for the year based on the Russell 3000 Growth and Value indexes.

Mid capitalization companies are subject to higher volatility than those of larger capitalized companies.

Small cap stocks may be subject to a higher degree of risk than more established companies' securities. The illiquidity of the small cap market may adversely affect the value of these investments.

Value investments can perform differently from the market as a whole. They can remain undervalued by the market for long periods of time.

International and emerging markets investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

During the quarter, growth benefited from outsized gains in the growth-heavy technology sector and biotech industry, while value was hurt by losses in the value-oriented energy and utilities sectors. Growth's rebound since the spring sell-off on heightened valuations concerns has brought its year-to-date return to 6.9%, in-line with the 7% return for the value index.

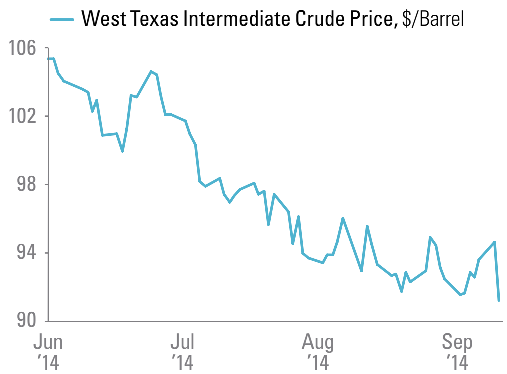
Weak Growth and Deflation Fears Continued to Weigh on European Market

Developed foreign markets trailed the U.S. stock market indexes by a sizable margin during the third quarter, as the MSCI EAFE Index lost 5.8%. The biggest losses came from Europe, where weaker growth, increased risk of deflation, and ties to Russia dampened sentiment. Stocks in Japan and Pacific markets also fell on uneven growth in Japan and concerns about a slowdown in China. The MSCI EAFE Index gave back all of its first half gains during the third quarter and has fallen 1% year to date.

Geopolitics Weighed on Emerging Markets (EM) Equities

Emerging markets also suffered losses, as the MSCI Emerging Markets Index lost 3.4% during the third quarter of 2014. Geopolitics was a key driver of the weakness, including Russia-Ukraine tensions and unrest in the Middle East. Fed rate hike fears also played a role, even though the start of a rate hike campaign is a ways off. Sanctions put on Russia after its latest incursion into Ukraine drove capital out of the country and led to sizable third quarter losses for that country's markets. The Brazilian market sold off on dimming prospects for pro-growth reforms amid worsening economic conditions and high inflation. Other markets suffering losses that weighed on EM include South Korea, Turkey, and South Africa. For the year, the EM Index has returned 2.8%, with strength in Mexico helping offset weakness in China, Russia, and South Korea.

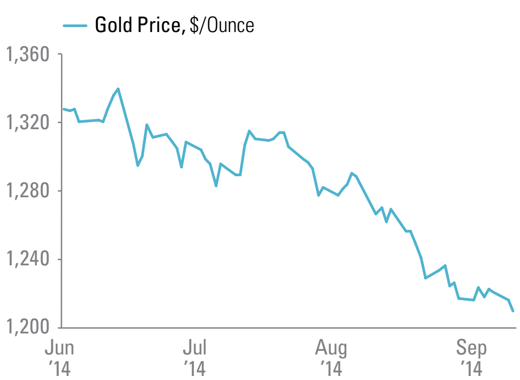
8 Supply and Demand Pressure Dragged Oil Prices Lower During Q3 2014



Source: LPL Financial Research, FactSet 09/30/14

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

9 Gold Tumbles on U.S. Dollar Strength



Source: LPL Financial Research, FactSet 09/30/14

The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

Precious metal investing is subject to substantial fluctuation and potential for loss.

Few Places to Hide in Commodities Downdraft

The Bloomberg Commodity Index (formerly the DJ-UBS Commodity Index) experienced its worst quarter since 2008, falling 11.8% due in large part to excess supply in select energy and grains sectors. The quarterly losses brought year-to-date performance into negative territory, with nearly half of the weakness attributable to corn (-27.6%), wheat (-25.7%), and soybeans (-14.4%). Grain weakness was driven by improving weather conditions across the Americas that resulted in record crop yields.

Crude oil (-11.5%) struggled as geopolitical headlines from Iraq and Russia have failed to overshadow increased production from non-OPEC countries, adequate U.S. supply, and reduction in global consumption estimates from the International Energy Agency (IEA) [Figure 8]. Elsewhere in energy, natural gas fell 9.2% as cooler weather in the United States brought reduced utility demand. Precious metals were not spared in the commodity downdraft, with gold falling 8.4% amid U.S. dollar strength—despite still heightened geopolitical tensions in Europe and the Middle East [Figure 9].

The broad sell-off spared only aluminum, zinc, cattle, and coffee. Aluminum and zinc benefited from capacity reductions and hopes of economic

10 Pace of Bond Market Strength Slowed in Q3 2014

Bond Market Performance, Ranked by Third Quarter Returns

Sector	Q3 2014 (%)	YTD (%)
Emerging Markets Debt	-1.7	7.3
Preferred Securities	0.7	10.8
TIPS	-2.0	3.7
Investment-Grade Corporates	0.0	5.7
Municipal Bonds	1.5	7.6
Foreign Bonds (Unhedged)	-5.4	0.3
High-Yield Corporates	-1.9	3.5
Mortgage-Backed Securities	0.2	4.2
Foreign Bonds (Hedged)	2.0	6.6
Barclays Aggregate	**0.2**	**4.1**
Municipal High-Yield	4.6	12.5
U.S. Treasuries	0.3	3.1
Bank Loans	-0.5	2.0

Source: LPL Financial Research, FactSet 09/30/14

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Asset class returns are represented by the returns of indexes and are not ranked on an annual total return basis. It is not possible to invest directly in an index so these are not actual results an investor would achieve.

11 U.S. Yields Bounced Around During Q3 2014 but Stayed Low

Source: LPL Financial Research, FactSet 09/30/14

High-yield/junk bonds are not investment-grade securities, involve substantial risks, and generally should be part of the diversified portfolio of sophisticated investors.

stimulus in China. Cattle rose on falling head count. And coffee prices rose due to uncooperative weather in Brazil (the world's largest producer) and disease-related crop damage in Central America.

Fixed Income–Taxable: Bond Market Performance Slowed in Q3 2014

Bond market performance slowed in the third quarter of 2014 after a very strong first half as the broad bond market (measured by the Barclays U.S. Aggregate Bond Index) returned just 0.2% during the quarter. Longer-term and higher-quality bond sectors performed best during the quarter, benefiting from the slight drop in long-term yields, while the most economically sensitive sectors and those most closely tied to the hotspots overseas, such as unhedged foreign bonds and EM debt, suffered losses during the quarter [Figure 10].

Interest Rates Ended the Quarter Right About Where They Started

Interest rates bounced around but stayed low, as the 10-year Treasury yield started and ended the quarter right around 2.5% [Figure 11]. The lack of movement in yields generally left only low-yielding coupons to produce bond market returns for the broad bond market and most of the key bond sectors, including U.S. Treasuries, mortgage-backed securities, and investment-grade corporates. Yields in the United States were held down by much lower yields on sovereign debt in Europe, Germany in particular, as global investors found U.S. Treasury yields attractive in comparison. Still-low inflation is also keeping yields down amid improving U.S. growth, the imminent end of QE, and prospects for rate hikes from the Fed, potentially in mid- to late 2015.

High-Yield Bond Weakness Comes Despite Positive Fundamentals

Credit fundamentals remain mostly positive, but high-yield bonds still suffered losses during the quarter. Investment-grade corporate bonds were flat, but the Barclays U.S. Corporate High-Yield Index lost 1.9%. Corporate America is generating solid earnings growth, maintaining healthy balance sheets, and keeping default rates quite low, all of which are supportive of high yield. But credit spreads that had reached post-recession lows, global growth fears, a surge in new bond issuance, and increased stock market volatility contributed to the high-yield bond sell-off. The less interest rate–sensitive and slightly

Asset Class Indexes: Emerging Markets Debt – JP Morgan Emerging Markets Global Index; Preferred Securities – Merrill Lynch Preferred Stock Hybrid Securities Index; TIPS – Barclays Treasury Inflation-Protected Securities Index; Investment-Grade Corporate – Barclays U.S. Corporate Bond Index; Municipal – Barclays Municipal Bond Index; Foreign Bonds (unhedged) – Citigroup Non-U.S. World Government Bond Index (unhedged); High-Yield – Barclays U.S. Corporate High-Yield Index; Mortgage-Backed Securities – Barclays U.S. MBS Index; Foreign Bonds (hedged) – Citigroup Non-U.S. World Government Bond Index Hedged for Currency; Municipal High-Yield – Barclays Municipal High-Yield Index; Treasury – Barclays U.S. Treasury Index; Bank Loans – Barclays U.S. High-Yield Loan Index

Bank loans are loans issued by below investment-grade companies for short-term funding purposes with higher yield than short-term debt and involve risk.

higher-quality bank loan sector held up better than high-yield bonds but still suffered modest losses during the quarter. Following recent weakness in high-yield bonds, investment-grade corporates have outperformed both high-yield bonds and bank loans year to date.

Treasuries Produced Gains but Lagged

U.S. Treasuries benefited some from the market's preference for higher-quality, longer-duration fixed income investments. Returns were modest due to low yields, but they did slightly outpace the broad bond market's return during the quarter. Treasuries have still slightly trailed the Barclays Aggregate Bond Index year to date with a 3.1% return versus the index's 4.1%.

Strong U.S. Dollar Weighed Heavily on Developed Foreign Bond Markets

Overseas bond markets had several factors in their favor, including slow growth, very low inflation, and prospects for more bond purchases from central banks. Those factors did drive outperformance of foreign bonds versus U.S. bonds, but only if those bonds were currency hedged. Big gains for the U.S. dollar on divergent growth trajectories and central bank policies around the world led to losses in unhedged foreign bonds, which was the biggest decliner among major bond sectors during the third quarter.

Significant upward pressure on domestic interest rates rates and a corresponding widening of credit spread could negatively impact the market price of emerging debt markets.

Emerging markets debt also suffered losses as global risk premiums rose amid geopolitical unrest and uneven growth in some EM economies, but it is still one of the best performing bond sectors year to date with a 7.3% return based on the JPMorgan Emerging Markets Bond Index.

Fixed Income–Tax-Free: Strong Quarter for Municipal Bonds

Municipal bonds were among the best performing high-quality bond sectors during the third quarter, with the Barclays U.S. Municipal Bond Index returning 1.5%. Though not a very attractive absolute return, municipal bonds did handily outpace U.S. Treasuries and investment-grade corporates and are among the best performing fixed income sectors year to date, even without factoring in the tax advantage. Municipal bonds have benefited from their interest rate sensitivity (municipal bonds tend to be more interest rate sensitive than the Barclays Aggregate), attractive after-tax valuations, better supply-demand balance, and low defaults. Investor fears around the next Puerto Rico or Detroit have also subsided and helped demand for municipal bonds.

Municipal bonds are subject to availability, price, and to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rate rise. Interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply.

It was an even better quarter for high-yield municipals, which have longer maturities and higher interest rate sensitivity than high-quality municipals. Higher coupons and subsiding fears over Puerto Rico's debt also helped performance. The strong gains came despite the widening credit spread experienced by high-yield corporate bonds of late. The high-yield municipal bond benchmark has returned 12.5% year to date after a 4.6% third quarter return, both well ahead of even the U.S. equity market in addition to all major bond sectors. ■

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

Stock investing may involve risk including loss of principal.

Duration is a measure of the sensitivity of the price (the value of principal) of a fixed income investment to a change in interest rates. It is expressed as a number of years. Rising interest rates mean falling bond prices, while declining interest rates mean rising bond prices. The bigger the duration number, the greater the interest rate risk or reward for bond prices.

Quantitative easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

Default rate is the interest rate charged to a borrower when payments on a revolving line of credit are overdue. This higher rate is applied to outstanding balances in arrears in addition to the regular interest charges for the debt.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise and bonds are subject to availability and change in price.

Currency risk is a form of risk that arises from the change in price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

Government bonds and Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.

Credit risk is the risk of loss of principal or loss of a financial reward stemming from a borrower's failure to repay a loan or otherwise meet a contractual obligation. Credit risk arises whenever a borrower is expecting to use future cash flows to pay a current debt. Investors are compensated for assuming credit risk by way of interest payments from the borrower or issuer of a debt obligation. Credit risk is closely tied to the potential return of an investment, the most notable being that the yields on bonds correlate strongly to their perceived credit risk.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Maximum drawdown measures the percentage drop in cumulative return from a previously reached high.

The PE ratio (price-to-earnings ratio) is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It is a financial ratio used for valuation: a higher PE ratio means that investors are paying more for each unit of net income, so the stock is more expensive compared to one with lower PE ratio.

Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate, and credit risk, as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features.

Mortgage-backed securities are subject to credit, default risk, prepayment risk that acts much like call risk when you get your principal back sooner than the stated maturity, extension risk, the opposite of prepayment risk, and interest rate risk.

INDEX DEFINITIONS

The Barclays U.S. Corporate High-Yield Index measures the market of USD-denominated, noninvestment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging markets debt.

The Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and non-agency).

The Barclays U.S. High-Yield Loan Index tracks the market for dollar-denominated floating-rate leveraged loans. Instead of individual securities, the U.S. High-Yield Loan Index is composed of loan tranches that may contain multiple contracts at the borrower level. Index data is sourced from Standard & Poor's and Markit Group, so a loan facility must be part of the S&P database in order to be index-eligible.

The Barclays U.S. Corporate Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate, taxable corporate bond market.

The Barclays U.S. Mortgage Backed Securities (MBS) Index tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

The Barclays U.S. Treasury TIPS Index is a rules-based, market value-weighted index that tracks inflation protected securities issued by the U.S. Treasury

The Barclays U.S. Treasury Index is an unmanaged index of public debt obligations of the U.S. Treasury with a remaining maturity of one year or more. The index does not include T-bills (due to the maturity constraint), zero coupon bonds (Strips), or Treasury Inflation-Protected Securities (TIPS).

The BofA Merrill Lynch Preferred Stock Hybrid Securities Index is an unmanaged index consisting of a set of investment-grade, exchange-traded preferred stocks with outstanding market values of at least $50 million that are covered by Merrill Lynch Fixed Income Research.

The Bloomberg Commodity Index is calculated on an excess return basis and composed of futures contracts on 22 physical commodities. It reflects the return of underlying commodity futures price movements.

The FTSE NAREIT U.S. Real Estate Index Series is designed to present investors with a comprehensive family of REIT performance indexes that spans the commercial real estate space across the U.S. economy. The index series provides investors with exposure to all investment and property sectors. In addition, the more narrowly focused property sector and sub-sector indexes provide the facility to concentrate commercial real estate exposure in more selected markets.

The FTSE NAREIT Equity REITs Index contains all Equity REITs not designated as Timber REITs or Infrastructure REITs.

The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000 Index and includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 represents approximately 92% of the U.S. market.

The Russell 3000 Index measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market.

The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index.

The Russell 3000 Growth Index measures the performance of the broad growth segment of the U.S. equity universe. It includes those Russell 3000 companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 3000 Value Index measures the performance of the broad value segment of U.S. equity value universe. It includes those Russell 3000 companies with lower price-to-book ratios and lower forecasted growth values.

The MSCI EAFE Index is recognized as the pre-eminent benchmark in the United States to measure international equity performance. It comprises the MSCI country indexes that represent developed markets outside of North America: Europe, Australasia, and the Far East.

The MSCI Emerging Markets Index captures large and mid cap representation across 23 emerging markets (EM) countries. With 822 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The JP Morgan Emerging Markets Bond Index is a benchmark index for measuring the total return performance of international government bonds issued by emerging markets countries that are considered sovereign (issued in something other than local currency) and that meet specific liquidity and structural requirements.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The U.S. Municipal Index covers the USD-denominated, long-term, tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds.

The Citi World Government Bond Index (WGBI) measures the performance of fixed-rate, local currency, investment grade sovereign bonds. The WGBI is a widely used benchmark that currently comprises sovereign debt from over 20 countries, denominated in a variety of currencies, and has more than 25 years of history available. The WGBI provides a broad benchmark for the global sovereign fixed income market. Sub-indexes are available in any combination of currency, maturity, or rating.

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