The Retirement Review

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Midyear Market Review and Outlook

Providing a complete review and outlook for the stock and bond markets involves summarizing a great deal of information, and due to space limitations in this newsletter, we cannot include as much background or explanatory information as we would prefer. Notes are included on page 4 to provide clarification and we encourage you to call (888) 582-3249 if you have questions regarding the topics addressed in this issue. Our goal is to enhance your investment knowledge to promote informed decisions.

Stock Market Review

- Despite a range of macroeconomic issues that caused periods of volatility throughout the semiannual period, U.S. stocks continued to advance and ultimately finished higher by midyear. The Russell 3000 Index (total U.S. market) gained 3.6%.
- In a reversal from 2015, value stocks meaningfully outperformed their growth counterparts - the Russell 3000 Value Index (+6.3%) beat the Russell 3000 Growth Index (+1.1%) by 5.2%.
- Regarding market capitalization, mid cap stocks were the strongest performers followed by large caps and small caps. However, micro cap stocks were a market weak spot and posted slight losses in the 1st half.
- A wide disparity in sector returns was evident in the 1st half as sectors that are more cyclical in nature (*e.g.* Financial Services and Consumer Cyclical) posted modest losses, while sectors that are less economically sensitive (*e.g.* Utilities and Energy) experienced solid double digit gains. Economic sensitivity was a factor, but on a sector-by-sector basis, there were other notable reasons for the disparity in returns.
- Internationally, a range of issues including continued growth concerns in China and a surprise decision by the U.K. electorate to leave the European Union (E.U.) had an impact on the performance of foreign stocks. International equities declined -0.9% as measured by the MSCI ACWI ex-U.S. Index (total international market).
- After a difficult stretch for Emerging Markets (EM) stocks, a rebound in commodity prices and a weakening of the dollar led to positive results for EMs in the 1st half of 2016, and they ultimately outperformed both the domestic and foreign markets. The MSCI EM IMI Index gained 5.7%.

Bond Market Review

- Interest rates steadily declined throughout the 1st half. The 10-year treasury yield stood at 2.2% at the beginning of 2016 and declined to 1.8% and 1.5% at the end of the 1st and 2nd quarter, respectively.
- Overall bond market performance was favorable as a result of the declining interest rate environment. The Barclays U.S. Aggregate Bond Index gained 5.3%.
- All primary bond sectors posted gains, led by Emerging Markets debt and high-yield corporate bonds. While still positive, the Mortgage-Backed Securities (MBS) and Municipal bond sectors posted the weakest returns.
- Across the quality and maturity spectrum, longer maturities and lower quality bonds outperformed. As expected, longer maturities experienced greater price increases as yields fell, and the low interest rate environment continues to entice investors to seek yield in lower quality bond sectors.
- High-yield default rates in the U.S. continue to run below their long-term average, but they rose in the 1st half of 2016. Although this has been primarily in the Energy and commodity related sectors, the phenomenon is not exclusive to these sectors or the U.S. As a result, global default rates at midyear were nearly 50% higher than they were at the same point in 2015.
- Contrary to the bond environment in 2015, foreign bonds performed exceptionally well during the YTD period. The Barclays Global Aggregate ex-U.S. Index gained 11.9%, besting its domestic counterpart by 6.6%.

Stock Market Synopsis - An increase in market volatility in the 1st half of 2016 led to a bumpy ride on global stock exchanges, and outcomes were highly divergent across different areas of the market. In the U.S., value stocks trounced growth, and large and mid cap stocks significantly outperformed small and micro caps. International stocks fared much worse than domestic stocks due to continued general economic weakness and political turmoil, most significantly the U.K.'s decision to leave the European Union. The exceptions rest within the Emerging Markets outside of China, which posted strong returns for the YTD period, particularly Brazil and Russia. While volatility has resulted in little to show in either direction for the year, managers believe opportunities remain on a selective basis.

Bond Market Synopsis - After the Fed's decision to raise interest rates in 2015, there was a market-driven decline in rates in the 1st half of 2016, which led to favorable results across the U.S. bond market. Every sector posted positive returns, and lower quality and longer maturity issues performed particularly well. With this said, Mortgage-Backed Securities and Municipal bonds provided weak results in comparison. In a reversal from last year, foreign bonds outperformed domestic, with EM bonds posting the strongest returns of all the bond sectors. The exception was Chinese bonds, which were slightly negative. Overall, bonds performed surprisingly well in the 1st half, but low interest rates continue to limit opportunities for meaningful returns among investment grade debt.

Market Outlook

Positive Stock Influences

- As odd as this may sound given the moderate pace of growth in recent years, the U.S. has continued to be the bright spot in the global economy. Unemployment is at its lowest level since 2007, and consumer financial conditions and housing data continue to improve.
- Economic conditions in Europe have been modestly improving - the decline in unemployment the region has experienced over the last couple of years has matched the rate at which U.S. unemployment has been declining. In addition, manufacturing data appear to be on an upward trend.
- Market insiders believe the U.K.'s decision to leave the E.U. will have little impact on U.S. economic performance and little medium to long-term impact on broader Europe or Asia. In addition, the Bank of England has stated they will intervene to help offset any potential negative effects within the U.K.
- A rebound in commodity prices, a weaker U.S. dollar (this is explained under Notes, page 4), and some stabilization in China (after intervention from the People's Bank of China) has led to a short-term recovery in EM stock prices. These factors could continue to have a positive impact on EM stock performance.

Negative Stock Influences

- The combination of weak business investment and labor force participation (in large part due to an aging population), along with global growth uncertainty, are holding back a breakout in economic growth in the U.S. While an improvement in business investment would be positive for the economy in the near term, demographic and global growth challenges will likely persist..
- After a strong run up in prices since March of 2009, the equity market appears to be fully priced. This means that a primary contributor to the rally, low valuations, is no longer present (this has generally been the case since the 2nd half of 2013).
- Signs of improving economic health are present in Europe, and the European Central Bank (ECB) will maintain an accommodative stance through their recovery. However, structural headwinds remain and the outlook for meaningful accelerations in corporate earnings growth is somewhat negative, which is what is needed for a material recovery of European equities.
- Uncertainty caused by the U.K.'s decision to leave the E.U. will likely cause financial market volatility over the short term on a global scale, and uncertainty caused by the decision may persist for some time as the exit is negotiated.

Positive Bond Influences

- Due to global concerns and a fear that premature interest rate increases could hamper economic growth, the Federal Reserve ("Fed") has maintained their "lower for longer" approach, with most Fed officials expecting just one rate increase in 2016. This may lower potential interest rate risk and uncertainty in the near term.
- Historically low (and in some cases, even negative) bond yields outside of the U.S. are acting as a funnel towards U.S. bond demand. On the domestic front, an aging population in the U.S. should also have a positive effect on the need for bonds.
- A focus on credit-worthiness after the pain of the Financial Crisis has resulted in a trend toward stronger corporate balance sheets in recent years - a fact that decreases the likelihood of negative events materially impacting U.S. bond prices. Since the primary role of bonds for most investors is a source of protection, this is a positive market development.

Negative Bond Influences

- A negative feedback loop is affecting interest rates. Due to the number of Americans that are dependent upon investment income to fund retirement spending, low rates are negatively impacting their ability to spend. The negative impact on consumption decreases economic growth and reduces the Fed's confidence in raising rates.
- The Fed's continued suppression of rates signals concern to the markets - particularly because rates are being held at crisis levels. Many market insiders believe the Fed should raise rates, at a measured pace, to signal that members are confident in the economic recovery.
- Rates around the globe are at historical lows and obtaining opportunities for meaningful yield in the fixed income market without taking a measurable amount of risk are scarce. This has forced investors to seek return in higher-risk sectors that are traditionally more illiquid and volatile (*e.g.* high-yield bonds).

Due to the difficulty of accurately predicting the investment markets, investors should continue to make prudent allocation decisions based on their goals, time horizon and risk tolerance.

Stock Outlook - Economic and market confidence in the U.S. remains balanced. Full stock valuations and recoveries from market setbacks signal investors have some degree of confidence. However, record amounts of cash held by individuals and corporations suggest investors are unwilling to stick their necks out too far. This is unsurprising given the degree of uncertainty in the world and the memories investors have of the two major downturns that occurred in the 2000's. The U.S. economy continues to structurally improve (overall), but investors are aware of the fact that the stimulative stance of the Federal Reserve is a key contributor. Overseas, the outlook is more negative, but many global economies are showing some degree of improvement. Britain's exit from the E.U. will likely have an adverse effect on Europe until trade deals are renegotiated and there is more clarity to the long-term implications of this move. In EM economies such as China, central bank efforts and stabilization in commodity prices are providing some relief from the challenges of recent years, and this could continue. Overall, full valuations in the U.S. and global uncertainties seem to paint a picture that should cause investors to be aware of potential risks. However, markets notoriously surprise investors, which is a primary reason we avoid forecasting and instead subscribe to a long-term fundamental approach.

Bond Outlook - Although the Federal Reserve increased interest rates in December 2015, market factors drove rates down in the 1st half of 2016. While this resulted in surprisingly positive semi-annual returns, the decline in yields only increases the likelihood that bond returns will be below long-term averages moving forward. Extremely low interest rates not only mean that newly issued debt pays less interest, it also means that there is a larger gap between current rate levels and where rates may be in the future if the economy strengthens (*i.e.* there may be more price risk in outstanding bonds today than there was at the beginning of the year). The demand for bonds remains strong, and this is unlikely to change as the American population ages. In addition, it is unlikely that rates will materially increase over the short to medium term. However, investors simply need to remind themselves on a regular basis that the primary goal when investing in bonds is protection. There may be more price risk today, for some bonds more than others, but even if rates materially increase, the price hit on a high-quality bond portfolio should be significantly less than the potential short-term loss in stocks.

Benchmark Information

	Stock Benchmarks	Description	Quarter	Semi Annual	1-Year Avg	3-Year Avg	5-Year Avg	10-Year Avg
Broad Indexes	Russell 3000	Total US Market	2.63	3.62	2.14	11.13	11.60	7.40
	Russell 3000 Growth	Growth Stocks	0.80	1.14	1.88	12.65	12.04	8.65
	Russell 3000 Value	Value Stocks	4.57	6.29	2.42	9.58	11.09	6.05
	S&P 500	Large Cap Stocks	2.46	3.84	3.99	11.66	12.10	7.42
	Russell 2000	Small Cap Stocks	3.79	2.22	-6.73	7.09	8.35	6.20
	MSCI AC World ex-US	Foreign Stocks	-0.68	-0.91	-9.61	1.65	0.39	2.16
Stock Categories	Large Growth	Morningstar Categories *(This section represents the performance of the Morningstar categories or peer groups. The categories vary by company size and style.)*	0.52	-1.96	-2.37	10.58	9.98	7.20
	Large Blend		1.74	2.13	-0.03	9.42	10.11	6.42
	Large Value		2.66	4.00	-0.09	7.97	9.36	5.54
	Mid Growth		1.96	0.06	-6.40	8.24	7.95	6.80
	Mid Value		2.35	4.85	-2.20	7.83	8.78	6.52
	Small Growth		3.77	-0.67	-9.86	6.47	7.28	6.56
	Small Value		2.29	4.64	-4.27	5.92	7.67	5.71
	Foreign Large Blend		-1.08	-3.04	-9.94	1.69	1.11	1.54
	Foreign Small/Mid Blend		-2.36	-2.44	-7.05	4.36	3.74	3.76
Stock Sectors	Basic Materials	Cyclical *(most sensitive)*	4.24	9.36	-0.34	8.03	3.78	5.31
	Consumer Cyclical		-1.57	-0.65	0.06	11.12	14.43	9.70
	Financial Services		0.63	-5.50	-7.66	7.21	10.87	-0.56
	Real Estate		6.75	12.20	20.28	12.47	11.34	6.30
	Communication Services	Economically Sensitive *(moderately sensitive)*	5.31	13.22	12.28	11.88	14.00	10.26
	Energy		11.16	15.15	-7.35	-2.32	0.13	4.91
	Industrials		1.41	6.18	4.91	11.82	11.14	7.42
	Technology		-2.03	-0.40	2.50	14.44	11.83	9.83
	Consumer Defensive	Defensive *(least sensitive)*	5.14	11.09	17.94	14.83	15.13	11.70
	Healthcare		5.61	-0.68	-4.32	16.62	17.50	11.50
	Utilities		7.03	23.18	31.45	15.31	13.70	9.23
	Fixed Income Benchmarks							
Broad Indexes	Barclays Aggregate	Aggregate Bond	2.21	5.31	6.00	4.06	3.76	5.13
	Barclays Government	US Government Bonds	2.04	5.22	6.04	3.45	3.38	4.73
	Barclays Credit	Investment Grade Corp. Bonds	3.48	7.54	7.55	5.26	5.20	6.11
	Barclays High Yield Corporate	High Yield Corporate	5.52	9.06	1.62	4.18	5.84	7.56
	Barclays Global Aggregate	Global Bonds	2.89	8.96	8.87	2.80	1.77	4.40
	Morningstar Emerging Markets	Emerging Mkt. Bonds	4.75	9.85	7.92	5.87	5.73	7.74
Bond Maturities	US T-Bill 3 Month	Money Market	0.07	0.14	0.19	0.08	0.08	0.95
	Short Term US Government	Morningstar Indexes *(This section represents the performance of varying maturity ranges and of Government bonds and Investment Grade Corporate bonds.)*	0.65	1.83	1.78	1.25	1.06	2.89
	Short Term Corporate		1.17	2.70	2.74	2.41	2.56	3.83
	Intermediate Term US Government		1.65	4.87	5.62	3.33	3.20	5.30
	Intermediate Term Corporate		2.36	5.76	5.77	4.77	4.87	6.32
	Long Term US Government		4.94	11.90	15.06	8.49	8.22	7.91
	Long Term Corporate		5.52	11.71	11.97	7.73	7.53	7.99

Notes

Impacts of dollar weakness on foreign nations:

Negative

When the dollar weakens relative to another nation's currency, it means that Americans receive less of that nation's currency per dollar exchanged. This makes items Americans import more expensive and reduces demand for that nation's products, negatively impacting their economy.

Positive

For that same nation, our currency is less expensive, meaning they are more able to afford items they import from us. In addition, if that nation borrows money from us by issuing bonds to the U.S., it is less expensive for them to pay back their debt, which puts them in a stronger overall financial position. These strengthening drivers, along with an increase in oil prices, offset the negative effects on exports and were the primary drivers of EM outperformance over other foreign markets in the 1st half of 2016.

Data Source: Morningstar, June 30, 2016; www.Morningstar.com; fund family Web sites; direct communication with fund families. Note: Past performance does not guarantee future returns. Investment returns and principal values vary and investors may realize a gain or loss when shares are sold. Mutual fund performance shown is after the deduction of all applicable fund operational expenses and fees (net). Mutual fund returns and index returns are provided by Morningstar. The total return is calculated assuming a purchase of the fund shares at Net Asset Value (NAV). More information on funds may be obtained by visiting fund Web sites or by requesting fund prospectuses from your Plan contact.

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