Market Insight

Second Quarter 2014

Solid Quarter for Stocks and Bonds as U.S. Economy Rebounds From Severe Winter

1 Q2 2014 At a Glance

Sector	Q2 2014
GDP*	3.5%
S&P 500 Index	5.2%
Barclays Aggregate Bond Index	2.0%
DJ-UBS Commodities Index	0.1%

Source: LPL Financial Research, FactSet, Bloomberg 06/30/14

*Bloomberg consensus as of June 30, 2014

Figures for S&P 500, Barclays Aggregate, and DJ-UBS Commodities Index are total returns from 03/31/14–06/30/14.

All indices 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 Quick Look Forward

We continue to believe U.S. economic growth is on track in 2014 to expand by 3%, owing to the return of business spending and absence of fiscal policy drag.

Earnings tracking to 5–10% growth, more confidence in the durability of growth, and a slight rise in valuations may potentially lead to a low double-digit gain for stocks in 2014.^

The first half of 2014 was kind to bond investors, leading to rich valuations, fewer opportunities, and unattractive yields. We expect yields to rise in the second half of 2014 as global growth strengthens and inflation picks up, and further gains are not likely.

For more insight into our forecasts, please see our *Mid-Year Outlook 2014: Investor's Almanac Field Notes* and the accompanying YouTube video (coming in mid-to-late July).

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

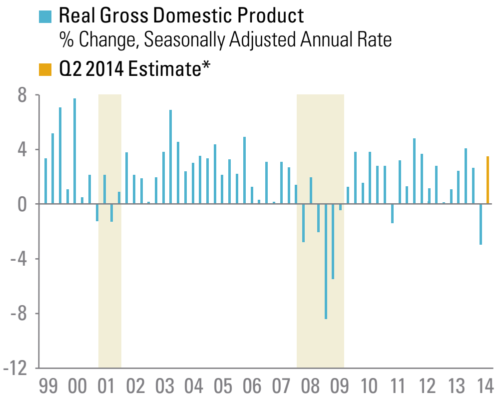
Please note: all return figures are as of June 30, 2014 unless otherwise stated.

- **U.S. economy rebounds from tough winter.** After a lackluster performance in 2013 of just 2% growth thanks to government spending cuts, tax hikes, and recession in Europe, the U.S. economy entered 2014 poised for a potential rebound. But Mother Nature had other ideas, and severe winter weather caused significant disruptions to economic activity. We do not believe first quarter gross domestic product (GDP) is a harbinger of another wrenching recession. In fact, the return to a more normal weather pattern nationwide has already led to a sharp snapback in economic activity.
- **Bull market continues.** The stock market continued its steady march higher during the second quarter, with the S&P 500 returning 5.2%. The quarterly gain was the index's sixth straight and got the sixth year of the bull market off to a solid start. The rebound in the U.S. economy during the spring, earnings gains, and the market's increased confidence in the growth outlook that has lifted valuations have been the biggest drivers of the continued strong stock market performance. Even after returning more than 30% in 2013, the S&P 500 added another 7% during the first half of 2014.
- **Flat quarter for commodities overall.** The Dow Jones-UBS Commodity Index barely eked out a positive return during the second quarter with a 0.2% gain, although several individual commodities saw good-sized declines. Among those were the grains, including corn, wheat, and soybeans, as each dropped more than 15% during the quarter after a very strong start to the year. The broad agriculture sector's nearly 10% loss was driven by better weather conditions in the United States, increased global inventories, and easing tensions in Ukraine, a large global grain exporter.
- **Strong first half for bonds.** The second quarter of 2014 was another rewarding one for bond investors. After a very challenging 2013 that saw the broad bond market, as measured by the Barclays Aggregate Bond Index, suffer one of its biggest losses in its more than 40-year history, the bond market has now put two good quarters in a row together this year and returned 3.9% in the first half. The yield on the 10-year Treasury note fell from 2.76% to 2.52% during the second quarter, after falling by a similar amount during the first quarter.

^As noted in our *2014 Outlook: The Investor's Almanac*, the stock market may produce a total return in the low double digits (10–15%). This gain is derived from earnings per share (EPS) for S&P 500 companies growing 5–10% and a rise in the price-to-earnings ratio (PE) of about half a point from just under 16 to 16.5, leaving more room to grow. The PE gain is due to increased confidence in improved growth allowing the ratio to slowly move toward the higher levels that marked the end of every bull market since World War II (WWII).

LPL Financial

2 U.S. Economy Is Snapping Back in Q2 After Weather-Driven Contraction in Q1

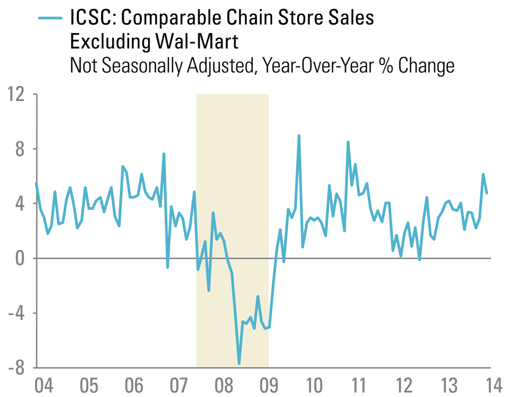


Source: LPL Financial Research, Bureau of Economic Analysis, Haver Analytics 06/30/14

Shaded areas indicate recession.

*Reflects Q2 2014 Bloomberg-tracked consensus of economic forecasters at 3.5%.

3 Retail Sales Growth Has Picked Up Following Winter Slowdown



Source: LPL Financial Research, ICSC, Haver Analytics 06/30/14

Shaded areas indicate recession.

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

U.S. Economy Rebounds from Tough Winter

After a lackluster performance in 2013 of just 2% growth thanks to government spending cuts, tax hikes, and recession in Europe, the U.S. economy entered 2014 poised for a potential rebound. But Mother Nature had other ideas, and severe winter weather caused significant disruptions to economic activity. After initial reports showing a negligible expansion, based on the first quarter's advance estimate of GDP, the Bureau of Economic Analysis (BEA) reported on June 25, 2014, in its second revision, that the U.S. economy had actually contracted by an annualized 2.9%, marking just the second time since the end of the Great Recession in mid-2009 that the economy had contracted [Figure 2].

The sharp slowdown was broad based and the result of weaker consumer spending than expected, especially on health care goods and services, slower trade, a drop in business spending on equipment, and an inventory adjustment that translated into less manufacturing here at home.

Q1 Contraction Unlikely a Harbinger of Recession

We do not believe first quarter GDP is a harbinger of another wrenching recession. In fact, the return to a more normal weather pattern nationwide has already led to a sharp snapback in economic activity. The U.S. economic data released thus far for April, May, and June 2014 suggest that economic growth accelerated during the second quarter to above the economy's long-term average growth rate after the weather-induced slowdown in the first quarter of 2014. The consensus for Q2 GDP growth based on the Bloomberg-tracked consensus of economic forecasters stood at 3.5% as of June 30, 2014. The snapback in retail sales [Figure 3], which represents about 20% of the overall U.S. economy, is among several data points signaling a return to growth.

This improved growth has contributed to inflation moving higher, which could present a challenge for the Federal Reserve (Fed) later this year. But at 1.5% for the latest (May) reading of the personal consumption expenditure deflator, the Fed's preferred measure, inflation remains well within the Fed's comfort range.

More Evidence of a Rebound From the Fed's Beige Book

The latest edition of the Fed's Beige Book, which is essentially a "window on Main Street," also provided evidence that the U.S. economy has rebounded 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. The latest (April) reading of our proprietary Beige Book Barometer (a count of positive words minus negative words) was quite strong and free of discussions of weather distortions, suggesting the economy rebounded in the second quarter.

Solid Trend for Business Spending

The latest readings on business spending are also indicating a turnaround. Shipments of non-defense capital goods excluding aircraft, a proxy for business capital spending that feeds directly into the GDP report, rose an annualized 8.1% during the three months ending in May 2014. That pace represents acceleration from the prior three-month period and suggests that business capital spending could add significantly to second quarter GDP. New orders showed an even bigger improvement, suggesting solid business capital spending growth is likely to extend into the second half of 2014.

Job Market Momentum Continues

The labor market has also staged a recovery since the weather began to improve in early 2014.

The labor market has also staged a recovery since the weather began to improve in early 2014, enabling job creation to surpass its pre-winter trend and for the U.S. economy to finally recover all of the jobs lost during the Great Recession of 2008–09. The harsh winter held job growth to only about 150,000 jobs per month in late 2013 and early 2014, well below the 205,000 averaged during the prior 12 months ending November 2013. Job growth has rebounded to average over 270,000 per month during April, May, and June 2014, while the unemployment rate stands at a cycle low of 6.1%, down from 6.7% where it ended both 2013 and the first quarter 2014.

Fed Support Remains in Place

Recognizing improving underlying fundamentals of the U.S. economy, in December 2013 the Fed began scaling back its bond-buying program, known as quantitative easing (QE), and continued to do so during the first half of 2014. QE, even reduced (tapered), along with the Fed's commitment to keep interest rates low for an extended period, still leaves the central bank providing considerable support to the economy. The Fed remains on track to eliminate QE by year end.

Slow Plateau in Europe

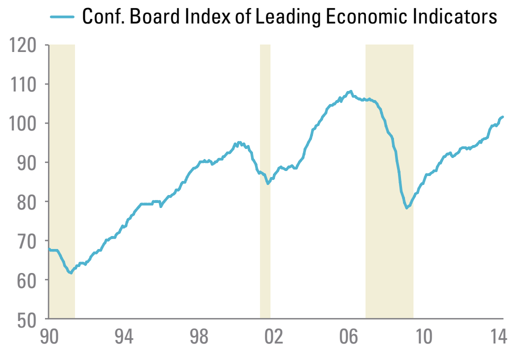
Recent data in Europe indicate that the region's economy is expanding, which was not the case one year ago, but the growth trajectory may have reached a plateau.

Recent data in Europe indicate that the region's economy is expanding, which was not the case one year ago, but the growth trajectory may have reached a plateau. Lackluster growth, which has been tracking to a 1% annualized pace as measured by GDP, coupled with recent low inflation readings suggest that the European Central Bank (ECB) may need to do more to support the Eurozone economy. Consensus forecasts among Bloomberg-tracked economists call for euro area GDP growth of just 1.1% in 2014. It is also worth noting that Europe faces unique challenges including structural constraints on the flow of credit through the region's banks and dependence on Russian and Ukrainian energy exports and infrastructure.

Emerging Markets Regain Their Footing

After struggling with Fed tapering early in the year, emerging market (EM) economies fared much better during the second quarter. Although geopolitical risk remains high in certain EM countries such as Russia, in general these economies have seen better growth, less political turmoil, and stronger currencies during the past several months. As the global growth outlook has improved, global money flow has returned to these economies, which in many cases depend on foreign capital to fund trade deficits. Local monetary policy actions have helped in many cases, such as China, where targeted stimulus measures likely had an impact on improvements in the latest measures of its economy. Recent elections have also fueled optimism of more pro-growth policies from India.

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

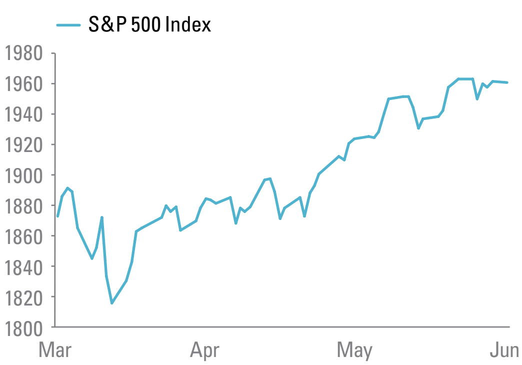


Source: LPL Financial Research, Bloomberg, Conference Board 06/30/14

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 S&P 500 Continued Its Steady March Higher During Q2



Source: LPL Financial Research, FactSet 06/30/14

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.

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 six 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 zero to 14 months. The year-over-year increase in the LEI of 5.9% in April 2014 [Figure 4], supported by less policy uncertainty in Washington and improving economic growth expectations, 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.

Bull Market Continues

The stock market continued its steady march higher during the second quarter, with the S&P 500 returning 5.2%. The quarterly gain was the index's sixth straight and got the sixth year of the bull market off to a solid start. The rebound in the U.S. economy during the spring, earnings gains, and the market's increased confidence in the growth outlook that has lifted valuations have been the biggest drivers of the continued strong stock market performance. Even after returning more than 30% in 2013, the S&P 500 added another 7.1% during the first half of 2014 and is on track for another very rewarding year for investors.

The market's ascent continues to be marked by a somewhat surprising lack of volatility. As shown in Figure 5, the stock market's march higher has been steady over the past three months with only a relatively minor blip in early April. In fact, the S&P 500 lost 1% or more in only three trading sessions during the entire quarter, all in early April, and the index has not moved more than 1% in over 50 trading sessions (as of quarter end), the longest such streak since the mid-1990s. Despite facing many challenges, including political unrest and violence in Ukraine and Iraq, more tapering of QE by the Fed, and above-average stock valuations, the stock market has continued to move higher.

Slower Growth and Falling Bond Yields Helped Support Defensive Sectors

All 10 equity sectors registered gains during the second quarter, led by energy. Although there was no clear trend in terms of cyclical versus defensive sectors, energy was a clear theme. The sector received support from several places. Key among them was higher oil and natural gas prices, which were lifted by inventory drawdowns, seasonal factors, and fears of supply disruptions in Ukraine and Iraq. Prospects for increased petroleum exports due to booming U.S. energy production also played a role. Utilities are sensitive to energy prices and interest rates, both of which moved in a positive direction for those stocks, enabling the sector to continue its strong 2014. Falling interest rates also drove more solid performance for

6 Higher Oil and Gas Prices and U.S. Energy Renaissance Fueled Strong Q2 for Energy
Ranked by Second Quarter Returns

Sector	Q2 2014 (%)	YTD (%)
Energy	12.1	13.0
Utilities	7.8	18.7
Technology	6.5	8.9
Materials	5.6	8.6
S&P 500	**5.2**	**7.1**
Consumer Staples	4.7	5.2
Health Care	4.5	10.6
Industrials	3.9	4.0
Telecom	3.8	4.3
Consumer Discretionary	3.5	0.6
Financials	2.3	5.0

Source: LPL Financial Research, FactSet 06/30/14

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 Strong Rebound for Emerging Market Stocks During Q2

Asset Class	Q2 2014 (%)	YTD
Emerging Markets	6.7	6.3
U.S. Large Caps	5.1	7.3
U.S. Mid Caps	5.0	8.7
Value	4.9	8.0
Growth	4.9	6.0
Developed Foreign	4.3	5.1
Small Caps	2.1	3.2

Source: LPL Financial Research, FactSet 06/30/14

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

Total returns from 01/01/14–06/30/14.

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real estate investment trusts (REIT), which returned 7.1% during the quarter based on the NAREIT Equity Index. Technology also enjoyed a strong quarter, as shares of the sector's largest constituent (Apple) rose 21% and semiconductor stocks delivered solid gains.

On the flip side, financials produced the weakest performance among sectors during the second quarter. Banks and capital markets stocks were hurt by a challenging trading environment, a flattening yield curve, and the ongoing wave of legal settlements stemming from the financial crisis. The rest of the laggards were composed mainly of defensive sectors, along with industrials, as consumer staples, health care, and telecom all trailed the S&P 500 during the quarter.

All 10 sectors had positive returns in the first half, though consumer discretionary just barely got there with its 0.6% first half return after struggling during the first quarter with the weather and the market's sensitivity to higher valuations.

Strong First Half for Mid Caps

Mid cap stocks produced similar returns as large caps during the second quarter, enabling them to hold their first quarter lead and outperform during the first half. Mid cap stocks have benefited this year from their higher market sensitivity, or beta, relative to large cap stocks as the stock market has produced gains, and from an active merger and acquisition environment that tends to favor mid cap companies.

Higher betas and an active merger and acquisition climate did not help small caps much during the quarter or the first half, however, as the Russell 2000 has lagged both the mid and large cap benchmarks for much of the year. Small caps have been hurt by valuation concerns, given they trade at substantial premiums to large caps. Small caps have also been hurt by the weather-driven weakness in the U.S. economy early this year, and by having less exposure to improving international economies, as smaller companies tend to be more U.S. focused.

Growth and Value in Line in Q2

In terms of style, growth matched value's performance during the second quarter, enabling value to hold on to the lead it built during the first three months of 2014. The Russell 3000 Growth and Value Indexes each returned 4.9% during the quarter, leaving value ahead by two percentage points for the first half. Value strength in early 2014 was driven by the market's increasing sensitivity to higher stock market valuations, especially during March, and by better performance from the more defensive, dividend-paying sectors, such as utilities, that compose more of the Russell Value Indexes. Meanwhile, earlier this year, growth was hurt by losses in consumer discretionary, a big growth sector.

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.

EM Equities Staged Strong Q2 Turnaround

After lagging in 2013 and early in 2014, EM equities came back strong during the second quarter and outpaced the primary U.S. equity benchmarks with a nearly 7% return, as measured by the MSCI Emerging Markets Index. Broadly, an improved global growth environment and increasing comfort with prospects for reduced stimulus from the Fed have helped encourage investors to go back into these markets after largely shunning them in 2013. Expectations for more market-friendly policies in several key countries such as India and increasing comfort with the geopolitical risks in Russia also helped drive the sharp turnaround in EM stock performance during the quarter. The turnarounds for the markets in India, Brazil, Russia, and Turkey were especially powerful.

Early 2014 Strength in European Stocks Not Sustained

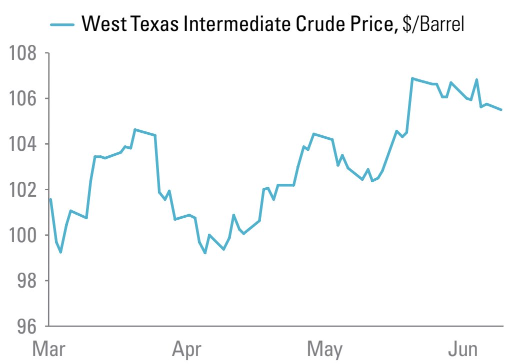
Developed foreign markets performed well during the second quarter but could not keep up with EM or the broad U.S. stock market indexes. The strength in European markets in the first quarter was not sustained, with the MSCI Europe Index returning 3.6% during the second quarter to trail the MSCI EAFE as well as the U.S. and EM benchmarks. European markets were hurt by sluggish growth as well as deflation fears. On a positive note, markets in Japan and Hong Kong performed well to help limit the performance drag from Europe.

Flat Quarter for Commodities Overall, but Oil and Metals Delivered Gains

The Dow Jones-UBS Commodity Index barely eked out a positive return during the second quarter with a 0.2% gain, although several individual commodities saw good-sized declines. Among those were the grains, including corn, wheat, and soybeans, as each dropped more than 15% during the second quarter after a very strong start to the year. The broad agriculture sector's nearly 10% loss was driven by better weather conditions in the United States, increased global inventories, and easing tensions in Ukraine, a large global grain exporter.

Most other key commodity sectors produced gains, including crude oil, which closed the quarter 3.7% higher at $105.37 on improving global growth and heightened geopolitical risk in the Middle East [Figure 8]. China-sensitive copper experienced a volatile quarter on the news that Chinese authorities were investigating fraud allegations related to multiple loans against the same copper stockpiles. This news drove copper prices lower before the metal bounced back to end the quarter more than 5% higher on improving global manufacturing and stabilization in China. Finally, gold rose 3% during the quarter as the US dollar and Treasury yields declined late in the quarter, while inflation rose and geopolitical tensions remained elevated, particularly in Iraq [Figure 9].

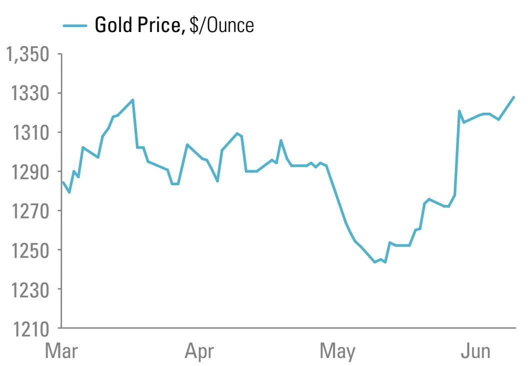
8 Heightened Geopolitical Risk and Improving Growth Have Given Oil a Boost



Source: LPL Financial Research, FactSet 06/30/14

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

9 June Strength for Gold on Weak Dollar and Heightened Geopolitical Risk Results in Quarterly Gain



Source: LPL Financial Research, FactSet 06/30/14

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.

Fixed Income–Taxable: Strong 2014 for Bonds Continued

The second quarter of 2014 was another rewarding one for investors in the bond market. After a very challenging 2013 that saw the broad bond market, as measured by the Barclays Aggregate Bond Index, suffer one of its biggest losses in its more than 40-year history, the bond market has now put two good quarters in a row together this year and returned 3.9% in the first half. Longer-term bonds and some of the most interest rate sensitive areas fared best during the second quarter, benefitting most from price gains associated with lower market interest rates.

The yield on the 10-year Treasury note fell from 2.76% to 2.52% during the second quarter, after falling by a similar amount during the first quarter. The latest drop in U.S. Treasury yields was largely driven by falling yields in Europe, which offer less attractive high-quality fixed income options than their U.S. counterparts, but also by ongoing stimulus from global central banks. Geopolitical risk, including unrest in Ukraine and Iraq, also likely contributed to bond market gains. Neither growth nor inflation in the United States contributed to the downward pressure on yields, as the most widely followed measures of both accelerated, which would typically be expected to put upward pressure on interest rates.

10 Falling European Bond Yields Dragged U.S. Yields Lower

Source: LPL Financial Research, FactSet 06/30/14

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

Strong Credit Quality Continues to Support Corporate Bonds

Falling yields supported broad-based strength in the bond market during the quarter, but credit and other economically sensitive fixed income sectors fared particularly well due to strong credit quality. Credit quality, or the ability to repay debt obligations, is being supported by corporate America's healthy balance sheets, strong earnings growth, and low default rates. These key fundamental supports for corporate bonds and other economically sensitive fixed income sectors helped drive narrowing credit spreads and resulted in strong second quarter performance for preferred stocks, investment-grade corporate bonds and high-yield corporate bonds, all of which outperformed the Barclays Aggregate Bond Index [Figure 11].

One economically sensitive bond sector that was again unable to keep up with the broad bond market was bank loans. As in the first quarter of 2014, the sector was held back by its limited interest rate sensitivity, but it still managed to produce a positive 1.4% return due to its economic sensitivity and above-benchmark yields.

11 Broad-Based Bond Market Strength Continued in Q2
Ranked by Second Quarter Returns

Sector	Q2 2014 (%)	YTD
Emerging Market Debt	5.4	9.1
Preferred Securities	3.3	10.0
TIPS	3.8	5.8
Investment-Grade Corporates	2.7	5.7
Municipal Bonds	2.6	6.0
Foreign Bonds (Unhedged)	2.6	6.0
High-Yield Corporates	2.4	5.5
Mortgage-Backed Securities	2.4	4.0
Foreign Bonds (Hedged)	2.0	4.5
Barclays Aggregate	**2.0**	**3.9**
Municipal High-Yield	1.5	7.5
US Treasuries	1.4	2.7
Bank Loans	1.4	2.5

Source: LPL Financial Research, FactSet 06/30/14

The indexes mentioned are unmanaged and you cannot invest 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.

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.

The risks associated with investment-grade corporate bonds are considered significantly higher than those associated with first-class government bonds. The difference between rates for first-class government bonds and investment-grade bonds is called investment-grade spread. The range of this spread is an indicator of the market's belief in the stability of the economy.

Credit quality is one of the principal criteria for judging the investment quality of a bond or bond mutual fund. As the term implies, credit quality informs investors of a bond or bond portfolio's credit worthiness, or risk of default.

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.

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.

Preferred stock investing involves risk, which may include loss of principal.

Longer Maturity Bonds Also Generally Fared Well

Treasury inflation-protected securities (TIPS) help eliminate inflation risk to your portfolio, as the principal is adjusted semiannually for inflation based on the Consumer Price Index—while providing a real rate of return guaranteed by the U.S. government.

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.

Although credit performed well during the quarter, falling yields also lifted some of the higher quality, longer-duration (more interest rate sensitive) areas of the bond market such as Treasury

Inflation-Protected Securities (TIPS), which also received a lift from the inflation uptick, outperformed the broad bond market benchmark. Emerging market debt (EMD), also highly interest rate sensitive, also benefited from falling yields.

Treasuries Produced Gains but Lagged

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.

U.S. Treasuries lagged again during the second quarter as they suffered from low yields and the market's preference for economically sensitive fixed income investments. As in the first quarter, Treasuries did not benefit as much on a relative basis from falling yields as they typically would due to the unusual combination of falling yields and narrowing credit spreads. U.S. Treasuries returned just 1.4% during the second quarter and are up just 2.7% year to date, versus 2.0% and 3.9% for the broad bond market index.

Developed Foreign Bond Markets Largely in Line With U.S.

Going overseas, foreign developed markets did not add much value for investors during the second quarter.

Going overseas, foreign developed markets did not add much value for investors during the second quarter, as the hedged foreign bond benchmark matched the broad U.S. bond market benchmark. But on an unhedged basis (including the impacts of a slightly weaker US dollar), foreign developed market bonds produced a 2.6% return and outpaced the Barclays Aggregate Index. Besides currencies, these markets were supported by lackluster economic growth and deflation fears in the Eurozone, which have fueled speculation that the ECB will initiate QE. Returns were much better in EMD, driven by lower interest rates and strengthening currencies related to improving fundamentals. The J.P. Morgan Emerging Markets Bond Index returned 5.4% during the second quarter, bringing its first half return to a stellar 9.1%.

Fixed Income – Tax-Free: Strong First Half 2014 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.

High-quality municipal bonds followed up a strong first quarter with another good return in the second quarter. The Barclays Municipal Bond Index returned 2.6% during the second quarter, bringing the first half 2014 return to a solid 6.0%. Greater sensitivity to falling interest rates, improved supply-demand balance, and a continued very low default rate environment all contributed to gains in the quarter and the first half, enabling municipal bonds to continue to outpace Treasuries on a total return basis, even without factoring in the tax benefits.

The quarter was not as good for high-yield municipal bonds. Despite their high degree of interest rate sensitivity, higher yields, and the favorable overall credit environment, the Barclays High-Yield Municipal Bond Index underperformed the Barclays Aggregate Index with a 1.5% return. This fixed income sector was still one of the best performers during the first half of 2014, with a 7.5% return despite ongoing concerns about Puerto Rico's credit quality. ■

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 indices 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.

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

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.

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.

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.

Materials Sector: Companies that are engaged in a wide range of commodity-related manufacturing. Included in this sector are companies that manufacture chemicals, construction materials, glass, paper, forest products and related packaging products, metals, minerals and mining companies, including producers of steel.

Energy Sector: Companies whose businesses are dominated by either of the following activities: The construction or provision of oil rigs, drilling equipment and other energy-related service and equipment, including seismic data collection. The exploration, production, marketing, refining and/or transportation of oil and gas products, coal and consumable fuels.

Health Care Sector: Companies are in two main industry groups — Health care equipment and supplies or companies that provide health care-related services, including distributors of health care products, providers of basic health care services, and owners and operators of health care facilities and organizations. Companies primarily involved in the research, development, production, and marketing of pharmaceuticals and biotechnology products.

Utilities Sector: Companies considered electric, gas or water utilities, or companies that operate as independent producers and/or distributors of power.

Consumer Staples Sector: Companies whose businesses are less sensitive to economic cycles. It includes manufacturers and distributors of food, beverages and tobacco, and producers of non-durable household goods and personal products. It also includes food and drug retailing companies.

Consumer Discretionary Sector: Companies that tend to be the most sensitive to economic cycles. Its manufacturing segment includes automotive, household durable goods, textiles and apparel, and leisure equipment. The service segment includes hotels, restaurants and other leisure facilities, media production and services, consumer retailing and services, and education services.

Telecommunications Services Sector: Companies that provide communications services primarily through a fixed line, cellular, wireless, high bandwidth and/or fiber-optic cable network.

Financials Sector: Companies involved in activities such as banking, consumer finance, investment banking and brokerage, asset management, insurance and investment, and real estate, including REITs.

Industrials Sector: Companies whose businesses manufacture and distribute capital goods, including aerospace and defense, construction, engineering and building products, electrical equipment and industrial machinery. Provide commercial services and supplies, including printing, employment, environmental and office services. Provide transportation services, including airlines, couriers, marine, road and rail, and transportation infrastructure.

Technology Software & Services Sector: Companies include those that primarily develop software in various fields such as the internet, applications, systems and/or database management and companies that provide information technology consulting and services; technology hardware & equipment, including manufacturers and distributors of communications equipment, computers and peripherals, electronic equipment and related instruments, and semiconductor equipment and products.

INDEX DEFINITIONS

The Barclays Aggregate Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment-grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

The Barclays Capital High Yield Index covers the universe of publicly issued debt obligations rated below investment grade. Bonds must be rated below investment-grade or high-yield (Ba1/BB+ or lower), by at least two of the following ratings agencies: Moody's, S&P, and Fitch. Bonds must also have at least one year to maturity, have at least $150 million in par value outstanding, and must be US dollar denominated and non-convertible. Bonds issued by countries designated as emerging markets are excluded.

The Barclays Capital High Yield Municipal Bond Index is an unmanaged index made up of bonds that are non-investment grade, unrated, or rated below Ba1 by Moody's Investors Service with a remaining maturity of at least one year.

The Barclays Capital Long Government/Credit Index measures the investment return of all medium and larger public issues of U.S. Treasury, agency, investment-grade corporate, and investment-grade international dollar-denominated bonds with maturities longer than 10 years. The average maturity is approximately 20 years.

Barclays Capital US Corporate Investment Grade Index measures the performance of investment grade corporate bonds.

Barclays Capital U.S. Intermediate Credit Bond Index measures the performance of investment grade corporate debt and agency bonds that are dollar denominated and have a remaining maturity of greater than one year and less than ten years.

The Barclays Corporate Index is an unmanaged index of publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility, and Finance, which include both U.S. and non-U.S. corporations. The non-corporate sectors are Sovereign, Supranational, Foreign Agency, and Foreign Local Government. Bonds must have at least one year to final maturity, must be dollar-denominated and non-convertible, and must have at least $250 million par amount outstanding. Bonds must be rated investment-grade (Baa3/BBB- or higher) by at least two of the following ratings agencies: Moody's, S&P, Fitch. If only two of the three agencies rate the security, the lower rating is used to determine index eligibility. If only one of the three agencies rates a security, the rating must be investment-grade.

The Barclays Mortgage-Backed Securities Index includes 15- and 30-year fixed-rate securities backed by mortgage pools of the Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), and Federal National Mortgage Association (FNMA).

The Barclays Municipal Bond Index is a market capitalization-weighted index of investment-grade municipal bonds with maturities of at least one year. All indices are unmanaged and include reinvested dividends. One cannot invest directly in an index. Past performance is no guarantee of future results.

The Barclays 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 Barclays U.S. Treasury TIPS Index is a rules-based, market value-weighted index that tracks inflationprotected securities issued by the U.S. Treasury. The U.S. TIPS Index is a subset of the Global Inflation-Linked Index, with a 36.0% market value weight in the index (as of December 2007), but is not eligible for other nominal treasury or aggregate indices. In order to prevent the erosion of purchasing power, TIPS are indexed to the non-seasonally adjusted Consumer Price Index for All Urban Consumers, or the CPI-U (CPI).

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 Index includes certain publicly issued, $25- and $100-par securities with at least one year to maturity.

Citigroup World BIG ex US Index is a market capitilization weighted index that tracks the performance of the international fixed rate bonds that have remaining maturities of one year or longer and that are rated BBB-/Baa3, or better, by S&P or Moody's, respectively. This Index excludes the U.S. and is unhedged USD.

The Conference Board Leading Economic Index is an American economic leading indicator intended to forecast future economic activity. It is calculated by The Conference Board, a non-governmental organization, which determines the value of the index from the values of ten key variables.

The Dow Jones Industrial Average Index is comprised of U.S.-listed stocks of companies that produce other (non-transportation and non-utility) goods and services. The Dow Jones Industrial Averages are maintained by editors of The Wall Street Journal. While the stock selection process is somewhat subjective, a stock typically is added only if the company has an excellent reputation, demonstrates sustained growth, is of interest to a large number of investors and accurately represents the market sectors covered by the average. The Dow Jones averages are unique in that they are price weighted; therefore their component weightings are affected only by changes in the stocks' prices.

The Dow Jones - UBS Commodity Index is composed of futures contracts on 19 physical commodities. Unlike equities, which entitle the holder to a continuing stake in a corporation, commodity futures contracts specify a delivery date for the underlying physical commodity.

The Institute for Supply Management (ISM) index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

The JPMorgan Emerging Markets Bond Index Global ("EMBI Global") tracks total returns for traded external debt instruments in the emerging markets, and is an expanded version of the JPMorgan EMBI+. As with the EMBI+, the EMBI Global includes U.S. dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million. It covers more of the eligible instruments than the EMBI+ by relaxing somewhat the strict EMBI+ limits on secondary market trading liquidity.

MSCI EAFE is made up of approximately 1,045 equity securities issued by companies located in 19 countries and listed on the stock exchanges of Europe, Australia, and the Far East. All values are expressed in U.S. dollars. All values are expressed in US dollars. Past performance is no guarantee of future results.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. As of May 2005 the MSCI Emerging Markets Index consisted of the following 26 emerging market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey and Venezuela.

The MSCI Europe Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the developed markets in Europe. As of June 2007, the MSCI Europe Index consisted of the following 16 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

The New York Mercantile Exchange (NYMEX) is a commodity futures exchange owned and operated by CME Group of Chicago.

The Russell 1000 Index consists of the 1,000 largest securities in the Russell 3000 Index, which represents 90% of the total market capitalization of the Russell 3000 Index. It is a large-cap, market oriented index and is highly correlated with the S&P 500 Index.

Russell 1000® Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.

Russell 1000® Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

Russell 2000® Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values.

Russell 2000® Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 3000 Value Index measures the performance of those Russell 3000 companies with lower price-to-book rations and lower forecasted growth values.

The Russell Mid Cap Index offers investors access to the mid cap segment of the U.S. equity universe. The Russell Mid Cap Index is constructed to provide a comprehensive and unbiased barometer for the mid-cap segment and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true mid cap opportunity set. The Russell Mid Cap Index includes the smallest 800 securities in the Russell 1000.

The Russell Mid Cap Value Index offers investors access to the mid cap value segment of the U.S. equity universe. The Russell Mid Cap Value Index is constructed to provide a comprehensive and unbiased barometer of the mid cap value market. Based on ongoing empirical research of investment manager behavior, the methodology used to determine value probability approximates the aggregate mid cap value manager's opportunity set.

The Standard & Poor's 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.

Consumer Price Inflations is the retail price increase as measured by a consumer price index (CPI). Core CPI is a subset of the total Consumer Price Index (CPI) that excludes the highly volatile food and energy prices. It is released by the Bureau of Labor Statistics around the middle of each month. Compare to Personal Consumption Expenditures (PCE); Core PPI; Producer Price Index (PPI).

The MSCI Japan Index is a free-float adjusted market capitalization weighted index that is designed to track the equity market performance of Japanese securities listed on Tokyo Stock Exchange, Osaka Stock Exchange, JASDAQ and Nagoya Stock Exchange. The MSCI Japan Total Return Index takes into account both price performance and income from dividend payments. The MSCI Japan Index is constructed based on the MSCI Global Investable Market Indices Methodology, targeting a free-float market capitalization coverage of 85%.

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