Investment Update
Second Quarter 2015

Markets

With the unravelling of Greek debt negotiations as June came to a close, global equity markets corrected and ended the second quarter flat to only slightly up. Most had been solidly in positive territory and even at all-time highs in the US, where smaller and mid-cap stocks continued to perform somewhat better than large-cap stocks.

European stocks are having a good year as very accommodative monetary policy has helped economic performance there to improve, at least outside of Greece. Emerging markets, after several years of significant underperformance, are keeping up with the more developed markets so far in 2015. However, for US investors in these foreign markets, the strong dollar is muting the good local-currency returns.

Equity Markets (Total Returns)	2nd Qtr	YTD	1-Year
Dow Jones Industrials	-0.3%	0.0%	7.2%
S&P 500	0.3%	1.2%	7.4%
S&P Mid Cap	-1.1%	4.2%	6.4%
S&P Small Cap	0.2%	4.2%	6.7%
MSCI All-Country World	0.5%	3.0%	1.2%
MSCI EAFE Developed Markets	0.8%	5.9%	-3.8%
MSCI Emerging Markets	0.8%	3.1%	-4.8%
US Bond Markets (Total Returns)	2nd Qtr	YTD	1-Year
Barclays US Gov/Credit Intermediate	-0.6%	0.8%	1.7%
Barclays US Gov/Credit Long	-7.6%	-4.5%	1.9%
Merrill Lynch Municipal Intermediate	-0.5%	0.2%	1.4%

Fixed income markets, except those for Greek and Puerto Rican bonds, have been relatively quiet although US yields have been gradually moving higher for most of the year as it has become more certain that the Fed will raise interest rates later in 2015.

Outlook

We are not very surprised that the Greek drama drags on. The compromises and temporary extensions of financial aid, and the token reforms undertaken by Greece, have only managed to postpone the eventual day of reckoning. Politically, it is virtually impossible for the leaders of Greece to implement the public spending cuts and further tax hikes being demanded by its creditors in exchange for ongoing aid. These conditions would decimate what little is left of the reeling Greek economy and amount to trying to get blood out of the proverbial turnip. It is equally difficult for the leaders of the creditor nations to sell the notion of debt forgiveness for Greece to their electorates. Unfortunately, long-term real debt relief seems like the better solution given that Greece's past borrowings, to a large extent, were wasted on papering over budget holes rather than being invested in things that could have enhanced the country's economic growth potential – the money is gone and their ability to repay is very limited.
While this is a tragedy for Greece, the direct effects on the rest of the world are relatively limited and should not, of themselves, become major headwinds for the global economy. There is a concern that Greece's example will lead to contagion, as other relatively weak and indebted European economies (Italy, Portugal, Spain) seek to restructure their debts or default and leave the euro. At the moment though, Greece looks to be the outlier because of the overwhelming nature of its problems and also because its departure from the euro would have relatively small direct effects on the rest of the member nations.

For that reason we don't expect to see this drama repeated soon but Greece and the future of the euro are definitely of concern and are situations to be watched carefully. The list of other global worries is still a long and familiar one: turmoil in the Middle East; tensions over Russia and Ukraine (though that situation seems to no longer be escalating); an increasingly militarily assertive China that is also trying to transition from a government-directed to a more consumer-driven economy; and the sub-par though relatively steady economic growth in the US where the Federal Reserve is likely to become less accommodative in the near future.

One way that we, as investment managers, deal with uncertainty about such major macroeconomic and political variables is to keep sight of the fact that we are investing in individual companies with real businesses that we know pretty well. Their stock prices are influenced from one day to the next by the flow of news, but "the market" is an aggregation of companies' stock prices that are ultimately set by the willing buyers and sellers on a given day who are participating for any number of reasons. While we do not expect to hold every stock we buy for clients forever, we do hope to hold them for at least several years as long as the company's fundamentals do not change. Just as in stock market bubbles, in moments of uncertainty or market corrections large disconnects can develop between the price of a company's shares and the economic reality of its future prospects. Despite the number of things to worry about today, if the market declines 20% tomorrow due to concerns about Greece, we will be looking for opportunities to buy shares in companies whose businesses are not worth 20% less than they were the day before.

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