

Q3

Quarterly Market Review

Third Quarter 2015

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This report features world capital market performance and a timeline of events for the past quarter. It begins with a global overview, then features the returns of stock and bond asset classes in the US and international markets.

The report also illustrates the performance of globally diversified portfolios and features a topic of the quarter.

Quarterly Topic: Should Investors Sell after a “Correction”?

Market Summary

Timeline of Events: Third Quarter 2015

World Asset Classes

US Stocks

International Developed Stocks

Emerging Markets Stocks

Fixed Income

Real Estate Investment Trusts (REITs)

Quotes

Should Investors Sell After a “Correction”?

Third Quarter 2015

Stock prices in markets around the world fluctuated dramatically for the week ended August 27. On Monday, August 24, the Dow Jones Industrial Average fell 1,089 points—a larger loss than the “Flash Crash” in May 2010—before rallying to close down 588. Prices fell further on Tuesday before recovering sharply on Wednesday, Thursday, and Friday. Although the S&P 500 and Dow Jones Industrial Average rose 0.9% and 1.1%, respectively, for the week, many investors found the dramatic day-to-day fluctuations unsettling.

Based on closing prices, the S&P 500 Index declined 12.35% from its record high of 2130.82 on May 21 through August 24. Financial professionals generally describe any decline of 10% or more from a previous peak as a “correction,” although it is unclear what investors should do with this information. Should they seek to protect themselves from further declines by selling, or should they consider it an opportunity to purchase stocks at more favorable prices?

Based on S&P 500 data, stock prices have declined 10% or more on 28 occasions between January 1926 and June 2015. Obviously, every decline of 20% or 30% or 40% began with a decline of 10%. As a result, some investors believe that avoiding large losses can be accomplished easily by eliminating

equity exposure entirely once the 10% threshold has been breached.

Market timing is a seductive strategy. If we could sell stocks prior to a substantial decline and hold cash instead, our long-run returns could be exponentially higher. But successful market timing is a two-step process: determining when to sell stocks and when to buy them back. Avoiding short-term losses runs the risk of avoiding even larger long-term gains. Regardless of whether stock prices have advanced 10% or declined 10% from a previous level, they always reflect (1) the collective assessment of the future by millions of market participants and (2) the expectation that equities in both the US and markets around the world have positive expected returns.

Our research shows that US stocks have typically delivered above-average returns over one, three, and five years following consecutive negative return days resulting in a 10% or more decline. Results from non-US markets are similar.

Contrary to the beliefs of some investors, dramatic changes in security prices are not a sign that the financial system is broken but rather what we would expect to see if markets are working properly.

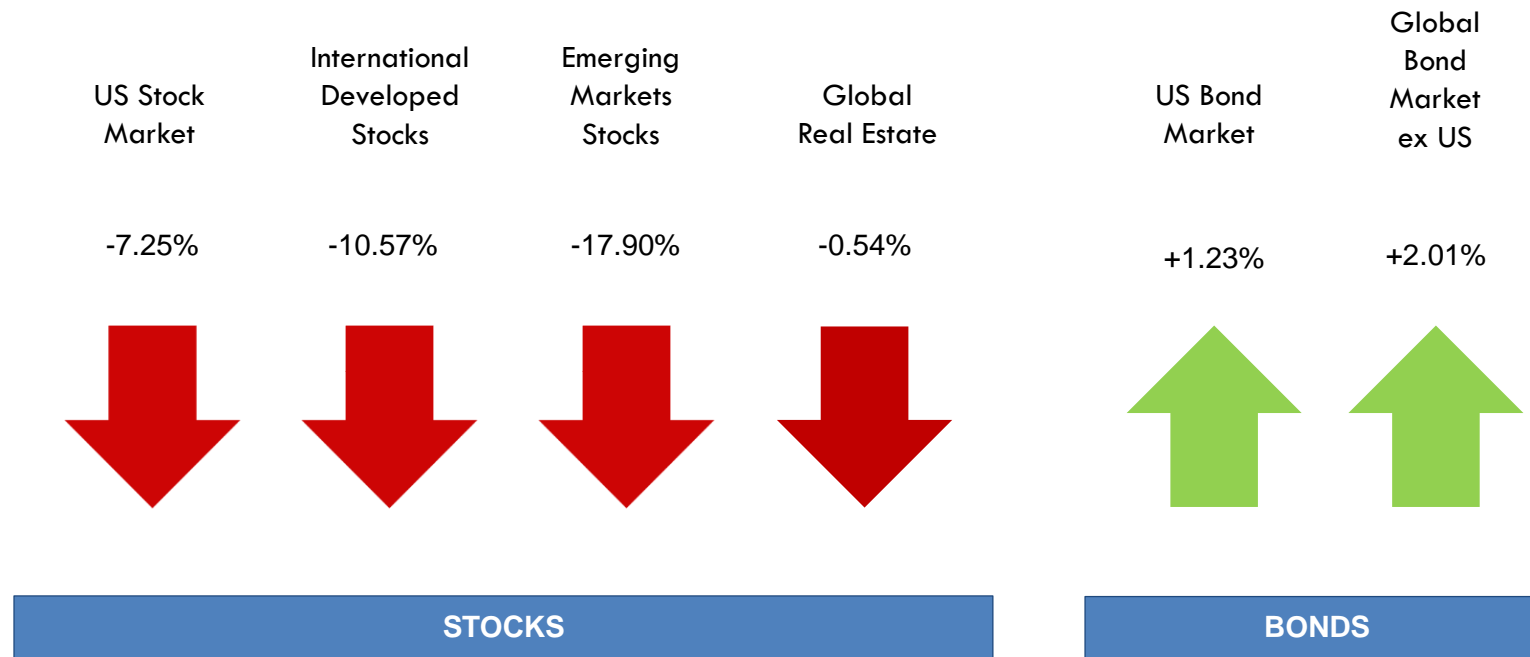
The world is an uncertain place. The role of securities markets is to reflect new developments—both positive and negative—in security prices as quickly as possible. Investors who accept dramatic price fluctuations as a characteristic of liquid markets may have a distinct advantage over those who are easily frightened or confused by day-to-day events and may be more likely to achieve long-run investing success.

References

- “Wild Ride Leaves Investors Grasping,” Wall Street Journal, August 25, 2015.
- “Investors Scramble as Stocks Swing,” Wall Street Journal, August 25, 2015.

Market Summary

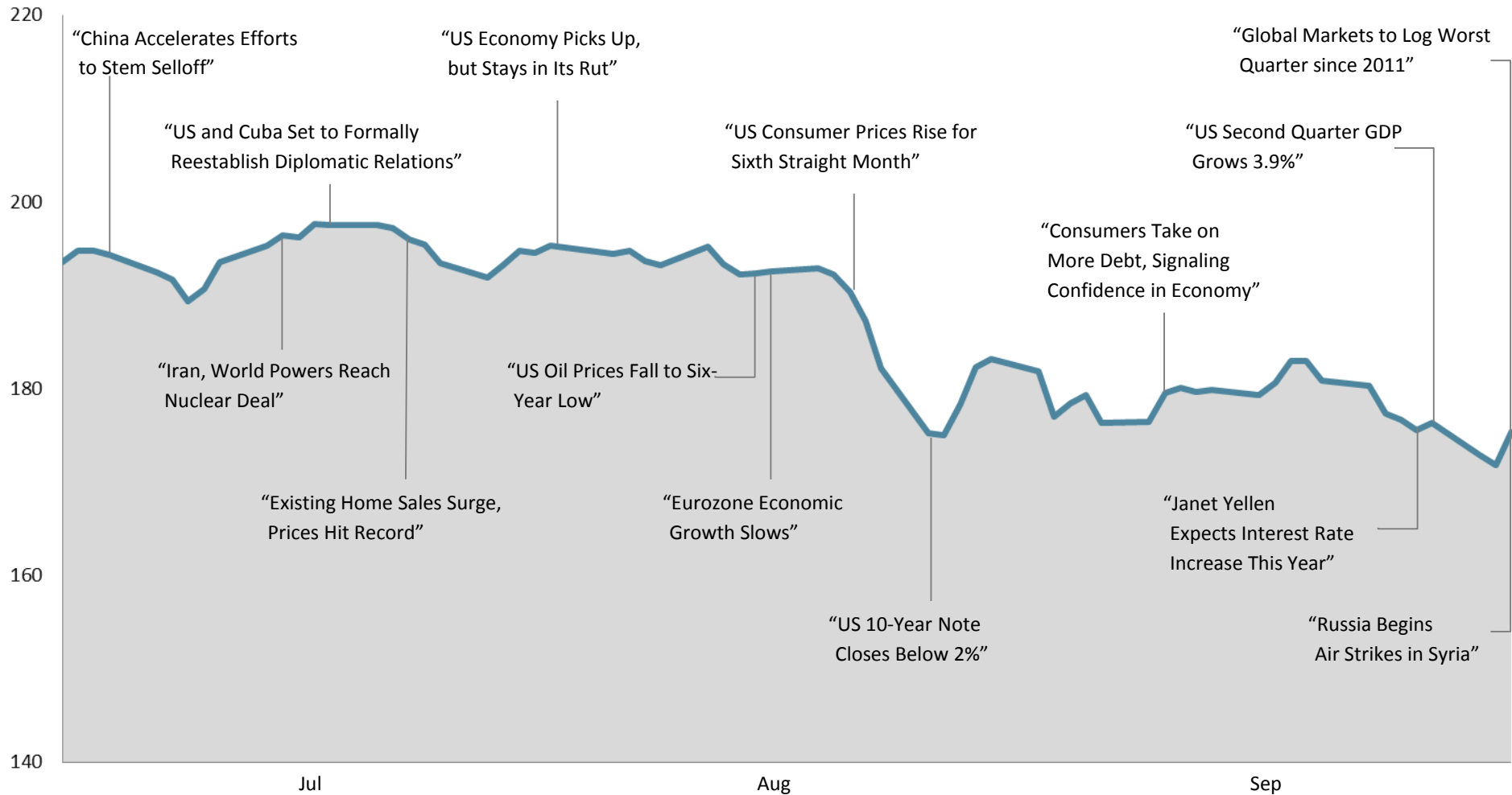
Third Quarter 2015 Index Returns



Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
 Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index), US Bond Market (Barclays US Aggregate Bond Index), and Global Bond ex US Market (Citigroup WGBI ex USA 1-30 Years [Hedged to USD]). The S&P data are provided by Standard & Poor's Index Services Group. Russell data © Russell Investment Group 1995-2015, all rights reserved. MSCI data © MSCI 2015, all rights reserved. Barclays data provided by Barclays Bank PLC. Citigroup bond indices © 2014 by Citigroup.

Timeline of Events: A Quarter in Review

Third Quarter 2015



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index. MSCI data © MSCI 2015, all rights reserved.

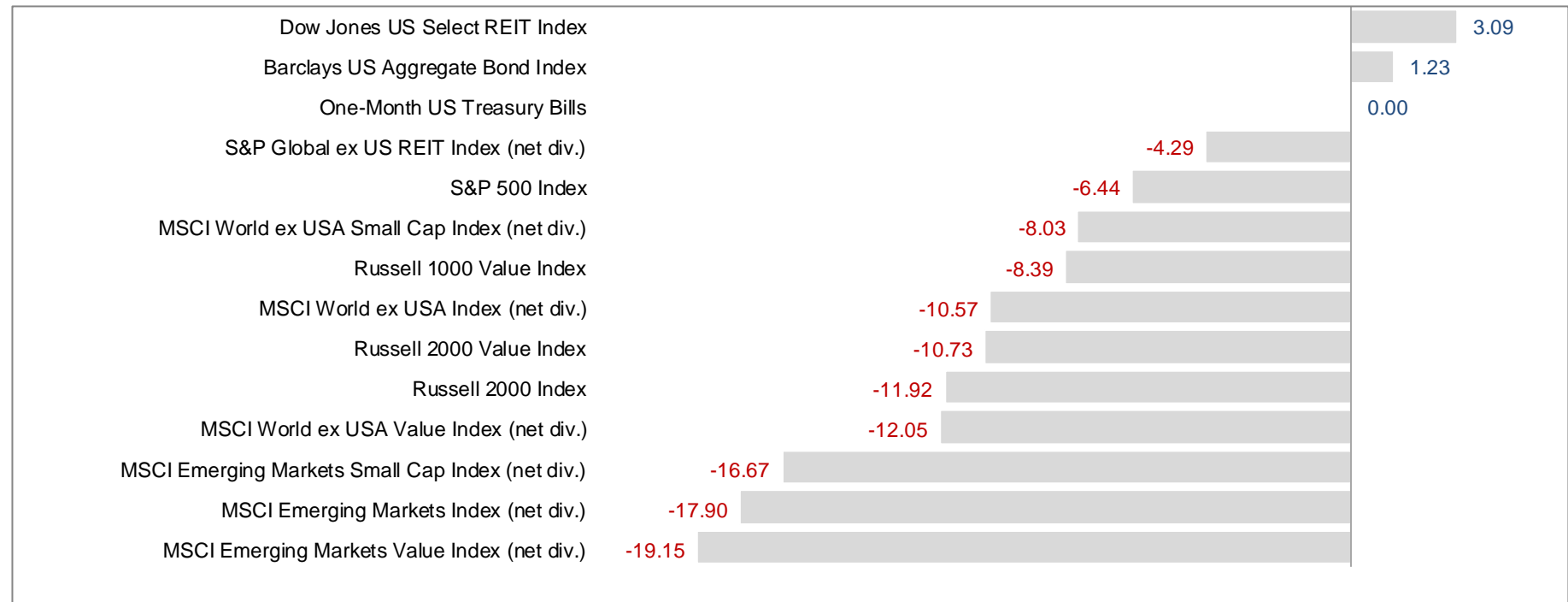
It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

World Asset Classes

Third Quarter 2015 Index Returns

Looking at broad market indices, the US equity market outperformed both developed ex US and emerging markets during the third quarter. US REITs recorded the highest returns, outperforming equity markets.

The value effect was negative in the US, developed ex US, and emerging markets. Small caps outperformed large caps in the non-US and emerging markets but underperformed in the US. The US dollar appreciated against most currencies.



Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. The S&P data is provided by Standard & Poor's Index Services Group. Russell data © Russell Investment Group 1995–2015, all rights reserved. MSCI data © MSCI 2015, all rights reserved. Dow Jones data (formerly Dow Jones Wilshire) provided by Dow Jones Indexes. Barclays data provided by Barclays Bank PLC.

US Stocks

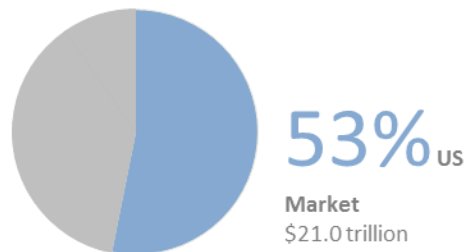
Third Quarter 2015 Index Returns

The US equity market recorded negative performance for the third quarter.

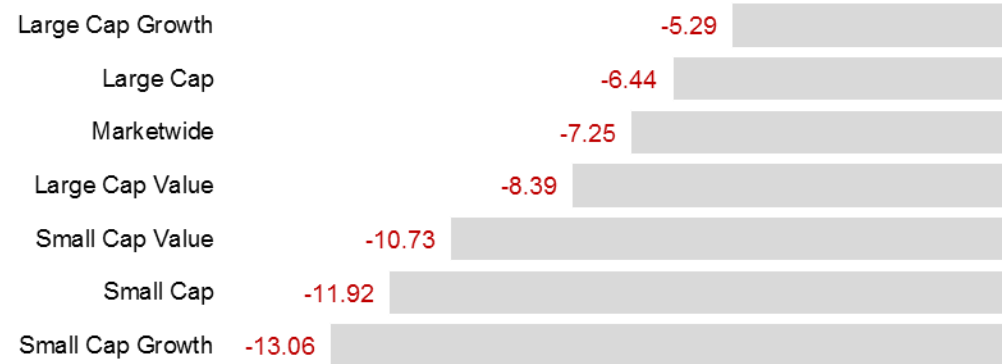
Small caps underperformed large caps.

Value stocks underperformed growth stocks among marketwide indices. However, in small caps, the effect was reversed with small cap value outperforming small cap growth.

World Market Capitalization—US



Ranked Returns for the Quarter (%)



Period Returns (%)

Asset Class	YTD	1 Year	* Annualized		
			3 Years*	5 Years*	10 Years*
Marketwide	-5.45	-0.05	12.53	13.28	6.92
Large Cap	-5.29	-0.61	12.40	13.34	6.80
Large Cap Value	-8.96	-4.42	11.59	12.29	5.71
Large Cap Growth	-1.54	3.17	13.61	14.47	8.09
Small Cap	-7.73	1.25	11.02	11.73	6.55
Small Cap Value	-10.06	-1.60	9.18	10.17	5.35
Small Cap Growth	-5.47	4.04	12.85	13.26	7.67

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: Marketwide (Russell 3000 Index), Large Cap (S&P 500 Index), Large Cap Value (Russell 1000 Value Index), Large Cap Growth (Russell 1000 Growth Index), Small Cap (Russell 2000 Index), Small Cap Value (Russell 2000 Value Index), and Small Cap Growth (Russell 2000 Growth Index). World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. Russell 3000 Index is used as the proxy for the US market. Russell data © Russell Investment Group 1995–2015, all rights reserved. The S&P data are provided by Standard & Poor's Index Services Group.

International Developed Stocks

Third Quarter 2015 Index Returns

Developed markets outside the US outperformed the US equity market but underperformed emerging markets indices in US dollar terms.

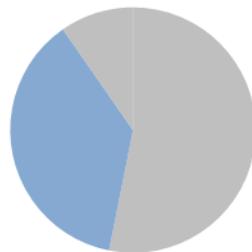
Small caps outperformed large caps.

Value underperformed growth indices across all size ranges.

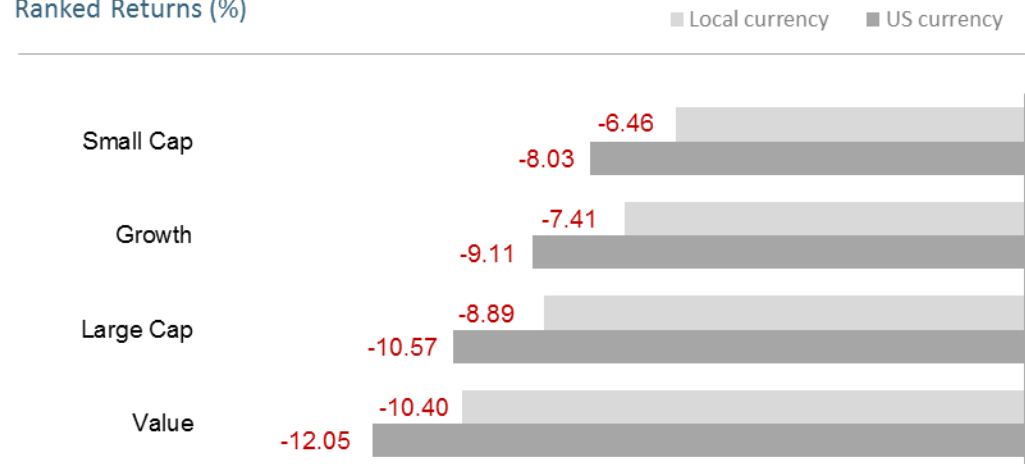
World Market Capitalization—International Developed

37%

International
Developed
Market
\$14.7 trillion



Ranked Returns (%)



Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	-6.69	-10.14	4.60	3.42	2.92
Small Cap	-0.34	-3.71	7.48	5.74	4.23
Value	-9.65	-14.32	3.56	2.61	2.12
Growth	-3.75	-5.88	5.59	4.18	3.65

* Annualized

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Emerging Markets Stocks

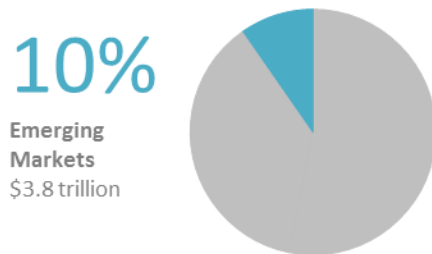
Third Quarter 2015 Index Returns

Emerging markets indices underperformed developed markets indices (including the US) in US dollar terms during the third quarter.

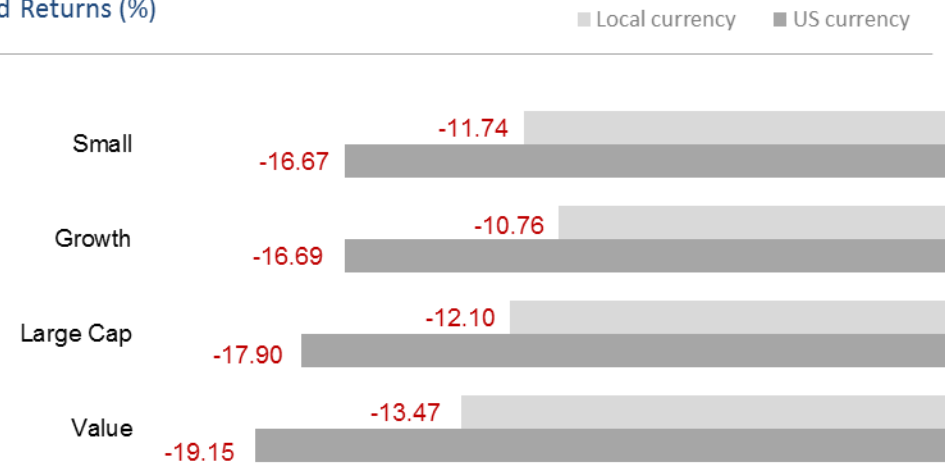
Small cap indices outperformed large cap indices.

Value underperformed growth indices across all size ranges.

World Market Capitalization—Emerging Markets



Ranked Returns (%)



Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	-15.48	-19.28	-5.27	-3.58	4.27
Small Cap	-9.80	-15.23	-1.09	-2.43	6.72
Value	-17.38	-22.70	-7.66	-5.09	4.12
Growth	-13.63	-15.89	-2.95	-2.12	4.35

* Annualized

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Fixed Income

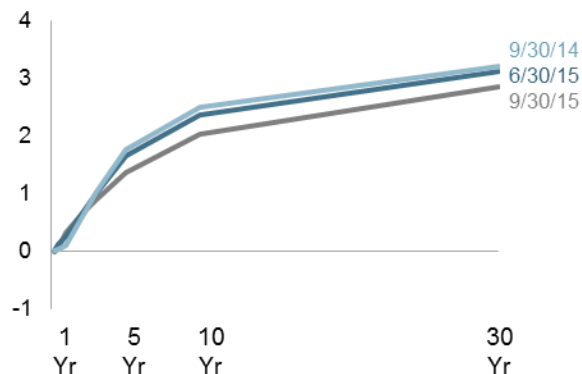
Third Quarter 2015 Index Returns

Interest rates across the US fixed income markets generally decreased during the third quarter. The yield on the 5-year Treasury note dropped 25 basis points to end the period at 1.38%. The yield on the 10-year Treasury note decreased 27 basis points to end the quarter at 2.06%. The 30-year Treasury bond fell 22 basis points to finish with a yield of 2.88%. Yields on the short end of the curve were relatively unchanged.

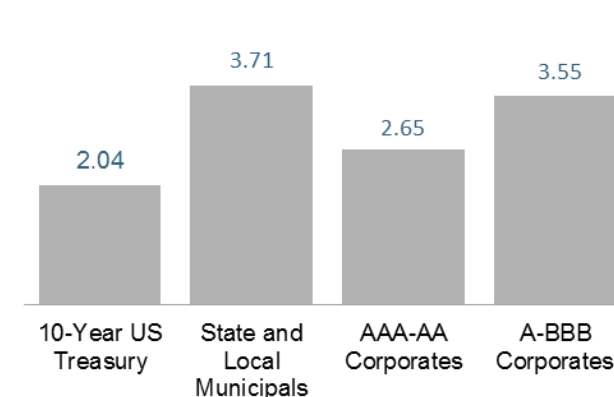
Short-term corporate bonds returned 0.30%, while intermediate-term corporate bonds returned 0.71%.

Short-term municipal bonds returned 0.74%, while intermediate-term municipal bonds returned 1.68%. Municipal general obligation and revenue bonds experienced similar returns.

US Treasury Yield Curve



Bond Yields across Issuers



Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	* Annualized
					10 Years*
BofA Merrill Lynch Three-Month US Treasury Bill Index	0.02	0.02	0.06	0.08	1.33
BofA Merrill Lynch 1-Year US Treasury Note Index	0.32	0.25	0.27	0.33	1.88
Citigroup WGBI 1-5 Years (hedged to USD)	1.09	1.57	1.34	1.50	2.97
Barclays Long US Government Bond Index	0.22	8.62	2.78	6.18	6.92
Barclays US Aggregate Bond Index	1.13	2.94	1.71	3.10	4.64
Barclays US Corporate High Yield Index	-2.45	-3.43	3.51	6.15	7.25
Barclays Municipal Bond Index	1.77	3.16	2.88	4.14	4.64
Barclays US TIPS Index	-0.80	-0.83	-1.83	2.55	4.02

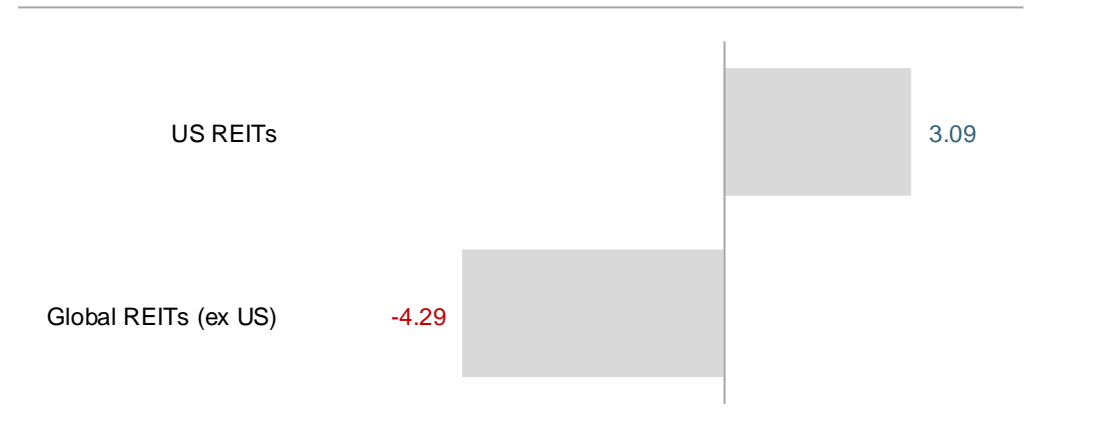
Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve. State and local bonds are from the Bond Buyer Index, general obligation, 20 years to maturity, mixed quality. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the Bank of America Merrill Lynch US Corporates, BBB-A rated. Barclays data provided by Barclays Bank PLC. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld). Citigroup bond indices © 2014 by Citigroup. The BofA Merrill Lynch Indices are used with permission; © 2014 Merrill Lynch, Pierce, Fenner & Smith Incorporated; all rights reserved. Merrill Lynch, Pierce, Fenner & Smith Incorporated is a wholly owned subsidiary of Bank of America Corporation.

Real Estate Investment Trusts (REITs)

Third Quarter 2015 Index Returns

US REITs were one of the best-performing asset classes during the third quarter, outperforming equities. Although REITs outside the US produced negative absolute returns, global REITs outside the US outperformed broad market equity indices.

Ranked Returns (%)



Total Value of REIT Stocks

41%

World ex US \$565 billion
243 REITs
(22 other countries)



59%

US \$565 billion
96 REITs

Period Returns (%)

* Annualized

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
US REITs	-2.84	11.82	9.92	12.31	6.69
Global REITs (ex US)	-5.30	-2.47	4.53	6.64	3.11

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Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Total value of REIT stocks represented by Dow Jones US Select REIT Index and the S&P Global ex US REIT Index. Dow Jones US Select REIT Index used as proxy for the US market, and S&P Global ex US REIT Index used as proxy for the World ex US market. Dow Jones US Select REIT Index data provided by Dow Jones ©. S&P Global ex US REIT Index data provided by Standard and Poor's Index Services Group © 2014.

Quotes

Third Quarter 2015

“Household net worth has reached an astounding \$85.7 trillion. That represents an increase of almost 30% (\$18.9 trillion) from the pre-recession levels of 2007. The increase was driven by a \$16.7 trillion increase in financial assets, and it occurred-in very healthy fashion-alongside a modest reduction in liabilities.”

-Scott Grannis, the Calafia Beach Pundit, September 18, 2015

“(Charlie) Munger’s invocation of multiple mental models has given him a mindset characterized by four guiding principles that any ordinary investor should follow: preparation, patience, discipline, and objectivity. When practiced correctly, these attributes should result in buying great businesses at good prices and keeping one’s portfolio turnover low”

-Robert Goldsborough, MorningstarAdvisor.com, May 1, 2015

“From the perspective of the experienced, long-term investor, risk is not about fluctuations in the prices of stocks. Rather, risk is defined as a permanent loss of capital. By definition, then, inflation is risk, a permanent loss of capital. You cannot reverse inflation. You can only attempt to outrun it. What outruns inflation? Well, stocks do.”

-Mitch Tuchman, MarketWatch.com, April 8, 2015

“Index funds hold a third of the total assets of stock funds, up from less than 20% a decade ago.”

-Jason Zweig, The Wall Street Journal, May 3, 2015

“Life can only be understood backwards; but it must be lived forwards.”

-Soren Kierkegaard

“Wealth consists not in having great possessions, but in having few wants.”

-Epictetus