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Maryland Capital Advisors

INVESTMENT COMMENT **July 8, 2015**

2nd Quarter Review and Strategy Update

The first half of 2015, particularly the 2nd Quarter, was marked by focus on two concerns:

- An imminent hike in interest-rates by the U.S. Federal Reserve
- A renegotiation of Greece's 2012 borrowing agreement[1], following the January election victory by Syriza, a party pledging to abolish the existing debt plan

Neither of these concerns are new, but they took on heightened attention during the 2nd Quarter. Interest-rate sensitive securities generated negative returns and Greece-Europe headlines increased market volatility. All-in-all, the 2nd Quarter generated flat portfolio returns, but there were material return differences among various segments of Risk and Low Risk Asset Classes.

Table 1: Selected Asset Classes	2nd Quarter	2015 YTD
SELECTED RISK ASSET CLASS SEGMENTS		
US Large Cap	+0.1%	+1.7%
US Large Cap Value	+0.1%	-0.7%
US Small Cap	+0.4%	+4.7%
US Small Cap Value	-1.2%	-0.7%
International Large Cap	+0.6%	**+6.1%**
International Small Cap	**+3.5%**	**+10.5%**
Emerging Markets	-0.5%	+1.6%
International Real Estate	-2.8%	-0.2%
US Real Estate Investment Trusts	**-10.5%**	**-6.3%**
SELECTED LOW RISK ASSET CLASS SEGMENTS		
US Treasury 1-3yr Notes	+0.1%	+0.7%
US Treasury 7-10yr Notes	-2.7%	-0.1%
US Treasury 20-30yr Bonds	**-9.6%**	**-5.8%**
US Treasury Inflation-Protected	-1.3%	-0.1%
Inv Grade Short Duration	-0.1%	+0.9%
Inv Grade Intermediate Duration	-1.6%	+0.7%
Inv Grade Long Duration	**-7.6%**	**-4.8%**
Mortgage-Backed Securities	-0.8%	+0.2%
International Bonds (Non-Dollar)	+1.1%	-5.0%
EQUITY INDICES		
MSCI All-Country World Index	+0.5%	+3.0%
S&P 500 Index	+0.3%	+1.2%
BALANCED PORTFOLIOS		
Vanguard 60/40 Fund	-0.7%	+1.0%
DFA 60/40 Fund	+0.0%	+2.0%
DFA 25/75 Fund	-0.2%	+1.3%
OTHER NOTABLE MARKET DATA		
Exchange value of Euro vs US$	**+3.9%**	**-7.9%**
Exchange value of Yen vs US$	-1.9%	**-2.2%**

Source: Bloomberg Professional

Note: Returns include reinvested dividends

2nd QUARTER CAPITAL MARKETS UPDATE

Higher interest-rates likely drove US Real Estate Investment Trusts (REITs) to be the worst-performing Risk segment during the 2nd Quarter (-10.5%). Returns on the most interest-rate sensitive Low Risk segments were also negative, with longer maturity US Treasury (-9.6%) and Investment Grade bonds (-7.6%) generating the lowest returns in 2nd Quarter.

The best-performing Risk segment was International Small Cap (+3.5%) as developed non-US markets have now outperformed US Risk in 2015.

It is interesting to note that the above segment returns are *in stark contrast to 2014, when US REITs (+30.3%), long-maturity US Treasuries (+27.3%) and Inv Grade bonds (+18.2%) produced the highest returns and International Small Cap (-6.1%) and International Large Cap (-6.2%) generated the lowest returns*[2]. This geographic disparity of returns in 2015 has occurred despite a further decline in the Euro

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[1] With Troika lenders: International Monetary Fund (IMF), European Central Bank (ECB), and European Union (EU)

[2] "4th Quarter Capital Markets Update", January 6, 2015 Investment Comment (LIBRARY tab, marylandcap.com)

(-7.9%) and Yen (-2.2%) versus the US Dollar – *developed non-US market returns were even stronger in their home currencies.*

STRATEGY UPDATE

Overall portfolio returns for 2015 have been modest. Against the backdrop of volatility caused by interest-rate movements and the latest Greek crisis, global capital markets have held-in quite well. As investors with a strategic approach to investing, we remain informed on the myriad issues that may affect our portfolios without reacting to forecasts or hype. The fact is, relying on the "certainty" of how any factor might influence investment segments is a suboptimal strategy in the long-run – we simply cannot time entries and exits to investment segments.

In light of recent events, are there changes to our investment strategy that should be considered? Short answer: no.

The Risk portion of our portfolios is globally-diversified. We have often highlighted the merits of geographic balance[3] and 2015 portfolio returns benefited from this diversity. The Low Risk portion of portfolios is constructed with relatively low interest-rate sensitivity and low default risk. The purpose of this design is also strategic: Low Risk assets serve as the capital preservation portion of our portfolio strategies.

As interesting as it is to read the latest headlines of China's stock market "meltdown", ongoing financial strains in Puerto Rico, or the evolving Greek crisis, our investment strategy avoids concentrated exposures. Such concerns may impact capital markets from time-to-time and thereby cause some needed portfolio adjustments back to targeted exposures. However, markets that may move lower should not cause anxiety for long-term investors, provided that the global financial system is sound. Much has changed since the 2008 Financial Crisis so that the global banking system can weather these strains. Foreign bank exposure to Greek debt, for example, has been cut 75% since 2008[4]. Such structural changes help explain why capital markets have viewed this latest Greek crisis with a muted response. The human strain is incredible, of course, but the impact on European and global financial markets appears contained.

Bottom-line: *2015's modest returns in both Risk and Low Risk investment segments should not be seen as a catalyst to "do something" or take more or less Risk. Recent performance is well within historical norms, especially when considering inflation-adjusted portfolio returns (year-over-year inflation has been zero in 2015).* And, as 2015 YTD and 2014 returns illustrate, investment segment returns are unpredictable. Long-term investment success is best achieved by maintaining a disciplined approach to managing a globally-balanced portfolio with strategic, targeted exposures of Risk and Low Risk assets.

The helpful comments of Paul Cucchissi, Shelley Quade, and Jenifer Owino are greatly appreciated

[3] See "Why hold non-US investments?" in our July 8, 2013 Investment Comment (LIBRARY tab, marylandcap.com)

[4] Bloomberg Intelligence, based on Bank of Greece and Bank for International Settlements data