


INVESTMENT COMMENT
Summer Update – Focus on Risk Assets

August 23, 2015

Global capital markets ended this past week with a classic “risk off” reaction: stock market segment returns across the globe declined roughly 5% (see table). Nearly all Risk segments are now negative for the 3rd Quarter and 2015 to-date. Despite some comparisons being made to previous market downturns and few hyperbolic headlines, there are some important points to appreciate:

- Recent returns are well within historical norms
- Our portfolios, constructed with a diverse balance of Risk and Low-Risk investments, have been considerably less impacted than certain market segments
- Securities markets and the global financial system are functioning normally (this is nothing like 2008)

Following on the heels of a flat 2nd Quarter¹, the 3rd Quarter – particularly the month of August – has been buffeted by a number of concerns:

- Puerto Rico defaulted on an August 1 bond payment
- Some US Presidential candidates have advocated for a government shutdown in September
- China devalued its currency on August 11 and 12

Then, just this week:

- Greek Prime Minister Tsipras resigned adding uncertainty to the recently-approved third bailout package
- North and South Korea exchanged artillery fire as North Korea warned of an imminent war

Selected Asset Classes	Past Week	3 rd Qtr QTD	2015 YTD
PORTFOLIO RISK SEGMENTS			
US Large Cap	-5.5%	-4.5%	-2.7%
US Large Cap Value	-5.4%	-4.6%	-4.7%
US Small Cap	-4.8%	-6.1%	-2.2%
US Small Cap Value	-4.8%	-6.0%	-4.2%
International Large Cap	-6.6%	-6.3%	-0.2%
International Large Cap Value	-6.4%	-6.2%	-1.7%
International Small Cap	-6.0%	-4.7%	+5.3%
International Small Cap Value	-5.1%	-5.2%	+4.5%
Emerging Markets	-8.1%	-17.4%	-14.8%
Emerging Markets Small Cap	-9.1%	-17.9%	-16.1%
Emerging Markets Value	-3.2%	-15.2%	-13.3%
US Real Estate Investment	-2.1%	+4.7%	-1.9%
International Real Estate	-5.8%	-6.5%	-2.4%
EQUITY INDICES			
MSCI All-Country World Index	-5.3%	-5.8%	-3.0%
S&P 500 Index	-5.7%	-4.2%	-3.0%
BALANCED PORTFOLIOS			
Vanguard 60/40 Fund	-3.1%	-2.2%	-1.3%
DFA 60/40 Fund	-3.2%	-4.0%	-2.1%
DFA 25/75 Fund	-1.1%	-1.4%	-0.1%
OTHER NOTABLE MARKET DATA			
Crude Oil	-5.1%	-32.0%	-24.1%

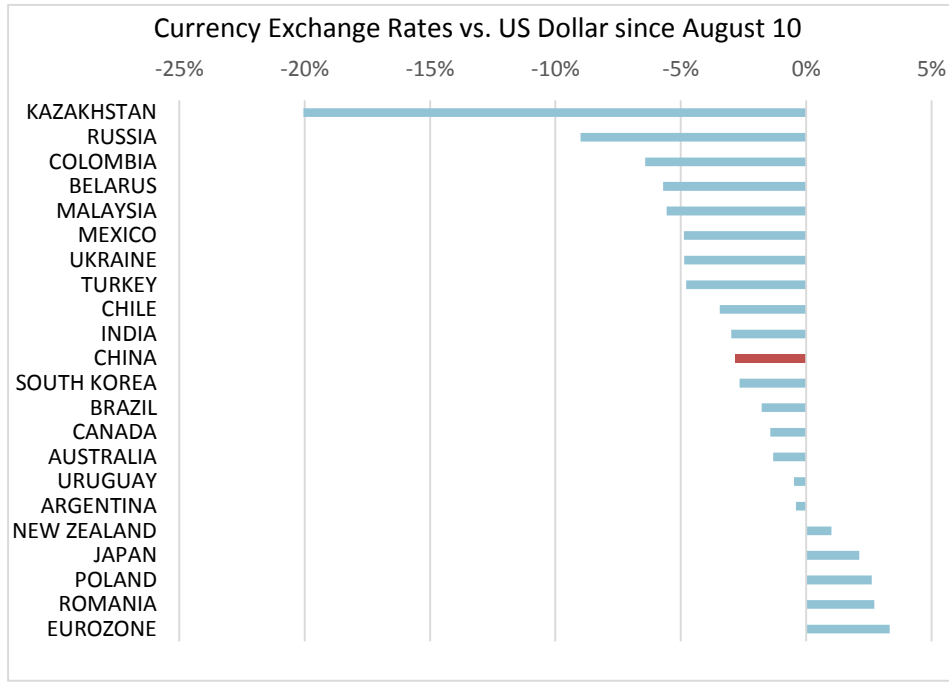
Source: Bloomberg Professional

Note: Returns include reinvested dividends

CAPITAL MARKETS UPDATE

For US investors, Emerging Markets returns have been approximately three times worse than Developed non-US and US markets. Concerns about Emerging Markets economies have increased as commodity prices weakened – in particular, Crude Oil (-32.0% in 3rd Quarter). Many commodity-exporting countries have been further stressed by the currency implications of China’s August 11/12 modest devaluation (see graph).

¹ See July 8, 2015 Investment Comment (LIBRARY tab, marylandcap.com)



PORTFOLIO AND STRATEGY UPDATE

How do all these market gyrations affect my portfolio?

Emerging Markets comprise approximately 12-13% of the Risk Asset portion of client portfolios. This strategic exposure mirrors the portion of global stock market value represented by Emerging Markets – *our portfolio strategy does not over- or under- weight Emerging Markets.*

Although Risk Assets have generated negative year-to-date returns, the Low Risk portion of our portfolios (even in the face of anticipated interest-rate increases) has performed its intended purpose: capital preservation that balances overall risk.

Have Emerging Markets or the Puerto Rico default negatively impacted my Low Risk holdings?

No. Our Low Risk investments do not include Emerging Markets bonds nor do we hold individual Puerto Rico bonds that are not fully guaranteed by third-parties or defeased by US government debt.

What next?

As of this writing, North and South Korean leaders are still meeting and Asian stock market futures have just begun trading (slightly lower). *Our focus is on the performance and structure of your overall portfolio, while sticking with our discipline. Given recent performance, we are monitoring portfolios for the following opportunities:*

Tax-Loss Harvesting

For taxable investors, where appropriate, we will begin to adjust some Emerging Market holdings to realize taxable losses and improve long-run tax efficiency.

Risk Rebalancing

We are monitoring portfolios for “allocation drift” from our strategic targets. This means that we may soon be purchasing select Risk Asset investments to return exposures to our established targets.

