Market Update & Portfolio Commentary
July 2015

Global Economic & Capital Markets Update

Although we have entered the typically quieter summer months for investors, a confluence of economic events has led to heightened volatility across global capital markets in recent weeks. In the U.S., investors continue to question the timing and potential impact of Federal Reserve interest rate increases widely expected to begin this fall. Greece has missed a debt payment to the International Monetary Fund and appears increasingly likely to be on a path to exit the Eurozone. Finally, Chinese equity markets have suffered a sharp sell-off in recent weeks as investors are concerned about a bubble in Chinese stock prices.

United States Continues to Stand Out But Federal Reserve Policy Uncertainty Ahead
The U.S. economy has been a bastion of strength and stability, particularly relative to the rest of the world, in recent years. Although the current economic recovery has been less robust than many historical recoveries, the domestic economy has grown at a slow, steady pace for several years. Further, the labor and housing markets have improved meaningfully alongside strong gains in U.S. equity markets and a strengthening U.S. dollar. The Federal Reserve has also been able to maintain highly accommodative monetary policies for an extended period as inflation, notably wage inflation, has remained muted throughout the recovery.

However, investors have become increasingly concerned that this 'goldilocks' combination of steady growth, low inflation, and accommodative monetary policy may be nearing its end in the U.S. The Federal Reserve has indicated that it plans to increase short term interest rates, specifically the Federal Funds Rate, in the fall of 2015 due to continued strength in the labor market and early indications that wages may be beginning to rise. Investors are concerned that higher interest rates may slow the already muted economic recovery in the U.S. even further. Due to this uncertainty surrounding Federal Reserve policy, U.S. equity and fixed income markets have seen heightened volatility and limited gains so far in 2015.

Signs of Recovery in Europe But Renewed Challenges from Greece
After several years of economic stagnation, the European economy finally appears to be recovering in 2015. The European Central Bank (ECB) announced its long awaited stimulus package in January, comparable in scale and scope to the U.S. Federal Reserve's quantitative easing programs of recent years, and these ECB policies were received favorably by European capital markets. Further, for the first time in years, signs of economic recovery have begun to emerge from peripheral European countries, notably Spain and Ireland, suggesting that the bailout packages put in place to support them are beginning to bear fruit. During the first five months of 2015, European equity markets responded strongly to this favorable confluence of events, outperforming their U.S. peers and recovering some of their lost ground from 2014. However, the lingering situation in Greece quickly deteriorated in June as negotiations broke down between Greece and its key creditors, which led to renewed concerns of Eurozone instability and the potential implications of a 'Grexit' (Greece abandoning the euro and becoming the first member nation to leave the Eurozone).

European capital markets have been volatile in recent weeks due to the widely publicized and ongoing negotiations between Greece and its key creditors – the International Monetary Fund, European Central Bank, and European

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Commission. In our view, the fundamental problems confronting Greece have not changed - the country has too much debt, its economy remains in a state of depression, and its banking system is reliant on the European Central Bank for liquidity to remain solvent. To emerge from this situation, Greece needs to restructure its liabilities, which struggling countries have historically done by devaluing their currency, in most cases. As a member of the Eurozone, Greece does not have the option to devalue its currency, the euro, which is the reason that many now predict that Greece will ultimately leave the Eurozone and abandon the euro.

For investors in European equities, the key question remains: what are the implications of a Greek default and potential departure from the Eurozone? Greece represents less than 2% of the European Union's total economic output, as measured by gross domestic product (World Bank). For perspective, the economy of Greece is comparable in size to the state of Connecticut in the U.S. (The Economist). Based on this data, Greece should have minimal direct impact on the broader European economy outside of Greece. However, the larger, and more important, question for investors is whether Greece leaving the Eurozone sets a precedent for other struggling countries that may ultimately undermine the common currency union in the future. Our view is that this 'contagion risk' remains unlikely to materialize today as the benefits of membership in the European Union, most notably access to the European free trade zone, still far outweigh the potential costs of membership. Based on this view, we continue to believe the European recovery story remains intact but that investors in European markets will experience increased levels of volatility due to the uncertainty emanating from Greece in the months to come.

Chinese Stock Market…From Euphoria to Crash

The Chinese stock market has been on a roller coaster ride over the past year. After rising nearly 150% from June 2014 to June 2015, the Shanghai Composite Index, which tracks domestic Chinese stocks, has fallen over 30% from its peak in recent weeks (Bloomberg). While the meteoric rise in Chinese stock prices over the past year has not been widely publicized in the financial media, investors have increasingly been calling for caution due to signs of a bubble in Chinese stock prices. The Chinese government has recently implemented several initiatives in an attempt to stem the selling of Chinese stocks. The prudence and likely effectiveness of these measures have been widely debated by investors. In our opinion, the recent correction has been necessary to bring Chinese stock prices back into reality with fundamentals after the unsustainable increases over the past year.

As the world's second largest economy, economic and capital market events in China matter to global investors. China's economy continues to decelerate as the country attempts the difficult transition from its investment and export driven growth model of recent decades to a future vision of an economy built upon domestic consumption. As China continues to liberalize its economy and capital markets in pursuit of this vison, we anticipate continued volatility in Chinese asset prices in the years to come. Importantly, events in China will continue to have an outsized impact on the entire Asian region due to China's significance as an exporter of manufactured goods and an importer of commodities and consumer products.

Portfolio Commentary

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Below are portfolio commentaries that summarize the positioning of investment strategies across each of our core Elements – Foundation, Dynamic, and Alternative – along with a summary of activity in our risk mitigation strategies. The Investment Committee at Freedom Capital Management Strategies® is continually monitoring the complex financial world in an effort to prudently manage the balance of risk and opportunity for our clients. We remain confident that our active investment strategy, with risk management at its core, is well positioned to navigate ever-changing capital markets in an effort to provide our clients a path to achieving their financial goals and dreams.

Freedom Foundation® Element

Despite increased levels of volatility across global capital markets in recent weeks, the Investment Committee has decided to maintain equity exposure at maximum levels in the Foundation models, a positioning that we have maintained for multiple years. This decision is driven by our belief that the current risk/reward opportunity remains more attractive in equities relative to fixed income. Although global equity markets have rallied strongly in recent years, especially in the U.S., valuations continue to remain reasonable in relation to long term historical averages. The opportunity in fixed income remains limited due to the suppressed level of interest rates around the globe, especially in developed country bond markets that continue to be influenced by central bank activity.

Equity Holdings

The equity holdings of the Foundation models remain globally diversified. We maintain significant allocations to large cap U.S. and developed international equities. In the U.S., we continue to observe improving economic fundamentals that we expect to remain supportive of corporate earnings in the coming quarters. In developed international equity markets, we believe that the nascent recoveries in Europe and Japan coupled with accommodative central bank policies should be positive for equities. We have implemented a significant portion of our international equity allocation through a hedged currency positon where possible due to the risk of currency depreciation relative to the U.S. dollar as central bank policies in Europe and Japan diverge from the U.S.

Fixed Income Holdings

We remain conservative in our fixed income holdings due to the low level of interest rates globally and prospects of an interest rate increase from the Federal Reserve in the second half of the year. We maintain the majority of our fixed income allocation in U.S. bonds across the credit spectrum due to a combination of more attractive yields and stronger economic prospects. We have minimal exposure to the sovereign bonds of developed international countries where interest rates remain at historically low levels. We also maintain our bias to active managers with flexible mandates that we feel are better positioned to navigate the increased levels of interest rate and liquidity risk present in global fixed income markets.

Freedom Dynamic® Element

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The Freedom Dynamic® Element is comprised of strategies that utilize tactical management and concentrated portfolios in an effort to achieve enhanced risk-adjusted returns.

During the second quarter, our core tactical strategy, Dynamic Focused, benefitted from targeted exposure to domestic regional banks as rising interest rates during the quarter proved to be a positive for bank balance sheets. Additionally, exposure to Asian equities during the quarter was beneficial for the portfolios as Japan led the way, outperforming both the U.S. and other developed international equities, driven by the continued weakening of the yen. Tactical allocations to U.S. healthcare and growth stocks detracted from performance during the middle of the quarter as severe volatility amongst biotech companies served as a headwind for these two market segments.

The concentrated individual security models in the Dynamic Element generated mixed results in the second quarter of 2015. Dynamic Dividend generated the strongest results due to strong stock picking and exposure to the financial sector. Dynamic Equity struggled due to a combination of stock picking challenges and outsized exposure to small market capitalization companies in the technology sector, which saw heightened volatility during the quarter. Finally, Dynamic Income lagged during the quarter as exposure to REITs and other yield-sensitive securities was unfavorable as interest rates increased on expectations of changes to Federal Reserve monetary policy.

Freedom Alternative® Element

The Freedom Alternative® Element seeks to capitalize on non-traditional asset classes and investment strategies in an effort to more holistically diversify investor portfolios. As is typical, the Alternative models were impacted by a variety of factors due to the unique, and oftentimes uncorrelated, nature of these strategies. The Absolute Return model generated a modest loss during the quarter with global allocation funds contributing positively and long/short strategies proving a detractor. The Quantitative model, which follows a relative-strength based, technical investment approach, struggled during the quarter due to an allocation to international equities and an overweight to growth equities in the U.S. The Hard Assets model declined again in the second quarter as commodity markets continue to struggle due to subdued global growth and a slowing Chinese economy.

Risk Management

The proprietary risk mitigation overlays available through Freedom Capital Management Strategies® are designed to provide an additional layer of wealth protection to investors through a systematic hedging process. Risk levels remained contained within our diversified portfolios during the second quarter. As a result, all five Risk Assist models remained fully invested and several Principal Guard vintages un-hedged.

Freedom Capital
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Authored by the Freedom Capital Management Strategies® Investment Committee

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