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MONTHLY MARKET UPDATE

June 2016

Economic indicators generally strengthened in the U.S. through June, but the British referendum to exit the European Union (the Brexit) sent shockwaves of uncertainty through global capital markets. The referendum occurred after most of the positive economic indicators were measured, which means positive news must be confirmed in the July economic releases to truly start to appreciate the impact of the Brexit.

Key Economic Statistics*	Period	Level	Vs. Prior
Manufacturing Economy Strength	June	53.2	Stronger
Service Economy Strength	June	56.5	Stronger
Monthly Jobs Report	June	287k	Stronger
National Unemployment Rate	June	4.9%	Weaker
Annualized Quarterly GDP Growth	Q1 – 3rd	1.1%	Stronger
Personal Consumption (Spending)	Q1 – 3rd	1.5%	Weaker
Inflation–CPI ex.Food/Energy	May	2.2%	Stronger

** See disclosure for underlying economic indicator definition. FactSet*

Brits Say "Cheerio" After Declaring the European Union Rubbish

Key Index Performance*	1 Mo	3 Mo	YTD	1 Yr	3 Yr	5 Yr	10 Yr
Equities							
Large Domestic Companies S&P 500 Total Return Index	0.26	2.46	3.84	3.99	11.66	12.10	7.42
Small Domestic Companies Russell 2000 Total Return Index	-0.06	3.79	2.22	-6.73	7.09	8.35	6.20
International Developed Companies MSCI EAFE Index	-3.36	-1.46	-4.42	-10.16	2.06	1.68	1.58
Emerging Market Companies MSCI EM Index	4.00	0.66	6.41	-12.06	-1.56	-3.78	3.54
Taxable Fixed Income							
Short Term Bonds Barclays U.S. 1-3 Year Aggregate Index	0.60	0.68	1.66	1.60	1.26	1.14	2.88
Intermediate Term Bonds Barclays U.S. Aggregate Bond Index	1.80	2.21	5.31	6.00	4.06	3.76	5.13
High Yield Bonds Barclays U.S. Corporate High Yield Index	0.92	5.52	9.06	1.62	4.18	5.84	7.56
International Government Bonds Citigroup World Government Bond Index	3.69	3.41	10.74	11.26	2.65	1.18	4.22
Tax Exempt Fixed Income							
Short Term Municipals Barclays Municipal 1-3 Year Index	0.30	0.46	0.94	1.44	1.08	1.08	2.42
Intermediate Term Municipals Barclays Municipal 5-10 Year Intermediate Index	1.25	1.84	3.42	6.48	4.70	4.47	5.18
High Yield Municipals Barclays High Yield Municipal Index	3.11	5.10	7.98	12.09	6.53	7.77	5.11
Real Assets							
Commodities Bloomberg Commodity Index	4.13	12.78	13.25	-13.32	-10.55	-10.82	-5.59
Global Real Estate Dow Jones Global Select REIT Index	4.39	4.02	10.28	17.83	11.96	10.58	5.94

** All data as of 6/30/2016. See disclosures for underlying index definitions. Periods longer than one year represent annualized performance.*

Economic Update

The big economic news for the month and for the quarter was the outcome of the United Kingdom's June 23 referendum to leave the European Union (EU). Coming into the vote, market expectations were firmly on the Remain side despite polls indicating that the gap between the Remain and Leave camps had narrowed significantly. As it became clear that the Leave camp would pull off a surprise victory, global capital market volatility picked up and investors were left to ponder the implications.

The debate on the merits of an exit continues. While both sides agree that the short term impact to the U.K.'s economic growth will be negative, there is much disagreement about the intermediate to long term impact. The Leave camp campaigned and won on a view that the U.K. will be stronger in the long run if it is independent from the EU. By contrast, the Remain camp continues to believe the benefits of free trade between EU members as well as being able to negotiate with the rest of the world as part of an economic block outweigh the costs.

So what are the implications of the Brexit vote? The short answer is that we don't know yet. There is a significant amount of uncertainty associated with the vote. To begin with, the outcome of the referendum was non-binding. Officially leaving means invoking Article 50 which officially starts a two year clock to negotiate an exit. Parliament, which has been pro-Remain, may yet decide not to pull the trigger on leaving. However, they would probably need some political cover for going against the outcome of the vote and incoming Prime Minister May has indicated she will honor the outcome of the referendum. Starting negotiations on the terms of an exit is not the same as negotiating on the future state of new trade agreements. Expectations are that full negotiation of new deals can take significantly longer than the two year exit period. Furthermore, the EU is fighting for its survival as several more members may consider exiting if the U.K. is able to secure advantageous deals. All of that probably means we end up with an arrangement which doesn't look significantly different from what we have today. Perhaps that realization is the reason most markets seemed to shrug off the vote, recovering near to pre-Brexit levels.

The above should not be read as the Brexit not having an impact. The U.K. has been one of the strongest growing developed economies, with expectations prior to the vote generally between 2 and 2.5% for the next several years. Following the vote, growth expectations have been haircut to between 0.4 and 1.5% for the next few years. Eurozone growth has been reduced by roughly a quarter of a percent. U.S. growth has been revised down by one to two tenths. In short, expectations are that global growth will slow as a result of the vote.

Economic indicators actually showed the U.S. economy was strengthening prior to the Brexit vote. Since the vote occurred towards the end of June, the impact won't be clear until economic releases for July start coming out. That being said, it is notable that the U.S. had been recovering from a hiccup in May. Following the weak May labor report, employers returned to hiring in June as the economy added 287,000 jobs. In addition to the hiring, measures for both the manufacturing and service economy ticked up. The service economy index moved back above 55, a level which is consistent with more robust growth. Importantly, within the index components the expectations for employment picked up, suggesting hiring will continue.

When the Federal Open Market Committee (FOMC) met in the middle of June, the most recent data they had available was a weak May labor market report and narrowing polls regarding the Brexit. They determined to stay on hold with interest rates pending a turnaround in labor markets and global economic conditions. While the June labor report certainly was a step in the right direction, the Brexit

outcome was not. Following the vote, the 10-year Treasury rate declined from 1.75% to roughly 1.50%, and has fallen further after month end. Expectations for a Fed hike are being pushed into 2017, and FOMC guidance suggests the long term equilibrium rate has declined. This generally means the Fed is likely to retain an accommodative monetary stance, while various foreign central banks may embark on further easing.

Capital Markets Update

While the Brexit vote caused market volatility, the damage was relatively contained as most markets recovered to pre-Brexit levels. U.S. large and small companies delivered positive returns for the quarter. Emerging market equities also were positive. Developed international equities were negative, with much of the negative results driven by currency translation effects.

U.S. equity markets recovered relatively quickly, and since month end the S&P 500 has pushed to a new record high. In part this likely is an acknowledgement that U.S. markets have limited exposure to trade with the U.K. More broadly, this likely is confirmation that the U.S. economy will continue to recover, and company earnings are expected to revert to growth through the third and fourth quarters of 2016. Market valuations are increasingly concerning as earnings decline while levels increase, inflating the price to earnings ratio. On a trailing basis, the S&P currently trades at 19.5x earnings, and on a forward basis, it trades at roughly 17x earnings. Both valuation levels are above long term averages. That does not mean valuations are unreasonable. In the context of a historically low interest rate environment, valuations may be considered reasonable. However, by most measures, valuations are stretched.

As stated in prior monthly updates, investors are placing a big bet on a future earnings recovery. As we enter the earnings reporting season, earnings for the S&P 500 are expected to decline by 5.6%. This would be the first time earnings have declined for five consecutive quarters since the turbulent between late 2008 and early 2009. Earnings are expected to slowly recover through the remainder of 2016 before accelerating to double digit growth in 2017. Notably, that expectation is significantly tied to a turnaround in the energy sector, an outcome which may get pushed further into the future as slowing global economic growth takes the pressure off of a rebalancing in the energy sector. Growth in the small cap segment, which is less tied to international trade, is expected to be stronger for the remainder of 2016 as well as 2017.

Despite the growth outlook globally being somewhat weaker than in the U.S., the earnings growth outlook is generally as attractive as in the U.S., with valuations discounted versus the U.S. That discount may reflect uncertainty about geopolitical risks, and it may reflect some expected currency volatility. Valuations have been persistently lower in foreign markets for several years, adding to frustrations of underperformance by diversified portfolios. These periods of regional leadership can last for a while, but historically the leadership does historically rotate.

Fixed income securities broadly benefited from falling interest rates, with much of the returns coming in the last week of June as rates declined following the Brexit vote. The downside of the strong returns in fixed income is that they are less and less likely to repeat as interest rates fall (and turn negative in many regions). The strong returns now reduces the expectation for reasonable returns going forward. Despite falling expectations, fixed income securities remain essential to reduce the risk inherent in equities.

While the price impact of a one percent move in interest rates is more severe at these low interest rate levels, the probability of a one percent move is also lowered because of the economic environment. Globally, central banks are fighting deflationary forces, not inflationary forces – this reduces the upward

pressure on interest rates. Globally, growth remains weaker than in prior recoveries – this reduces upward pressure on interest rates. Globally, central banks are on balance looking at further monetary easing, not tightening – that reduces upward pressure on interest rates. The FOMC has said as much by providing guidance for a lower long term expected federal funds rate. Their guidance has come down to expectations around 3%, down from approximately 4.5% as recently as 2012.

Since August of 2015, when market volatility has broken out it has also quickly receded. This may be the new normal, or at least it may continue for as long as global monetary policy continues at near zero interest rates. Overall, the global economy appears set to continue growing, with likely bouts of volatility as geopolitical shocks transmit through the system. We continue to believe the most effective strategy to deal with uncertainty is to have a financial plan in place and to periodically review the plan to determine if you are on track to meet your financial goals or if changes are needed. If recent market events have you concerned, we suggest speaking with your HD Vest Advisor.

Asset allocation and diversification do not assure or guarantee better performance and cannot eliminate the risk of investment losses. Your individual allocation may be different than the HDVAS sample strategic model due to your unique individual circumstances.

Disclosures:

Unless footnoted and disclosed otherwise, all economic data throughout report sourced from FactSet.

Large domestic companies measured by the S&P 500, which is an index of 500 major U.S. large cap corporation.

Small domestic companies measured by the Russell 2000 Index which measures the performance of small-cap segment of the U.S. equity universe. Small domestic companies also measured by the S&P Small Cap 600 index.

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International developed companies measured by the MSCI EAFE Index, which is an unmanaged market capitalization-weighted index of equity securities of companies domiciled in various countries. The Index is designed to represent the performance of developed stock markets outside the United States and Canada and excludes certain market segments unavailable to U.S. based investors.

The Euro Stoxx index measures the performance of a subset of 12 Eurozone countries within the Stoxx Europe 600 index.

Emerging market companies measured by the MSCI Emerging Markets Index, which is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.

Short-term taxable bonds measured by the Barclays U.S. 1-3 Year Aggregate, which is a subset of the Barclays U.S. Aggregate index, representing securities with 1 to 3 years remaining until maturity.

Intermediate-term bonds measured by the Barclays U.S. Aggregate Bond index, which measures the performance of investment-grade bonds in the U.S. fixed-income universe. It includes U.S Treasury issues, agency issues, corporate bond issues and mortgage-backed issues. It is unmanaged, includes reinvestment of dividends, does not reflect the impact of transaction, manager or performance fees and is unavailable for investment.

High-yield bonds measured by the Barclays US Corporate High Yield Index, which tracks the performance of domestic non-investment grade corporate bonds.

International government bonds measured by the Citi World Government Bond Index (WGBI), which measures the performance of 23 government bonds markets including Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Malaysia, Mexico, the Netherlands, Norway, Poland, Portugal, Singapore, Spain, Switzerland, Sweden, the United Kingdom and the U.S.

Short-term municipals measured by the Barclays Municipal 1-3 Yr index, which measures the performance of investment-grade municipal securities with 1 to 3 years remaining until maturity.

Intermediate term municipals measured by the Barclays Municipal Intermediate 5-10 Year index, which measures the performance of investment grade municipal securities with 5 to 10 years remaining until maturity.

High-yield municipals measured by the Barclays High Yield Municipal index, which measures the performance of below investment-grade municipal securities with at least 1 year remaining until maturity.

Commodities measured by the Bloomberg Commodity index, which is comprised of future contracts on physical commodities which trade here in the U.S. and certain foreign markets. It measures the performance of investment in a broad basket of commodity futures contracts.

Real estate measured by the Dow Jones Global Select REIT index, which represents equity real estate investment trusts (REITs) and REIT like securities traded globally.

Manufacturing economy strength measured by the Institute for Supply Management Manufacturing Index. A measure above 50 indicates expansion while a measure below 50 indicates contraction.

Service economy strength measured by the Institute for Supply Management Non-Manufacturing Index. A measure above 50 indicates expansion while a measure below 50 indicates contraction.

Monthly jobs report measured by the Bureau of Labor Statistics' US Employees on Non-Farm Payrolls Month over Month net change.

National unemployment rate measured by Bureau of Labor Statistics.

Annualized Quarterly GDP Growth measured by Bureau of Economic Analysis and is released as preliminary (1st estimate), revised (2nd estimate) and final over the course of a quarter.

Personal Consumption growth measured by the Bureau of Economic Analysis and represents final market value of all goods and services produced in the U.S.

Annual Inflation Rate measured by the Bureau of Labor Statistics Consumer Price Index (CPI). Value reflects year over year change in the CPI ex-Food and Energy index.

An investment cannot be made directly into an index.

Investments are subject to market risks including the potential loss of principal invested.

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