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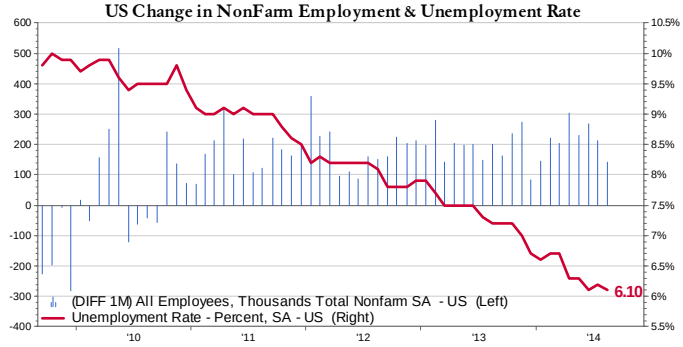
Market Review

August 2014

Economic Review

U.S. second quarter real GDP was revised from 4.0% to 4.2% as private investment increased more than initially reported, according to the Bureau of Economic Analysis. The third quarter GDP growth is expected to be around 3%.

The labor market continued to improve as total nonfarm payroll employment increased by 209,000 in July, the sixth consecutive month of 200,000+ job gains. Payroll figures in May and June were also revised higher by a combined 15,000 jobs. The unemployment rate remained little changed at 6.2%, according to the U.S. Bureau of Labor Statistics. The civilian labor force participation rate remained stable at 62.9%.

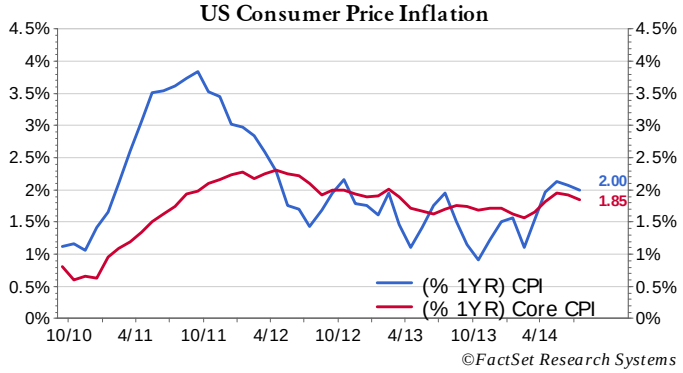


The employment-to-population ratio also remained unchanged for the month at 59%, but edged up 0.3% year-over-year (YoY). The average workweek for all employees on private nonfarm payrolls was 34.5 hours for the fifth straight month. Average hourly earnings edged up 1 cent to $24.45, and have managed only a 2% increase over the past 12 months.

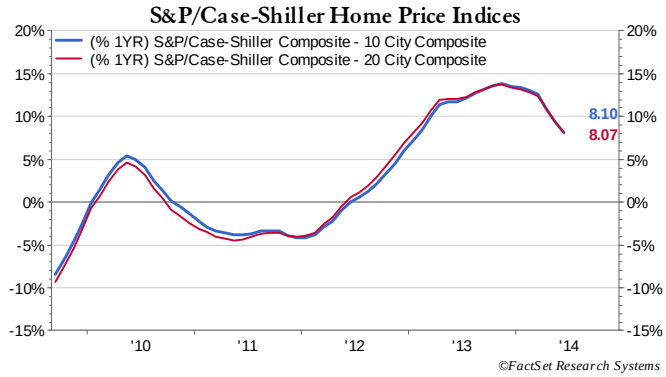
Regional and national manufacturing data released in August indicated strength in the U.S. manufacturing economy. The ISM Manufacturing Index rose to 57.1% in July, up from 55.3% in June, suggesting an expansion for the 14th consecutive month. The new orders index came in at 63.4%, up from 58.9% in June. The ISM Non-Manufacturing index was at 58.7%, up from 56.0% in June and above the consensus forecast of 56.5%. This is the highest reading for the index since January 2008.

Consumer confidence rose to 92.4 in August, its highest level since October 2007. Job growth and improving business conditions boosted confidence, according to the Conference Board. The personal saving rate rose to 5.7% from 5.4% in June. Personal incomes rose 4.3% YoY. However, retail sales were flat in July raising questions about the strength of the U.S. consumer going into the third quarter.

The Consumer Price Index (CPI) increased +0.1% Month over Month (MoM) in July, (the slowest pace since February) and +2.0% YoY. The soft headline inflation data were driven by lower energy and commodity prices, offset by higher food prices. Core CPI rose +0.1% MoM and +1.9% YoY.

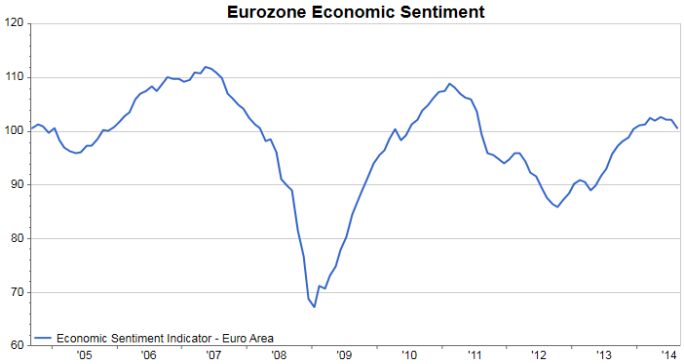


August housing data indicated that the recovery has slowed in recent months. Home prices, as indicated by S&P Case Shiller 20 city composite Index, gained 8.1% YoY in June, the lowest gain since January 2013. Existing home sales increased for the fourth consecutive month during July as sales increased 2.4% MoM to an annualized rate of 5.15 million. Despite this gain, total existing home sales declined -4.3% YoY. The inventory of existing homes for sale increased to 2.37 million, representing a 5.5-month supply. New home sales declined -2.4% in July as sales disappointed for the second consecutive month.



The Federal Reserve Bank of Kansas City hosted the annual symposium in Jackson Hole, Wyoming. Speaking at the conference, the Fed Chair cautioned that considerable uncertainty remained with the current state of the labor market and that the Federal Open Market Committee will take into account a large range of information on the labor market as part of their debate on the future path of monetary policy.

Economic data for Europe released in July was mostly poor. Eurozone inflation ticked slightly higher to -0.3% from -0.4% in July, which was the lowest level since the bottom of the 2009 global financial crisis. Deflation fears, combined with an 11.5% unemployment rate, have sparked speculation that the European Central Bank will pursue an even more accommodative monetary policy. The estimate for Eurozone second quarter GDP growth was 0%, which included zero-growth readings from France and contraction in the German economy (-0.2%). The gloomy economic data have spread to business and consumer confidence surveys, which both fell from the previous month. The Economic Sentiment Indicator (ESI) for the Eurozone fell to 100.6 from 102.1 in July, as ongoing geopolitical tensions and deteriorating economic data have concerned European consumers and businesses.



In the United Kingdom, economic data were mixed. The unemployment rate fell to 6.4% in June, below May's 6.5% reading; the unemployment rate is now the lowest since December 2008. Average wages, excluding bonuses, rose only 0.6%, the slowest rise since 2001. Including bonuses, wages fell for the first time since 2009, sliding -0.2% in June. In addition, inflation fell more than expected in July, dropping to 1.6% from June's 1.9% reading. Disinflation fears, combined with slowing growth in the U.K.'s surging housing market, has created expectations that the Bank of England will push back the timetable for raising interest rates.

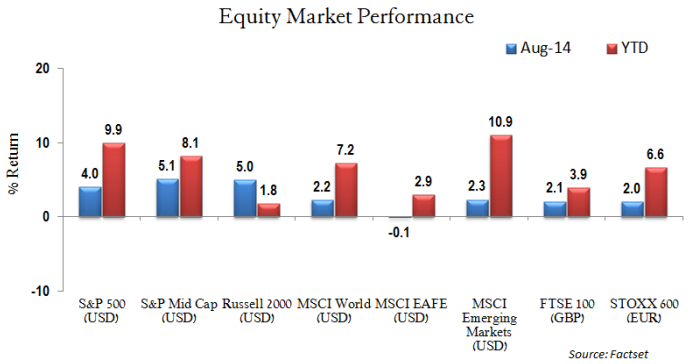
In Asia, Japan's economy is feeling the effect of a large sales tax increase, as Japan's second quarter GDP growth fell by -6.8%. The significant decline was slightly better than the -7.1% forecast. The Japanese government enacted a massive sales tax increase in April to combat rising government debt, which currently stands at 240% of GDP. The advanced announcement of a pending tax increase caused consumption in the first quarter of 2014 to spike, as consumers rushed to make purchases before the tax hike. Japanese first-quarter GDP growth was 6.1%, which has now been reversed by the contraction in the second quarter.

In India, the economy grew 5.7% on a year-over-year basis. This is the highest growth in more than two years. India has seen recent improvement in business investment, manufacturing, and consumer demand, as investors and consumers view the new government coalition led by Prime Minister Narendra Modi as positive for the Indian economy.

The Reserve Bank of Australia (RBA) lowered its forecasts for both inflation and GDP growth, citing a further decline in the mining industry. The RBA lowered inflation forecasts to 2% from 2.75% and lowered GDP growth forecasts to 2-3% from 2.25-3.25%. These forecast revisions come as Australia's unemployment rate rose to 6.4% in July, a 12-year high and up from 6.0% in June. The RBA has maintained its policy stance, holding cash rates at a record low of 2.5%.

Equity Markets

Global equities mostly rose in August, rebounding from a sharp decline at the end of July. The MSCI World Index gained 2.2% in August and is up 7.2% in 2014. Domestic large-cap stocks, as measured by the S&P 500, rose 4.0% in August after a strong revision to second quarter GDP. The S&P 500 is up 9.9% year-to-date (YTD). Domestic mid-cap stocks measured by the S&P 400 rose 5.1%, while the Russell 2000 small-cap index gained 5.0%. The headline indices for Europe (STOXX 600) and the U.K. (FTSE 100) gained 2.0% and 2.1%, respectively. The MSCI Emerging Markets Index posted a 2.3% gain in August, and is currently up 10.9% in 2014, after falling 2.27% in 2013.

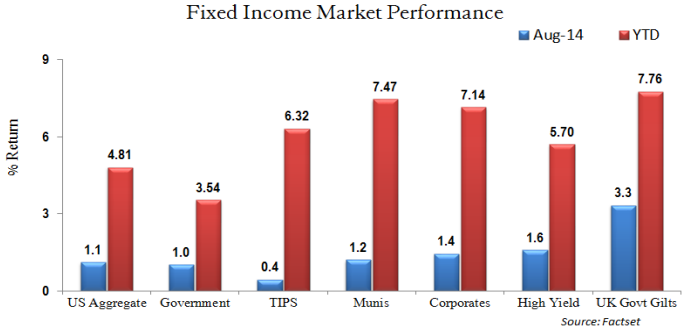


Global equities traded choppily in the first week of the month, continuing the downturn from the end of July on European deflation concerns and global political unrest. The S&P 500 subsequently traded up for the remainder of the month, rallying over 5% from August 7 through the end of the month. Market volatility, as measured by the CBOE Market Volatility Index (VIX), trended down throughout August, closing the month at 11.98 after opening the month at 16.95.

Bond Markets

Global bond markets rallied, reversing July's volatility to post across-the-board gains in August. The U.S. bond market, as measured by the Barclays U.S. Aggregate Index, rallied 1.1% during the month. The 30 Year U.S. Treasury Bond yield declined sharply in August, finishing the month 24 bps lower at 3.07%. The monthly close of 3.07% was the lowest since April 2013, when the 30 Year closed at 2.877%. The Treasury yield curve continued to flatten with the 2/30 year spread, flattening 22 bps in August and nearly 95 bps YTD. High Yield credit spreads (measured by the Bank of America Merrill Lynch US High Yield Master II Option-Adjusted Spread Index) decreased by 20 bps to close August at 3.84%.

The FTSE UK Government Gilts Index rose 3.3% in August as the yield on 10-year benchmark gilt declined 0.35 bps to 2.25%. The yield on German 10-year benchmark bonds fell 26 bps to end August at 0.89%.

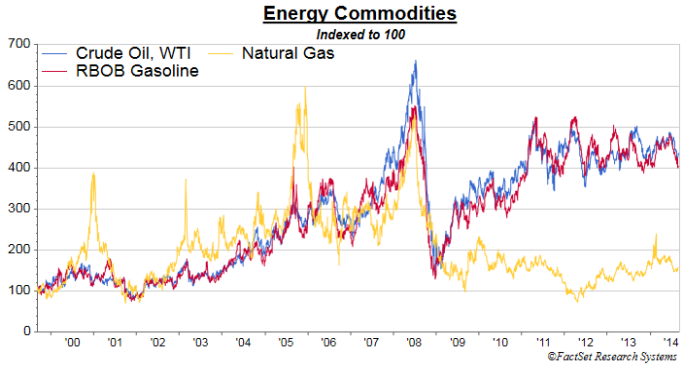


Commodities

The S&P GSCI Total Return Index, a headline index of 24 commodities, fell -1.64% in August, sliding into negative territory for the year (-1.53% YTD). The Agricultural sub-index continued its four-month slide, losing -0.75% in August. The YTD performance for the sub-index stands at -7.92% after recording 19% gains from January through April. Sugar [-5.89%], Corn [-1.00%] and Soybeans [-5.34%] all posted losses in August. The Livestock sub-index fell -3.85%, paring year-to-date gains to 13.20% after a strong first half of 2014.

The Industrial Metals sub-index rallied 0.78% in August, the only of the 10 headline sub-indices to finish the month in positive territory for the second consecutive month. Aluminum [4.86%], Nickel [1.46%], and Lead [0.51%] contributed gains to the Industrial Metals sub-index, while Zinc [-0.55%] and Copper [-1.81%] were negative contributors.

The Energy [-1.88%] and Petroleum [-2.17%] sub-indices were among the worst performers in August, despite mounting tension between Russia and Europe and continued unrest in the Middle East. West Texas Intermediate (WTI) Crude Oil opened August at $98.17/bbl, and traded lower throughout the first three weeks of the month, bottoming at $92.86/bbl on August 19. WTI Crude then traded up to close the month at $95.96/bbl. Natural Gas rose 5.20% in August, while refined petroleum products (Heating Oil, Gasoline, and Gasoil) each fell over 1%.



Currency

The US Dollar continued to rally against a basket of peers in August on generally positive U.S. economic reports, uncertainty around the European economic recovery and geopolitical concerns. The US Dollar index appreciated 1.57% in August and has appreciated +3.37% YTD.

The Euro declined -1.55% against the US Dollar to close at 1.3172 USD/EUR vs. 1.338 USD/EUR in the prior month. The British Pound depreciated -1.63% against the US Dollar in July to close at 1.660.