March 2015

Investment Portfolios Perform Well in February as Stocks Lead the Way

Overview

The first two months of 2015 have been rewarding for disciplined, diversified investors. Foreign stocks have posted strong returns. U.S. stocks have performed well, and U.S. economic growth has continued to move upward at a record/comfortably fast pace. According to the U.S. Labor Department, for instance, the number of new jobs has increased from November 2014 through January 2015 at the strongest rate since 1997. For now it seems this upward trend will continue in the U.S. economy at least as hiring picks up and lower energy costs provide relief to consumers focused on balancing their budgets. Wal-Mart, one of the nation's largest employers, recently announced that it is raising its entry-level wages, a development that will boost income for 500,000 people. We continue to stress that diversification across many asset classes is the best way to make the most of this strong economic picture at home and improvement abroad while also protecting your portfolio against the inherent risks associated with investing.

Performance

Most asset classes performed well in February. Both U.S. stocks and international equities performed very well, returning over 5.0%. . In a pleasant shift from 2014, international equities have been the strongest performing investment through the first two months of 2015, with the MSCI EAFE index returning 6.50%. Alternative investments also performed well during the month, with the HFRX Hedge Fund index returning 2.02%. Core bonds, however, were hurt by rising interest rates.

Index Name	Feb 2015	YTD 2015	5-Year Annlzd	10-Year Annlzd	Category
BarCap Municipal TR USD	-1.03	0.72	5.00	4.75	US Muni Bonds
BarCap US Agg Bond TR USD	-0.94	1.14	4.29	4.82	US Taxable Bonds
BarCap US Corporate High Yield TR USD	2.41	3.09	9.38	7.92	US Corporate HY Bonds
JPM EMBI Global Diversified TR USD	0.85	1.79	7.58	7.83	Int'l/Emerging Bonds (USD)
JPM GBI EM Global Diversified TR USD	-1.34	-1.01	2.14	6.16	Int'l/Emerging Bonds (Local)
HFRX Equity Hedge USD	2.27	1.59	1.29	0.47	Hybrid/Hedged Equity
DJ Industrial Average TR USD	6.01	2.22	14.83	8.12	US Equity -- Large
S&P 500 TR	5.75	2.57	16.18	7.99	US Equity -- Large
NASDAQ Composite TR USD	7.25	5.02	18.63	10.31	US Equity -- Large
Russell 1000 TR USD	5.78	2.87	16.39	8.30	US Equity -- Large
Russell Mid Cap TR USD	5.54	3.89	17.74	9.92	US Equity -- Mid-sized
Russell 2000 TR USD	5.94	2.53	15.97	8.31	US Equity -- Small
MSCI EAFE NR USD	5.98	6.50	7.78	4.84	Int'l Equity -- Developed
MSCI EM NR USD	3.10	3.71	3.64	7.89	Int'l Equity -- Emerging
Bloomberg Commodity TR USD	2.58	-0.85	-4.95	-2.71	Commodities
HFRX Global Hedge Fund USD	2.02	1.72	1.33	0.88	Multi-Asset Alternative Invm't

Source: Morningstar Direct. Data through 2/28/2015

During the month of February, the Ten Year Treasury yield jumped from 1.67% to 2.00%, which negatively affected longer duration fixed income investments. High yield taxable bonds and unconstrained fixed income strategies, however, were able to post positive returns in the face of rising interest rates

Outlook

Since the financial crisis in 2008, the U.S. economic recovery has been solid but not spectacular. GDP growth over the last three calendar years has been 2.3%, 2.2%, and 2.4%. By comparison, the long-term historical average GDP growth in the U.S. has been 3.2%. We point out this discrepancy for a few reasons. First, despite growth in the U.S. that has been stronger than in other developed markets, the state of the economy in the U.S. has felt lackluster. Unemployment has been fairly high until recently, and the memory of the financial crisis still lingers in investors' minds. Because of this, consumer confidence and spending have only just recently begun to rise at an accelerated rate. This leads into our second point.

Since 1945, the average economic expansion has lasted about 5 years. Given that we just completed the fifth calendar year of expansion, this cycle may seem long in the tooth and *could* prompt concerns of a looming recession. This is where the aforementioned gap between historical growth and experienced growth since the end of the crisis comes into play. Because the U.S. economy has been underachieving historical levels of post-recession growth, it also has not experienced the excess and euphoria that are typically associated with the wind-down of economic cycles. *This lack of excess indicates to us that there is still room to run for the current U.S. expansion.* Employment is only just now getting back to levels considered "normal," and businesses have finally shifted from hunkering down to engaging in capital expenditures and job creation.

These factors inform the investment landscape in a couple of ways. The first implication is that continued economic growth provides support for U.S. profits. According Standard & Poor's, analysts are forecasting earnings growth of around 4.77% for the full year of 2015. Lower energy costs provide an important boost to growth also, especially considering that consumption makes up around 68% of U.S. GDP. This is all to say there is a solid backdrop that should support continued appreciation for U.S. stocks. The second implication, however, is that investors must balance expectations of decent growth with the fact that U.S. stock returns have been nothing short of sensational over the last three years. To have some cooling off in U.S. stock price appreciation would not be surprising in the least.

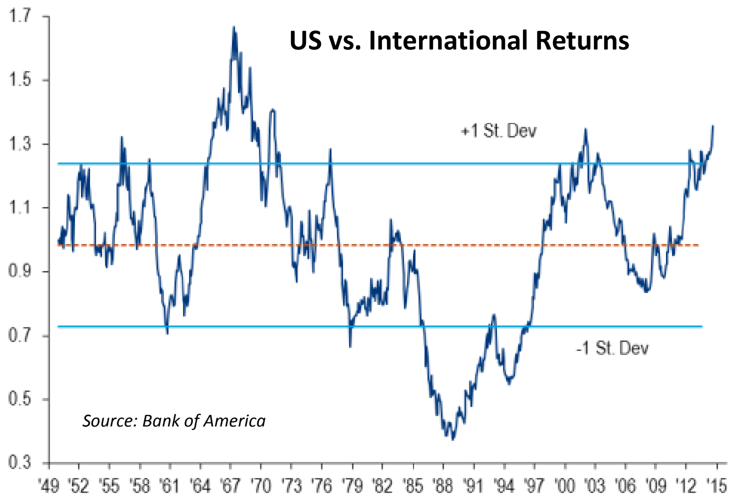
We anticipate positive rates of return going forward, but at a less euphoric level than the major indices have experienced recently.

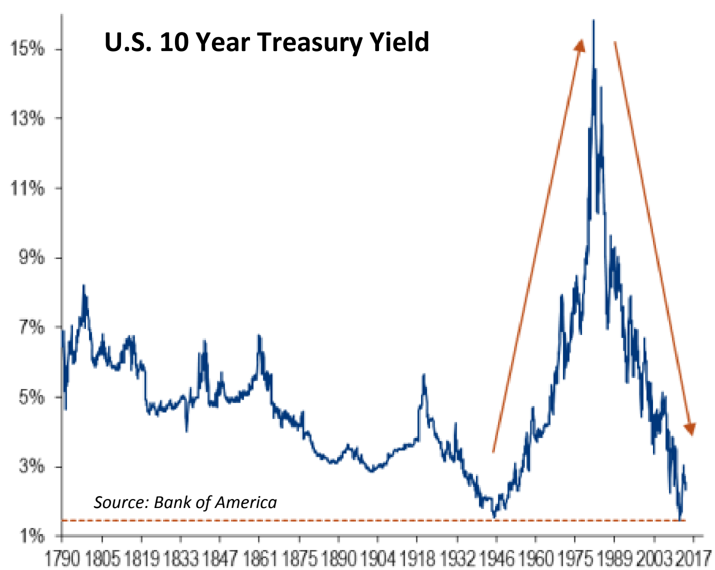
Then and Now: Similarities Between the U.S. in 2011 (prior to very strong equity returns) and the Eurozone now	
Sentiment	Investors were concerned about the debt ceiling much like investors have focused on a Greece default.
Economic Malaise	Concerns over a double dip recession carried the tide as opposed to looking at the potential for future growth.
Monetary Stimulus	The Fed was on the precipice of engaging in a massive stimulus program, similar to the ECB's plan to push 1 trillion Euros into the marketplace.

If U.S. stocks end up posting more modest returns, it would imply that investors must continue to look abroad for both adequate diversification and future return opportunities. The parallels between where the Eurozone is at present and where the U.S. stood three years ago (prior to the stunning equity returns) are striking. The Eurozone economy is just starting to shake out of recession and register notable growth in lending and hiring. In 2011, the U.S. economy was still growing at a lackluster rate of just over 1.0%. Sentiment regarding the

Eurozone is still extremely negative. In 2011, the only thing investors could talk about in the U.S. was the risk of a "double dip" and political blundering. In the Eurozone, the ECB has already rolled out three stimulus measures and just recently announced a 1 trillion Euro bond purchase program. In 2012 (when U.S. equities started to turn around) the Fed engaged in a massive stimulus some referred to as "QE-Infinity."

Keeping these things in mind, we encourage Sage's clients to maintain their international equity exposure. Although returns of foreign stocks, relative to those in the U.S., have been weak in recent years, this relationship should not always be the case. There was fear over U.S. equity exposure in 2011 given the risks of debt ceiling and a swing back into recession, but the prudent decision then was to maintain that exposure. We are suggesting something similar for maintaining foreign equity exposure now. It is impossible to time exactly when asset classes will go in and out of favor, or how far ahead of their peers they will run or fall when they do. Still, given how strong U.S. stocks have been since 2011 and considering the fact that their valuation levels are significantly higher, there is a high likelihood that asset class performance dominance will rotate from the U.S. to international stocks. This is one reason we have maintained, and in many cases increased, our international equity exposure over the last year even though it has not been popular to do so.





Looking at bond markets, another area within the broad portfolio allocations that Sage has focused on is reducing interest rate risk. The chart of the U.S. 10 Year Treasury yield on the left shows just how low yields are relative to historical levels. For reference, the 10 Year yield ended February at 2.01% compared to a historical average yield of 6.47%. JP Morgan recently estimated that $3.6 trillion of government bonds are trading at *negative* yields. The world-wide record lows of government bond yields has prompted us to reallocate our fixed income portfolios over the last few years. We have incorporated investments such as unconstrained bonds, short maturity holdings, high yield investments, and emerging markets bonds. While the short-term trends, especially in 2014, have continued to favor the type of long-maturity holdings that Sage has been allocating away from, we encourage investors to look at the bigger picture and focus on future returns. The Fed continues to indicate ever greater willingness to raise rates. Yields will rise at some point and the market will favor flexible bond allocations.

The potential for rising rates also underscores the continued need for alternative investments in portfolios. Both of Sage's alternative investment managers have been able to generate returns from going long *and* short fixed income positions over the last two years. We continue to believe that an allocation to alternative strategies is necessary within a well-diversified portfolio. Not only can alternatives reduce the overall level of risk a portfolio is exposed to, they can provide returns at a time when traditional fixed income investments may be challenged by rising rates. Patience with these types of investments has paid off, as they have performed well in recent periods, and our hope is that they will continue to benefit Sage's portfolios going forward.