SAWGRASS Asset Management, L.L.C.

Financial Review & Outlook

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Stock Market: Quarter in Review

- The equity markets experienced the most significant bout of volatility in over four years as the steady march higher gave way leaving the major indices in negative territory for the quarter and year to date periods.
- In a five day decline near the end of August, equities lost almost 11% (S&P 500). The selling was authoritative leaving the markets vulnerable to further weakness.
- Given the more defensive environment during the quarter, factor performance favored lower volatility, lower beta, and higher stability/consistency despite continued strength in momentum and growth.
- The persistent outperformance of growth over value was notable in the weak environment that also favored large caps over small caps, while consumer staples/utilities outperformed energy/materials/healthcare.

Stock Market: The Quarter Ahead

- The bull market enters the fourth quarter after experiencing its first significant challenge since the third quarter of 2011. After four years of moving steadily higher, investors may be complacent about the possibility of a more significant decline.
- Given the weakness in the broader market, we have not seen momentum-oriented names fully participate in the market downdraft, and this opens the possibility of further selling before the markets find a more significant area of support. For example, biotech names just recently started to show relative weakness after persistent advances over the last 4-5 years while higher valuation market leaders such as AMZN (+65% YTD), SBUX (+40% YTD), NFLX (+111% YTD), NKE (+29% YTD), etc. have resisted overall market declines. This leaves the impression that risk seeking behavior under the surface has yet to be fully balanced.
- On the other hand, the strength of these momentum leaders during the market decline highlights the possibility that the market has given back enough gains and is building a base to head higher despite numerous perceived obstacles.
- The Federal Reserve's continued unwillingness to raise interest rates coupled with a historical balance sheet accumulation has left investors concerned about the Fed's ability to steer the market through any future difficult periods. The Federal Reserve may be out of "levers to pull within the market."
- Valuations continue to be elevated in the current economic growth environment, while volatility has remained heightened since the start of the recent correction.
- Despite the continued resilience of the markets to every perceived challenge over the last several years, current conditions have shifted the balance to a more volatile environment. We head into the end of the year with increased downside risk until the markets find stronger support.

3rd Quarter Scorecard — Table 1

Index	Quarter	1 Year
S&P 500	-6.4	-0.6
Russell 1000	-6.8	-0.6
Russell 2000	-11.9	1.3
Russell 3000	-7.3	-0.5
Russell 3000 Growth	-5.9	3.2
Russell 3000 Value	-8.6	-4.2
Barclays Capital US Aggregate	1.2	2.9
3 Month T-Bills	0.01	0.02

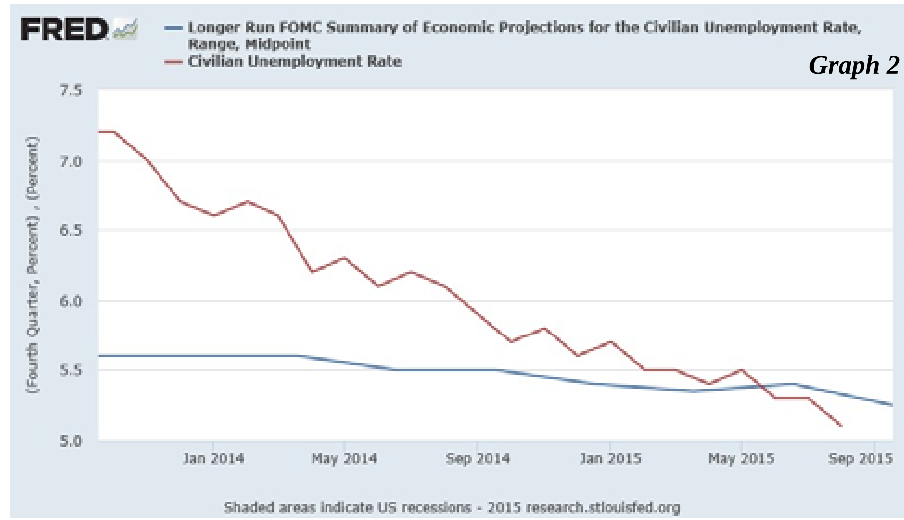
Source: Bloomberg & Russell Investments

Fixed Income Markets

All Eyes on the Fed

Well, as we all know by now, the Federal Reserve passed up their most recent chance to remove the intense spotlight on themselves. Starting the slow, shallow path of increasing over-night interest rates will have to wait. The large up and down movements in the markets – both stock and bond – have settled lower. Lower stock prices and lower interest rates are the result of The Fed stating that “recent global economic and financial developments may restrain economic activity somewhat.” “Recent,” “may” and “somewhat” all in one sentence sum up the lack of confidence in their current economic expectations. Is the US economy so weak that the emergency monetary accommodations established six years ago cannot be replaced with a mere ultra-accommodative stance? Most measures of domestic activity suggest higher rates are coming.

Research reports with catchy titles filled our inbox. “Onward to December,” “Punchbowl Still on the Table,” “Gone Fishing Until 2016” and my favorite, “The Certainty of Misery is Better than the Misery of Uncertainty.” Falling commodity prices (See Graph 1) driven by slack global demand has a larger impact to those countries reliant on exporting the commodities. Emerging markets, China and even our largest trading partner, Canada are prime examples. The rising US dollar makes our exports increasingly more expensive and continues to put a lid on the measures of US inflation. The central focus will return to the consistent, growing GDP – recently measured at a robust 3.9% growth, steady increase in job creation – three month average of over 200,000 and an unemployment rate at a level most consider “full employment” (See Graph 2). As these trends persist, further job increases will be harder to come by and wage inflation will follow.



US Markets

For the quarter ending September 30, 2015, global concerns have dominated domestic strength leading interest-rates lower by 10 to 20 basis points (See Table 2). Equity market weakness and massive corporate bond issuance in anticipation of higher rates to come have allowed Treasury debt to out-perform corporate debt. Below investment-grade debt suffered significantly. The Bank of America Merrill Lynch High Yield Index lost 4.9% in the quarter. As a whole, the bond market as measured by the Barclays Aggregate posted a strong 1.23% gain, recouping much of the prior quarter’s drop. For the last twelve months, the aggregate’s total return of 2.95% comes as a pleasant surprise.

The conflicting forces of foreign weakness vs. domestic strength continues to collide. The US growth engine looks likely to survive, but the Federal Reserve has specifically told us that they will be “monitoring developments abroad” for confirmation.

Currently, higher volatility worldwide has led to falling stock prices, weak corporate bonds and flight-to-quality lower US Treasury interest rates. Risk management, safety and liquidity are part of our daily focus. Let us know how we can make them part of yours.

Interest Rate Summary — **Table 2**

	9/30/14	6/30/15	9/30/15	Qtr Change	12-Month Change
3 Month T-Bills	0.0	0.0	0.0	0.0	0.0
5 Year Treasury	1.8	1.6	1.4	-0.3	-0.4
10 Year Treasury	2.5	2.4	2.0	-0.3	-0.5
30 Year Treasury	3.2	3.1	2.9	-0.3	-0.3
5 Year Corporate (‘A’)	2.3	2.5	2.4	-0.1	+0.1
10 Year Corporate (‘A’)	3.5	3.6	3.4	-0.1	0.0
30 Year Fixed Rate Mortg.	4.1	4.2	3.8	-0.3	-0.3

Source: Bloomberg

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