July 14, 2015
Volume 16, Number 2

Nauset Market Commentary
Second Quarter 2015

Market Performance Recap: **Flat Returns Mask Turbulence**

For Q2, the large cap Russell 1000 inched up +0.1% after zigzagging up slightly for two months and turning down in June due to turmoil in Greece and China. US small cap and international stocks were also flat for the quarter. Within stock sectors, healthcare and financials posted gains, while energy, utilities, real estate and telecom suffered declines. Fixed income markets were slightly lower for the quarter on Fed rate hike concerns, as the Barclays Intermediate Gov't/Credit Index fell -0.6%.

Economic & Market Discussion: **Taking Stock of Market Risk**

With the stock market hitting the pause button and volatility ramping up, let's take a look at current market risk. Five years of very strong US stock returns have driven markets to fresh highs. Despite extremely low volatility, the current choppiness has focused investors on potential downside market risk. Here is how we think about the risk/return dynamic within our portfolio strategy.

- Defining risk. Declining portfolio values can cause distress, but the biggest risk to your objectives is permanent impairment to asset values. As long-term investors, our advantage is we can absorb temporary declines and stay invested, letting time heal the wound. That said, we constantly ask ourselves, "What is the risk of permanent impairment? Is this dead money?" We try to avoid entering situations where the probability of permanent impairment is high. If we are invested in an asset we deem to have suffered permanent loss or facing a long recovery, we will cut losses and move on to a more productive area.
- Choosing the right mix of risk – To earn returns we must accept uncertainty of the return. But not all risks are equal. General stock market risk is much different than idiosyncratic risk of a single stock. Risk in one asset area can be offset by different, negatively-correlated risk in another area. Our Managed Risk Asset Allocation approach invests in a wide mix of sectors with differing risk profiles to deliver returns with a lower level of risk than a simple stock/bond portfolio.
- Close watch on current US stock risk– Today's US stock market is experiencing low volatility and this investor complacency may actually be feeding a cycle of increasing risk. While a -10% correction is always possible, we are comfortable with US stock market risk given the underlying economic strength. We currently hold a target weight in US stocks, but will modify our exposure as the risk/return parameter changes versus other asset classes. We expect near-term returns will be lower and volatility higher, but for now, equity risk/return is attractive relative to other asset sectors.

Portfolio Strategy: **Diversification of Return Opportunities**

Our portfolio strategy focuses on a wide range of risk/return opportunities, overweighting the most attractive areas and underweighting the weaker ones. Currently, we favor growth equities in tech, health care and consumer cyclical sectors, as well as international developed stocks. We are underweight traditional bond holdings, with target weights in high-yield securities and real assets, such as MLPs, and real estate. And we have a full allocation to alternative and hedged securities to further diversify returns.

Market Performance **% Change for Periods Ended 6/30/2015**

Market Index	Second Quarter	2015 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	0.11	1.71	7.37	17.73	17.58
MSCI EAFE – Non-US	0.62	5.52	-4.22	11.97	9.54
Russell 2000	0.42	4.75	6.48	17.81	17.08
MSCI Emerging Markets Equity	0.69	2.95	-5.13	3.71	3.68
DJ US Real Estate	-9.07	-5.19	3.62	8.28	13.42
Bloomberg Commodity	4.66	-1.56	-23.71	-8.76	-3.91
Barclays Gov't/Credit Interm. Bond	-0.62	0.81	1.68	1.60	2.79
IQ Hedge Multi-Strategy	-0.74	1.31	1.33	4.86	4.50
3-Month T-Bill	0.00	0.01	0.02	0.05	0.06

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