Investment OUTLOOK

NOVEMBER 2016

FRAGASSO
FINANCIAL ADVISORS

Dear Valued Client:

Fragasso Financial Advisors is pleased to share the Investment Outlook which presents the analysis and decisions of our latest quarterly Investment Committee. For many of you, our recent portfolio management panel discussion at PNC Park provided an abridged version of those meetings. We sincerely appreciate your attendance as it helps us better communicate the results of our work for you. We would love to hear more feedback on our publications and communications and encourage you to complete a survey included in this edition of the Investment Outlook. While the presidential election has garnered much of the attention and media coverage, the portfolio management team has been busy at work. Our research led to a number of portfolio adjustments, as well as ongoing academic work, which forms critical signals for future adjustments and preparedness. With a spirited debate and critical thinking, we made a number of conclusions that focused on achieving our client's goals.

We continue to focus on the recent Federal Reserve meetings and the implications on the challenging low interest rate environment. Looking across our borders, we also continue to study how other central banks may influence global growth and financial markets. And most importantly, how do we manage the return and risk equation in an ever changing global world? Regardless of the presidential election or the current investment climate, we continue to actively manage risk on a full-time basis through time-tested, textbook principles.

- Maintain asset allocation in line with client objectives.
- Manage portfolio risk.
- Hedge riskier positions to protect against worst-case scenarios.
- Adjust tactfully within market dynamics.

If you find our methodology helpful and believe others may also benefit, please don't keep us a secret. We have a dedicated and experienced team that stretches across multiple disciplines to generate the insights to help other people, organizations and businesses that are important to you.

We sincerely appreciate your business.

DANIEL DINGUS, AIF®, MBA
PRESIDENT AND EXECUTIVE DIRECTOR OF PORTFOLIO MANAGEMENT

MAJOR ASSET *Class Returns* 2016

16.4% EMERGING MARKETS	**10.8%** U.S. EQUITY SMALL/MID CAP	**6.7%** U.S. EQUITY LARGE CAP
5.8% *fixed income*	**0.0%** CASH	**-2.2%** DEVELOPED INTERNATIONAL MARKETS

As of September 30, 2016

U.S.EQUITIES

U.S. Equities continue to hover above historical averages, making market cap and sector selectivity very important. *Read more about areas for investing opportunity on page 6.*

INTERNATIONAL EQUITIES

International Equities received a much needed boost in the third quarter of this year. *Read more on page 8 to see why it might be time to start favoring them.*

FIXED INCOME

Fixed income investing continues to be a struggle in the search for yield. *Read more on page 9 to see how investors can overcome lower-for-longer yields.*

Source: Morningstar Direct

OPPORTUNITIES FROM *Overlooked Headlines*

WRITTEN BY **MICHAEL GODWIN, CFA**

As we head towards the end of the year, we often reflect on events of the past year to take stock and make a plan of action for the year to come. I'm sure we can all agree there were many events that stuck with us and perhaps some that we wish we could forget. In the investment arena, it's always the big events like Brexit or Fed decisions that cause us to pause and reassess our investment strategy. But what about those under the radar headlines that have just as much impact on our portfolios? In our final Investment Outlook for the year, our analyst team takes a look at some of the less publicized events that affect your portfolios.

What Happened to CHINA?

Earlier in the year, investors became accustomed to dramatic headlines that described China as being in a downward spiral. The stock market seemed to be falling off a cliff and China appeared to be the culprit. So what has happened since? Why hasn't China been in the news much lately?

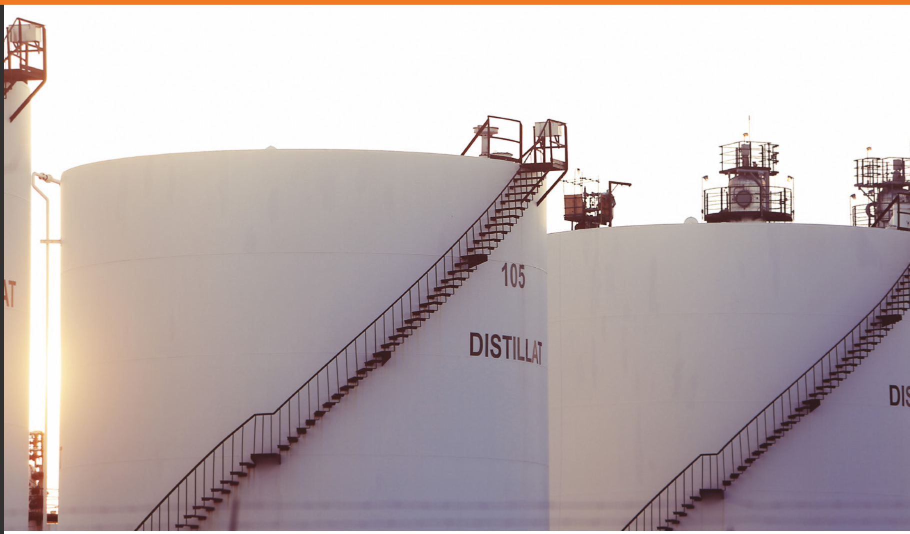
The concerns from January were:

- China's growth is slowing considerably.
- China is manipulating their currency.
- China's massive debt problem is going to cause another crisis.

But since the mid-February stock market lows, amidst many articles citing China's impending demise, global stock markets have rebounded considerably. As of Sept. 30, the U.S. and China stock markets are up 6.1 and 8.1 percent respectively,[1] both very nice returns. However, the issues plaguing China earlier in the year haven't been dealt with yet. China has essentially "kicked the can down the road" and has chosen to focus on sustaining economic growth with the hope that it will not cause major problems down the line.

Time will tell though as China's overall debt is now higher than it was in January, the real estate market is arguably close to bubble territory and China's currency has devalued another 3 percent against the dollar.

1 Thomson Reuters EIKON



GROWTH AND Value Factor *Reversal*

WRITTEN BY
MADISON NESTOR, CFA

Last year, value lagged behind growth by over 9 percent.[1] Since 2009, this was the first time that the difference between the two factors exceeded two percent.[2]

This was largely caused by a plunge across commodity prices, including that of oil, which traded below $30 per barrel.[3] As a result, energy and materials were the worst performing sectors in 2015. The financial sector, which is also comprised of value stocks, struggled as the Fed balked at raising interest rates. Meanwhile, growth sectors like consumer discretionary and technology saw strength as the U.S. consumer buoyed the economy.[4]

So far, 2016 has been a different story. As value stocks are outperforming their growth counterparts by more than three percent.[5] This year, energy and materials have made a recovery, as oil prices have reached $50 per barrel,[6] and more defensive sectors, like consumer staples and utilities, have been popular with investors who believe that the U.S. economy is in the later stages of the business cycle. Additionally, healthcare stocks that are traditionally growth companies, have suffered under pressure from the Clinton presidential campaign.

1 Thomson Reuters EIKON

2 Morningstar Direct

3 Morningstar Direct

4 http://www.bloomberg.com/quote/CL1:COM

5 http://www.sectorspdr.com/sectorspdr/Pdf/All%20Funds%20Documents/Document%20Resources/10%20Year%20Sector%20Returns

6 Morningstar Direct

THAILAND Proves TO BE Diamond in the *Rough*

WRITTEN BY
LISA BRIGNONI, CFA, AIF®

When investors think of emerging markets, we often use the outlook on China and Brazil as a proxy for the rest. When the outlook turns negative, as it did early in 2016, investors want to be completely removed from this asset category. But one of the often overlooked benefits and reasons why investors shouldn't shy away so quickly is diversification amongst the countries that make up the group. This is why it is important to dig deeper into each of these pockets of the world to seek investing success in this category.

Thailand comes to mind as a great example of an equity market that thrived despite headlines about China.

During the first quarter when China's equity market dropped 4.8 percent, Thailand returned an impressive 17.0 percent and YTD is up 29.3 percent.[1]

What led to such stealthy returns can be attributed to a diversified equity market with strong players in telecommunications, mining and media. However, the Thai equity market may be in for a downturn following the death of King Bhumibol Adulyadej and the government's calling for one year of mourning. During this period, tourist-focused businesses are expected to scale back activities, which may undermine the recent growth spurt.

1 Thomson Reuters EIKON

INVESTMENT *Opportunities*

At Fragasso, we maintain investment portfolios diversified across all asset classes to reflect a global allocation and a long-term focus on balancing return and risk objectives. We seek to outperform the markets through both tactical asset allocation and investment selections. Here's where we see and don't see those opportunities for the remainder of 2016 and beginning of 2017:

U.S. EQUITIES

- For U.S. markets to be more compelling, we would want to see either sustained improvement in growth trends across economic data or lower equity valuations.
- We recommend a modest tilt towards defensive sectors over cyclicals.

INTERNATIONAL EQUITIES

- Economic data still have positive notes for EU countries and the U.K., and these markets can outperform if they can overcome headline risks of current events.
- Growth from emerging markets is proving to be more enduring than previously suspected. While we still expect some pullback to occur due to extra exuberance from investors, structural reforms and commodity outlooks will be tailwinds.

FIXED INCOME

- Interest rates will most likely remain lower for longer. This is also a negative. It will become more difficult to generate adequate income within the bond market over the medium term.
- It will be important for investors to generate solid, stable income over the next couple of years. We are looking for additional alternatives to supplement our clients' holdings.

U.S. *Equities*

WRITTEN BY
MATTHEW KARR, CFA, MBA

KEY TAKEAWAYS

- Economic data is showing diverging themes: very weak industrial conditions and spending, while consumer metrics (employment, confidence and income growth) are doing better.
- For U.S. markets to be more compelling, we would want to see either sustained improvement in growth rates for both categories of economic data or lower valuations.
- We recommend a modest tilt towards defensive sectors over cyclicals.

SELECTED *U.S. Economic Data*

	5 MONTHS AGO	4 MONTHS AGO	3 MONTHS AGO	2 MONTHS AGO	1 MONTHS AGO	MOST RECENT
Non-Farm Payrolls[1]	1.88%	1.70%	1.73%	1.71%	1.72%	1.72%
Unemployment Rate	5.0%	4.7%	4.9%	4.9%	4.9%	5.0%
Disposable Income[1]	3.98%	3.82%	3.52%	3.43%	3.45%	3.36%
Real Consumer Spending[1]	2.17%	2.76%	2.50%	2.88%	2.94%	2.63%
Consumer Confidence	94.70	92.40	97.40	96.70	101.80	104.10
Core Inflation[1]	1.55%	1.60%	1.64%	1.60%	1.61%	1.69%
Industrial Production[1]	-2.00%	-1.30%	-1.26%	-0.53%	-0.55%	-1.12%
Durable Goods Order[1,2]	-1.97%	-1.36%	-0.76%	-3.50%	-1.10%	-0.92%
Purchasing Managers Index	50.80	51.30	53.20	52.60	49.40	51.50

POSITIVES

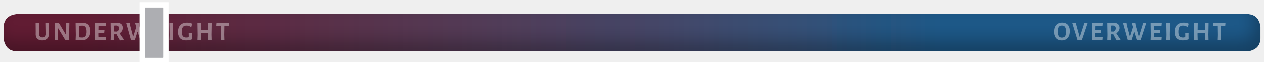
- Payroll growth in the U.S. remains steady, albeit slowing a bit in terms of the pace of growth.
- After several quarters of slowing economic growth in the U.S., it is possible that headline numbers could modestly improve.
- The Fed's delay in raising interest rates has supported asset prices.

NEGATIVES

- Disposable income growth is slowing down despite wages increasing.
- Consumer spending has carried economic growth for most of the last two years. The late stage of the economic cycle could add further pressure to growth rates in this key metric.
- Industrial data is trending at levels not seen outside of recessionary conditions.

Source: Datastream
1 Year-over-year growth presented
2 Orders exclude transportation equipment
3 50is line of expansion/contraction

U.S. *Equities:* CYCLICALS VS. DEFENSIVES



While the bar for economic growth is fairly low over the next several quarters, a lack of material improvement in more high frequency economic indicators suggests it makes sense to remain a bit more defensive. Further, in aggregate, valuations for cyclical sectors as a group are a bit less extended than for cyclicals.[1]

CYCLICALS

› CONSUMER DISCRETIONARY
Sector is among the cheaper cyclicals, and could present some good opportunities, as it tends to do well once growth slowing is widely accepted.

› ENERGY
Oil prices have rallied off of lows. Strong sector performance will require ongoing high oil prices, which we question in the short-term.

› FINANCIALS
Recent outperformance is a key change and the sector looks relatively cheap, but low rates and excess capital for banks and insurers is making it hard to grow profits.

› INDUSTRIALS
Slowdowns in key industrial metrics are a concern, and it is an expensive sector.

› MATERIALS
With inflation potentially picking up, revenues could improve, as pricing ebbs and flows with overall input costs. Industrial activity is a mitigating factor, however.

› REAL ESTATE
Valuations are susceptible to rises in interest rates if that is not coupled with improving economic data.

› TECHNOLOGY
The sector has potential opportunity for revenue and earnings acceleration, as companies are comparing against weak periods.

DEFENSIVES

› CONSUMER STAPLES
With inflation potentially picking up, companies could see revenues improve, as pricing ebbs and flows with overall input pricing. After some underperformance of late, the sector is looking more attractive.

› HEALTHCARE
Performance versus S&P 500 has been hit or miss over the last year and a half. Election rhetoric is harming sentiment around drug makers and wholesalers. We prefer diversified businesses in the sector.

› TELECOM
Even with recent strength in performance, valuation multiples are attractive versus themselves. The sector has some cyclical tendencies, as investors like the yield when times are weak, but company metrics improve when economic growth improves.

› UTILITIES
The sector is expensive on valuation metrics, but this has been the case for the last five years. We think pure-play utilities with well-covered dividends are reasonable investments after pullbacks since early 2016.

1 “Cyclicals are a higher weight in the S&P 500 index than defensive sectors. The bar represents our views on how to tilt between the categories relative to one another.”

INTERNATIONAL *Equities*

KEY TAKEAWAYS

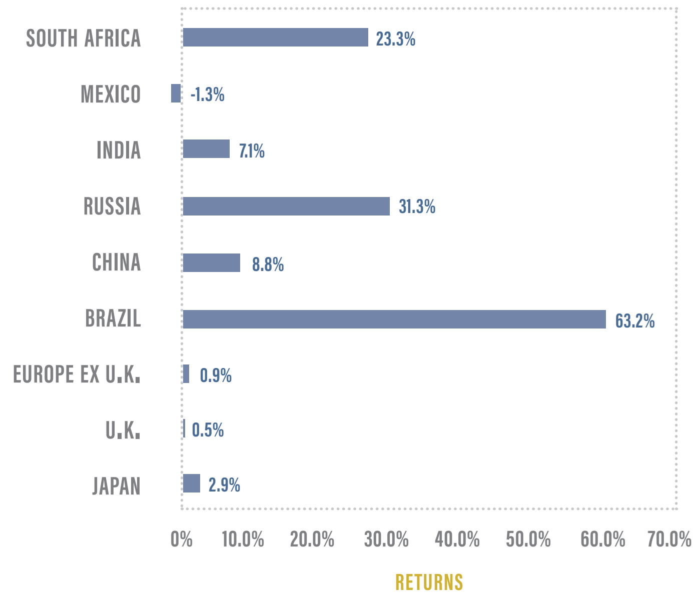
• The EU rallied strong after fears from the Brexit vote abated. Though the EU still has strong fundamentals, anxiety amongst investors seems to be driving results this past year.

• Japan was one of the strongest performing economies in Q3 2016, but still struggles to see any meaningful inflation from monetary stimulus. Fiscal policy, focusing on infrastructure development, will be a focus moving forward.

• After an apparent rebound from Brexit, investor sentiment is turning sour again for the U.K. Negotiations for exit from the EU will be contentious and consumer confidence is down due to that. The Bank of England will have to work overtime on monetary policy in an effort to delay recession.

• Emerging markets had a positive turn in Q3 with some help from rebounding commodities. Mexico's fortunes have been closely tied to the U.S. presidential election and equity markets have had an inverse relationship with Trump's campaign prospects.

2016 *YTD Equity Returns by Country***



POSITIVES

- Growth from emerging markets is proving to be more enduring than previously suspected. While we still expect some pullback to occur due to extra exuberance from investors, structural reforms and commodity outlooks will be tailwinds.
- Economic data still have positive notes for EU countries and the U.K., and these markets can outperform if they can overcome headline risks of current events.
- Foreign central banks are still being accommodative to their respective economies.

NEGATIVES

- Economic growth has been cut for the year in Mexico citing lower manufacturing expectations. Even if Trump is defeated, Mexico will have other domestic headwinds to face this year.
- Russia has performed well during the year but may also be in for a downturn after fallout from the U.S. elections and ongoing war in Syria.
- Lingering uncertainty from the Brexit vote will continue to sway currency and equity markets in Europe.

*As of September 30, 2016. Source: Morningstar Direct

FIXED *Income*

WRITTEN BY
MICHAEL GODWIN, CFA

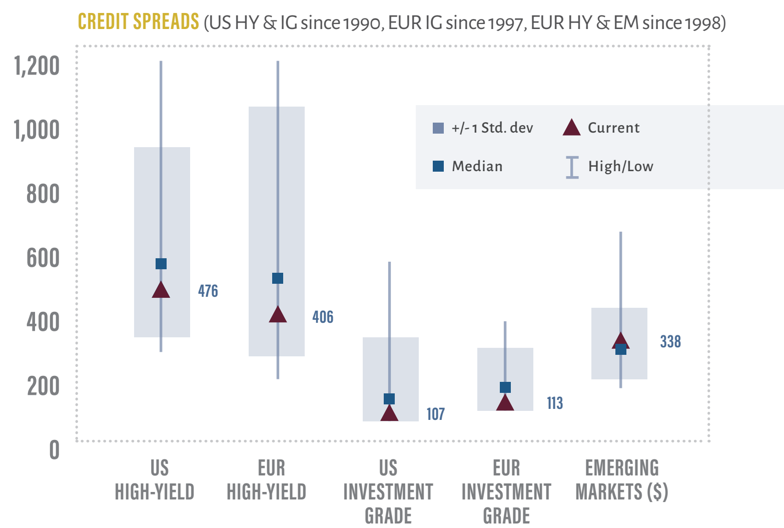
KEY TAKEAWAYS

- $10.7 trillion of global bonds have negative yields.[1]
- Longer dated bonds (i.e. bonds that mature in 20-30 years), and riskier bonds such as high yield and emerging market debt have outperformed this year. With interest rates near all-time lows, investors have been taking on more risk in order to generate more return.
- The 35-year bond bull market is close to the end – it will become more important to generate income and find those areas within the bond market that still provide diversification from equities.

POSITIVES

- Interest rates will most likely remain lower for longer. There will still be a global search for yield, which should help support bond prices.
- U.S. government bonds, though yielding very little, still show that they are able to provide uncorrelated returns when compared to equities.
- It will be important for investors to generate solid, stable income over the next couple of years. We are looking for additional alternatives to supplement our clients' holdings.

CREDIT *YTD Spreads**



NEGATIVES

- Sometimes positives are also negatives. As such, interest rates will most likely remain lower for longer. It will become more difficult to generate adequate income within fixed income over the medium term.
- With central banks driving interest rates down to zero percent (and in some cases below zero), investors have been inclined to take on more risk, even if economic fundamentals have been deteriorating. *In the chart above, if the triangle is below the square, that signals the asset class is more expensive now that its historical average.*

*Source: Datastream, Yieldbook, Goldman Sachs Global Investment Research
1 http://www.bloomberg.com/news/articles/2016-10-10/negative-yield-debt-falls-to-10-7-trillion-after-september-rise

A word about risk: Equities may decline in value due to both real and perceived general market, economic and industry conditions. Investing in the bond market is subject to certain risks including market, interest rate, issuer credit and inflation risk; investments may be worth more or less than the original cost when redeemed. Investing in foreign denominated and/or domiciled securities may involve heightened risk due to currency fluctuation, economic and political risk, which may be enhanced in emerging markets. Mortgage and asset–backed securities may be sensitive to changes in interest rates, subject to early repayment risk, and their value may fluctuate in response to the market's perception of issuer credit worthiness; while generally supported by some form of government or private guarantee, there is no assurance that private guarantors will meet their obligations. High-yield, lower-rated securities involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risks than portfolios that do not. Alternative strategies such as arbitrage, hedged equity, market neutral or long/short may result in higher internal transaction costs and tax consequences of short-term gain. Funds may engage in option transactions and short sales. Option transactions involve special risks that may make it difficult or impossible to unwind a position when the fund desires. With short sales, you risk paying more for a security than you received for its sale. In addition to the normal risks associated with investing, merger arbitrage strategies may realize losses if the proposed reorganizations in which the strategy invests are renegotiated or terminated. Other arbitrage strategies may include but are not limited to convertible risk, synthetic convertible risk, convertible hedging risk, and covered call writing risk. In hedged equity strategies, selling index call options can reduce the risk of owning equities, but it limits the opportunity to profit from the increase in the market value of equities in exchange for the upfront cash at the time of selling the call option. Additionally hedged equity strategies may lose part or all of the cash paid for purchasing index put options. Unusual market conditions or the lack of a ready market for any particular option at a specific time may reduce the effectiveness of a hedged strategy. Diversification does not ensure against loss. There is no guarantee that these investment strategies will work under all market conditions or are suitable for all investors. Each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market.

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