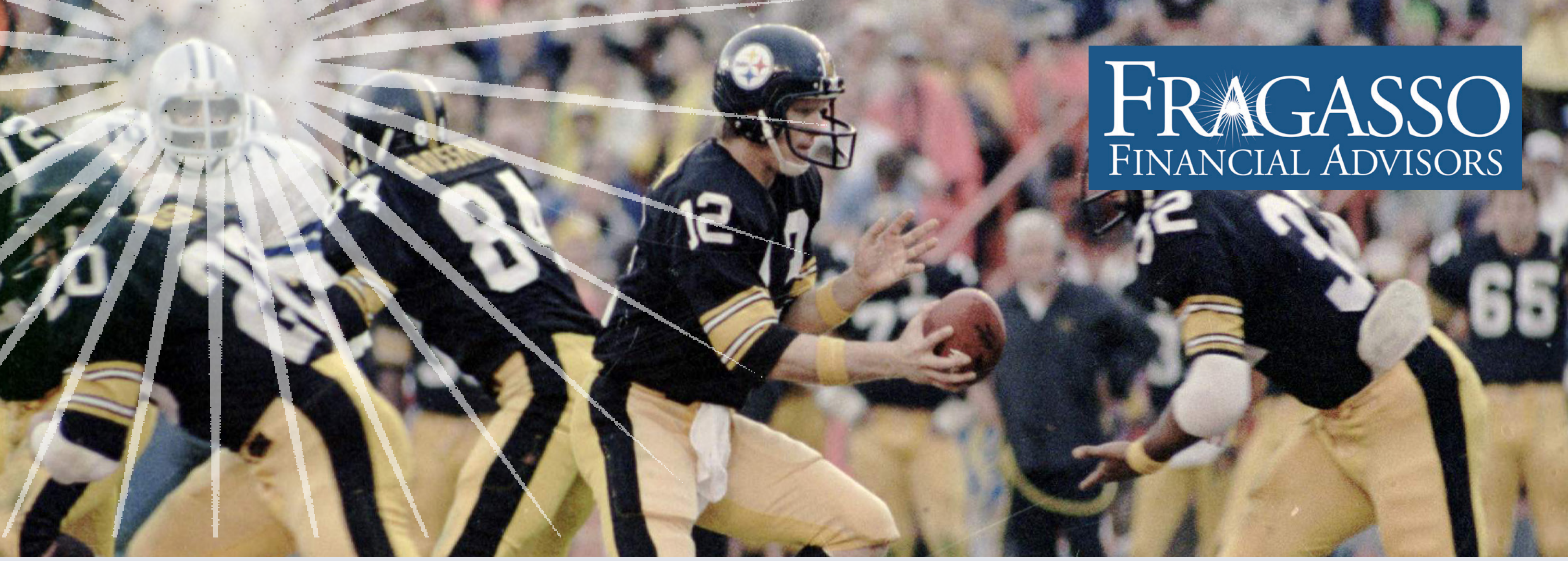

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INVESTMENT OUTLOOK - MAY 2015

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Key Takeaways

In this Investment Outlook we discuss how team structure benefits our clients in the contruction of their portfolios. We also revisit the differences between active and passive management along with these topics:

- Active and passive management, Fragasso's core-satellite approach to asset allocation, has been implemented across portfolios for increased control over investment outcomes, better transparency as well as lower internal cost and tax efficiency.
- We maintain a diversified, balanced investment allocation to help reduce risk. We continue to look for pockets of opportunity. As valuations have increased domestically during this recovery period, our search for value in specific sectors of consumer discretionary spending, select high-quality energy companies and technology remain on our radar.
- U.S. stocks in general continue to maintain higher valuations versus global counterparts.
- European equities have rallied as the $1.3 trillion European Central Bank stimulus takes hold.
- While the stimulus has assisted European equities and the dollar appreciated, future currency movement may be negligible.
- Emerging Markets equities are relatively cheap compared to domestic equities. China's loosening of stock trading and purchase via Hong Kong has created a liquidity boom to these Asian markets.
- In fixed income, while we do not believe rates will increase drastically in the near term, we believe it is prudent to avoid long maturities as risks have increased.
- While maintaining a long-term posture geared towards preserving capital, we also seek to capture available short-term returns in various areas of the bond market.
- The municipal market has softened since 2014's strong return. We continue to adjust portfolios to pockets of opportunity in this difficult low-yield environment.

Team Construction

"The single most important thing we had in the Steelers of the '70s was the ability to work together." - Chuck Noll

Like many life-long Pittsburgh natives, I often reminisce about the sports dynasty that was the 1970s Steelers football team. The characters, the lore and the incredible success of those teams each play a part in my fond memories. Certainly the unassuming, spotlight-shy Chuck Noll was a major fixture in the orchestration of those great teams.

But merely remembering those teams for the characters of players like Jack Lambert (I will spare the toothless pictures), the lore of the Immaculate Reception (a welcome sign of being home at Pittsburgh International Airport) and the four super bowl victories is a bit shallow. Dig below the fireside story and you will find two critical leadership and organizational lessons.

The first, as Chuck Noll states, is teamwork. Teamwork can be defined in many ways. One critical component is that diversity to encourage creativity and innovation can lead to superior results. A team's success is often based on trust and a common vision among participants. At Fragasso Financial Advisors, that brand of teamwork is evident across the firm, and certainly critical to collaboration and synergy of our centralized Portfolio Management Department.
In portfolio management, our team structure allows for recognizing a common problem among individual and institutional investors quickly and seeks to eliminate it. This provides an added layer of security as compared to other firms that may not have the depth and infrastructure of a larger, collaborative firm. Asset allocation decisions are less likely to be made using what behavioral finance theory calls personal biases, which can lead to irrational decision making.

A second lesson from the Steelers' 1970s team is the ability to adapt and have balance. The early super bowl teams were built on strong defense and running the ball. In 1979 the Steelers played for the Super Bowl championship against the L.A. Rams. Ultimately it was the passing attack of Terry Bradshaw and the stellar play of wide receivers John Stallworth and Lynn Swann that helped clinch the victory. It was a defining moment where each side, offense and defense, contributed to the team's success.

We recognize the constant changes happening in the investment landscape. We have chosen to adapt to those changes and believe the right balance is in the active and passive investment management portfolio strategies we implemented in the first quarter of 2015.

Both strategies provide their own unique benefits within a balanced approach:

1. Risk control of a more balanced portfolio
2. Increased diversification for various market conditions and environments
3. Lower overall cost and tax efficiency

We have detailed the key benefits of this balanced approach in a special Fragasso blog: "Active Versus Passive Management: Solving the Debate."

Portfolios are personalized based on each client's unique circumstances and built around the same sound principles of asset allocation, global diversification and risk control within the contexts of financial goals.

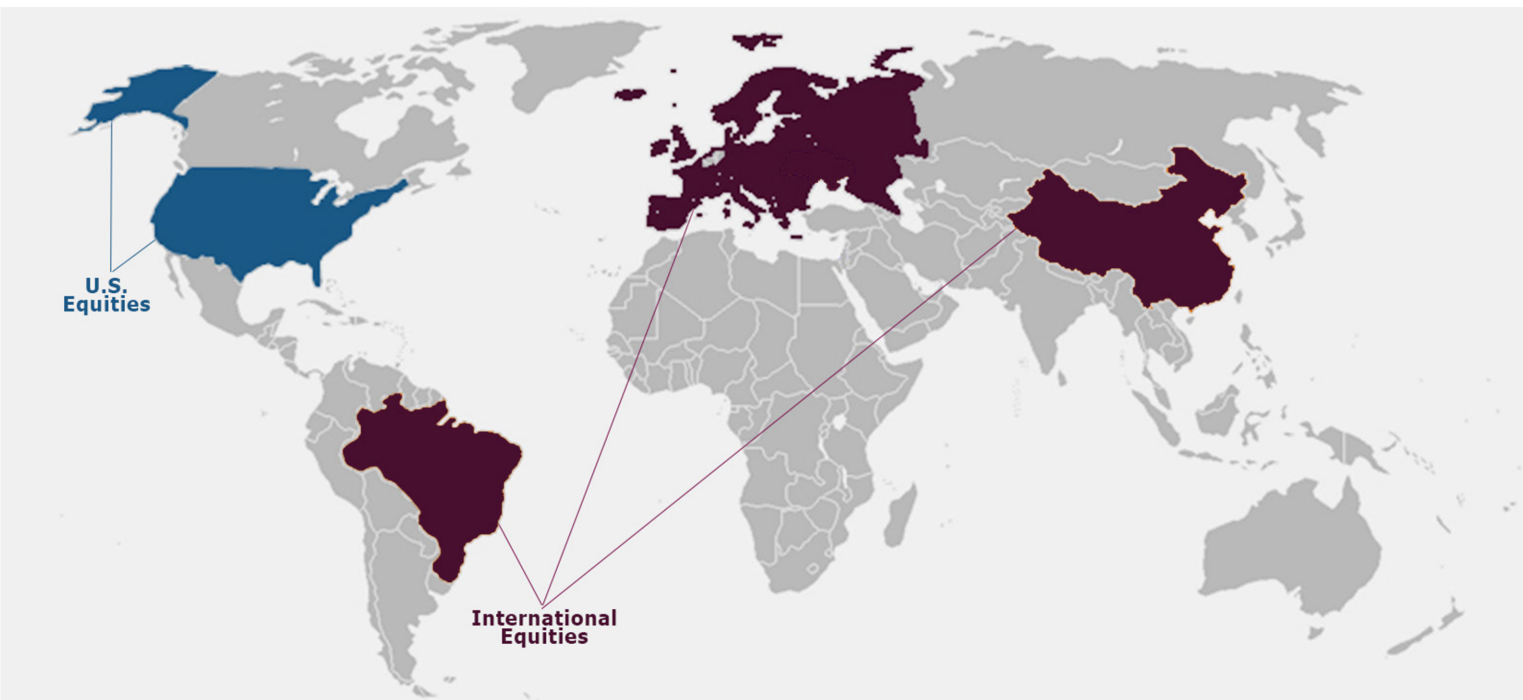
2015 – Divergence Continues but Reversed

As we look back on 2014, we recognize that U.S. equities, specifically your larger company stocks, performed very well on an absolute basis. The S&P 500 returned 13.69 percent in 2014.[1] Contrast that with global market indices and emerging markets, whose returns were negative, and the relative returns of the S&P 500 look downright spectacular.

Reiterating a theme of balance and diversification, and recognizing that global equities looked opportunistic, our portfolios have benefited from an earlier tilt to international markets as domestic equities in 2015 have trailed. Through April 30, 2015, the year-to-date returns of the major equity indices are as follows:[2]

MSCI EM	10.2%
MSCI EAFE	9.4%
S&P 500	1.9%
Russell 2000	1.7%

As such, markets are diverging but almost in reverse to what we witnessed in 2014. Asset classes typically have a reversion to the mean and this time is no different.



U.S. Equities - Outlook

Following impressive bull runs through 2013 and 2014 that yielded 32.3 percent and 13.7 percent returns on the S&P 500 respectively, one might be weary of U.S. equity valuations going into 2015.[3] Though U.S. equity valuations remain high from both a global and historical comparison, we caution against investors using the "b" word – bubble. It's not uncommon to hear or read news stories once a week that reference the S&P 500 hovering near record highs, but even at these highs, forward P/E ratios are still only slightly higher than historical averages at 16.9x as of Q1 2015.[4] Compare that to the P/E ratios near the peak of the tech bubble in 2000 of 25.6x and the valuations now seem reasonable.[5] That said, investors are less likely to see the same high returns from the S&P 500 in the upcoming years, which means diversification will likely play a bigger role in portfolio performance.

As the U.S. economy continues its recovery from the global financial crisis of 2008, the benefits of that recovery are now spreading beyond wealthier Americans to the middle class through growth in wages and loosening of credit. We view the U.S. economy as being in the later stages of the business cycle. Growth can continue, albeit at a slower pace, as rising wages put a damper on corporate earnings. However, with leverage at the lowest rates in 20 years, companies are still strong financially and are expected to weather the impending rise of interest rates better than in years past. As such, we expect to see modest growth through 2015 of less than 10 percent.

Though much of the focus in U.S. equities is on the performance of the S&P 500 representing larger multinational companies, we shouldn't forget about the small cap stocks that did not perform so well last year. As of the end of Q1 2015, small cap stocks represented by the Russell 2000 were up 4.32 percent YTD, though the numbers have pulled back at the start of the second quarter.[6] Relative to larger companies that are facing headwinds from currency exposure in other countries due to an appreciating dollar, smaller regional companies focused on operations in the U.S. are expected to outperform this year, benefitting from the expansion of economic growth to the middle class.

Another major focus for the U.S. economy has been oil prices. The major drop in oil prices starting in the second half of 2014 may have been a much needed wake-up call for the U.S. oil industry. After experiencing the effects of oversupply and the appreciating dollar on the price of oil, refineries and service providers have taken a hard look at their operations and trimmed down where necessary. As those operational changes have been quick to flow through the financials, we're starting to see a comeback in certain players, specifically the service providers, with positive returns year to date for some. As the industry adjusts to oil prices that may be below $100 per barrel, we expect volatility to decline and earnings to pick up over the long term.

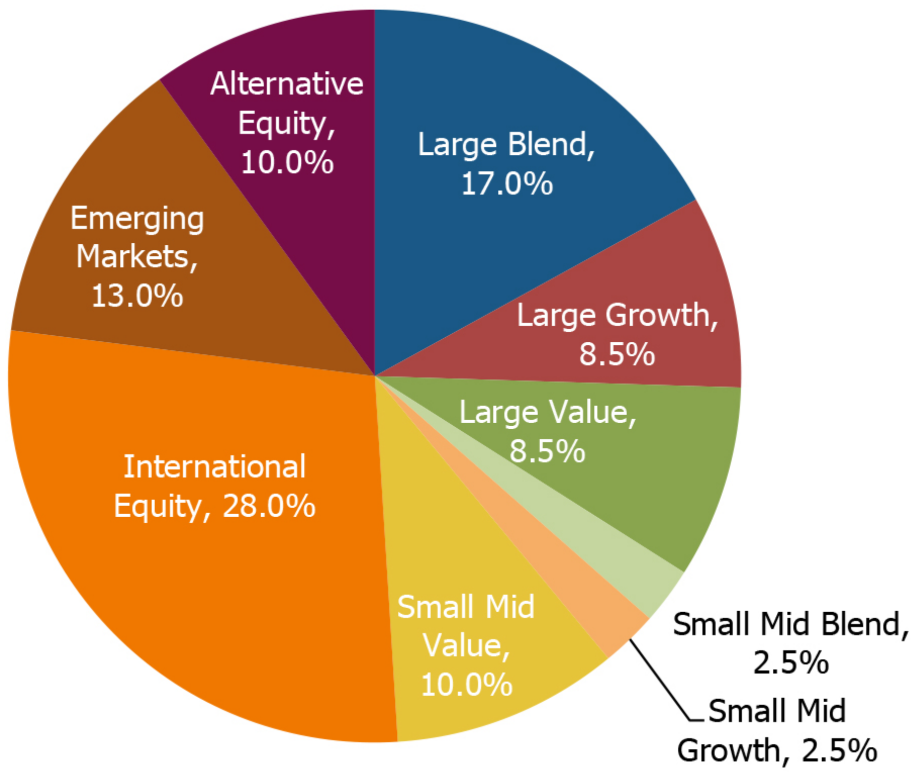
International Equities - Outlook

With sputtering growth in Europe, negative sentiments in Brazil, crises in Russia and slowing growth in China, it's no wonder that international equities did not shine in 2014. That path has begun to turn the corner with Europe leading the way. The European Central Bank (ECB) announced this year that it would begin a quantitative easing program in March 2015 and the European stock market has responded favorably so far this year with strong growth. Another result of the quantitative easing program has been the depreciating euro, which has improved demand for European exporters but hurt Europe as an importer of oil and gas. That said, after the euro's rapid decline we eliminated the dedicated exposure to hedged European equities as it reached what we suspect to be a short- to mid-term bottoming.

As a major trade partner with several other emerging markets economies, China sent some ripple effects throughout the asset class with its economic slowdown. Many market watchers predicted a hard landing of China's economy with severe economic contraction after years of real estate overdevelopment and a shadow banking economy. Though China has been slowing down, the hard landing once predicted seems to be over played and China appears to be positioned for modest growth. Forward P/E ratios for emerging market countries as a whole are significantly cheap compared to the rest of the world and from historical standards.

1 - Morningstar
2 - Ibid
3 - Ibid
4 - J.P. Morgan Asset Management
5 - Ibid
6 - Morningstar

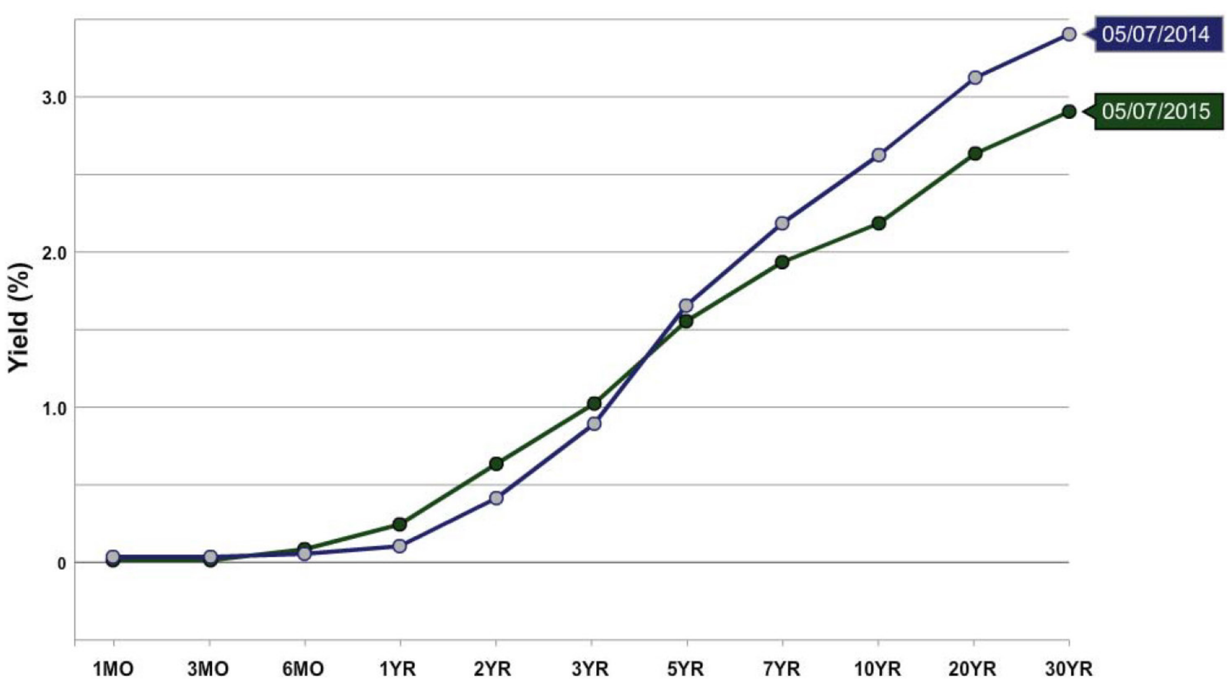
Current Diversified Equity Allocation as of 05/15/2015



Fixed Income – In Review

As the proverbial can gets kicked further down the road, all eyes are on the Fed and interest rates. So far in 2015, economic growth in the United States has been lackluster. Inflation remains underwhelming and economists are wondering if the economy really needs cooled-off by tightening monetary policy. Since last year at this time, the U.S. Treasury yield curve has further flattened, with 2-year bonds rising in yield and that of 30-year bonds falling to just 2.9 percent.[7] This has been a dilemma for investment managers who prudently remained shorter duration to protect investors' portfolios in anticipation of an inevitable rate hike, only to be tormented by gains in long-term bonds.

Treasury Yield Curve



Source: U.S. Department of the Treasury. 2015. *Treasury Yield Curve*. Retrieved May 8, 2015, from http://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/Historic-Yield-Data-Visualization.aspx

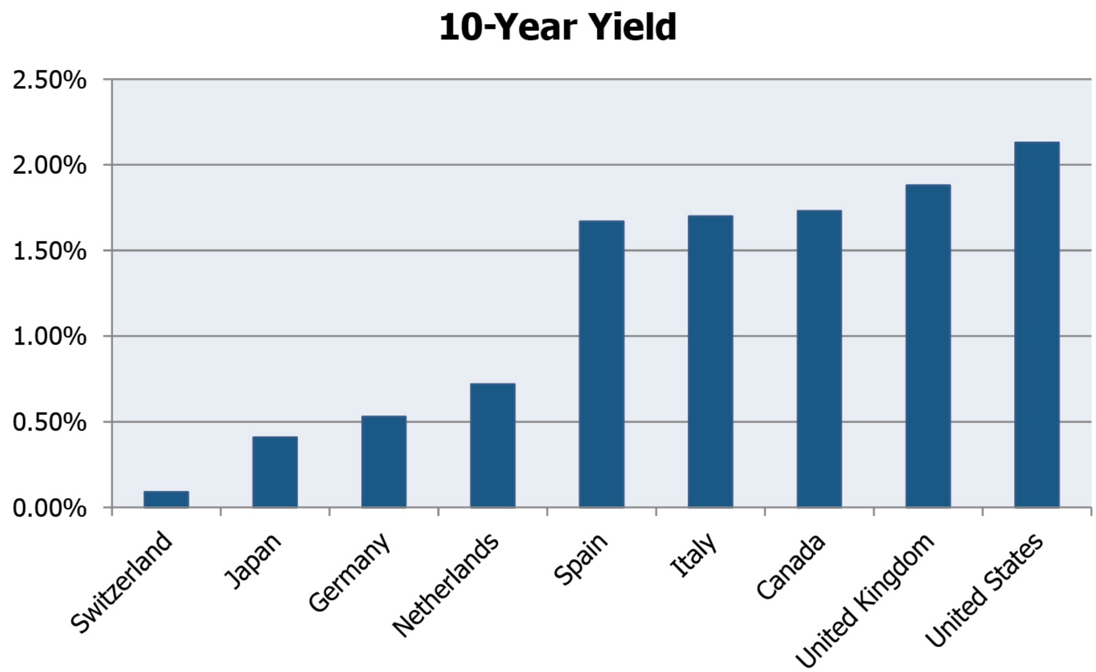
Fixed Income – Outlook

The current sentiment as it relates to fixed income is not "if" but "when" interest rates increase. As June's Fed policy meeting quickly approaches, the consensus is that a rate increase is off the table. At the earliest an increase could occur at September's policy meeting.

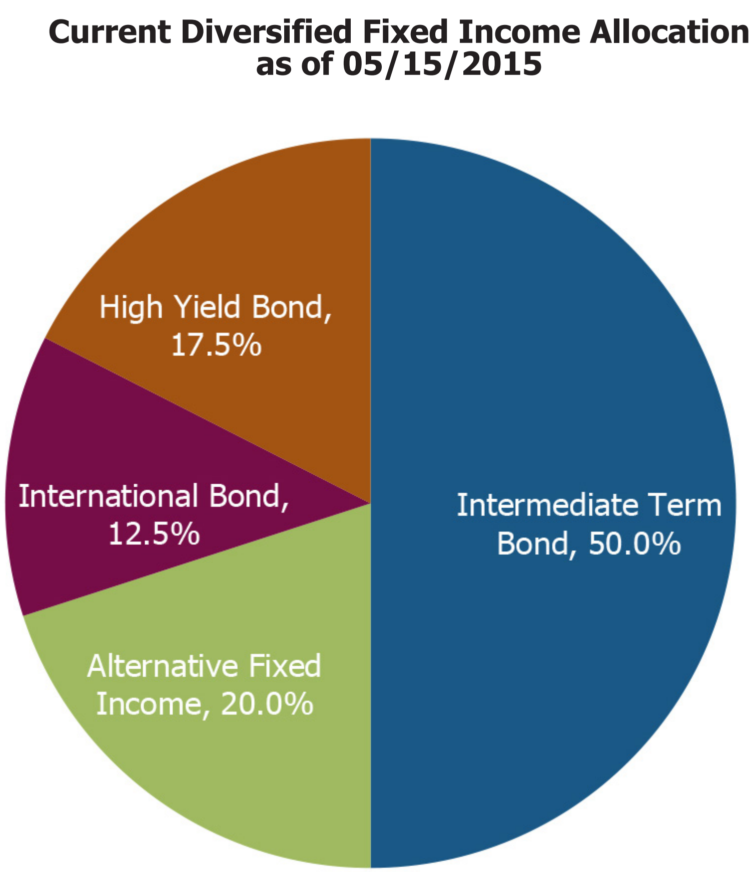
During this economic cycle, additional obstacles have been introduced to the mix of variables the Fed must consider when formulating monetary policy. One of those is the appreciation of the U.S. dollar relative to a basket of other foreign currencies that has occurred since last summer. The economy has slowed as multinational companies that translate unhedged revenue back to U.S. dollars are facing unfavorable exchange rates. The dollar has undoubtedly been a large factor in delaying lift-off of interest rates.

Secondly, as the ECB and Bank of Japan embark on their own quantitative easing programs, historically low U.S. Treasury yields begin to look attractive relative to those of other developed nations. When the Fed does decide to raise short-term rates, this may not necessarily translate into higher long-term rates immediately, as foreign investors may purchase Treasuries and drive yields lower.

7 - Bloomberg



Source: BloombergBusiness. 2015. *10-Year Government Bond Yields*. Retrieved May 8, 2015, from http://www.bloomberg.com/markets/rates-bonds/



Our view at Fragasso Financial Advisors is that rates will rise later and more gradually than previously expected. It is sensible to avoid long maturities as these bonds have the longest duration and can be the most negatively impacted. We are maintaining a long-term posture, conservatively focusing on preserving capital, but implementing strategies to capture yield where prudent in the meantime.

Our Philosophy

We believe a broadly diversified portfolio that is not overly exposed to any one risk stands the best chance to provide desired risk/reward profiles in the current environment. Actual adjustments to individual client portfolios will vary and are always personalized to one's unique circumstances. Implementation methods and vehicles may also vary from case to case so not every theme mentioned here is equally reflected in all cases.

We believe proper risk control remains the key to avoiding costly mistakes. As market conditions change, we actively manage risk on a full-time basis through time-tested, textbook principles:

- Keep asset allocation in line with objectives.
- Avoid overexposure to any one risk.
- Hedge riskier positions to protect against worst-case scenarios.
- Adjust tactfully within market dynamics.

In today's low-interest rate environment, many investors are confronted with the conundrum of reconciling their need for income with their desire to preserve capital. We continue to navigate this balancing act in the difficult fixed-income environment with both goals in mind.

If you find our methodology helpful and believe others may also benefit, please don't keep us a secret. We have the experience and know-how to help other people, organizations and businesses that are important to you.

We sincerely appreciate your business.

Daniel Dingus, AIF®
President and Chief Operating Officer

Investment in the portfolios mentioned in this document may not be suitable for all investors. Past performance is not a guide for future performance and should not be the sole factor in consideration when selecting investmenents. The price of investments may go up or down and the investor may not get back the amount invested. Your income is not fixed and may fluctuate. The value of investments involving exposure to foreign currencies can be affected by exchange rate movements. Levels, bases and reliefs from taxation can change.

Past performance is no guarantee of future returns.

Cover photo: 1979 Steelers, Associated Press Archive

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.

Investment advice offered through Fragasso Financial Advisors, a registered investment advisor.