ACCESS FINANCIAL SERVICES, INC.

Quarterly Review and Outlook — Third Quarter, 2015

INDEX	3rd Quarter, 2015	Year-To-Date	Last 12-Months
US STOCKS			
S&P 500 Index (large-cap stocks)	(6.44)	(5.29)	(0.61)
Russell 2000 Index (small-cap stocks)	(11.92)	(7.73)	1.25
FOREIGN STOCKS			
MSCI EAFE Index (developed foreign markets)	(10.23)	(5.28)	(8.66)
MSCI Emerging Markets Index	(17.90)	(15.48)	(19.28)
MSCI BRIC Index (Brazil, Russia, India, China)	(21.11)	(14.57)	(18.06)
COMMODITIES			
US Dollar Index	0.91	6.74	12.12
Gold Spot $/oz.	(4.87)	(7.11)	(8.43)
Silver Spot $/oz.	(6.69)	(8.27)	(14.38)
GSCI Commodity Total Return Index	(19.30)	(19.46)	(41.74)
BONDS			
BarCap US Aggregate Bond (investment-grade bonds)	1.23	1.13	2.94
BarCap US 20+ Yr Treas Bd Idx (long-term US treas)	5.32	(0.21)	9.12
Barclays Municipal Bond Total Return Index	1.65	1.54	2.82
Barclays US Credit Bond Index (corporate bonds)	0.53	(0.26)	1.50
Markit iBoxx USD Liquid High Yield Index	(4.40)	(2.18)	(2.90)
S&P/Citi Intern'l Treas Bond Ex-US (foreign bonds)	1.36	(5.03)	(7.59)

Source: iShares.com & Bloomberg

Following a generally flat but volatile second quarter, risk assets across the spectrum declined materially during the third quarter (table above and Exhibit 1). While we highlighted some of the warning signals we were watching in last quarter's letter, the 12.3% decline in the S&P 500 between July 20 and August 25 was sharper than we anticipated. This marked the first 10%-plus correction for the US stock market since 2011, an unusually long stretch given historically corrections occur roughly every year or so.

Exhibit 1

Source: Bloomberg (Developed Foreign Stocks: MSCI EAFE Index; Emerging Markets Stocks: MSCI Emerging Markets Index)

When markets move, people want explanations. Most coverage of the market's weakness has focused on deterioration in the Chinese economy and "uncertainty" related to monetary policy. While both were meaningful factors contributing to the selloff during the third quarter, a third catalyst that received far less coverage is the contraction in global corporate earnings growth.

There were also a growing number of conditions developing in the months prior to the selloff pointing to an increasing likelihood of broad based weakness. It's almost as though all the volatility we should have had in the preceding six months was compressed into six trading days between August 15 and August 25. Ultimately, the selloff in equity markets brought volatility in line with that of many other major asset classes (bonds, currencies and commodities) during the year.

As stocks declined, the market's view on the probability of the Fed lifting interest rates at their September 17 meeting fell from over 50% to around 25% (based on fed funds futures pricing) and the S&P 500 changed course and gained almost 7% between August 27 and September 17.

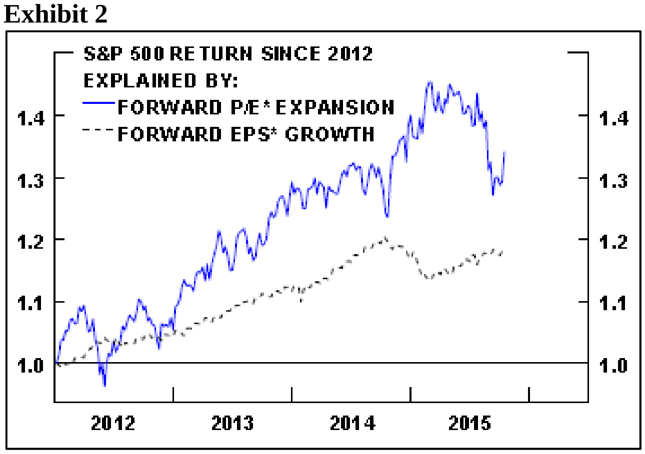
Ultimately, the Fed decided not to raise the fed funds rate on the 17th. Normally, this would have been a bullish development (it's hard to remember a time when the Fed moved this dovishly and the market didn't advance). However, stocks responded negatively and retreated through the end of the quarter. The Fed stated that "recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term." In her press conference, Fed Chair Janet Yellen pointed specifically to the recent developments in China and emerging markets as factors that gave them pause. She also noted the "tightening of financial conditions" due to the stock market declines, a stronger dollar, and wider credit spreads since the FOMC's last meeting. In addition, the Fed's preferred measure of inflation (core PCE) is still well below its 2% target, at 1.3% year over year. These comments were a significant contrast to her recent speeches where she offered an upbeat economic assessment. There was always a bit of caution, but her message was clear. She claimed we were headed for a very gradual liftoff in 2015 as the economy continued to heal.

Now, three weeks into the final quarter of 2015, global stocks have again rebounded strongly. The S&P 500 is up 8% and less than 5% below its recent high made on July 20. The areas of the market that were hit the hardest during the third quarter have posted the strongest gains. Market expectations for when the Fed will lift short-term interest rates have once again been pushed out a number of months and there is growing confidence the Chinese government will step up with more stimulus. While we welcome the rebound, we expect volatility to continue.

The sharp swings in market performance over the last few months continue to be largely driven by changes in the outlook for monetary policy – both here and abroad. However, the sustainability of a recovery in stock prices over a cyclical horizon is likely to become more dependent on corporate earnings growth than central bank policy because as the Fed prepares for liftoff, risk asset prices will be far more exposed to their underlying fundamentals.

The S&P 500 has risen by 62% since the beginning of 2012. Exhibit 2 shows that almost 60% of returns have been driven by forward price/earnings multiple expansion with only about 40% resulting from forward earnings growth. We think it is reasonable to assume that valuations have peaked for this cycle. This view is consistent with historical patterns where the early part of cyclical bull markets tends to be driven by valuation expansion, whereas the latter stages are usually driven by actual growth in corporate earnings. Therefore, earnings growth should become an increasingly important variable.

Exhibit 2



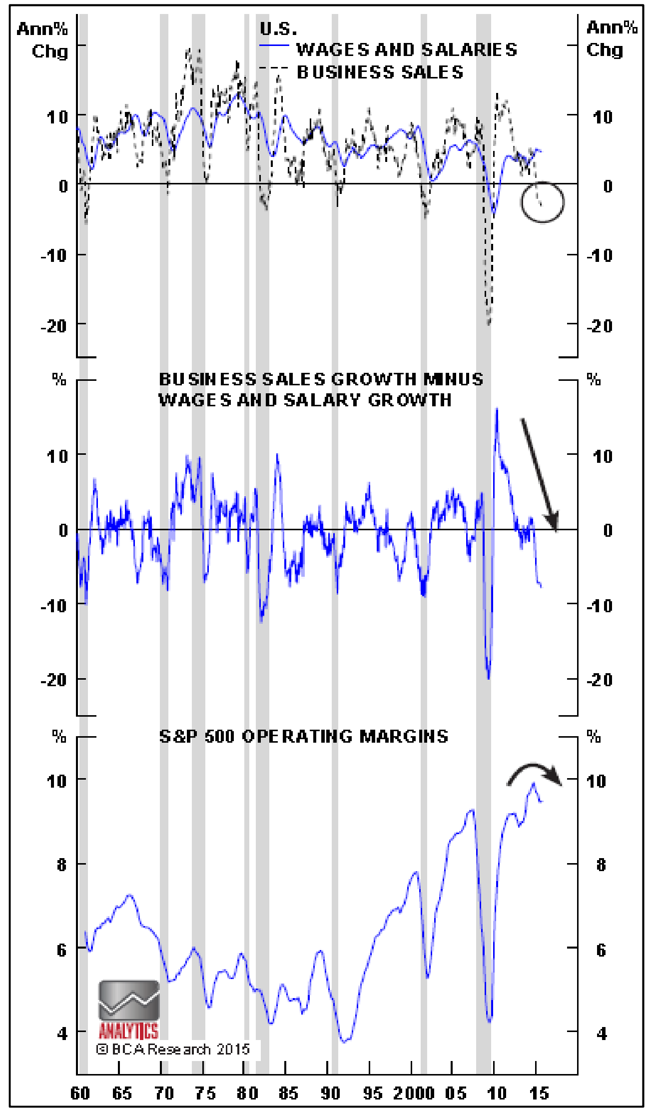
Source: BCA Research

Unfortunately, growth in corporate earnings and profits will likely take time to materialize and require stronger global economic growth.

- Exhibit 3 shows that sales are contracting while wage and salary growth is strong. Historically, this has resulted in lower profit margins.
- The Great Recession created a lot of pent up demand which has slowly been unwound.
- The Atlanta Fed's GDPNow forecasting model points to third quarter GDP of around 1%, down from 3.9% as of the end of the second quarter (Exhibit 4)
- The positive impact from credit growth is set to weaken because the *change in credit growth* is more important than credit growth itself in influencing economic growth. Credit growth has been increasing from a low of around -4% in 2009 to 5% at present.

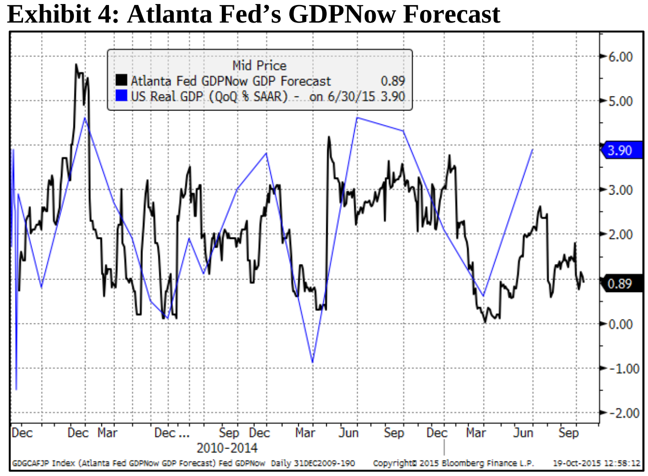
As credit growth stabilizes, the "credit impulse" falls toward zero.

Exhibit 3



Source: BCA Research

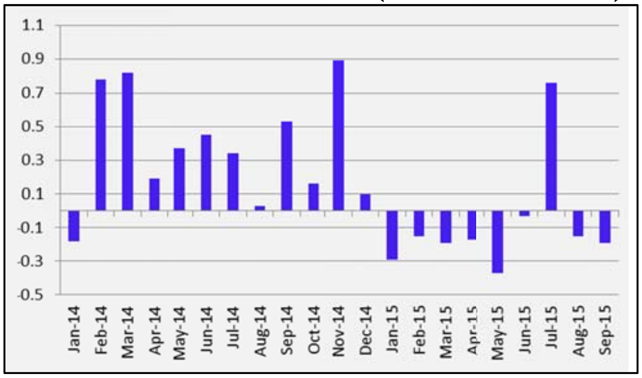
Exhibit 4: Atlanta Fed's GDPNow Forecast



Source: Bloomberg

- Industrial production has increased only once in the past eight months (Exhibit 5).

Exhibit 5: Industrial Production (Month-Over-Month)



Source: Bloomberg

- Corporate earnings during the third quarter should decline slightly. As of October 19, 47 (9%) companies have reported results so far this quarter with average earnings growth of -4% and revenue growth of -3.6% (Exhibit 6). Weakness is broad based with 5 of the 10 major sectors expected to show year-over-year profit declines.

Exhibit 6: S&P 500 3rd Quarter Results*

SECTOR	REVENUE	EARNINGS PER SHARE
CONSUMER DISCRETIONARY	4.1%	10.9%
CONSUMER STAPLES	1.6%	-2.0%
ENERGY	-36.8%	-64.9%
FINANCIALS	1.6%	11.0%
HEALTH CARE	7.6%	3.3%
INDUSTRIALS	-5.0%	-2.7%
MATERIALS	-9.0%	-19.3%
TECHNOLOGY	1.6%	2.8%
TELECOM	14.2%	11.2%
UTILITIES	2.9%	-2.2%
S&P 500	-3.6%	-4.0%

**Blended between reported and expected*
Source: BCA Research and Thomson Reuters/IBES

- Leading indicators for corporate profitability such as factory orders and the latest ISM survey tell a similar story.

The bottom line is that earnings are likely to contract over the next quarter or two. Beyond that, earnings growth should be positive but not nearly as strong as we've seen over the last few years. As a result, we are inclined to tread cautiously regarding the latest market bounce.

Tactically, we reduced portfolio risk during the quarter. While our clients' portfolios are managed on an individual basis, in almost all cases we reduced equity exposure just prior to the selloff by reducing or eliminating our position in real estate investment trusts (REITs) and moved our high yield bond exposure into high quality bonds. In almost all cases, our clients' portfolios are underweight stocks, overweight cash and have little (if any) exposure to credit risk in their bond allocations.

While we are encouraged by the market's recent strength, the conditions outlined above keep us cautious and we expect higher levels of volatility to persist. This is particularly true because the recent rally has been focused on assets that are sensitive to world growth and the underlying macro drivers of these assets are fragile (to say the least).

We continue to believe high quality bonds remain an attractive hedge against stock market volatility, even if the Fed does raise rates in the months ahead because growth and inflation are likely to stay low which should underpin the asset class.

-Brant Kairies
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