The second quarter of 2016 has been one for the books. Negative interest rates continued to confuse investors, Puerto Rico defaulted on their constitutionally guaranteed GO debt, US politics continue to provide global amusement…however the UK eclipsed them all with a surprise vote to leave the European Union. The "Brexit" surprised markets and caused a rush of volatility near the end of the quarter. Fortunately, the swing was quick and the market bounced back before quarter end. The S&P ended the quarter up 2.5%. However, volatility has taken a toll on bond yields, and safe havens like US Treasuries yields have continued to fall; the 10 year Treasury yield ended the quarter at 1.49%. The May employment report was bleak and the Fed predictably punted on a rate increase. After the Brexit, the market is predicting only a 50% possibility of even one increase this year.

"Brexit" and politics have been beaten to death by the media, so let's discuss Puerto Rico's bond crisis. Governor Padilla has warned since last June that shrinking revenues would result in a default on most of its $70bn in debt, including constitutionally protected GOs. After months of creative accounting, the island defaulted on $911mm in payments on July 1, of which $780mm were GO bonds. President Obama signed legislation to deliver oversight and debt relief, however, PROMESA (The Puerto Rico Oversight, Management and Economic Act) provides no financial relief to the island. It will not help liquidity or bondholders; it simply prevents creditor lawsuits. Talks with GO bondholders have broken down and a group of hedge funds sued the island in June for illegal use of a moratorium law to skip payments on debt protected by Puerto Rico's constitution. So far, the island has avoided major lawsuits by engaging in talks with creditors on electric utility bonds and guaranteed bonds, but the GO bondholders are different: they're hedge funds who are not afraid to use their substantial resources to fight for what was promised to them. Puerto Rico is facing an uphill battle whose fate will not be decided for quite some time. And unfortunately, a few other debt plagued states may be watching the outcome closely.

The biggest concern for the municipal market in Puerto Rico's wake is the precedent it will set. US states are expected to address their liabilities by taxing and cutting their way out of debt. But what if they refuse to in hopes of a bailout, and public health and safety are threatened? Puerto Rico and Flint have shown the federal government has no tolerance for threats to resident welfare. If police officers stop getting paid or pension incomes suddenly cease, expect the Federal government to get involved…for better or for worse. We aren't sounding the alarm yet, but investors will want to incorporate this possibility if places like Illinois, New Jersey, and Pennsylvania continue to fight for political advantage instead of addressing their fiscal problems.

Taxable Fixed Income Performance Composite

While our strategy for taxable bonds has favored taxable municipals, we have been selective about where we invest. Puerto Rico, New Jersey, Illinois or any other state that has serious fiscal deficits or pension liabilities have not been a consideration for us. Investment grade Corporate bonds have started to provide a slightly better yield, however we continue to see value in high quality taxable municipal bonds. We continue to recommend a shorter average duration and maturity compared to the benchmark, however bonds in the 10 year range are more attractive at this time than extremely short bonds in the 1-4 year range. Our composite continues to hold higher credit quality and shorter duration than the benchmark, while also matching its benchmark performance.

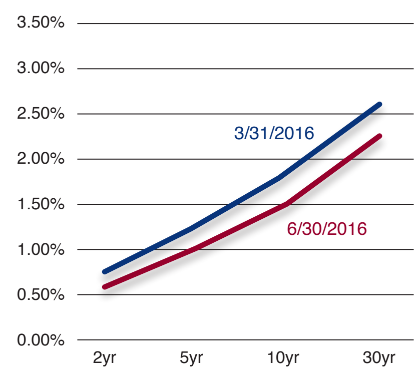
Portfolio Characteristics:

Average Maturity	3.7 yrs
Average Duration	3.3 yrs
Average Yield to Maturity	2.15%
Average Coupon	4.25%
Average Quality	AA-

Credit Quality:

AAA	15%
AA	53%
A	24%
BBB	8%

Treasury Yield Curve



Fixed Income Sector Breakdown