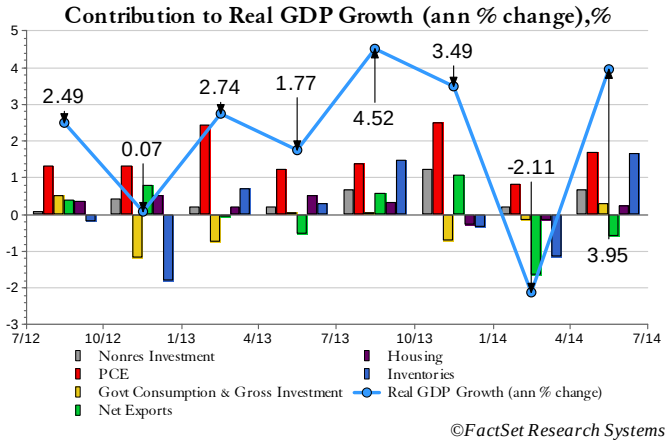
VANTAGE CONSULTING GROUP
3500 PACIFIC AVENUE VIRGINIA BEACH, VA 23451 (757) 491-1200 FAX (757) 422-5378

Market Review

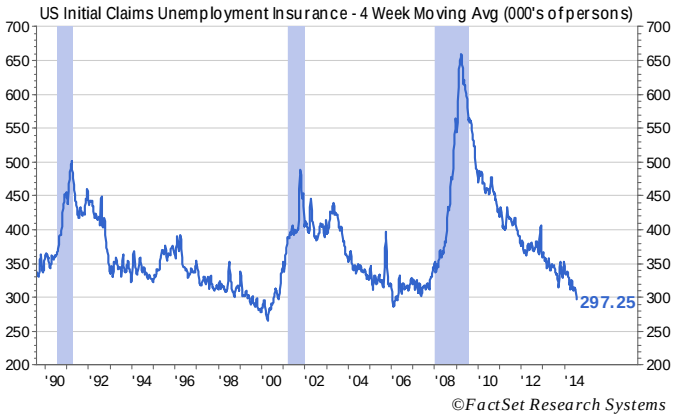
July 2014

Economic Review

Economic data released in July was mostly positive. The U.S. economy, as measured by real GDP, grew at a 4% annualized rate (a.r.) during the second quarter of 2014, well above the 3% forecast, according to the advance estimate released by Bureau of Economic Analysis (BEA). The increase in real GDP was broad based across every major sector with the exception of net exports. The annual revision to prior quarters resulted in faster growth for the second half of last year. First quarter real GDP was also revised to -2.1% compared to -2.9% as previously reported. The initial estimate of second quarter GDP is subject to revisions by BEA over the next two months.

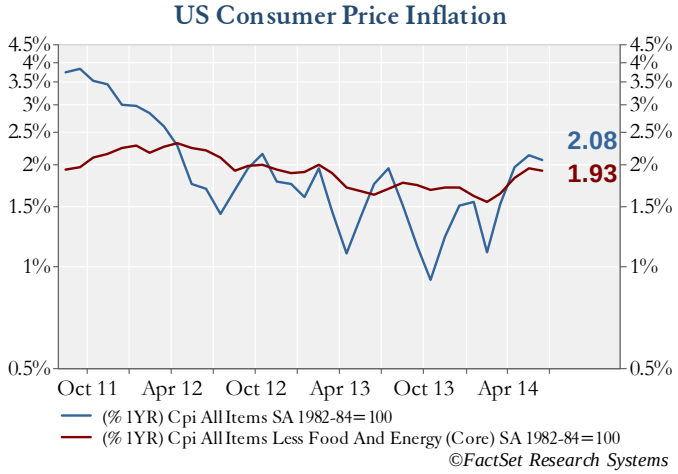


The labor market continued to show improvement in July. The unemployment rate declined to 6.1% in June, the lowest level in nearly six years, according to the U.S. Bureau of Labor Statistics (BLS). Total nonfarm payroll employment increased by 288,000 in June, the fifth consecutive month with over 200k jobs. April and May data were revised higher by a net 29,000 jobs. July weekly initial



jobless claims averaged less than 300,000 for the first time in eight years. Though labor market conditions seem to be improving, wages continue to be under pressure. Average hourly earnings have risen by 2% while real average earnings have declined 0.1% over the past twelve months ending June 2014. The Employment Cost Index also indicated little wage pressure as wages and salaries only increased 1.9% over the past twelve months.

Headline Consumer Price Index (CPI) increased +0.3% Month over Month (MoM) in June, primarily driven by gasoline prices. The inflation index is up +2.1% Year over Year (YoY), in line with expectations. CPI less food and energy increased +0.1%, after a +0.3% increase in May and is up +1.9% YoY. The Producer Price Index rose +0.4% in June, after a -0.2% decline in May. The 5 Year/5 Year Forward breakeven inflation rate increased 7 bps, to 2.45%.



July housing data reports continued to indicate a slowdown in the housing market recovery. Home prices, as measured by S&P/Case-Shiller 20-City Composite Index, increased 9.3% YoY in May, the slowest pace since February 2013, after rising 10.8% in April. Existing home sales climbed 2.6% MoM, the third consecutive monthly gain, to an a.r. of 5.04 million units. Yet, existing homes sales are 2.3% lower than a year ago as sales of single-family houses remained weak. The supply of existing homes increased to 5.8 months. Sales of new homes declined 8.1% in June, reversing the 8.3% gain in May. Housing starts contracted by 9.3% MoM to 893,000 a.r., the lowest in twelve-months. Building permits declined 4.2% to an a.r. of 963,000.

As anticipated, the Federal Open Market Committee (FOMC) reduced the pace of its asset purchases by another $10 billion to $25 billion at its July month end meeting. The FOMC minutes released mid-month indicated that the Fed expects to end the current bond purchase program by October.

Economic data for Europe released in July was mostly weak. Eurozone inflation fell in July to the lowest level

since the bottom of the 2009 global financial crisis, which renewed deflation fears across Europe. The Eurostat estimate of annualized inflation in July was 0.4%, down from 0.5% in June and the lowest reading since October 2009. Industrial production in May showed a 1.1% decline, reversing the 0.7% rise in April. On a yearly basis, industrial output grew at 0.5% following a 1.4% rise in April. The Eurozone unemployment rate ticked down to 11.5% from 11.6% in May. Spain (24.5%) and Greece (27.3%) continue to have crippling levels of unemployment, while Austria (5.0%) and Germany (5.1%) lead the region.

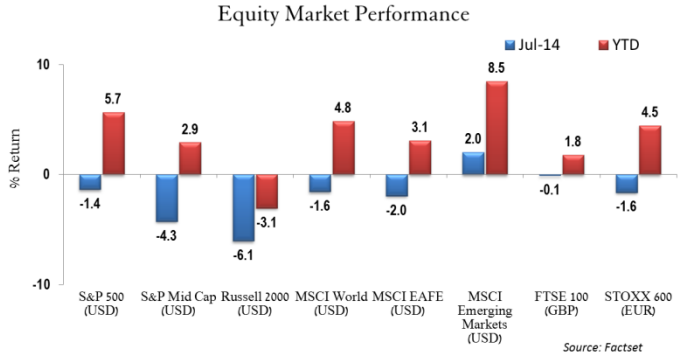
In the United Kingdom, economic data was positive. The unemployment rate fell to 6.5% in May, below April's 6.6% reading; the unemployment rate is now the lowest since December 2008. Inflation rose to 1.9% in June from 1.5% the previous month and above economists' estimate of 1.6%. The uptick in inflation was due mostly to rising food and clothing prices, which are expected to reverse next month. Core CPI, which excludes food, energy, alcohol, and tobacco, costs rose at a rate of 2% last month, up from 1.6% in May. Growth in home prices accelerated to 10.5% in May from 9.9% in April.

In Asia, the flash estimate of Chinese second quarter GDP showed 7.5% growth, better than the forecast of 7.4%. The Chinese government has expanded credit and accelerated government spending in recent months to reaccelerate the economy. The Japanese government downgraded the 2014 growth outlook, citing weakening domestic demand and exports as concerns. Japan's Council on Economic and Fiscal Policy estimated that GDP would grow at 1.2% for the year ending March 2015, lower than previous estimates of 1.4%. In India, new Prime Minister Narendra Modi unveiled a budget to stimulate economic growth including programs to increase foreign-direct-investment and improve infrastructure. Modi and his Finance Minister, Arun Jaitley, expect that Indian GDP growth can reach 7-8% within 3 years while maintaining a modest deficit-GDP ratio of 4.1%.

On July 30, Argentina defaulted on its sovereign debt for the second time in 13 years. The Argentine government had been in negotiations with a group of bondholders to stave-off bankruptcy, but a deal was not reached by the deadline, pushing the recession-hit nation into default. Elliott Management, a U.S. hedge fund managed by billionaire Paul Singer, led the investors' cohort. The investors owned a large block of holdout bonds from Argentina's 2001 default, which they refused to haircut and exchange for new bonds. Singer and the investors demanded full-payment and equal treatment of the holdout bonds, to which Argentina's government refused to comply.

Equity Markets

Global equities mostly fell in July, after posting five consecutive positive months from February-June. The MSCI World Index lost -1.6% and is up 4.8% in 2014. U.S. large-cap stocks, as measured by the S&P 500, fell -1.4% in July despite a significant upward revision to U.S. first-quarter GDP and better than expected estimates for the second quarter. Mid-cap stocks measured by the S&P 400 declined -4.3% while the Russell 2000 small-cap index lost 6.1%. The headline indices for Europe (STOXX 600) and the U.K. (FTSE 100) lost -1.6% and -0.1%, respectively. The MSCI Emerging Markets Index posted a 2.0% gain in July, and is currently up 8.5% in 2014 after falling 2.27% in 2013.



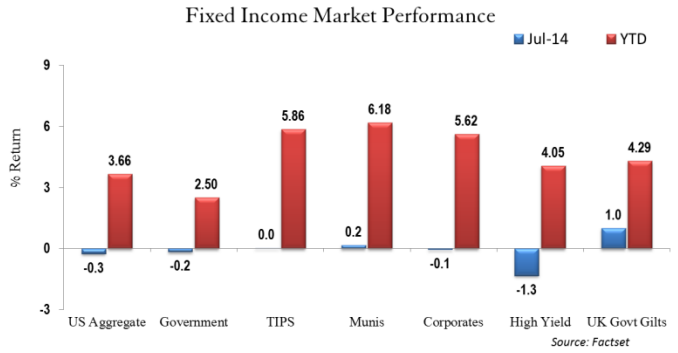
Stocks traded mostly flat through July until the last day of the month, when the S&P 500 lost 2% to finish July in negative territory. The end of July coincided with deflation fears in Europe, the probable bailout of Portuguese bank, Banco Espirtio Santo, and increasing fears of a debt default by the Argentine government. Market volatility, as measured by the CBOE Market Volatility Index (VIX), recorded an intra-day low of 10.28 on July 3rd, then ultimately rose to 16.95 at the end of the month. While the 16.95 reading was the highest monthly close since January, the VIX remains well below the long-run average of 20.

Bond Markets

Bond market volatility rose in July as geopolitical risks escalated. The U.S. bond market, as measured by the Barclays U.S. Aggregate Index, declined -0.3% during the month. The 30 Year Treasury Bond yields declined through most of July, reaching the lowest level in over a year before rising sharply towards the month end. The Treasury yield

curve continued to flatten with the 2/30 year spread flattening 11 bps in July and 79 bps YTD. Investment grade credit spread remained largely unchanged, with the Credit Index Option Adjusted Spread declining 1 bps to close at 95 bps.

The yield on the 30-year U.S. Treasury bond finished 3 bps lower, at 3.31%, while the 10-year yield increased 4 bps to end the month at 2.56%. The yield on UK 10-year benchmark bonds declined 7 bps to close at 2.6%. The yield on German 10-year benchmark bonds fell 8 bps, ending July at 1.16%.



Commodities

The S&P GSCI Total Return Index, a headline index of 24 commodities, fell -5.30% in July, reversing most of the year-to-date gain. The Agricultural sub-index continued its three-month slide, losing 8.74% in July. The year-to-date performance for the Agricultural sub-index stands at -7.23% after recording 19% gains from January through April. Corn [-14.74%], Cotton [-14.47%], Wheat [-8.18%], and Soybeans [-6.50%] - all posted substantial losses in July. Global drought concerns have lifted in recent months, leading to better-than-expected estimates for crop harvests and excess supply concerns.

The Energy and Petroleum sub-indices were among the worst performers in July, with each posting over 5% losses despite mounting tension between Russia and Europe as well as continued unrest in the Middle East. After peaking at $104.59/bbl. on July 21st, Crude Oil prices slumped throughout the remainder of the month, closing at $98.17/bbl., the lowest monthly close since January. The Natural Gas sub-index fell -13.74%, as the mild summer reduced output from electric utilities, the biggest consumer of natural gas. The Unleaded Gasoline sub-index fell -7.16% after weekly government inventory reports showed stockpiles increasing while experts predicted summer demand for gasoline will be light due to decreased traveling.

The Industrial Metals sub-index rallied 2.68% in July, the only headline sub-indices to finish the month in positive territory. Positive manufacturing data in the U.S. and a report that China is stockpiling strategic industrial metals pushed the sub-index higher. Zinc [6.61%] led the rally, as falling stockpiles and growing concerns about mine supply pushed the price higher. Aluminum [5.40%], Lead [2.62%], and Copper [1.32%] also contributed gains to the Industrial Metals sub-index.

Currency

The US Dollar increased the most in over 15 months against a basket of peers as better economic reports increased market expectations that the Federal Reserve will raise interest rates next year. The US Dollar index, which measures the U.S. currency's value against a basket of six major currencies, appreciated 2.1% in July, the most since February 2013, to close at 81.46.

The USD closed at an eleven month high against the Euro amid slowing inflation in Europe. The Euro declined -2.3% against the greenback to close at 1.338 USD/EUR vs. 1.369 USD/EUR in the prior month. The British Pound depreciated -1.3% against the US Dollar in July to close at 1.688.