GIA PARTNERS

1st Quarter 2015

Highlights

- During the first quarter, weaker than expected economic data generated expectations that the Fed would delay rate hikes. Interest rates declined, but credit markets recovered as investors sought yield;
- The detrimental economic effects of the strong dollar and reduced energy investment affected first quarter data. We believe the beneficial effects of lower oil prices and better wages are coming;
- Deteriorating liquidity has affected fixed income markets. After the 2008 crisis, market participants were forced to alter their behavior. We believe liquidity has value that can benefit long-term investors.

Markets

		Returns (%)	
GIA*	Average Quality	1Q15	12 Months
Core Plus Composite	(A)	2.01	3.81
Global Credit Plus	(BBB-)	2.40	2.65
Global High Yield Composite	(B+)	2.18	-2.63
Emerging Market Debt Composite†	(BB)	1.70	-0.65

**Returns are net of fees*

Benchmark Bonds			
Barclay's U.S. Aggregate Index	(AA+)	1.61	5.72
Treasury	(AAA)	1.64	5.36
Credit	(A)	2.16	6.74
Mortgage	(AAA)	1.06	5.58
Government/Credit	(AA)	1.84	5.86
BoA Merrill U.S. Corps & Yankees	(A)	2.15	6.48
BoA Merrill Corporate Master	(A-)	2.26	6.77
BoA Merrill High Yield	(B+)	2.53	1.98
BoA Merrill EM Corporate Plus	(BBB)	2.19	3.47
JPM Emerging Markets EMBI+	(BBB-)	1.87	4.53
JPM CEMBI Broad	(BBB)	2.44	3.67
JPM GBI-EM Global Diversified	(BBB+)	-3.96	-11.14
Citi Non-U.S. World Govt. Bonds	(AA-)	-4.36	-9.82

Benchmark Equities			
S&P 500	NA	0.44	10.44
Nasdaq Composite	NA	3.48	16.72
Russell 2000	NA	3.99	6.80
MSCI EAFE	NA	4.19	-3.46
Europe	NA	2.85	-7.39
Japan	NA	9.47	10.26
MSCI Emerging Markets Equity	NA	1.91	-2.02

Markets

During the first quarter of 2015 a lot happened, but not a lot changed. After experiencing roller coaster-like moves in January, U.S. equity markets hit new highs in February, but ended the quarter with modest year-to-date gains. Government bond prices moved higher on a decline in rates, but also experienced sharp swings during the quarter. Investment performance in the U.S. oscillated with economic data, and how it would affect Fed policy rather than underlying business activity. The country confronted another poor weather quarter, but economic drags also appear to have come from the strengthening U.S. dollar and the rapid contraction in oil field investment. After the European Central Bank commenced its largest quantitative easing program, Euro area government bond yields sank. The appreciating dollar put pressure on oil and commodities, which further dampened the growth outlook for emerging markets. Since this narrative started in the second half of 2014, the financial market impact in 1Q 2015 was modest. For the quarter, the S&P 500 returned 0.44%, the Japanese Nikkei returned 9.61% in U.S. dollars, the German DAX returned 7.69% in U.S. dollars, and U.S. treasuries were up 1.75%.

High yield bonds recovered from their fourth quarter slump as investors returned to the asset class and liquidity improved. Energy related companies continued to lag, but stabilized after a sharp fourth quarter decline. The Bank of America Merrill Lynch High Yield Cash Pay Index (J0A0) was up 2.53% for the quarter. Spreads narrowed from 501 b.p. to 488 b.p., and the yield to worst decreased from 6.54% to 6.16%. Mutual fund investors added $10.1 billion to high yield funds during the quarter in a reversal of sizeable outflows in both December and full year 2014. The default rate increased to 3.0% in March compared to 2.96% in December, but was slightly lower than February. Defaults have not yet been meaningfully impacted by the stressed energy sector, although a few small exploration and development companies did fail. During the quarter new issues totaled $95.6 billion, which was higher than the first quarter of 2014 and the seventh highest issuance quarter on record.

The investment grade corporate bond index, the Bank of America Merrill Lynch U.S. Corporate Index (C0A0), was up 2.26% on the back of lower interest rates, but experienced volatility during the quarter with a robust January followed by negative returns in February. The corporate index outperformed the U.S. treasury index (+1.75%) in absolute numbers, but underperformed on a duration adjusted basis. Investment grade corporate spreads narrowed by 2 b.p. to 136 b.p., and the yield to worst of the index declined from 3.21% to 2.94%. Issuance for the quarter was robust at $353 billion as rates declined sharply in January and investor demand recovered.

Emerging markets debt had a mixed quarter despite a dour outlook from many strategists. Dollar denominated bonds performed relatively well, while local currency markets suffered from an appreciating U.S. dollar. Within the sector, Russia, one of last year's worst performers, delivered the best individual country performance. Brazil, on the other hand, continued to suffer from a corruption scandal and weakening economic performance. The JPM Emerging Markets Bond Index Plus (EMBI+), a dollar denominated sovereign index, was up 1.87% for the quarter, the JPM Corporate Emerging Markets Broad Index (CEMBI Broad) returned 2.44% for the quarter, and the JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, returned -3.96%.

Portfolios

Our *Core Plus Composite* consists of portfolios that can hold up to 30% in securities rated below investment grade. The Composite outperformed the Barclays U.S. Aggregate Index, net of fees, by 40 basis points for the quarter, but was behind by 191 basis points over the last twelve months. During the quarter, the portfolio retained exposure to high yield and emerging markets, which contributed most of the outperformance. The portfolio was underweight government bonds and mortgages, which detracted from performance, but not enough to offset the benefit from credit. Over the last 12 months the underperformance is attributable to high yield and emerging markets as those sectors declined during the second half of 2014 and interest rates fell taking government bond prices higher.

Global Credit Plus Composite consists of portfolios holding investment and non-investment grade credit related securities. The Composite is measured against a benchmark consisting 70% of the BofA Merrill Lynch U.S. Corporate Index and 30% of the BofA Merrill Lynch U.S. Cash Pay High Yield Index. The Composite outperformed the benchmark, net of fees, by 4 basis points during the quarter, but was behind by 268 basis points over the last twelve months. The portfolios had an allocation of approximately 39.4% U.S. investment grade, 24.7% high yield, and 35.8% emerging markets, of which 14.4% was investment grade rated. During the quarter, both high yield and emerging markets recovered, interest rates declined, and investment grade credit largely kept pace. The portfolio benefited marginally from its exposure to the higher yielding sectors, but not enough to meaningfully outperform. Over the last twelve months, the portfolios' emerging markets exposure caused almost all of the underperformance as the portfolios' investment grade and high yield holdings outperformed their respective benchmarks.

Our *Global High Yield Composite* consists of portfolios investing primarily in U.S. high yield, higher yielding investment grade credit and emerging markets corporate bonds. The Composite underperformed the Bank of America Merrill High Yield Cash Pay Index by 35 basis points, net of fees, in the quarter, and was behind the index by 461 basis points over the last 12 months. During the quarter and the last 12 months, the Composite held a meaningful exposure to emerging markets. Although Russian bonds recovered, Brazilian securities underperformed. In addition, oil and commodity related borrowers continued to decline. Over the last twelve months the underperformance is attributable primarily to the emerging markets exposure, which was affected by the decline in oil prices that began in the second half of 2014.

Our *Emerging Markets Debt Composite*[†] consists of portfolios investing in dollar denominated emerging market credit securities, primarily from corporate issuers. The Composite is measured against the BofA Merrill Lynch US Emerging Markets Plus Index (EMUB). During the quarter, the portfolio underperformed the benchmark by 49 basis points, net of fees, and was behind by 412 over the last twelve months. During the quarter, we increased the portfolio's exposure to Latin America, particularly Brazil. While the portfolio's Russian holdings recovered nicely, the Latin exposure underperformed. Over the last twelve months the portfolio was overweight to both Russia and Ukraine, which performed poorly. In addition, the portfolio was underweight Asia, a region with many lower yielding, high quality names that benefited as interest rates declined.

Economy

On April 3, 2015 the Labor Department released a nonfarm payroll report that was lower than market consensus by nearly 100,000 people, although wages improved and the unemployment rate remained at 5.5%. In addition, earlier reports on manufacturing, durable goods, and retail sales printed below expectations. By quarter end many economists had lowered their growth expectations. The bump we were expecting from the "oil price dividend" did not materialize, while the drag from reduced investment and a stronger U.S. dollar did. New unease about the strength and permanence of the U.S. economy has crept into the conversation. According to the economists who fill out the WSJ Economic Survey, the adjustments are timing related rather than permanent. These economists lowered their average forecast for the first quarter from 2.7% to 2.3% and increased their second quarter forecast from 2.9% to 3.0%.

Ironically, U.S. – and to some extent global – equity markets have celebrated the weaker data because it may delay the Fed's move to normalize rates. In our opinion, the problem with this thinking is that monetary policy then contributes further to pricing distortions and capital misallocation. We are already on pace to set records for merger and acquisitions transactions in 2015. Normally, M&A indicates corporate leaders have confidence in the economy and the sustainability of profits. If economic readings are wrong, then the transactions would be driven purely by the low cost of capital.

One of the factors weighing on the U.S. economy is the appreciation of the U.S. dollar. The appreciation has resulted from both superior economic performance in the U.S. and aggressive monetary policies abroad. The question then is whether the U.S. has the strength to pull Europe and Japan out of their malaise through the currencies' pricing realignment, or whether we are headed to another bout with recession. Fortunately, the world is enjoying an assist from low oil prices.

In emerging markets, headlines do not seem to help. China, the world's locomotive a couple of years ago, seems to be intent on squeezing excesses out of the economy at a cost of lower near-term growth. Oil producers like Russia and Mexico face challenging reductions of resources and Brazil is grappling with low commodity prices and ineffective government policies. Among the large countries, only India appears to be a beneficiary of the global realignment of prices.

While current economic indicators appear worrisome, we believe the benefits of low commodity prices and currency revaluations have not yet translated into global consumption. It takes time for prices to adjust supply/demand imbalances especially when many prices are adjusting simultaneously. During the first quarter, European equity markets hit record highs. Some of this is due to the Central Bank's policy and record low interest rates, but part is due to the expectation that the lower Euro, combined with low energy prices, will finally get the region on a better growth path.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the economy growing 2.5% to 3.0% in 2Q and 3Q 2015. We believe the drags from the reduction in energy sector investment and a stronger dollar (and poor weather) manifested themselves in the first quarter. The benefits from lower oil prices and improving wages have not yet appeared. The Fed seems to be intent on normalizing interest rates as the rationale for record low policy rates continues to erode. While the Fed may be hostage to external events, the ability to be complacent because of the oil price "inflation dividend" is coming to an end. We believe the eventual move to raise rate will be so expected, it will have limited economic effect. PROBABILITY 65%

2. A second scenario has the economy recovering to above-trend growth of 3.5% to 4.0% over the next six months. We experienced two quarters like this in 2014, although partly due to the weather-related transfer of activity from the first quarter. In 2015 we may again have weather related transfer of activity. In addition, Europe may be reacting more quickly to the Central Bank's policies, likely because of their effect on currency values. With strength remaining in the U.S. and some improvement abroad, growth could surprise on the upside. PROBABILITY 15%

3. A third scenario has the economy declining to a 0.5% to 1.5% growth rate due to economic drags from net exports, curtailment of investment and inaction by consumers on lower energy prices. The improvements we expect abroad from currency devaluations may not materialize and the U.S. may not have sufficient strength to pull the rest of the world along. In this scenario emerging economies sink further as capital does not return and government policy fails to stimulate consumption. PROBABILITY 20%

Market Outlook

U.S. investors are experiencing a "tug-of-war" between a convoluted economic outlook and stretched valuations across most asset classes. External conditions only cloud the outlook as foreign central bank stimulus makes it harder for the Fed to normalize policy in the U.S. We believe the benefits of low oil prices and improving employment have not fully taken hold. While the data may delay the Fed's move to normalize interest rates, we believe policy adjustments will begin this summer. The implication for fixed income markets is that interest rates may remain low for a few more months. However, as both the U.S. and global economy begin to benefit from low oil prices and monetary policy support, we believe rates will begin to rise. In this environment the ascent in equity markets may pause, but spread markets in fixed income should attract investor interest. In the U.S., the continuing flow of foreign funds supports a favorable outlook for both high yield and emerging markets. In addition, some of the headwinds from commodity prices and currency devaluations should begin to ease.

Commentary – On Liquidity

Liquidity in financial instruments is an often discussed subject that is hard to corral. Investors and analysts use the term frequently to describe characteristics of certain assets, conditions in the marketplace, or investment flexibility. In fixed income the term has become particularly important because changes in market characteristics have altered the way securities trade and forced adjustments in investor behavior. Some critical questions for bond investors relate to how these will affect fixed income sectors in the future, and implications for investment strategy.

J.P. Morgan analyzed U.S. corporate bond market liquidity and presented a useful report looking at changes in marketplace behavior of issuers, investors, and dealers.[1] The analysis shows that each group (and the market as a whole) has witnessed meaningful changes after the 2008 financial crisis and those changes have played a role in altering liquidity conditions. It is not surprising that markets and participants adjust behavior after a crisis, but the question is whether the changes are helpful and ultimately beneficial to markets.

One challenge in addressing the liquidity question is that no change occurs in isolation. Many factors affect changes in behavior. Perhaps the most visible changes occurred on the regulatory front. With regulators blaming banks and dealers for the financial crisis, it is not surprising that authorities targeted these institutions for further oversight. In the U.S., the most meaningful constraints came from the Dodd-Frank bill, which imposed additional capital requirements and, critically, eliminated proprietary trading. In bonds the combination meant that banks can no longer "act as a shock absorber to market flows." In 2014, dealer positions averaged about $18.7 billion (0.25% of bonds outstanding), which is less than one day's average trading volume, compared to over $130 billion before 2008.[2] These changes engendered some radical adjustments to the market structure which investors and dealers are slowly learning to manage.

Prior to the crisis, the major dealers dominated trading in corporate and asset backed bonds. Their size and presence could be described as the nexus around which the market revolved. With active proprietary desks, banks had the flexibility to operate indistinguishably through proprietary or flow desks to help accommodate large trades and dampen volatility. Since 2008, even though daily trading volume has increased, the absence of an easing agent has led to many bouts of illiquidity and stalled trading activity. The dealers' role as the central marketplace has declined leaving investors to search for an alternative, which does not yet exist.

In the meantime, changes triggered by the crisis and new regulations led to a massive increase in public bond issuance. Over the last five years investment grade borrowers issued $5.1 trillion of securities, which matched issuance from this same group over the previous twelve years.[3] In addition, the number of new issuers increased by 71%. In U.S. high yield the story is similar with the number of issuers growing by 22%. In emerging markets the J.P. Morgan Corporate Emerging Markets Bond Index has grown from $496 billion at the end of 2007 to $793 billion at the end of 2014. The huge expansion in public market borrowing has been driven by a combination of the sharp decline in interest rates, which resulted from central bank policies, and regulatory constraints on bank lending. While it is gratifying to see that public markets stepped in to fund new issuers after the crisis, J.P. Morgan points out that most new issuers have less public debt outstanding and the average size of their bonds is smaller. These two factors have been associated with reduced liquidity in the secondary market.

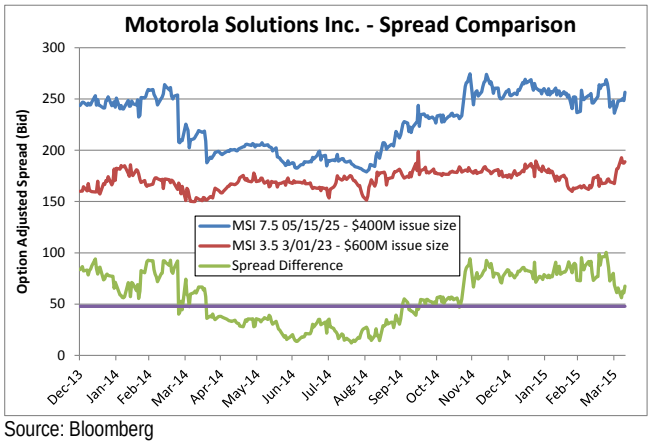
Bonds differ from stocks in the retail space. Few retail investors buy individual bonds, but, subsequent to the crisis, many moved money into mutual funds and bond exchange traded funds (ETFs). Both of these vehicles offer daily liquidity and allow investors to select the bond asset class without having to analyze each issuer. According to J.P. Morgan, the share of U.S. corporate bonds held in these vehicles doubled since before the crisis. In addition, because of the changing

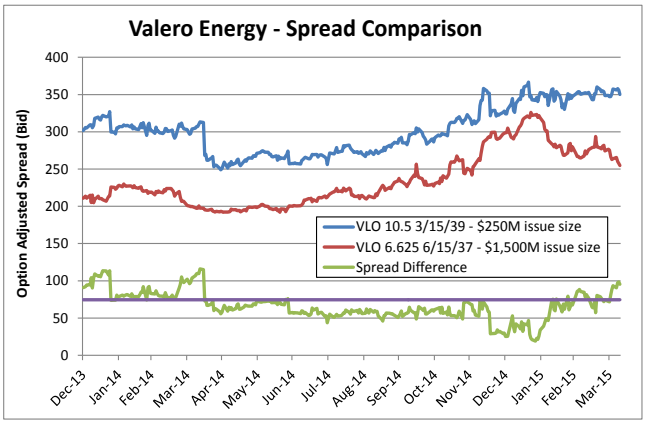
[1] U.S. Corporate Bond Market Liquidity – An Update, J.P. Morgan, March 31, 2015
[2] Ibid, pg. 9
[3] U.S. Investment Grade Corporate Update, Barclays, January 5, 2015.

structure of the market, these vehicles have tended to purchase the "most liquid" bonds, leading to a high correlation between flows and changes in price. Without a market stabilizer, large fund flows now create a reverse liquidity effect, whereby securities generally considered to be more liquid are bought and sold at the same time by more influential players, without a group of participants able to readily absorb those trades.

So, we can determine that liquidity has deteriorated and identify market participant behavior that contributed to the phenomenon. The question of implications remains elusive. As investors, we have posited that liquidity is a risk, like any other, that has a price. If that is true, perhaps there is a way to measure the price of liquidity and assess its value. As stated above, it is challenging to properly attribute changes in prices to the factors that precipitate those changes. In fact, we would argue that liquidity is never the precipitator of a price spiral, rather it is always a consequence of the other factors that initiate change. For example, during the last quarter of 2014 credit markets sold off. A precipitating factor was the sharp decline in oil prices, which led to sales of energy related companies, which, with limited liquidity, generated a spiral that exaggerated price changes across other industries and sectors. Our challenge is to segregate the liquidity driven component to measure its effect.

In fixed income smaller and aged issues tend to be less liquid and often pay a premium over larger “on the run” issues for the same borrower. The charts below illustrate that phenomenon for reasonably similar bonds of two borrowers. Since the borrowers are the same, we can reasonably argue that the price of liquidity is the quote differential, which, like any bond price, varies over time. While not scientific, we would observe that individual issuer liquidity can be worth between 30 and 100 basis points, depending on other factors influencing the market. Tactically, an investor should purchase the more liquid bond at the low end of the range and the less liquid one at the high.





Source: Bloomberg

Applying this logic to trading liquidity makes sense for investors that have trading flexibility in periods of poor liquidity. The challenges remain in measuring the price changes attributable to liquidity AND executing transactions when liquidity becomes an impediment. At this juncture, that measurement remains more an art than a science. However, applying a methodology derived from examples like we present above, we can observe reasonable distinctions between price changes for a rating category or an industry from fundamental factors and from liquidity. For example, during the oil price-related selloff at the end of 2014, all energy company spreads widened. Some bonds widened substantially more than others even though their credit risk was not discernably higher. For long term investors those liquidity-driven concessions can be attractive. Of course, to take advantage of them investors must find ways to maneuver, since poor liquidity applies to both the bid and the offer.

April 10, 2015

† Please note net returns for the Emerging Markets Debt Composite have been recalculated from February 2014 to March 2015 to reflect management fees at 0.75 percent.

GIPS requires GIPS Disclosure Statement (please see attached disclosure)
GIPS requires GIA fee schedule disclosure "GIA's fees are (i) .35% annually for standard USA fixed income, (ii) .50% annually for enhanced fixed income and (iii) .75% annually for specialized products"

Important Information

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Past Performance: The performance data quoted represents past performance. Past performance is not an indication of future performance provides no guarantee for the future and is not constant over time. The value of an investment may fluctuate and may be worth more or less than its original cost when redeemed. Current performance may be lower or higher than the performance data quoted.

Forecasts and Market Outlook: The forecasts and market outlook presented in this material reflect subjective judgments and assumptions of the investment manager and unexpected events may occur. There can be no assurance that developments will transpire as forecasted in this material.

Management Fees, as well as account minimums and other important information are described in GIA's Form ADV - Part IIA. Since management fees are deducted quarterly, the compounding effect will be to increase the impact of such fees by an amount directly related to the account's performance. For example, an account with a 10% gross annual return and a 1% annualized management fee that is deducted quarterly will have a net annual return of about 8.9%.

*Important GIPS disclosures pertaining to composite performance may be found at the back of this letter.

Index Definitions

Barclays US Aggregate Index
The Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Barclays US Treasury Index
This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Barclays US Government/Credit Index
The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Barclays US Credit Index
This index is the U.S. Credit component of the U.S. Government/Credit index. Publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

Barclays US Mortgage Backed Securities Index
This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

Bank of America Merrill Lynch US Corporate & Yankees Index
The Bank of America Merrill Lynch US Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

Bank of America Merrill Lynch US Corporate Index
The Bank of America Merrill Lynch US Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

Bank of America Merrill Lynch US High Yield Master Cash Pay Only Index
The US High Yield Master Cash Pay Only Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

JP Morgan Corporate Emerging Markets Bond Index (CEMBI)
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. Both indices are also available in Diversified versions.

JP Morgan EMBI+ Index
The EMBI+ tracks total returns for U.S-dollar-denominated debt instruments of the emerging markets: Brady bonds, loans, Eurobonds. The EMBI+ currently covers 104 instruments across 15 countries.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

Citigroup Non-US World Government Bond Index
The Index is comprised of foreign government bonds with maturities over one year.

S&P 500 Index
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI EAFE- Europe Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe.

MSCI EAFE- Japan Index
The index is a capitalization weighted index that monitors the performance of stocks from Japan.

MSCI Emerging Markets Equity
The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.