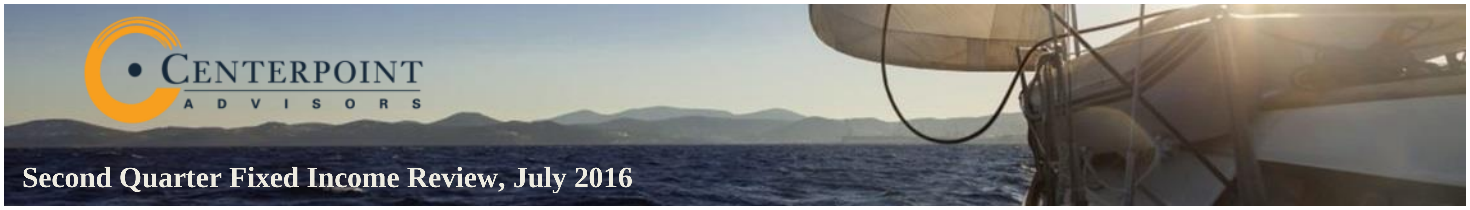


John E. Wolfsberg, *Managing Principal*

Overview

As we entered the second quarter the market seemed to have regained its appetite for risk assets. Oil prices had recovered from the multiyear lows of the first quarter and investors began to feel confident that the economy would improve and interest rates would begin to finally increase. The "Brexit" vote (the UK referendum on whether the country should leave the European Union (EU)) scheduled for late June was widely expected to be in favor of staying.

However, as June progressed the markets grew nervous and a flight to quality slowly began moving rates lower. Labor figures released in early June were weak and other economic releases suggested the domestic economy was slowing. Brexit polls in the UK suggested that a vote to leave was more of a possibility than originally thought. The flight to quality accelerated when on June 23rd the Brexit vote surprised the market with a win for the "Exit" camp and investors' concern over the global economy (particularly Europe) peaked.

While the markets remained concerned about the repercussions of a break from the EU by the UK, within a few days investors realized that the exit process could take as long as two years and would therefore allow them time to position themselves accordingly, and it was at this point the market began to stabilize.

As a result of June's economic releases and events in the UK, 10 Year Treasury yields (which had opened the quarter at 1.79%) dropped 30bps to 1.49% to close out the quarter. In fact, bonds across virtually every sector rallied for the quarter as investors bid up prices in a search for yield.

Economy, Markets, and FOMC

US economic data for the quarter was mixed but generally positive and suggested that the economy continued to move along at a gradual pace. Labor figures were stable to improving with May payrolls (released in early June) as the notable exception. Subsequent to quarter-end, the release of payroll data for June suggested that the May data might have been an aberration, as June figures were quite strong. Oil extended its rally off February lows, positively impacting risk assets, and seems to have settled in the $45/b range. Further consolidation of weaker names in the sector should reduce output capacity and provide support for current prices.

The somewhat mixed economic data in the US coupled with the concern over the pending Brexit vote and its implications gave the FOMC sufficient reason to hold interest rates steady during its June meeting. The decision to leave rates unchanged was validated as a vote to exit the EU raised investor concern that a global slowdown would follow and that monetary policy in Europe and

Japan may be insufficient to countering it. Market expectations now point to only one (or none at all) rate increases in 2016.

Taxable Market

- **The yield curve flattened (2yr to 30yr) as Treasury yields declined, with the 30yr yield falling 31 basis points**
- **Corporate credit performed well under strong investor demand for yield**
- **Treasuries became more and more attractive to global investors as negative yields abroad increased**

As previously noted, the fixed income markets experienced a flight to quality late in the quarter with credit spreads widening in primarily European names and issuers having significant exposure to the UK economy such as global banks. However, the majority of US corporate bonds (both investment grade and high yield) participated in much of the rally in Treasuries, with spreads remaining firm or tightening somewhat. With many global government bonds trading at negative yields, US Treasuries and a majority of domestic corporate issuers offer attractive yields (on a relative basis) to investors looking for the safety of the US Treasuries and exposure to an economy with signs of growth.

U.S. Treasury Yields

Source: Morningstar Direct as of 6/30/2016

U.S. Treasury Yields	6/30/2016	3/31/2016	12/31/2015	9/30/2015	6/30/2015
2-year	0.58%	0.73%	1.06%	0.64%	0.64%
5-year	1.01%	1.21%	1.76%	1.37%	1.63%
10-year	**1.49%**	**1.78%**	**2.27%**	**2.06%**	**2.35%**
20-year	1.86%	2.20%	2.67%	2.51%	2.83%
30-year	2.30%	2.61%	3.01%	2.87%	3.11%

Fixed Income Sector Returns[1]

Source: Morningstar Direct as of 6/30/2016

Taxable Sectors	YTD 2016	Q2 2016	Q1 2016	Q4 2015	Q3 2015
U.S. Aggregate Bond	**5.31%**	2.21%	3.03%	-0.57%	1.23%
Short-Term Corporates	**3.28%**	1.44%	1.81%	-0.29%	0.34%
Intermediate-Term Corporates	**7.65%**	3.37%	4.15%	-0.44%	0.37%
Long-Term Corporates	**14.00%**	6.67%	6.87%	-1.11%	0.48%
Mortgage-Backed	**3.10%**	1.11%	1.98%	-0.10%	1.30%
High Yield	**9.32%**	5.88%	3.25%	-2.17%	-4.90%
Bank Loan / Floating Rate	**4.51%**	2.92%	1.55%	-2.10%	-1.35%
Global Bond	**11.94%**	3.40%	8.26%	-1.26%	0.64%

[1] Fixed income sectors shown above are represented by the following indices: U.S. Aggregate Bond: Barclays U.S. Aggregate Bond; Short-Term Corporates: BofAML U.S. Corps 1-5 YR; Intermediate-Term Corporates: BofAML U.S. Corps 5-10 YR; Long-Term Corporates: BofAML U.S. Corps 10+ YR; Mortgage-Backed: Barclays U.S. MBS; High Yield: BofAML U.S. Corps HY Master II; Bank Loan/Floating Rate: S&P/LSTA Leveraged Loan 100; Global: Barclays Global Aggregate ex-USD

Tax-Exempt Market

- **Municipals rallied in lockstep with Treasuries during the quarter**
- **A strong technical environment (supply/demand) helped to push yields lower**
- **Investors continued to reach for yield as they focused on lower rated issuers**

Municipal bonds posted strong returns for the quarter as they rallied in lockstep with Treasuries, a somewhat unusual occurrence as retail investors will often balk at yields below a certain threshold. Technical factors including a lack of issuance and strong demand from fund flows helped to drive yields lower. Lower rated municipal credits (mostly found in the healthcare sector) continued to perform well as investors willingness to go down in credit quality for additional yield increased. During the quarter, President Obama, signed into effect the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) which provides a framework for Puerto Rico and its creditors to negotiate a deal relating to its troubled debt. In general, the act provides for an oversight board to supervise the restructuring of debt. On July 1st the commonwealth defaulted on nearly half of the $2bn in debt services payments that were due by the island and its agencies. The move, while widely anticipated, should increase the incentive for both sides to begin earnest restructuring talks.

Current Municipal Yields

Source: Morningstar Direct and Bloomberg as of 6/30/2016

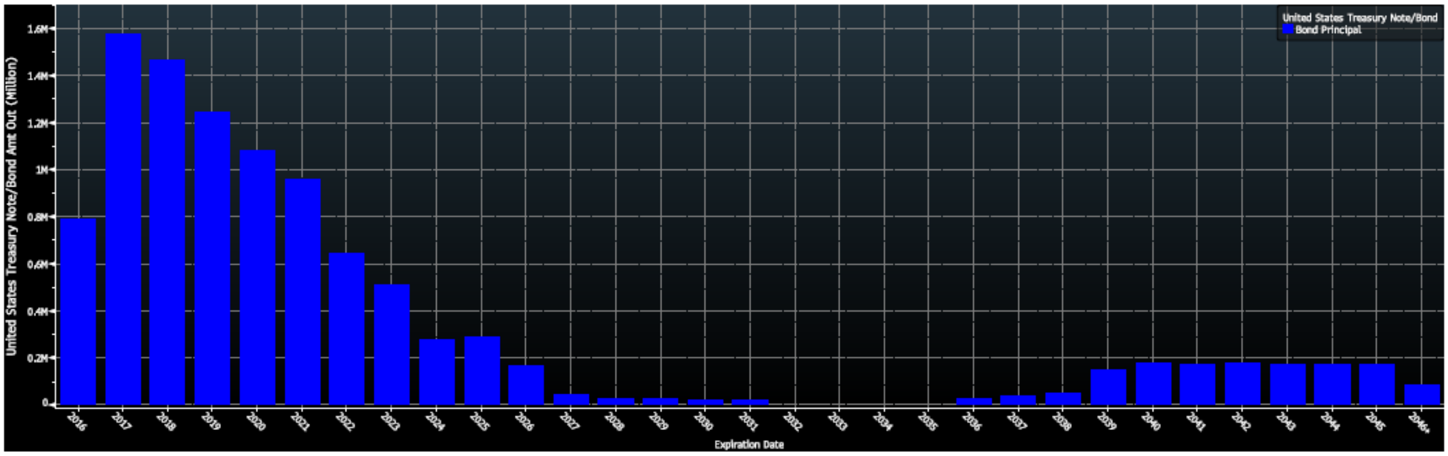
Generic State G.O. AA Rated Municipal Bonds	Yield to Maturity as of					As % of U.S. Government Treasuries				
	6/30/2016	3/31/2016	12/31/2015	9/30/2015	6/30/2015	6/30/2016	3/31/2016	12/31/2015	9/30/2015	6/30/2015
2yr General Obligation	0.78%	0.85%	0.85%	0.69%	0.76%	134%	116%	80%	108%	119%
5yr General Obligation	1.10%	1.27%	1.40%	1.41%	1.60%	109%	105%	80%	103%	98%
10yr General Obligation	1.77%	2.11%	2.22%	2.37%	2.64%	119%	119%	98%	115%	112%
20yr General Obligation	2.65%	3.06%	3.26%	3.52%	3.60%	142%	139%	122%	140%	127%

Outlook

With the flight to quality trade (post Brexit) slowly unwinding and solid economic releases domestically, interest rates should continue to slowly move higher. We anticipate the Federal Reserve will look to increase rates later this year but expect that the uncertain outlook for the global economy should keep rates from backing up too far too fast. We do expect to see continued pockets of volatility as details of the UK separation process from the EU unfold with the market forming its opinion as to implications for issuers and specific countries/regions. In addition, our own Presidential election could increase volatility as the candidate’s views and the potential market implications are considered. Finally, where we are in the economic cycle continues to be a question. Are we in the middle of an expansion or closer to the end? Since monetary policy and interest rates change considerably during each phase of the economic cycle having a sense as to where we are in the cycle is key. That said, we feel we may be in the later stages of expansion where overall credit spreads should perform well but where opportunities to upgrade in credit quality should be considered.

On a separate note, while the issue may not impact yields over the next one to two quarters it is likely it will be a factor in the next year or two. The wall of maturities coming due in US Treasuries is significant over the next 5 years.

Maturity Distribution of US Treasuries



Source: Bloomberg

Unlike its private sector counterparts, the US government has chosen to roll its debt out along shorter maturities over the last several years rather than paying the additional coupon to lock in a 30-year rate (something corporate issuers have been doing at a frenzied pace)…effectively "kicking the can down the road". Should our government decide to take a long-term (and fiscally prudent) view to our nation's debt load and extend maturities it is likely we would see some upward pressure on rates.

Our Portfolios

We continue to slowly add duration as opportunities present themselves both on the taxable and tax exempt side. While we expect rates to move up we do not expect a radical sell off to higher rates for reasons previously noted. Our taxable portfolios continue to perform well with lower exposure to US Treasuries vs the Barclays Aggregate as we do not feel yields offered by Treasuries are compelling vs corporates. In general, our portfolios are higher quality with under 10% allocated to domestic high yield names. We continue to prefer to buy good quality names during sell offs in the market rather than look to acquire high yield names in a reach for yield. While we recognize the potential for high yields in the non-investment grade sector we feel the volatility added by the exposure does not warrant an increased allocation. On the tax exempt side our portfolios have been extended as well with an increase to intermediate municipals and a small allocation to a longer duration fund. We began building our position in this fund in 2015 and completed our allocation in the second quarter. The fund provides exposure to longer dated issues as well as BBB names the manager feels offer compelling value.

We look forward to updating you at the end of the third quarter. As always, please feel free to contact us with any thoughts or questions you may have.

Clients of Centerpoint should contact us if there have been any changes to your financial situation or investment objectives, or if you wish to place or modify any restrictions on the management of your accounts.

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