Dear Friends: October 10, 2015

3rd Quarter 2015 Newsletter

As discussed in recent newsletters released by Locust Capital throughout the quarter, volatility dominated the financial markets during the months of August and September. This led to a correction-level pullback for the S&P 500 Index in late August with the index ending the quarter down 7%. A number of factors contributed to the drawback; however the trifecta of Federal Reserve indecision, slowing growth in China, and slumping commodity prices led the way.

Markets have been sensitive to news out of the Federal Reserve since 2008 when the Fed furiously reduced rates in an attempt to prop up the economy and reduce negative effects of the global economic meltdown that had occurred. Everybody knew then and understands now that at some point rates must return to a more normalized level and that getting there is not going to be easy. The raising of rates is typically accompanied by slower long-term growth of an economy, and people prefer their economies to be booming (until they bust that is). After years of easy money and quantitative easing analysts were finally predicting that the Federal Reserve would begin tightening the money supply and the ascension to more normalized rates. However, this all came to a halt as worries over China reared their ugly head and put off talk of a rate hike until December or early 2016 at the earliest. While rising rates are bad for the financial markets in the sense growth will begin to slow, what is really damaging the markets currently is a lack of understanding of when and how these rate rises will come. The volatility (which in August hit its highest level since 2011) we have experienced is due to the uncertainty from the Fed; without clarity from the Fed the markets will continue to react to any small piece of information they can latch onto (which is currently any news out of China). As we discussed in previous newsletters a small and incremental increase in rates will not have a dramatic impact on the economy, but uncertainty over if and when that increase will come is putting investors on edge.

A key point leading to such indecision from the Fed is the increased attention paid to China over its economic growth worries. As the world's second largest economy, the Fed must take into account data coming from China as it debates its decision. News out of China is not encouraging as analysts predict growth to fall from 7% annually to closer to 5-6% annually, manufacturing has reached a six-year low, and the Shanghai Index is down over 40% since mid-June. Fortunately for the People's Bank of China (and unlike the Fed currently) they have a number of options when it comes to trying to stimulate growth and prevent the fall of their stock market. During the quarter they implemented numerous measures in an attempt to stop the tumble of their stock market as they lent money to brokerage firms to purchase stock, restricted selling by

large and government-owned shareholders, and halted trading in certain stocks. They quickly discovered that these actions were not enough to prevent a sell-off and will likely have to wait for valuations to become attractive again until buyers will enter the market. As discussed in previous newsletters, the PBOC has implemented a stimulus plan that includes reducing rates and increasing the money supply (similar to what the U.S. did in 2008). Only time will tell if government intervention is enough to prop up the faltering economy.

Effects of a Chinese slump were not just felt in the U.S. equity markets as commodity prices also took a big hit. Since China accounts for nearly half of the global demand for key industrial commodities such as iron, cooper, and coal when Chinese demand falls, so do the prices of these commodities. Included in the commodities fall was the collapse of oil prices which continue to move lower and fell to under $40 per barrel in late August for the first time since 2009. Concerns over reduced demand (China is the world's second largest petroleum consumer) and over-supply (due to increased production in the Middle East and U.S. domestic shale production) kept WTI Crude prices down during the quarter.

Despite the negatives addressed above, the U.S. economy is stronger than expected and the consumer is optimistic! Data released by the Fed has been very positive as Real GDP growth estimates for 2015 have been revised up from 2.0 to 2.3, the unemployment rate has fallen to 5.1% and inflation is still low-to-non-existent. The consumer seems to be ignoring the news out of China, as key metrics of consumer activity and confidence trend upwards. Restaurant sales, auto sales, and single family home starts are key figures and are all putting together good runs. The activity of the consumer is critical for the overall U.S. economy as over 70% of U.S. GDP comes from the consumer. Additionally analysts are predicting continued strength from the consumer as recent savings in energy prices have been saved away by the consumer as opposed to spent on discretionary goods. Furthermore, the U.S. economy is in a better position to withstand reduced demand from China as it is not an export dependent economy and is well insulated in comparison to other world economies. This can be seen in domestic markets as small cap stocks have outperformed large cap stocks due to the understanding that smaller U.S. based companies are better insulated from low global growth than large cap companies.

While equity markets dominated the headlines, the yield on the 10 Year Treasury bond decreased throughout the third quarter from 2.42% on June 30th to 2.06% by the end of the quarter. This was somewhat contrary to consensus expectations as worldwide central bank easing, low inflation, and low demand for money kept interest rates low. Falling rates during the quarter caused bond prices to be an area of stability with the Barclays Aggregate Bond Index gaining 0.74% for the quarter, one of the few asset classes with positive returns for the quarter. Another important development in credit markets was the widening of credit spreads to levels not seen since the Greek debt crisis of 2012. This is important because as investors become more risk averse and less willing to invest in the debt of corporations, corporations are forced to increase

the interest rates on their debt to attract investors. This increases their borrowing costs, which reduces their earnings and therefore can also affect their stock prices.

Index	**Index Close**	**Quarter Price Return (%)**	**YTD Price Return (%)**
S&P 500	1,920.03	-6.94%	-6.74%
DJIA	16,284.70	-7.58%	-8.63%
NASDAQ	4,620.16	-7.35%	-2.45%
Barclays Aggregate Bond	109.58	0.74%	-0.49%
MSCI Europe-Australasia-Far East	57.32	-9.72%	-5.79%
MSCI Emerging Markets	32.78	-17.26%	-16.57%

At Locust Capital we stress a long term view of the markets and avoid short term "market noise." Locust Capital reduces the risk in client's portfolio through our investment manager selection and diversification across multiple asset classes. Locust Capital believes that investing for the long term requires discipline and patience and we thank you for your trust in our process.

We hope you all are enjoying the fall and look forward to speaking with you in the near future.

All the best,

Locust Capital Management, LLC