Central Trust Company
THE CENTRAL VIEW

CENTRAL TRUST COMPANY IS PROUD TO PROVIDE YOU THE FOLLOWING MARKET COMMENTARY.

THIRD QUARTER 2016

THE DAWN OF BREXIT

By a vote of 51.9% versus 48.1%, the British voted in favor of leaving the European Union thus ushering in a transformational change for Britain, Europe and the rest of the world. Not only does this represent significant economic change but political change as well. It was a vote for independence for the British people who were becoming more and more distressed about the loss of control regarding their country's destiny (specifically regarding immigration). It also may be a vote in the context of being against Globalization (with respect to trade) as well. Events in the short term, however, will center on economic and financial matters rather than the political, thus significantly impacting the British, European and world financial markets.

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Brexit sentiment may not just be isolated to Great Britain. Other nations in the EU are now questioning whether they want to stay or leave as well (including Hungary, France, Italy, Spain and Sweden). In addition, will Germany want to pick up an increasing tab to keep the EU together without Britain? We also see signs of this attitude spreading with expressions of economic populism worldwide. Specifically, signs of this populist attitude are appearing in the U.S., as reflected by the tone of the current presidential campaigns (both in the primaries and in the upcoming general election).

The separation of the United Kingdom from the European Union (if enacted) will be akin to a rancorous divorce and probably quite nasty in the short-term. It may also possibly include the breakup of the United Kingdom as well. Scotland voted 62% to 38% and Northern Ireland voted 55.8% to 44.2% to **remain** in the EU. A second Scottish independence vote is "highly likely" according to First Minister Nicola Sturgeon and the Deputy First Minister is calling for a vote on a united Ireland after Brexit.

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The EU leadership will want to punish the UK in order to try to dissuade others from following suit (which may or may not be successful). There is, however, the possibility this "divorce" may not occur at all as time passes, debate intensifies and ramifications sink in. Already, there are calls and petitions for a "do over" regarding the vote. There may be another referendum on the horizon. Britons (with the agreement of the EU) may decide to maintain and strengthen the ECONOMIC ties to the EU while severing the POLITICAL ties.

The rationale for the formation of the EU in the beginning, was to create a United States of Europe (in the sense of a European government). As Margaret Thatcher frequently pointed out, however, "Europe is not America, and the notion that a collection of (now) 28 different nations with their own languages, cultures and history can be artificially welded together into a United States of Europe is pure fantasy. The United States is a glorious example of a common language, culture and institutions that have made one people out of immigrants from every corner of the globe." That is clearly not the case with the European Union. "'Europe' in anything other than a geographical sense is a wholly artificial construct." She urged a fundamental renegotiation of the UK's relationship with the EU and was the first major British political figure to raise the prospect of Brexit, citing NAFTA and the European Free Trade Association (EFTA) as possible alternatives to EU membership. Given the recent financial fallout, Britain and other European nations may decide to embrace just the economic aspects of the EU. If not, it will take at least two years for Britain to withdraw from the EU of which Britain is a major economic and financial force.

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One interesting fact is that the narrow vote regarding Brexit is not legally binding. That being said, here are some possible ways Brexit could be prevented from actually occurring:

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1. The UK Parliament decides to vote against Brexit.
2. The EU makes some concessions that the new British Prime Minister deem sufficient.
3. Scotland and Northern Ireland manage to block it. According to respected legal scholars, the Parliaments of Scotland, Northern Ireland, and Wales might need to approve an exit. But since Scotland and Northern Ireland did not approve to leave the EU, their Parliaments most likely would vote against it.
4. A second referendum is called and shows a different result. An enormous number of signatures have been collected in favor for a new referendum. At the very least, the large number of signatures collected might influence both the Parliament and the choice of the next Prime Minister." (referenced from Cornerstone Macro)

INVESTMENT RAMIFICATIONS

Does this mean a recession is now on the horizon for the U.S. in the near future? We do not believe so, although we continue to see muted growth over the next 6 to 12 months. It does, however, significantly increase the odds of a British recession in the near-term. We expect a continued rise in market volatility in the short-term, not only for equities but for the other asset classes as well.

Because of this increased volatility, we continue to recommend investors remain in well diversified portfolios constructed with many different security styles and types (equities, fixed income, and alternatives).

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In late 2015 and early 2016, we increased our allocations to investment grade bonds, gold and silver through ETFs and money market funds. At the same time, we decreased our allocation to foreign stocks, eliminated our emerging markets exposure (to both equities and fixed income) and increased our domestic equity exposure. This has been an effective strategy. We do not foresee an interest rate increase by the Federal Reserve for the remainder of 2016.

Currently, more favorable values in European equities are being created. The price/earnings ratio is 13 times estimated 2016 earnings (the U.S. is about 17), dividend yields are averaging 4% (2.4% for the U.S.), and are at good value levels relative to European bond yields.

In the short term, markets can be (and often are) quite volatile. As investors, it is at times like these that patience and a firm commitment to remain in the markets are especially important in order to let our long-term asset allocation strategy work to increase our wealth. **And most importantly, trust in your Central Trust financial advisor's ability to navigate your investments through the ever changing financial environment we find ourselves in.**

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Will we see the "sunset" of Brexit with Britain deciding not to leave entirely? Possibly, IF the EU moves to accommodate the relationship as an economic union without unacceptable political constraints.

MARKET RECAP FOR THE FIRST HALF AND SECOND QUARTER OF 2016

The first half was volatile with equities ending modestly higher. Bonds outpaced stocks as interest rates and yields made new record lows. U.S. equity markets led as the S&P 500 gained 3.8%, outperforming international equities that fell -3.0%. In the second quarter, commodities and gold led while U.S. stocks and bonds both gained over 2%. Stocks started the year under pressure on concerns of a global recession, falling oil prices, a Chinese hard landing and political uncertainty. Stocks rebounded back near record highs in mid-June before the surprise Brexit vote to leave and then sold off for two days before recovering back to near record highs to end the first half.

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In the first half, real assets led asset class returns as fears of a recession receded and signs of a rebound in inflation appeared. Gold and commodities had double digit gains. REITs gained 12% for the first half. Alternatives were modestly positive. The U.S. dollar slipped 2.9% in the first half after gaining over 20% the last two years. Overall, balanced investment portfolios posted gains in the first half.

Equities

Global equity markets were led by U.S. equities as the S&P 500 gained 3.8% with dividends and the MSCI All Country World Index advanced 1.4%. International equities declined 3% after a weak June as U.S. outperformance continued. Emerging markets gained 6.4% in dollar terms, but lagged in local currency gaining 3.4%. The U.S. market is triple the level of the lows reached in 2009 and remains near all-time highs. The U.S. market has been led by defensive sectors of energy, staples, telecom, and utilities in the first half. Value has outperformed growth this year by a wide margin after underperforming for an

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Exhibit 1: Equity *Trailing Performance (Annualized when > 1 year)*

Asset Class	Index	QTD	YTD	1Y	3Y	5Y	10Y
Global	MSCI All Country World IMI	1.1%	1.4%	-3.9%	6.1%	5.4%	4.5%
Large Cap	S&P 500	2.5%	3.8%	4.0%	11.6%	12.1%	7.4%
	Russell 1000	2.5%	3.7%	2.9%	11.5%	11.9%	7.5%
Styles	R1000 Growth	0.6%	1.4%	3.0%	13.1%	12.3%	8.8%
	R1000 Value	4.6%	6.3%	2.9%	9.9%	11.4%	6.1%
Large Cap L/S	S&P 500 / LIBOR plus 3	1.7%	2.8%	3.7%	7.4%	7.7%	5.9%
Small/Mid Cap	Russell 2500	3.6%	4.0%	-3.7%	8.6%	9.5%	7.3%
Mid Cap	Russell Mid Cap	3.2%	5.5%	0.5%	10.8%	10.9%	8.0%
Small Cap	Russell Small Cap	3.8%	2.2%	-6.7%	7.1%	8.4%	6.2%
International	MSCI World Ex US (net)	-1.1%	-3.0%	-9.8%	1.9%	1.2%	1.6%
Emerging Markets	MSCI Emerging Markets (net)	0.7%	6.4%	-12.1%	-1.6%	-3.8%	3.5%

Source: Central Trust Company

extended period.

Fixed Income

Interest rates dropped sharply in the first half on concerns of slowing growth and uncertainty from the Brexit vote that caused a flight to safety. As a result of the decline in yields, the Barclays Aggregate Index gained 5.3% in the first half. TIPs gained 6.6% as yields fell and inflation turned up from low levels. The credit sensitive sector rebounded as spreads narrowed since mid-February leading to gains in the first half in high-yield of 9.1%, floating rate debt of 4.5%, and emerging market debt of 10.9%. Global investment-grade yields are at record lows with negative rates in many countries. At the end of the first half of the year, over 34% of the government bonds in developed markets had negative interest rates.

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Exhibit 2: Fixed Income *Trailing Performance (Annualized when > 1 year)*

Asset Class	Index	QTD	YTD	1Y	3Y	5Y	10Y
Global	Citi World Broad Investment Grade	2.4%	8.4%	8.6%	2.7%	1.8%	4.4%
U.S. Aggregate	Barclays US Aggregate	2.2%	5.3%	6.0%	4.1%	3.8%	5.1%
Money Market	Citigroup 1-month T-Bill	0.0%	0.1%	0.1%	0.1%	0.0%	0.9%
U.S. Government	Bloomberg Bond Index US Govt (ST)	0.5%	1.5%	1.4%	1.0%	0.8%	2.5%
	Bloomberg Bond Index US Govt (IT)	1.2%	3.7%	4.1%	2.6%	2.4%	4.5%
	Bloomberg Bond Index US Govt (LT)	6.6%	15.2%	19.8%	10.5%	10.2%	8.8%
U.S. TIPS	Citi U.S. Inflation Linked Securities	1.8%	6.6%	4.7%	2.5%	2.8%	4.8%
Tax Exempt	S&P Municipal Bond Index	2.7%	4.3%	7.8%	5.6%	5.5%	5.0%
U.S. Corporate	Barclays iShares Intermediate Corp	2.1%	4.8%	4.8%	3.6%	3.7%	1.0%
U.S. Corp High Yield	Barclays U.S. Corporate High Yield	5.5%	9.1%	1.6%	4.2%	5.8%	7.6%
U.S. Floating Rate	S&P/LSTA Leveraged Loan	2.9%	4.5%	0.9%	2.8%	3.8%	4.5%
International	Citi Non USD WGBI	4.0%	13.5%	13.8%	2.4%	0.3%	4.0%
Emerging Markets	JPM Emerging Markets	5.4%	10.9%	10.3%	6.4%	6.2%	7.9%

Source: Central Trust Company

Real Assets

Real assets have rebounded sharply since February as recession concerns receded, oil prices rebounded and inflation began to rise. U.S. REITs gained 12.3% in the first half as interest rates plunged and property fundamentals remain firm. REITs continue to have higher yields than bonds. Commodities jumped 13.3% due to signs of nascent inflation and firming industrial prices. Gold was the best performing asset class year-to-date gaining 28%. Gold benefits from financial uncertainty.

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Exhibit 3: Real Assets *Trailing Performance (Annualized when > 1 year)*

Asset Class	Index	QTD	YTD	1Y	3Y	5Y	10Y
Commodities	Bloomberg Commodities	8.9%	12.8%	2.6%	0.6%	-0.1%	-0.1%
Real Estate	S&P Developed REIT	12.8%	13.3%	-13.3%	-10.6%	-10.8%	-5.6%
Real Estate (US)	MSCI US REIT	5.0%	12.3%	18.5%	11.8%	10.6%	5.5%
Gold	Spot Gold	6.8%	24.0%	12.3%	2.2%	-2.7%	8.2%
Inflation	*Consumer Price Index*	0.6%	0.6%	0.8%	1.1%	1.3%	1.7%

Source: Central Trust Company

Alternatives

Alternatives provide additional stability to portfolios by enhancing diversification and reducing volatility due to low correlations with other asset classes. They are an attractive alternative to traditional fixed income in a rising interest rate environment.

Exhibit 4: Alternatives *Trailing Performance (Annualized when > 1 year)*

Asset Class	Index	QTD	YTD	1Y	3Y	5Y	10Y
ALTERNATIVES	LIBOR + 3	0.9%	1.7%	3.3%	3.2%	3.2%	4.3%
Conservative	Hedge Fund Reseach HFRI FOF	1.0%	-1.1%	-2.9%	1.9%	2.0%	1.4%
Multi-Strategy	HFRI Multi Strategy	1.3%	1.5%	-0.6%	2.6%	3.4%	3.7%
Global Macro	Credit Suisse Global Macro Ind	0.0%	-2.2%	-4.5%	0.5%	3.0%	5.7%
Managed Futures	Credit Suisse Managed Futures	-6.1%	-2.1%	1.1%	3.2%	1.5%	3.8%

Source: Central Trust Company

PORTFOLIO MANAGEMENT IMPLICATIONS

The implications to your portfolio may vary depending on your particular individual situation. Please consult with your Central Trust financial advisor. We build portfolios by utilizing five major asset classes. They are: equities, fixed income, real assets, alternatives and cash.

Asset Allocation

We expect slower global growth with higher but limited risk of recession at this time in the U.S., and more volatility ahead as Brexit uncertainty weighs on Europe, and lower interest rates for longer. We see strength in the U.S. on a relative basis compared to Europe and Japan. The most immediate impact from the UK decision to leave the EU has been sharply lower government bond yields across the globe to new record lows. We expect continued accommodative monetary policy to support economic growth and asset prices. We anticipate corporate earnings to begin to slowly improve after declines for five quarters in a row. With modest earnings growth and valuations in the U.S. being above average, we expect lower returns compared to historical levels. We favor high quality stocks and bonds, income oriented investments like dividend growers and investment grade bonds, and portfolio diversifiers that include real estate and gold. Overall, our asset allocation continues to be moderately overweight equities, market weight fixed income, below weight on real assets, and market weight on alternatives and cash.

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Equities

Looking out twelve to eighteen months, we have a positive outlook for stocks based on the expectations of higher corporate earnings as oil prices stabilize, a favorable consumer backdrop (rising employment, lower mortgage and energy costs), and stocks' attractive relative valuation to bonds. While we continue to favor equities, we reiterate our view that higher volatility will continue in global equity markets from higher economic and political uncertainty and as the business cycles matures. We continue to favor U.S. equities and developed international markets, while minimizing emerging markets due to their exposure to China and commodities prices. We favor high quality, large cap equities and quality dividend growers.

Fixed Income

We expect yields will remain low globally as central banks continue accommodative monetary policy to push back against deflationary forces and support growth. With negative interest rates overseas, we favor U.S. fixed income that has higher real yields and lower currency risk compared to international bonds. Bonds play a core role in providing deflation protection in portfolios. While the fixed income sector remains challenging due to the absolute low levels of interest rates across the globe, they continue to provide income and hedge against growth sectors of the portfolios that have higher risk (equities, real assets). Over the last five years, we have diversified our sources of income for investors to include the fixed income credit sector. In the last year, we increased our exposure to U.S. investment grade bonds that act as a diversifier and provide deflation protection for portfolios in slower growth and recessionary periods. Credit was reduced to lessen portfolio sensitivity to credit spreads and the economy. International fixed income was minimized due to the low levels of, and in many cases negative, interest rates overseas that don't adequately compensate for the perceived foreign currency risk. We favor quality taxable and tax-exempt investment grade bonds, and Treasury Inflation-Protected Securities (TIPS) for inflation protection.

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Real Assets

We are below weight real assets at this time. In this asset class, we are invested in real estate and gold as a portfolio diversifier. We added gold where appropriate in portfolios at the beginning of the year. Gold benefits from financial uncertainty and low interest rates. REITs generally provide above-average yield and appeal to investors seeking income. Real estate benefits from rising rents and economic growth in the U.S. Our underweight has been in the commodity sector that continues to be oversupplied and is sensitive to slowing growth in China.

We are below weight real assets at this time. We added gold where appropriate in portfolios at the beginning of the year. Gold benefits from financial uncertainty and low interest rates.

Alternatives

The strategies we utilize in building portfolios are designed to lower portfolio volatility and improve portfolio efficiency. Alternatives contribute to this strategy due to their low correlations with other asset classes. Alternatives act as a hedge in volatile markets and provide better performance in a rising interest rate environment.

Cash

Portfolios will typically have a cash balance due to interest income and dividends being generated. At times, higher allocations of cash are beneficial to decrease portfolio volatility and provide a source of funds for purchases of attractive opportunities.

You can be confident that we are staying abreast of current events. Our outlook for the global markets is under continual review and will be adjusted as needed to reflect real fundamental changes, but we will stay firmly positioned when the "news" is deemed to simply be noise or distraction without relevance to investment results over the long term.

Sign up to receive The Central View via e-mail by visiting our website at www.centraltrust.net.

Please consult with your Central Trust Company advisor for more guidance on how Central Trust can tailor solutions for your particular needs based on these evolving economic and market conditions.

With approximately $5.0 billion in combined client assets, Central Trust Company provides investment management, trust, fiduciary and retirement plan services to individuals, charities, and businesses. With offices in St. Louis, Kansas City, Columbia, Jefferson City, Springfield, and Lake Ozark, Central Trust Company employs more than 100 professionals, with more than 23 years of average experience, serving high net worth individuals and families. For more information, visit Central Trust Company online at www.centraltrust.net.

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