Equity Market Update

As of June 30, 2015 / Volume 4, Issue 2 / FFTAM.COM

To start the year, we predicted 2015 would be a volatile year for stocks with limited total return potential. With half of the year now gone, our prediction appears to be correct. For six months, investors have battled four primary factors that have led to the low returns: 1) Greece defaulting on its debt; 2) weak year-over-year earnings growth; 3) diverging monetary policy between the US Federal Reserve and other central banks around the world; and 4) above average valuation for stocks.

Through June 30th, the S&P 500 has returned only 1.23% year-to-date. Almost all of the return has come from dividends as the price of the index has been stuck in a tight trading range all year. In the 2nd quarter, the S&P fell 0.20%. This was the first time in nine quarters the index was negative.

The Dow Jones Industrial Average fared worse than the S&P 500. It was virtually unchanged in the first half with a total return of 0.03%. The NASDAQ continues to be the darling with a year-to-date gain of 5.99%. Large increases in regional banks, biotechs and social media stocks have propelled the index to record highs. The NASDAQ has earned a positive total return for 10 consecutive quarters.

Domestically, mid and small-sized companies had better total returns than their large-cap peers. The S&P 400 Mid-Cap Index advanced 4.19%, while the S&P 600 Small-Cap Index gained 4.15%. Investors flocked to these companies to gain greater access to the US economy and to lessen their exposure to foreign currency effects.

Chatter about the Federal Reserve raising short-term interest rates for the first time in almost a decade, along with weak economic results overseas, caused the US dollar to have one of its strongest six-month rallies ever. The increase in the dollar disproportionately hurt large cap stocks, since many of those companies do considerable amounts of business around the world. Besides multinational companies, energy and commodity stocks were also hit hard as their businesses are negatively impacted by the rising dollar.

A strong dollar helps international companies, especially those located in Europe and Japan, that export goods to America. This enabled the MSCI EAFE Index to gain 5.93% in the first half of the year. These stocks are also being aided by large quantitative easing programs being conducted by the ECB and the Bank of Japan.

The MSCI Emerging Markets Index also outperformed US Large-Cap stocks with a total return of 3.05%. Most of this gain is attributable to a large run-up in Chinese stocks; however, it has come under

FFTAM Office Locations

Abilene	Fort Worth	Stephenville	San Angelo	Sweetwater	Odessa	Beaumont	Lubbock
400 Pine Street	550 Bailey Avenue	2201 W. South Loop	301 West Beauregard	201 Elm Street	2651 JBS Parkway	3515 Dowlen Road	4903 82ns Street
Suite 300	Suite 300	Stephenville, TX 76401	San Angelo, TX 76903	Sweetwater, TX 79556	Bldg 4, Suite E	Beaumont, TX 77706	Suite 30
Abilene, TX 79601	Fort Worth, TX 76107	(254) 918-6262	(325) 659-5987	(325) 235-6644	Odessa, TX 79762	(409) 600-6460	Lubbock, TX 79424
(325) 627-7100	(817) 410-4972				(432) 367-8912		(806) 543-4114

FIRST FINANCIAL TRUST & ASSET MANAGEMENT COMPANY NA

pressure recently as investors debate whether Chinese stocks have advanced too far, too quickly. For the most part, a strong US dollar is negative for emerging markets since it syphons away capital from risky, emerging countries back to more stable investments in the US. As result, borrowing costs and risk rise in emerging economies, thus reducing growth.

Halfway through 2015, our actively managed, large-cap portfolios trail the overall market. Our biggest downfall has been failing to foresee how much impact a rising dollar would have on our holdings. By nature, we tend to gravitate towards established companies with large economies of scale, above average profit margins, and little to no debt. This usually means we are overweight large, multinational companies located within the S&P 500. These type of companies continue to grow their earnings in the current economic environment; however, much of the growth is lost once their foreign operations are translated into US dollars for financial reporting purposes.

Our Equity Income style has also been negatively impacted by the potential for higher interest rates. Investors have shied away from dividend paying stocks all year in anticipation of a move by the Fed. We are not the only ones having a tough time with dividend paying stocks this year. Of the 16 equity Lipper indexes listed in the *Wall Street Journal,* the Equity Income category is the worst performer; however, our return in the Equity Income style exceeds Lipper's.

Our Core and Strategic Growth styles have been hurt by some of our Industrial and Technology picks. Industrials have trailed the market thus far in 2015 as investors are concerned about capital expenditure cuts from the oil and gas industry, along with the sector's large exposure to emerging markets. Most of our holdings are in transportation names, like airlines and rails, that are more directly correlated to the US economy, so we anticipate investors will soon begin adding to these names. In technology, we own more established companies with lower valuations and large cash balances. This is contrary to investors seeking out faster growing social media and information security companies.

This leads to a very important point about the stock market thus far in 2015. We have noticed, despite all the turmoil and volatility in the market, investors have an insatiable appetite for fast growing companies in biotech, information security, social media and consumer discretionary regardless of their valuation. These areas clearly have momentum; however, we have learned not to chase highly valued corners of market.

FFTAM Office Locations

Abilene	Fort Worth	Stephenville	San Angelo	Sweetwater	Odessa	Beaumont	Lubbock
400 Pine Street	550 Bailey Avenue	2201 W. South Loop	301 West Beauregard	201 Elm Street	2651 JBS Parkway	3515 Dowlen Road	4903 82ns Street
Suite 300	Suite 300	Stephenville, TX 76401	San Angelo, TX 76903	Sweetwater, TX 79556	Bldg 4, Suite E	Beaumont, TX 77706	Suite 30
Abilene, TX 79601	Fort Worth, TX 76107	(254) 918-6262	(325) 659-5987	(325) 235-6644	Odessa, TX 79762	(409) 600-6460	Lubbock, TX 79424
(325) 627-7100	(817) 410-4972				(432) 367-8912		(806) 543-4114

FIRST FINANCIAL TRUST & ASSET MANAGEMENT COMPANY NA

Equity Market Update

As of June 30, 2015 / Volume 4, Issue 2 / FFTAM.COM

Our investors that hold diversified positions outside of US large cap have experienced better results. With the four factors affecting market returns we listed earlier still very much intact, we believe this trend will continue. If given the opportunity, we will look to increase our allocation to US small cap, while lowering our exposure to international small cap.

As we move into the 2nd half of the year, we believe the US economy is still improving as evidenced by better than expected jobs data and the end of the West Coast port strike. Next, analysts have severely chopped 2015 earnings estimates, to the point they may actually be too low. Finally, if the Fed does raise interest rates, it will be by a small amount. This leads us to believe there is a good chance of a 2nd half rally in stocks; however, the return will be much less than what we have witnessed since 2009.

We still believe in our overweight positions in energy, technology, industrials and healthcare. The energy space has been decimated in the past year, and current valuations are very low by historical standards. However, we believe the recovery in energy will take longer than we initially anticipated, so we have begun lowering the amount in which we are overweight the index.

Finally, stock valuations are still above the historical average. We are currently trading at 17.9x 2015 EPS estimates, which is higher than the 10-year average of 15.7x. As stated above, we would not be surprised to see the 2015 estimate revised higher after analysts aggressively cut their outlook earlier this year. Plus, given our view that interest rates will remain low for a prolonged period of time due to structural forces like an aging population and low interest rates around the world, an above average valuation on US stocks is warranted. This does make stocks vulnerable to unexpected short-term events; however, we intend to use those temporary pullbacks as opportunities to put our clients' cash to work.

FFTAM Office Locations

Abilene	Fort Worth	Stephenville	San Angelo	Sweetwater	Odessa	Beaumont	Lubbock
400 Pine Street	550 Bailey Avenue	2201 W. South Loop	301 West Beauregard	201 Elm Street	2651 JBS Parkway	3515 Dowlen Road	4903 82ns Street
Suite 300	Suite 300	Stephenville, TX 76401	San Angelo, TX 76903	Sweetwater, TX 79556	Bldg 4, Suite E	Beaumont, TX 77706	Suite 30
Abilene, TX 79601	Fort Worth, TX 76107	(254) 918-6262	(325) 659-5987	(325) 235-6644	Odessa, TX 79762	(409) 600-6460	Lubbock, TX 79424
(325) 627-7100	(817) 410-4972				(432) 367-8912		(806) 543-4114

FIRST FINANCIAL TRUST & ASSET MANAGEMENT COMPANY NA