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QUARTERLY TAXABLE REVIEW
QII 2015

Although the second quarter is behind us, many of the themes which dominated the markets over the past few months continue to draw our attention. As we write this letter, the markets are preoccupied by financial turmoil in Greece, China, and Puerto Rico, and are trying to discern the direction of the US economy, as well as that of Europe and Asia. Meanwhile, the Fed will likely channel all of these inputs to time its first rate hike in many years without disrupting improvement in the domestic economy. Despite liquidity concerns in the fixed income markets, demand for high quality assets remains very strong, and as we have entered a season where net supply is expected to wane, the prospect of continued turmoil in Greece and China is likely to keep a ceiling on Treasury yields as a safe haven asset.

Markets remain focused on trying to anticipate both the timing but also the pace of the Fed's policy tightening, with the consensus that the pace will be "gradual." US GDP was weak for the first quarter, with an initial reading of +0.2% being revised down to -0.2%. The soft reading was shrugged off by many, the Fed included, attributed to unseasonable weather in the Northeast and a West Coast port slowdown. Many economists, including Fed members, are calling for a rebound in the second half of the year and some data suggests they may well be right: auto sales are showing strength, the housing recovery is gaining momentum, and the labor market continues to improve. However, the Fed will have to weigh these indicators of growth against stubbornly low inflation. Wage growth remains anemic, and we continue to believe inflation will struggle to rise until this changes. While the unemployment rate has fallen well below the Fed's target to 5.3%, we believe the first rate hike will likely occur with inflation well below its 2.0% target.

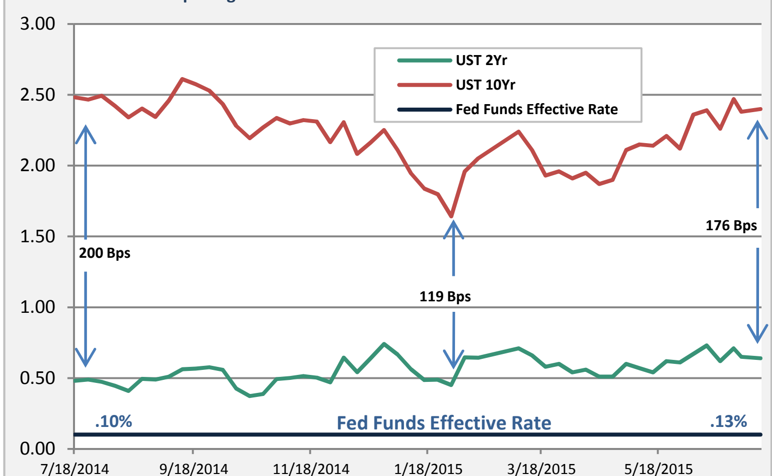
The Greek Drama and the Chinese Uncertainty Require Central Bank Action

Central Bank activism continues to provide a safety net for the markets. While the US is beginning to remove accommodation, the ECB and the People's Bank of China are fueling their economies with funding, QE-type strategies, and incentives to re-energize their banking systems. Despite all of this record intervention, the dollar appears to have stabilized after the surge of the last six months. The prospect of further deterioration in Greece directly impacted the Treasury market, and caused some credit spread widening late in the quarter. Greece's "No" vote in the referendum at the start of July added considerable uncertainty to the marketplace, until on July 12th it appeared that an initial deal involving *austerity and bail-out* had been reached. However, there are no guarantees. With or without a final agreement with the EU, the Greek drama will continue to plague the markets, with the July 20th debt payment to the ECB being the first major hurdle.

Rate Moves in the Quarter Occurred in the Longer End

Rate moves in the quarter reflected the uncertainty that accompanies a potential turning point in a rate cycle. While the curve has tended to flatten during and after a prolonged period of hikes in short term rates, early in the cycle the entire curve may move higher and even steepen, as it did this quarter. While 2Yrs continued to trade in the 60bp area throughout the quarter, 10Yrs ranged from 1.85% to 2.48%, and closed the quarter 40bps steeper at 2.38%. As a Fed Funds Rate "lift-off" approaches, there may be a bigger response in the short end of the yield curve. It is important to note, however, that while the 2Yr yield can be controlled by the Fed, longer bonds will be impacted by extraneous factors like supply and demand imbalances, and geo-political or event risk. The EU dilemma, oil price volatility, and weakness in China all played a part in heightening the volatility in the 10Yr and these risks should remain for some time.

The Fed Continues to Look for Validation from the Economic Data to Initiate the Move Toward Rate Normalization - While the Curve Flattened Early in the Year, the Prospect of a Near Term Resolution to the Greek Crisis Pushed Longer Rates Higher at the End of QII, Steepening the Curve to Levels Not Seen Since Last November



Source: Bloomberg

Bond Market Liquidity – The Landscape Is Changing and It Is More Critical Than Ever to Own Your Own Bonds

Much of the bond market news in the quarter was centered on the lack of liquidity brought on by the Great Recession and the financial meltdown. The largest Primary Dealers supporting the bond market, particularly the secondary market, carry half the balance sheets that they did in 2008-2009. The major institutional players on the buy side - hedge funds, mutual funds, ETFs, and central banks - have picked up much of that shortfall. There are some consistent themes in the ways that market access has changed:

- Consolidation within the larger Broker Dealer (BD) community has lessened the number of players, while the scrutiny of the regulatory environment has increased the cost of running a balance sheet and discouraged risk taking. However, according to SIFMA, the total number of BDs has remained stable.

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- There has been an increase in Electronic Communication Networks (ECNs) in the last several years. In some ways, these platforms have been making liquidity easier in that they use the BD community as the vehicle to connect buy side to buy side customers, or by connecting buy side firms together directly without the BD.
- Liquidity for long High Yield credit is very, very low, while higher quality intermediate bonds, Treasuries, Agency MBS, and larger ABS issuers have not suffered the same liquidity issues, even during periods of volatility.

It is key for managers to have broad access to BD firms, both small and large, and to employ all options available in the ECN arena. The benefit of focusing on large, liquid issuers who routinely trade in the market has become more apparent in the wake of the financial crisis. Additionally, the increased flexibility and tax efficiency of owning your own bonds (versus a comingled fund or ETF) will be more and more important as we enter the next phase of the rate cycle.

Balance Sheet Trends Impacting the Corporate Bond Market – Looking Through the GE Lens

We continue to view the greatest threat to corporate credit as the "event risk" of management teams targeting large-scale M&A or shareholder distributions, through dividends and buybacks. The second quarter brought a new chapter in this financial engineering trend. Of note in April, General Electric announced it would pursue the complete exit of its commercial and remaining real estate GE Capital businesses, along with the rest of its global consumer finance businesses. Management anticipates ~$35 billion of after-tax proceeds from ~$275 billion in asset sales, the vast majority of which is expected to be dedicated to share buybacks.

While shareholders cheered the decision, running the stock up in the two trading days following the announcement, this appears to be a situation where all stakeholders (including bondholders) should benefit. In conjunction with the asset sale announcement, management also said that GE would guarantee GE Capital Corporation's (GECC) debt and signaled it would eventually merge the two entities. The guarantee, combined with the diminishing risk of continual refinancing of GECC's liabilities should improve the credit profile for the refocused company. With that said, we will closely monitor the transition, as a transformation of this scale is not without execution risk.

Though management stressed the strategic decision was driven by the goal of refocusing around its core industrial operations (aircraft, energy and healthcare), we note that the move likely goes a long way towards GE escaping from its Systematically Important Financial Institution (SIFI) designation, a move that would create more financial flexibility for the company. *While we do hold GE securities in certain Appleton portfolios, the above commentary is not a buy/sell recommendation for the security, but is highlighted here due to its significant nature in the current market.*

Strategy Performance Recap

After a quiet April and May, turmoil in Greece, Puerto Rico, and China shattered the quarter's tranquility in late June, driving both our strategy and its benchmark negative on the quarter as the curve steepened and spreads widened. According to FactSet data, spreads on Single A 5-year Financials widened from 96bps to 103bps over the course of June, while Single A 5-Year Industrials widened from 67bps to 79bps on the month. As we maintain a credit-heavy positioning relative to our benchmark, we closed the quarter down -0.58%, 6bps behind our strategy benchmark. However, we remain comfortably ahead of our benchmark year to date, returning 1.15% vs. our benchmark's 0.88%. While our preference for corporates over Treasuries was a slight detractor in the second quarter, we outperformed our benchmark in virtually all sectors. Our Taxable Municipal sector exposure was the strongest contributor, though we also saw sizeable outperformance in the Insurance, Capital Goods, Healthcare, Consumer Goods, and Tech & Electronics sectors, only lagging in Telecommunications. Security selection remains a positive contributor year-to-date, with significant outperformance in the Banking, Consumer Goods, Taxable Municipal, and Tech & Electronics sectors. Curve positioning, neutral in the second quarter, remains a positive contributor year to date, with an underweight to the 1-3Yr area of the curve and an overweight to the 4-7Yr area both positively impacting performance. Credit allocation, while a detractor in the second quarter, is merely neutral on the year.

We continue to remain diligent and disciplined in our investment process as volatility in the markets should persist. The Fed and the economy will remain the major focal points, with a short term rate hike expected by the end of the year. The balance between the Fed's willingness to raise rates and the market's expectations will most likely cause yields to remain range-bound and put pressure on liquidity at times. Our focus on large global issuers and strong credits should offer greater liquidity in the event that a liquidity squeeze becomes evident. We will continue to maintain our duration with a target of around 3.90 years, and are poised to take advantage of the potential market disruptions as investment opportunities.

As always, we welcome your comments and questions. Please contact us if there are any changes to your financial situation or investment objectives.

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