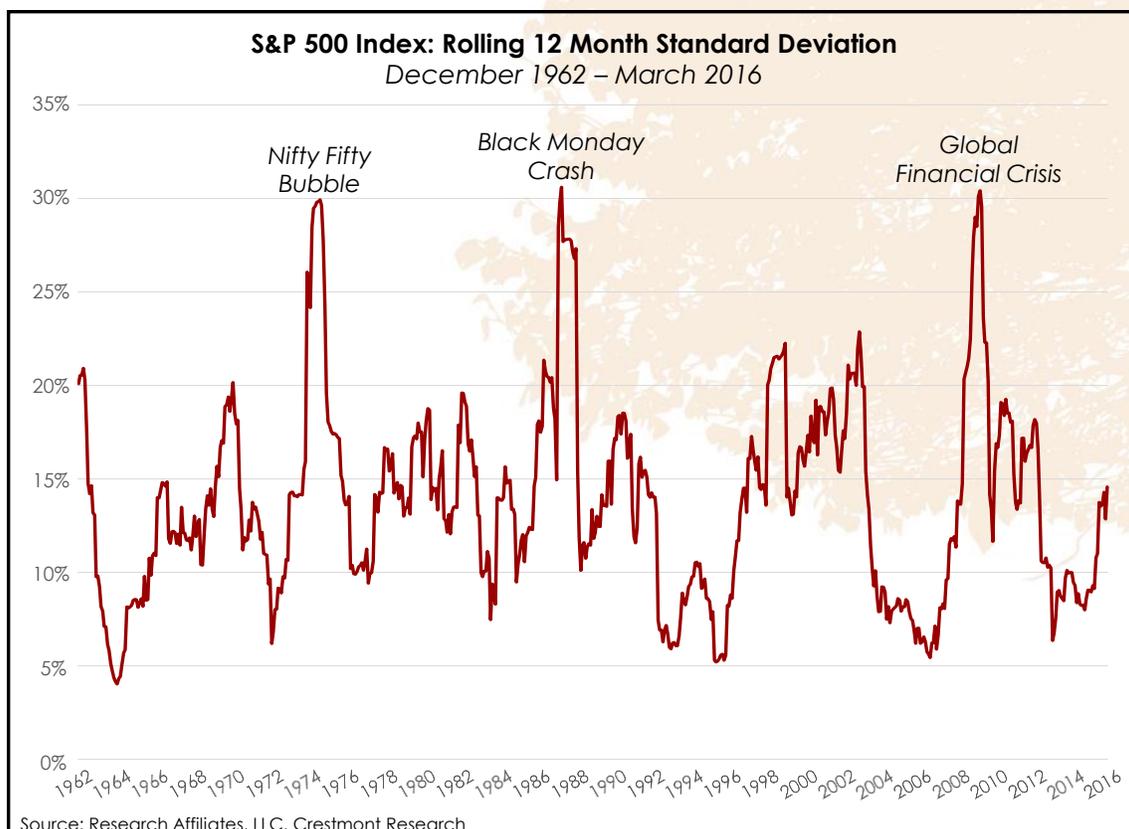


April 2016

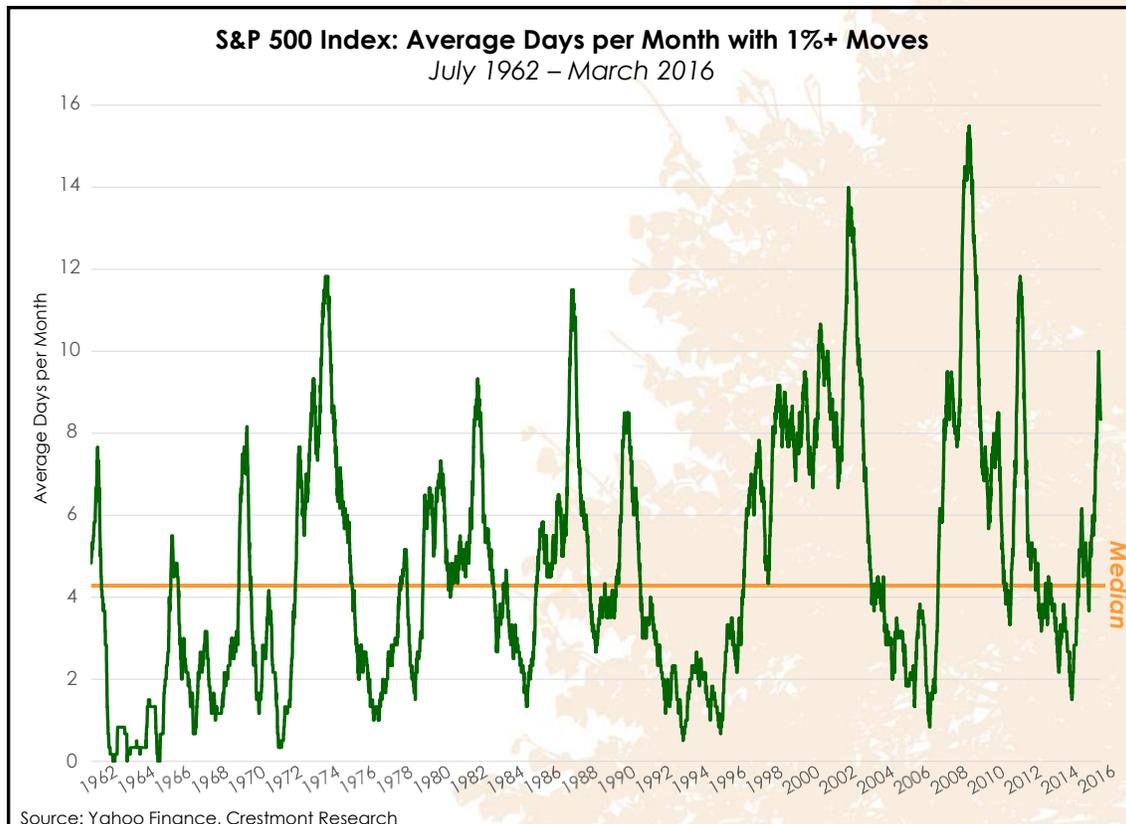
CAPITAL MARKETS UPDATE | Equity markets followed a v-shaped pattern in the first quarter. Amid concerns about slowing growth in China and collapsing oil prices, the Dow Jones Industrial Average plunged in the first ten trading days of the year, its worst start since 1897. Central bank reassurance and some encouraging economic data helped markets stabilize and recover. A weaker U.S. Dollar catalyzed a surge in Emerging Market Equities (+5.7%) while U.S. Large Cap (+1.4%) and U.S. Small Cap (-1.5%) finished the quarter near break-even. International Equities were the weakest performer (-3.0%) with uncertainty regarding negative interest rate policy in Japan and Europe. A near 50 basis point decline in the 10-Year U.S. Treasury yield buoyed the U.S. bond market (+3.0%) and Real Estate (+6.0%). After such a volatile quarter, it is instructive to review the last half century to gain perspective on what is normal.

VOLATILE VOLATILITY | Let's first look at the most common measure of volatility: standard deviation. It indicates the amount of variation in historical returns. As the first quarter reminds us, stocks are a volatile asset with a wide range of returns. In other words, stocks have a high standard deviation. The chart below plots the rolling twelve month standard deviation for the S&P 500 Index since 1962 (the earliest available monthly return data). By updating the standard deviation for the prior year as of each month end, we can see how annual volatility has changed over time.



What we see is *volatile volatility*. The average is approximately 15% within a general range of 10% to 20%. However, it is common for volatility to spike and plunge well beyond this range. Interestingly, periods of extreme calm tend to precede the next violent spike in volatility. The pendulum of investor emotion tends to over swing in both directions between fear (high volatility, often abrupt stock market declines) and greed (relative calm, handsome returns). By this measure, volatility has recently increased to a more moderate level after an extended period below the norm.

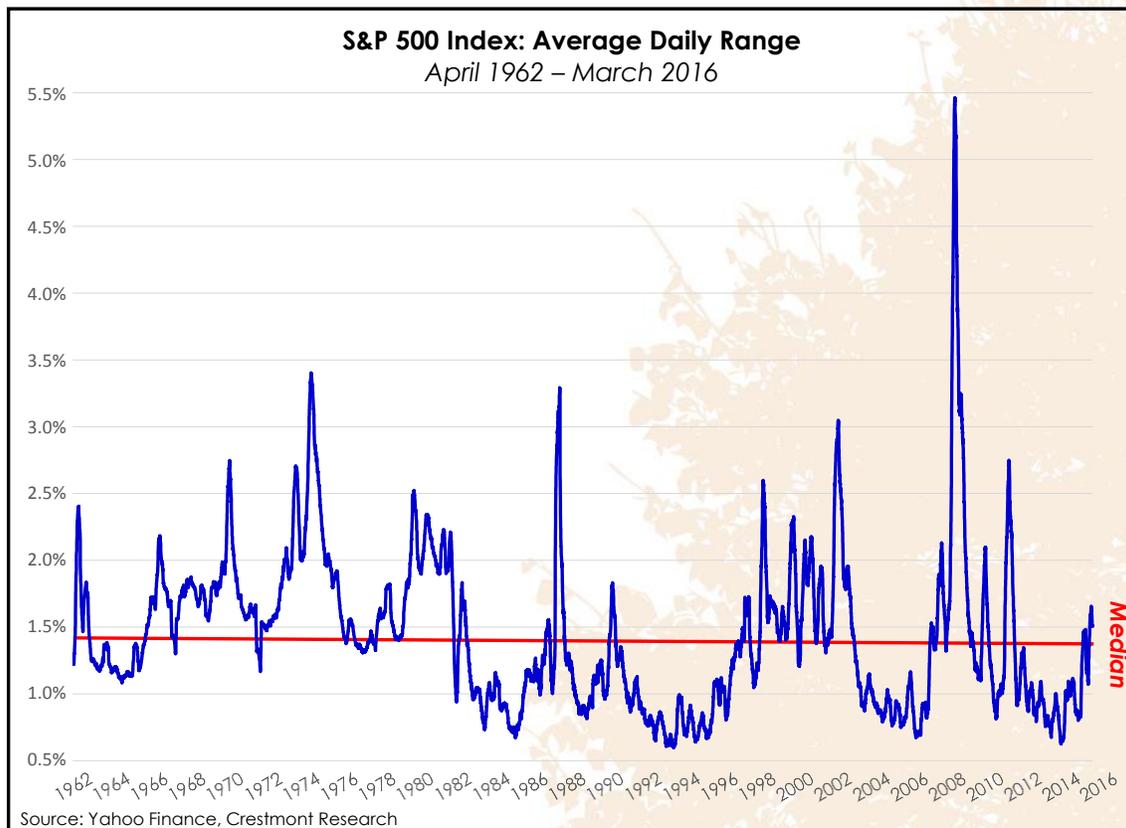
DAY TO DAY SWINGS | A simpler, more intuitive way to measure volatility is how often the stock market has a big up or down day. On average, how many days per month did the stock market close up or down by greater than 1%? The chart below plots the rolling six month average of these greater than 1% days for the S&P 500 Index.



Since 1962, the median for the S&P 500 Index was approximately four days per month or about once a week. Similar to the standard deviation measure, day to day swings also tend to oscillate between extremes. The highest volatility periods were in recent times in the aftermath of the late 1990s stock market bubble and the 2008/2009 Global Financial Crisis with day to day swings more than triple the average. Over the last year, day to day swings have been increasingly intense at more than double the average. How volatile was the first quarter of 2016? Very! We logged twenty-six days with greater than 1% moves or almost 9 days per month, more than double the long-term median.

ROLLER COASTER DAYS | A final volatility statistic is the daily trading range. What was the average price change from high to low as a percentage of the prior close? Some days have wild swings with little net change. Others coincide with the big day to day swings discussed above. The chart on the next page depicts the rolling three month average of the daily trading range.

Since 1962, the median daily range for the S&P 500 Index is 1.4%. For perspective, this would translate to a daily range of approximately 250 points on the Dow Jones Industrial Average. Half the time the range exceeds this level, half the time it falls short. Similar to the other two volatility measures, abnormal highs follow abnormal lows and vice versa. Though volatility has been rising lately from an abnormally low level, recent daily trading ranges are not that unusual.



INVESTMENT IMPLICATIONS | Volatility is indeed volatile. While extreme highs tend to follow extreme lows and vice versa, inflection points come unannounced. High volatility periods are emotionally taxing as they generally coincide with declining stock markets. However, the initial turn in market recoveries also tends to coincide with high volatility amid a vigorous bounce higher. In volatile times, it is emotionally tempting to reduce portfolio risk and wait until things feel better. History shows that trying to time the markets adds risk and diminishes portfolio returns. There is no better recent example than Emerging Market Equities, the top returning asset in the first quarter. Emotionally, it would have been tempting to join the crowd and sell on January 20th after a 12% decline in the first twelve trading days of January. Over the remainder of the quarter, Emerging Market Equities rallied 20%. Setting an appropriate risk budget, sticking with the asset allocation through volatile markets and strategically rebalancing to targets is a disciplined recipe for long-term success.

NEW ARBOR REPORTING | We are pleased to introduce new Arbor quarterly reports. The enhanced format provides a clearer overview of the portfolio, enhanced detail on the asset allocation and clearer performance reporting. The first page summarizes the mix of Equities, Alternative Investments, Fixed Income and Cash by account and provides a pie chart for the total portfolio. The second page presents the current asset allocation vs. portfolio targets with subtotals for the major categories. We omitted the summary of individual holdings by account since this duplicates the information provided in monthly account statements provided by the custodian. The third page provides a cash reconciliation for the most recent quarter and performance for various historical periods. This reconciliation continues to break out Arbor management fees for the most recent quarter. The new software does not generate a detailed invoice for the next quarter. Please let us know if you would like to continue to receive this invoice. We are happy to provide it by email or hard copy. We look forward to any thoughts or questions you may have on the new reporting. We value your feedback.

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ARBOR INVESTMENT ADVISORS, LLC

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