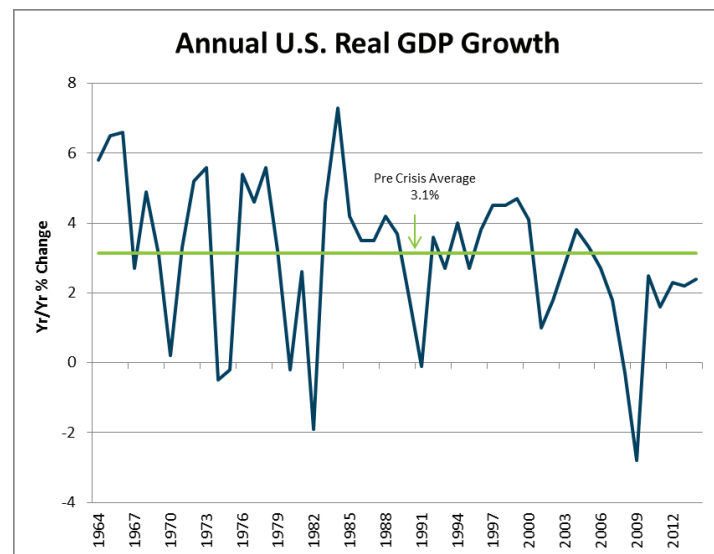


Highlights

While U.S. economic growth has disappointed versus typical expansions, the capital markets have performed largely in line with our market outlook. U.S. stocks have considerably outperformed their fixed income counterparts thus far in 2015. U.S. equity indices are at or near record highs while bond market yields have recently begun to move higher. Year to date S&P 500 index returns exceed 4% while U.S. broad bond market index returns have returned less than 1%. Given the current phase of the credit cycle, we anticipate equities and credit should outperform government bonds. With that said, our outlook calls for higher volatility to dampen returns for stocks and higher interest rates to limit returns for bonds in the year ahead.

Three Quarter Speed Recovery

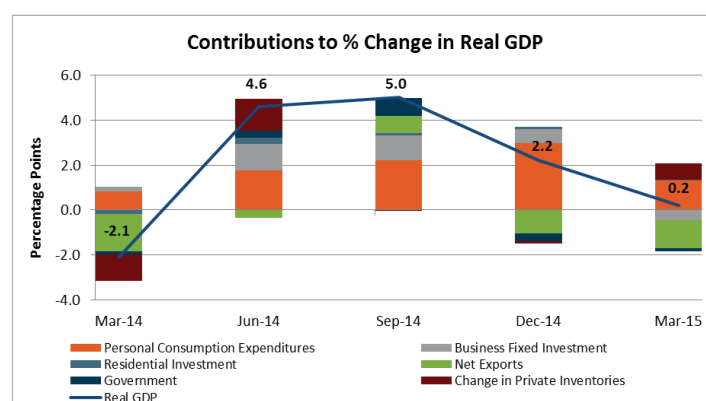
Despite the softer economic releases over the past two quarters, we believe the domestic economy remains on track for a sustainable and healthy 2.5%-3.0% growth level in the year ahead. This should allow the Federal Reserve to eventually move away from their extraordinary levels of policy accommodation. Soft consumer demand, low productivity measures and weak export levels combined to restrain growth during the first quarter. While lower oil prices were expected to help spur short-term consumption, recent data suggests much of the potential stimulus has been saved versus spent by U.S. households. Personal consumption expenditures, government spending and business fixed investment were particularly disappointing. While average real GDP growth over the past 50 years has been in the 3% range, the growth rate during the current expansion has averaged a substandard 2%.



Source: Bloomberg

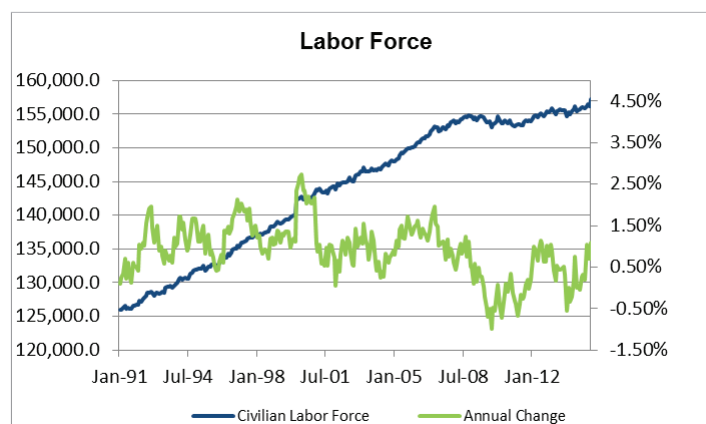
Despite the lackluster growth, the U.S. economy remains a bright spot when compared to the economic challenges facing many of our global peers. However, recent economic news out of Europe is much improved.

Notwithstanding a recent slow down in the German economy, the Euro zone managed to generate economic growth of 0.4% during the most recent quarter; the fastest rate in nearly two years. The UK also continues to post stable economic growth. The BRIC economies, while growing at a faster rate than G10 countries, are showing continued signs of weakness. China's central bank reduced its main interest rate for the third time in six months as the country decelerates faster than expected.



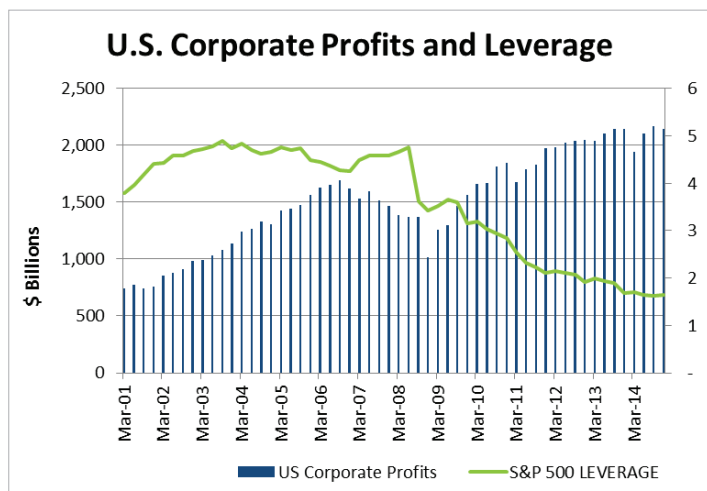
Source: Bloomberg

Back here at home, strong labor markets, continued corporate profitability, low leverage levels and a resurgent real estate sector should bolster economic activity in the year ahead. Over three million new jobs have been created over the past year as we have virtually reached full employment. Nearly 70% of GDP comes from personal consumption and we would expect the improved job environment to translate into higher economic growth in the upcoming quarter. Furthermore, some economists now predict supply side constraints to further economic growth as the labor force is growing at approximately half the rate of new job creation. Net new job creation since February 2010 is now positive across all sectors of the domestic economy, excluding government workers. A healthy labor market drives a healthy economy, which one would expect could drive healthy returns for the prudent investor in the years ahead.



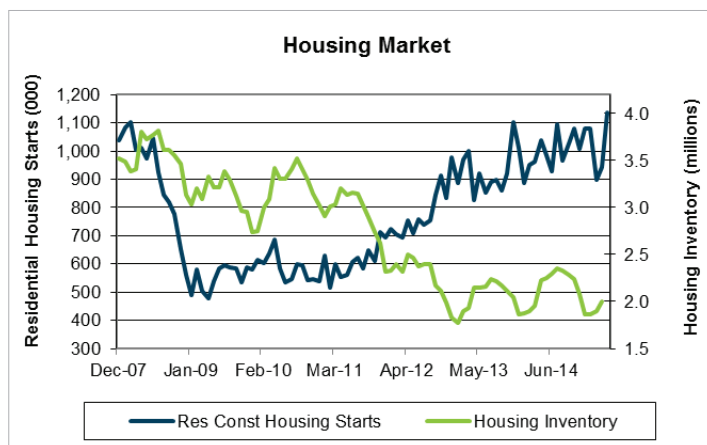
Source: Bloomberg

From a credit cycle standpoint, we believe we are progressing toward the middle stage of a mature bull market. We expect to see additional merger and acquisition activity in the year ahead. We also expect continued shareholder-friendly moves such as share buybacks and special dividends. While this can be a concern to credit quality, both corporate and household leverage remain at or near all-time lows, so we don't forecast a material increase in defaults or delinquencies. We believe that lessons learned during the Great Recession still resonate across corporate boardrooms and households alike, thereby making this expansion slower and longer lasting than previous cycles.



Source: Bloomberg

The real estate sector, both at the single family and commercial level, has rebounded quite nicely since the crisis. While residential investment increased at a slow pace in recent quarters, this sector should continue to bolster economic and market growth in the year ahead. Inventory levels are down to two million units nationwide, while new build levels have returned to prerecession levels. In our outlook, home prices should continue to increase, although at a much slower pace than what we've seen over the past several years. Some of the limiting factors involve generational housing concerns as many baby boomers look to downsize while young families remain saddled with little or no home equity. In addition, commercial cap rates have already tightened, significantly limiting the potential for appreciation. Unforeseen in our real estate outlook is the degree of future monetary policy tightening and the effect it has on long term interest rates. Mortgage rates are generally tied to the ten year part of the curve and higher yields may impact investor behavior.



Source: Bloomberg

Tighter Policy Coming

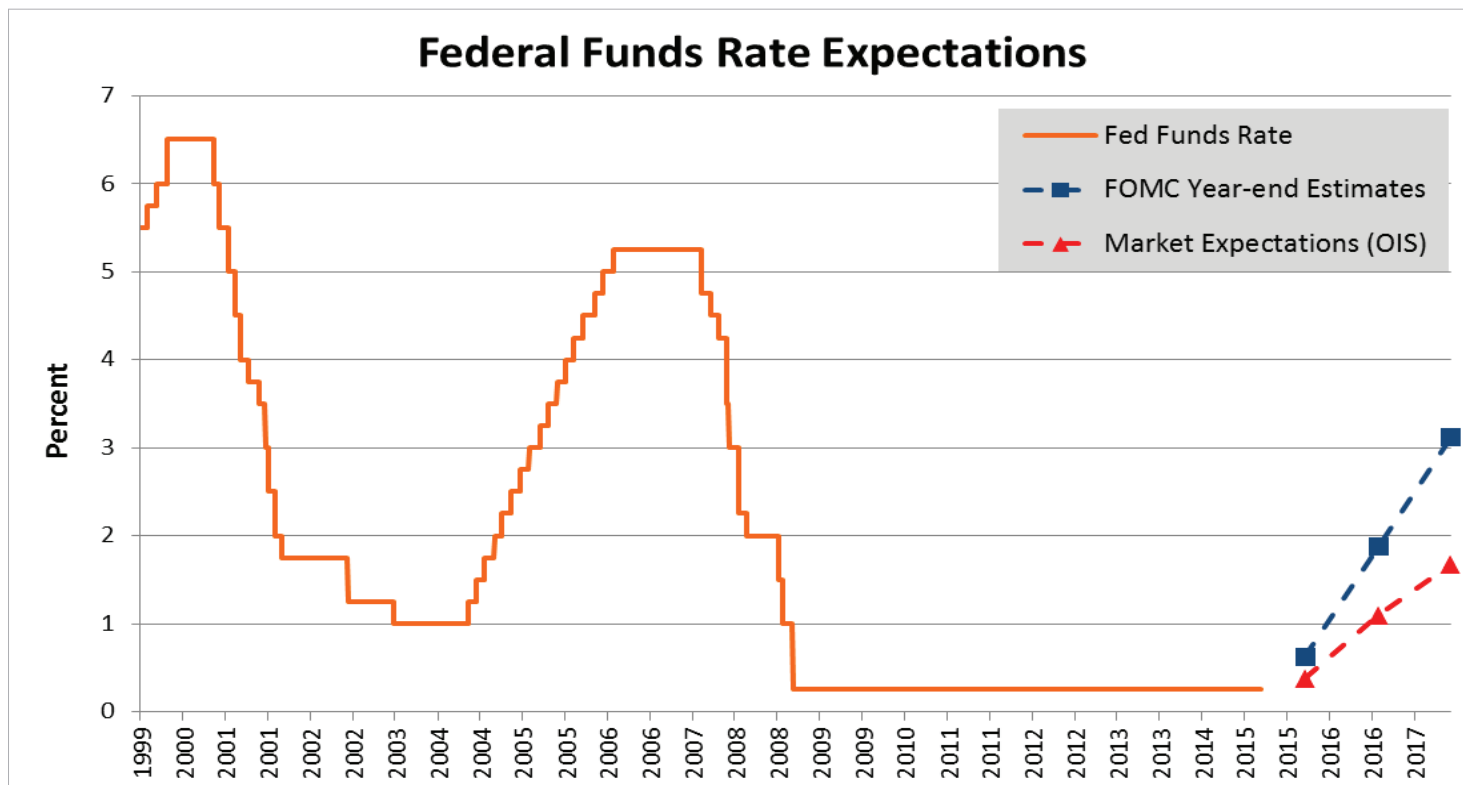
Since our Winter 2015 Market Outlook, a lot has changed with the Federal Reserve. Janet Yellen has replaced Ben Bernanke as Fed Chair, Bill Dudley is the new Fed Vice Chair and several new voting members have joined the Federal Open Market Committee. In addition, the Fed formally removed their "patient" policy language and Fed members have materially reduced their official forward Fed Funds rate guidance. Despite these changes, nothing has changed in terms of our outlook for Fed Policy. We continue to believe that the Fed will begin to tighten policy at some point later in 2015. We expect rates to increase one to three times, likely not in succession, over the next year. This will allow the Federal Reserve to maintain accommodative monetary policies while providing them the flexibility to lower rates should economic growth slow at some point in the future. We think a higher rate will put discipline in the market and create some lower bound to the cost of credit. In our opinion, zero interest rate policies are no longer necessary at this point in the recovery. We need to see if the economy can stand on its own.

Expected Returns

So what does our research indicate for the direction of interest rates here in the U.S.? We believe that the front end of the curve tends to trade off of economic expectations and the long end of the curve tends to value itself based on inflation expectations. FOMC forward rate guidance continues to indicate a higher Fed Funds rate than what the market currently anticipates. Our view is that the market is likely a better predictor of future Fed policy than what the FOMC's own predictions might indicate. Short term rates should move higher, although not as high as what the Fed is currently predicting. Given that short term rates inside of two years have remained relatively well anchored, we expect these rates to experience most of the pressure in the year ahead. As these rates rise, bond prices will fall, but not precipitously. If you are primarily investing your dollars in short term bonds, it continues to make good sense to keep your laddered strategy in place, reinvesting cash flows and maturities out the curve at what we expect to be higher rates in the year ahead. Timing the market is dangerous to one's financial health. Plan your maturities to align with your cash flow liabilities.

Despite the difficult global economic environment, corporate profitability has remained surprisingly resilient in recent quarters. Our outlook calls for continued healthy, albeit lower, operating performance for U.S. corporations in the year ahead. S&P 500 earnings and margins are at or near record, and balance sheets are very healthy. We expect credit sectors, such as high quality corporate bonds, to outperform government sectors in the year ahead.

With respect to the U.S. equity markets, we expect to see higher volatility and some larger price shocks as the Fed begins to lift short term rates. While stocks ultimately traded higher during the past three rate hiking cycles, stocks traded lower initially as policy firmed. However, we remain relatively optimistic for stock returns given underlying market fundamentals. While top line growth and margins will normalize with time, earnings should continue to grow over the next several years. Utilizing a conservative estimated range of 1-2% for earnings growth, a dividend yield of 2% and no change in market multiples, we expect a 3-5% return for stocks in the year ahead. While relative valuations are certainly higher than recent history, metrics are not overly extended at this point in a mature bull market.



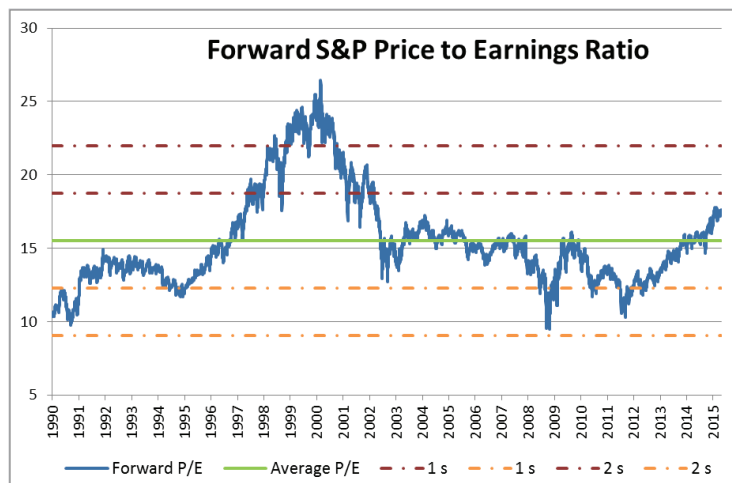
FOMC March 2015 Median Forecast

OIS is the Overnight Swap Rate as of 05/26/15

Source: Bloomberg

In addition, we haven't seen the kind of investor behavior out of bonds and into stocks that we would typically see ahead of large market correction.

Overall, we continue to emphasize higher quality portfolios strategically diversified across allowable sectors. While U.S. equities should outperform most U.S. investment grade fixed income sectors in the year ahead, many investors can't afford to put their principal at risk either by policy or choice. Fixed income, while not as attractive on a historical basis, will continue to serve investors well; especially when term matched on an asset/liability basis. Stay high quality at this point in the credit cycle with your fixed income allocation.



Source: Bloomberg. The latest economic projections were released on 12/17/14

Risks to Our Outlook

One thing you can count on every year is to expect the unexpected. Tail risks are, by definition, very hard to predict. However, managing identifiable risk is the prudent investor's fiduciary obligation. As such, we have found such extrapolation useful within our investment process.

- Geopolitical. Risks – Russia, MENA, Southeast Asia, Southern Europe
- Pestilence – Ebola concerns have long faded but infectious disease can spread to markets as well
- Asian Markets – Growth falters, liquidity vanishes and asset losses follow
- Federal Reserve Policy – Worry replaces patience
- Wage Inflation – Supply side issues push wages and interest rates higher
- EU – Unforeseen Grexit repercussions

Long Term Rate Expectations

We don't have any immediate concerns on the inflation front and expect long rates to remain somewhat capped for several reasons. First, should the Federal Reserve tighten, this would signify to long term fixed income investors that the Fed is remaining vigilant on their mandate to keep any potential inflation pressures well contained. Again, inflation continues to trail historical levels and deflationary risks are at a higher order of concern for many FOMC members. Tighter policy will play to the prudent investor's fear of inflation, thereby supporting prices for fixed income securities further out the curve. Second, investible global fixed income market yields are virtually all at lower rates (yields) than those available in the U.S. market. Given the rule of law, relative political stability and vast market liquidity, the U.S. Treasury market is the place to be when the global markets experience stress or volatility. Third, the U.S. bond market is also the largest market in the world, virtually twice the size of the Japanese bond market. Sovereign Wealth Funds, Foreign Governments and Corporations alike don't have many alternative choices if they need to invest reserves. Finally, while headline inflation should move higher in upcoming quarters given the recovery we've seen in oil prices, the Federal Reserve has already been targeting the core inflation rate in determining appropriate policy levels. We do not see any immediate shocks that will pressure the core inflation rate to move materially higher over the next year.

One wildcard is what the Fed decides to do with proceeds from maturing Treasuries held on their balance sheet in coming years. If the Fed chooses to not re-invest proceeds, this could put upward pressure on yields as the market will have to absorb that supply. Given rates have recently moved to a new higher range, we expect rates to move modestly higher in the year ahead, resulting in low single digit returns at best. If forward rates come to fruition, or rates move beyond what's currently priced in the market, returns could be flat to negative for most U.S. Treasuries.

	1 YR UNCHANGED	1 YR FORWARD
Cash	0.10	0.10
1 Year	0.19	0.19
2 Year	1.15	(0.10)
3 Year	1.93	(0.07)
4 Year	2.51	0.15
5 Year	2.56	(0.17)
6 Year	3.27	0.21
7 Year	2.91	0.24
8 Year	3.01	0.22
9 Year	2.97	0.36
10 Year	2.68	0.02
30 Year	3.06	(0.01)

Source: Prudent Man Advisors, Inc. and Bloomberg

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John Huber, CFA, leads Prudent Man Advisor's asset management business and investment process. He is responsible for portfolio management and directs the advisor's research and trading efforts. Mr. Huber is a proven investment leader with over 20 years of experience managing institutional portfolios. He received his Bachelor of Arts from the University of Iowa and earned an MBA in Finance from the Carlson School of Management at the University of Minnesota. He is a Chartered Financial Analyst (CFA) charter holder and a member of the CFA Society of Minnesota.



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