# MARKET REVIEW
# THIRD QUARTER, 2014

| INDEX | 3RD QUARTER % | 1 YEAR % | 3 YEAR % | 5 YEAR % |
|---|---|---|---|---|
| Dow Jones Industrial | 1.87 | 15.29 | 19.02 | 14.85 |
| NASDAQ Composite | 1.93 | 19.14 | 22.99 | 16.18 |
| Standard & Poor's 500 | 1.13 | 19.73 | 22.99 | 15.70 |
| Russell 1000 | 0.65 | 19.01 | 23.23 | 15.90 |
| Russell Midcap | -1.66 | 15.83 | 23.79 | 17.19 |
| Russell 2000 | -7.36 | 3.93 | 21.26 | 14.29 |
| Barclay US Aggregate Bond | 0.17 | 3.96 | 2.43 | 4.12 |
| MSCI World ex. US | -5.74 | 4.86 | 13.15 | 6.52 |
| MSCI Emerging Markets | -3.49 | 4.30 | 7.19 | 4.42 |
| **COUNTY OF SAN BERNARDINO 457(b) PLAN PERFORMANCE** | **-1.81** | **12.61** | **19.66** | **13.20** |
| **COUNTY OF SAN BERNARDINO 401(k) PLAN PERFORMANCE** | **-1.91** | **12.60** | **19.88** | **13.41** |
| **COUNTY OF SAN BERNARDINO RMT PLAN PERFORMANCE** | **-1.30** | **11.15** | **16.50** | **11.82** |

The third quarter gave pause to the steady rise that had characterized the equity markets over the last five years. As a result, U.S. equities finished the third quarter flat (Russell 3000 Index). International equities fared worse, finishing down 5.8 percent (MSCI EAFE Index). Fixed income, like U.S. equities, also took pause as rates held steady over the quarter. The yield on the 10-year Treasury bond, a proxy for long-term interest rates, finished at 2.5 percent, where it was a quarter ago. Domestic fixed income, however, returned a positive total return of 0.2 percent for the third quarter (Barclays Capital Aggregate Bond Index), inching higher due to coupon payments received over the quarter. As long-term bond yields remained stable, the Fed continued to reduce the amount of long-term bonds it was purchasing through its quantitative easing program.

In September, the Fed tapered another $10 billion from bond purchases which put their total bond purchases at $15 billion per month. This is expected to end in late October, which would put an end to the current quantitative easing program which began back in the fall of 2012. This is good news for the economy, as it indicates the Fed's belief that the economy is improving and should continue to do so. Many economic measures, with the notable exception of housing, have continued to show improvement. Unemployment, for example, one of the Fed's key considerations in setting monetary policy, dropped to 5.9 percent in September. This is just under its long-term average of 6.1 percent (50-year average, J.P. Morgan) and well below the Fed's initial 6.5 percent target set a couple of years ago as the level where it would stop suppressing

rates, which is currently being done through quantitative easing. The Fed has been comfortable slowly reducing bond purchases while inflation remains below their 2 percent target.

While the U.S. has continued to show signs of improvement, it has been the Fed's monetary policy that has introduced more volatility as investors question how fast and by how much the Fed will tighten monetary policy. This is the next biggest monetary policy issue after the Fed ends its quantitative easing program, likely in late October. More important, may be the issues abroad and the extent they impact the global economy. Not only did the third quarter see more geo-political risk in Russia/Ukraine and the Middle East, but some foreign economies are beginning to slow, posting little to negative growth. This is sparking foreign central banks to consider easing monetary policy at a time when the U.S. is doing just the opposite.

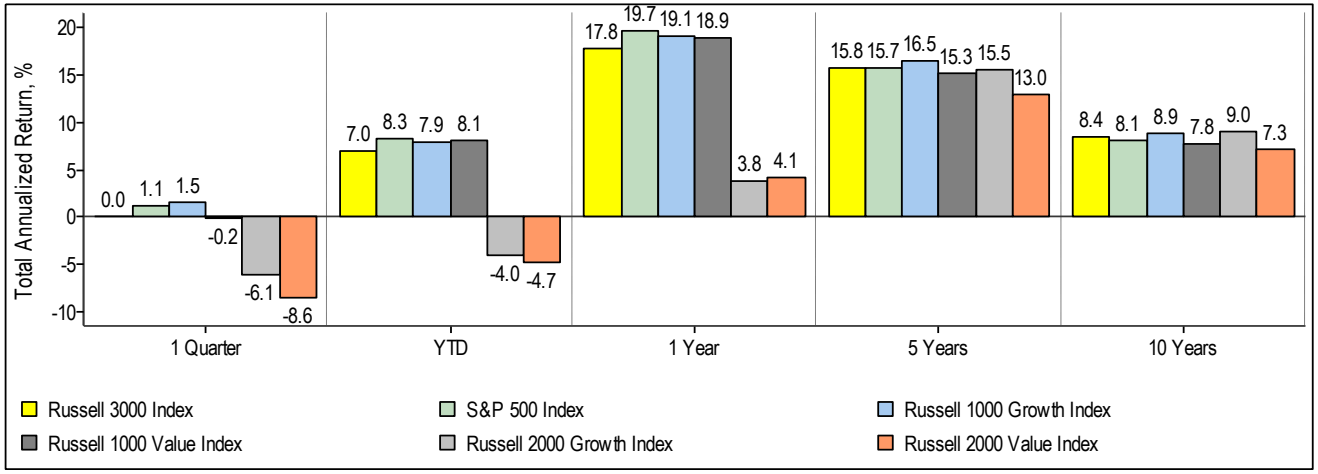
| U.S. Equity | International Equity | Fixed Income |
|---|---|---|
| While the broad U.S. equity market was flat for the quarter, the various U.S. equity styles posted very different results. Large Cap stocks, which were generally positive over the quarter, outperformed small cap stocks, which experienced large negative returns. Large cap growth was the best performing U.S. equity style, at 1.5 percent (Russell 1000 Growth). The worst performing style was small value, returning a negative 8.6 percent (Russell 2000 Value). | Developed international equity under-performed U.S. equity over the quarter, returning a negative 5.8 percent (MSCI EAFE). All international equity styles experienced negative returns for the quarter. The best performing region was Japan, which returned a negative 2.2 percent for the quarter (MSCI EM and Japan). Europe ex UK was the worst performing region, returning a negative 7.4 percent (MSCI Europe ex UK). | The broad U.S. fixed income market posted a small gain for the quarter, returning a positive 0.2 percent (Barclays Capital U.S. Aggregate). Municipal bonds were the best performing sector, returning a positive 1.5 percent (BC Muni Bond). TIPS were the worst performing sector, returning a negative 2.0 percent (BC TIPS). Global fixed income under-performed the broad U.S. fixed income market, returning a negative 2.6 percent (BofA ML Global Broad Market) for the quarter. |

# Market Review - 3rd Quarter 2014

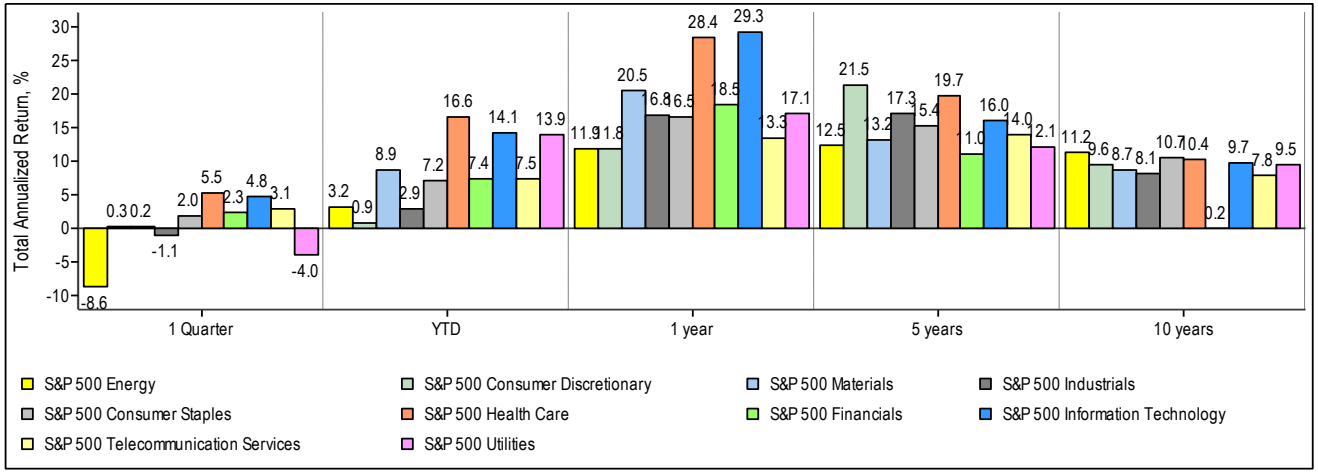
*Domestic Equity Overview*

- U.S. equity styles posted mixed results for the quarter
- Large cap outperformed small cap
  - Large cap growth was the best performing, up 1.5%
  - Small cap value was the worst performing, down 8.6%
- Best performing sectors for the quarter:
  - Health Care, up 5.5%
  - Information Technology, up 4.8%
- Worst performing sectors for the quarter:
  - Energy, down 8.6%
  - Utilities, down 4.0%

## U.S. Equity Index Performance




## U.S. Equity Sector Performance

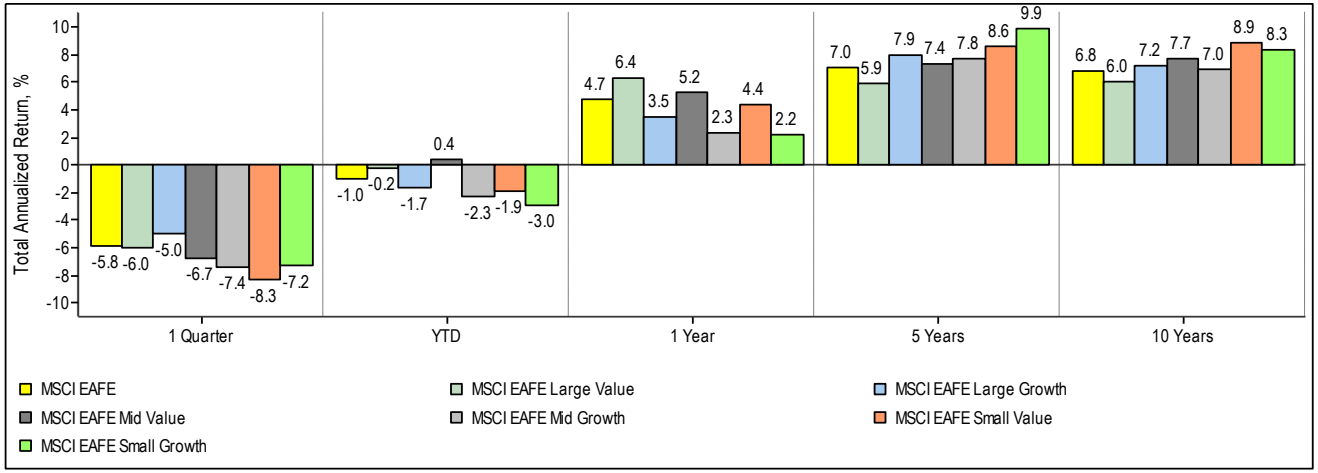


# Market Review - 3rd Quarter 2014

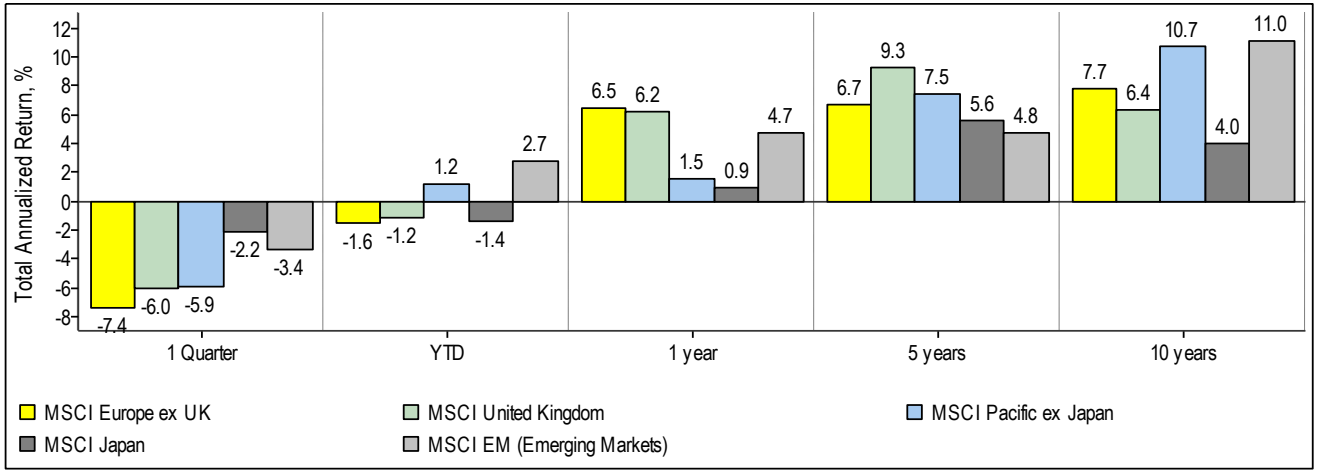
*International Equity Overview*

- All international styles posted negative returns for the quarter
- The best performing style for the quarter:
  - Large growth, down 5.0%
- The worst performing style for the quarter:
  - Small value, down 8.3%
- Best performing region for the quarter:
  - Japan, down 2.2%
- Worst performing region for the quarter:
  - Europe ex UK, down 7.4%

## International Index Performance by Style and Capitalization




## International Index Performance by Region

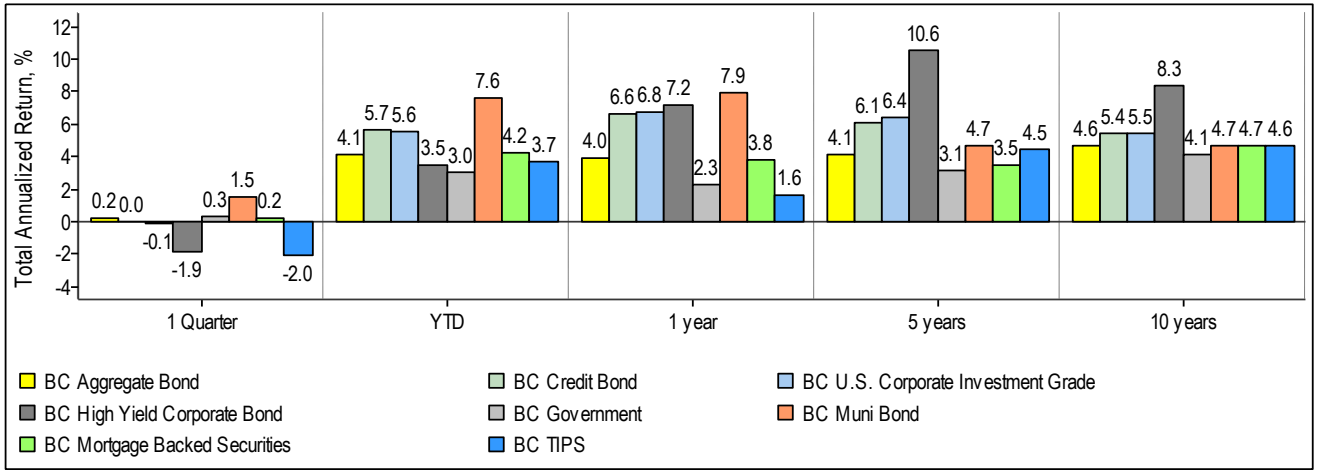


# Market Review - 3rd Quarter 2014

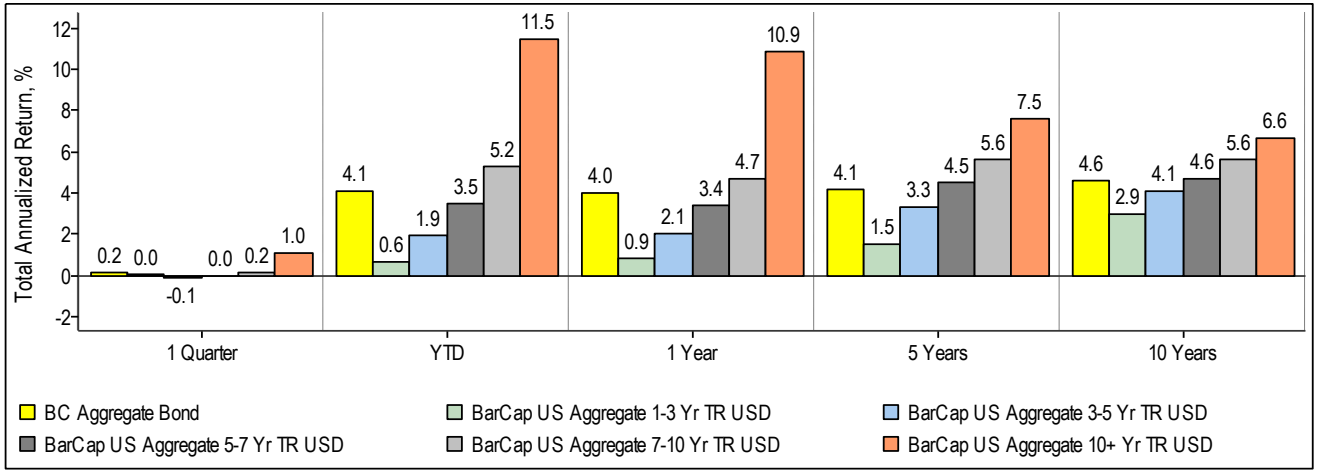
*Fixed Income Overview*

- Fixed income performance was mixed across all sectors
- Yields remained stable over the quarter
- The best performing sector for the quarter:
  - Muni Bonds, up 1.5%
- The worst performing sector for the quarter:
  - TIPS, down 2.0%
- As yields remained steady over the quarter, longer term maturities outperformed in part due to their higher yields

## Fixed Income Sector Performance




## Fixed Income Performance by Maturity



# Market Review - 3rd Quarter 2014

## *Annualized Style Box Performance*

| 1 Quarter (%) | | | |
|---|---|---|---|
| Value | Blend | Growth | |
| 0.89 | 1.71 | 2.52 | Large |
| -2.65 | -1.66 | -0.73 | Mid |
| -8.58 | -7.36 | -6.13 | Small |
| | | | |
| Int'l Equity | Global Equity | Core Fixed Income | 3-Month T-Bill |
| -5.83 | -2.16 | 0.17 | 0.01 |

| 3 Year (Annualized %) | | | |
|---|---|---|---|
| Value | Blend | Growth | |
| 23.59 | 23.00 | 22.41 | Large |
| 24.72 | 23.79 | 22.74 | Mid |
| 20.61 | 21.26 | 21.91 | Small |
| | | | |
| Int'l Equity | Global Equity | Core Fixed Income | 3-Month T-Bill |
| 14.16 | 17.93 | 2.43 | 0.07 |

| Year to Date (%) | | | |
|---|---|---|---|
| Value | Blend | Growth | |
| 8.05 | 8.46 | 8.88 | Large |
| 8.20 | 6.87 | 5.73 | Mid |
| -4.74 | -4.41 | -4.05 | Small |
| | | | |
| Int'l Equity | Global Equity | Core Fixed Income | 3-Month T-Bill |
| -0.99 | 3.89 | 4.10 | 0.03 |

| 5 Year (Annualized %) | | | |
|---|---|---|---|
| Value | Blend | Growth | |
| 14.39 | 15.39 | 16.37 | Large |
| 17.24 | 17.19 | 17.12 | Mid |
| 13.02 | 14.29 | 15.51 | Small |
| | | | |
| Int'l Equity | Global Equity | Core Fixed Income | 3-Month T-Bill |
| 7.04 | 10.86 | 4.12 | 0.10 |

| 1 Year (%) | | | |
|---|---|---|---|
| Value | Blend | Growth | |
| 19.53 | 20.46 | 21.40 | Large |
| 17.46 | 15.83 | 14.43 | Mid |
| 4.13 | 3.93 | 3.79 | Small |
| | | | |
| Int'l Equity | Global Equity | Core Fixed Income | 3-Month T-Bill |
| 4.70 | 12.20 | 3.96 | 0.05 |

| 10 Year (Annualized %) | | | |
|---|---|---|---|
| Value | Blend | Growth | |
| 6.86 | 7.73 | 8.57 | Large |
| 10.17 | 10.34 | 10.24 | Mid |
| 7.25 | 8.19 | 9.03 | Small |
| | | | |
| Int'l Equity | Global Equity | Core Fixed Income | 3-Month T-Bill |
| 6.80 | 7.12 | 4.62 | 1.59 |

*Performance as of September 30, 2014. Data is for informational purposes only and cannot be guaranteed. Past performance does not guarantee future results. Russell Top 200, Top 200 Growth, and Top 200 Value used for Large Blend, Large Growth and Large Value categories. Russell Mid-cap, Mid-cap Growth and Mid-Cap Value used for Mid Blend, Mid Value and Mid Growth categories. Russell 2000, 2000 Growth and 2000 Value used for Small Blend, Small Growth and Small Value categories. MSCI EAFE used for International Equity category. MSCI Global used for World equity category.*

# Market Review - 3rd Quarter 2014

*Kaleidoscope: Changing Leadership*

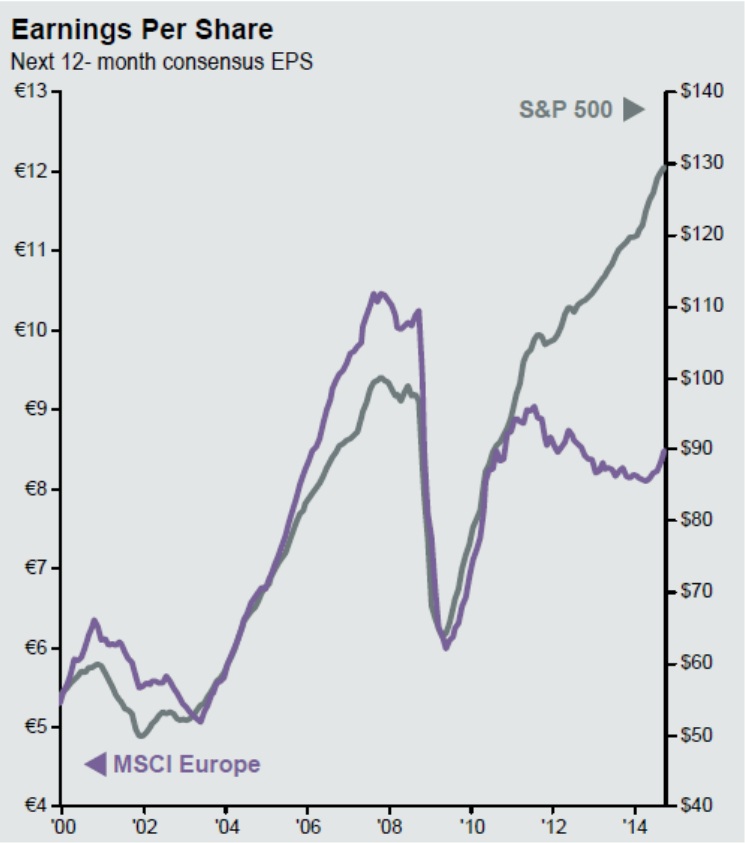
The following chart exhibits the volatility of asset class returns from year to year by ranking certain key indices in order of performance. Also included in the chart is a balanced index, which represents a mix of U.S. equity, international equity and fixed income indices. The chart graphically displays the volatility of asset class returns from year to year, highlighting the importance of diversification. Top-performing asset classes in a given year do not tend to repeat their stellar performance in subsequent years. Accordingly, the worst performing asset classes in a given year often tend to outperform in future years. Said differently, past performance is not a good indicator of future performance. Diversification, demonstrated by the balanced index, helps reduce return volatility and the uncertainty that accompanies trying to pick the best asset class (or avoid the worst) in any given year.

| *2003* | *2004* | *2005* | *2006* | *2007* | *2008* | *2009* | *2010* | *2011* | *2012* | *2013* | *YTD* |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 48.54 Russell 2000 Growth | 22.25 Russell 2000 Value | 14.02 MSCI EAFE USD | 26.86 MSCI EAFE USD | 11.81 Russell 1000 Growth | 5.24 BarCap US Agg | 37.21 Russell 1000 Growth | 29.09 Russell 2000 Growth | 7.84 BarCap US Agg | 18.05 Russell 2000 Value | 43.30 Russell 2000 Growth | 8.07 Russell 1000 Value |
| 46.03 Russell 2000 Value | 20.70 MSCI EAFE USD | 7.05 Russell 1000 Value | 23.48 Russell 2000 Value | 11.63 MSCI EAFE USD | -22.48 Balanced Index* | 34.47 Russell 2000 Growth | 24.50 Russell 2000 Value | 3.04 Balanced Index* | 17.90 MSCI EAFE USD | 34.52 Russell 2000 Value | 7.89 Russell 1000 Growth |
| 39.17 MSCI EAFE USD | 16.49 Russell 1000 Value | 5.45 Balanced Index* | 22.25 Russell 1000 Value | 7.05 Russell 2000 Growth | -28.92 Russell 2000 Value | 32.46 MSCI EAFE USD | 16.71 Russell 1000 Growth | 2.64 Russell 1000 Growth | 17.51 Russell 1000 Value | 33.48 Russell 1000 Growth | 5.02 Balanced Index* |
| 30.03 Russell 1000 Value | 14.31 Russell 2000 Growth | 5.26 Russell 1000 Growth | 13.35 Russell 2000 Growth | 6.97 BarCap US Agg | -36.85 Russell 1000 Value | 20.58 Russell 2000 Value | 15.51 Russell 1000 Value | 0.39 Russell 1000 Value | 15.26 Russell 1000 Growth | 32.53 Russell 1000 Value | 4.10 BarCap US Agg |
| 29.75 Russell 1000 Growth | 9.84 Balanced Index* | 4.71 Russell 2000 Value | 12.17 Balanced Index* | 6.61 Balanced Index* | -38.44 Russell 1000 Growth | 20.05 Balanced Index* | 12.47 Balanced Index* | -2.91 Russell 2000 Growth | 14.59 Russell 2000 Growth | 23.29 MSCI EAFE USD | -0.99 MSCI EAFE USD |
| 20.80 Balanced Index* | 6.30 Russell 1000 Growth | 4.15 Russell 2000 Growth | 9.07 Russell 1000 Growth | -0.17 Russell 1000 Value | -38.54 Russell 2000 Growth | 19.69 Russell 1000 Value | 8.21 MSCI EAFE USD | -5.50 Russell 2000 Value | 11.79 Balanced Index* | 17.42 Balanced Index* | -4.05 Russell 2000 Growth |
| 4.10 BarCap US Agg | 4.34 BarCap US Agg | 2.43 BarCap US Agg | 4.33 BarCap US Agg | -9.78 Russell 2000 Value | -43.06 MSCI EAFE USD | 5.93 BarCap US Agg | 6.54 BarCap US Agg | -11.73 MSCI EAFE USD | 4.22 BarCap US Agg | -2.02 BarCap US Agg | -4.74 Russell 2000 Value |

**Balanced Index comprised of 50% Russell 3000, 10% MSCI EAFE and 40% Barclays Capital U.S. Aggregate, rebalanced quarterly.*

## U.S versus Europe: Earnings Per Share

Earnings Per Share (EPS) is a measure of a company's earnings, or revenue, per each unit, or share, of their company stock. Everything else being equal, the higher the EPS, the better. EPS, and specifically EPS growth can help indicate the health of a company. The chart below shows the historical consensus estimates for the next 12-month earnings for both U.S. companies (S&P 500) and European companies (MSCI Europe). Over the last few years, the chart below shows that earnings for U.S. companies have taken a much different path than that of their European counterparts.




Source: J.P. Morgan, as of 9/30/14

# Market Review - 3rd Quarter 2014

## *Disclosures*

Performance of indexes reflects the unmanaged result for the market segment the selected stocks represent. Indexes are unmanaged and not available for direct investment.
Citigroup Corporate Bond is an index which serves as a benchmark for corporate bond performance. You cannot invest directly in an index.

Citigroup Mortgage Master is an index which serves as a benchmark for U.S. mortgage-backed securities performance.

Citigroup WGBI Index is an index which serves as a benchmark for global bond performance, including 22 different government bond markets.

Credit Suisse High Yield Index is an unmanaged, trader priced index constructed to mirror the characteristics of the high yield bond market.

BC (Barclays Capital) U.S. Aggregate Bond Index represents securities that are U. S., domestic, taxable, and dollar denominated. The index covers the U. S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

BC Credit Bond Index includes publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

BC U.S. Corporate Investment Grade represents investment grade corporate securities that are U. S., domestic, taxable, and dollar denominated.

BC High Yield Corporate Bond represents below investment grade corporate securities that are U. S., domestic, taxable, and dollar denominated.

BC TIPS Index includes publicly issued U.S. government treasury inflation protected securities that meet the specified maturity, liquidity and other requirements.

BC Mortgage Backed Securities covers agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARMs) issued by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

BC Muni Bond covers the USD-denominated long term tax exempt bond market with four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

BC Government Index includes publicly issued U.S. government securities that meet the specified maturity, liquidity and other requirements.

BarCap U.S. Aggregate 1-3 Yr. TR USD Index represents securities in the BC U.S. Aggregate Index that have maturity dates over the next 1 to 3 years.

BarCap U.S. Aggregate 3-5 Yr. TR USD Index represents securities in the BC U.S. Aggregate Index that have maturity dates over the next 3 to 5 years.

BarCap U.S. Aggregate 5-7 Yr. TR USD Index represents securities in the BC U.S. Aggregate Index that have maturity dates over the next 5-7 years.

BarCap U.S. Aggregate 7-10 Yr. TR USD Index represents securities in the BC U.S. Aggregate Index that have maturity dates over the next 7 to 10 years.

BarCap U.S. Aggregate 10+ Yr. TR USD Index represents securities in the BC U.S. Aggregate Index that have maturity dates over 10 years.

DJW 5000 (Full Cap) Index measures the performance of all U.S. common equity securities, and serves as an index of all stock trades in the United States.

MSCI FI Emerging Markets is a rules-based index which serves as a benchmark for emerging country fixed income performance.

MSCI FI EAFE International is a rules-based index which serves as a benchmark for developed international country fixed income performance.

MSCI EAFE Index is listed for foreign stock funds (EAFE refers to Europe, Australia, and Far East). Widely accepted as a benchmark for international stock performance, it is an aggregate of 21 individual country indexes.

MSCI EAFE Large Value represents the large cap value stocks within the MSCI EAFE Index.

MSCI EAFE Large Growth represents the large cap growth stocks within the MSCI EAFE Index.

MSCI EAFE Mid Value represents the mid cap value stocks within the MSCI EAFE Index.

MSCI EAFE Mid Growth represents the mid cap growth stocks within the MSCI EAFE Index.

MSCI EAFE Small Value represents the small cap value stocks within the MSCI EAFE Index.

MSCI EAFE Small Growth represents the small cap growth stocks within the MSCI EAFE Index.

MSCI EM (Emerging Markets) Index serves as a benchmark for each emerging country. The average size of these companies is (U.S.) $400 million, as compared with $300 billion for those companies in the World index.

MSCI World Index is a rules-based index that serves as a benchmark for the developed global equity markets.

MSCI Europe ex UK Index is a rules-based index that serves as a benchmark for the Europe's equity markets, excluding the United Kingdom.

MSCI Pacific ex Japan Index is a rules-based index that serves as a benchmark for Asia Pacific's equity markets, excluding Japan.

MSCI United Kingdom Index is a rules-based index that serves as a benchmark for the United Kindgom's equity markets.

MSCI Japan is a rules-based index that serves as a benchmark for Japan's equity markets.

Nareit All Reit Index includes all tax-qualified REITs with common shares that trade on the New York Stock Exchange, the American Stock Exchange or the NASDAQ National Market List.

3-Month T-bills (90 Day T-Bill Index) are government-backed short-term investments considered to be risk-free and as good as cash because the maturity is only three months.

Russell 1000 Growth Index is a market-capitalization weighted index of those firms in the Russell 1000 with higher price-to-book ratios and higher forecasted growth values.

Russell 1000 Value Index is a market-capitalization weighted index of those firms in the Russell 1000 with lower price-to-book ratios and lower forecasted growth values.

Russell Top 200 Growth Index is a market-capitalization weighted index of those firms in the Russell Top 200 with higher price-to-book ratios and higher forecasted growth values.

Russell Top 200 Value Index is a market-capitalization weighted index of those firms in the Russell Top 200 with lower price-to-book ratios and lower forecasted growth values.

Russell 2000 Growth Index is a market-weighted total return index that measures the performance of companies within the Russell 2000 Index having higher price-to-book ratio and higher forecasted growth values.

Russell 2000 Index consists of the smallest 2000 companies in the Russell 3000 Index, representing approximately 7% of the Russell 3000 total market capitalization.

Russell 2000 Value Index is a market-weighted total return index that measures the performance of companies within the Russell 2000 Index having lower price-to-book ratios and lower forecasted growth values.

Russell MidCap Growth Index is a market-weighted total return index that measures the performance of companies within the Russell MidCap Index having higher price-to-book ratios and higher forecasted growth values.

Russell Mid-Cap Index includes firms 201 through 1000, based on market capitalization, from the Russell 3000 Index.

Russell MidCap Value Index is a market-weighted total return index that measures the performance of companies within the Russell MidCap index having lower price-to-book ratios and lower forecasted growth values.

Russell Top 200 Index consists of the 200 largest securities in the Russell 3000 Index.

Russell 3000 Index is a market-capitalization weighted index, consisting of 3,000 U.S. common equity securities, reflective of the broad U.S. equity market.

Salomo n 1-10 Yr. Governments is an index which serves as a benchmark for U.S. Government bonds with maturities ranging from 1 to 10 years.

S&P 500 Index measures the performance of the largest 500 U.S. common equity securities, and serves as an index of large cap stocks traded in the United States.

S&P 500 Energy Index measures the performance of the energy sector in the S&P 500 Index.

S&P 500 Industrials measures the performance of the industrial sector in the S&P 500 Index.

S&P 500 Financials measures the performance of the financials sector in the S&P 500 Index.

S&P 500 Utilities measures the performance of the utilities sector in the S&P 500 Index.

S&P 500 Consumer Discretionary Index measures the performance of the consumer discretionary sector in the S&P 500 Index.

S&P 500 Consumer Staples Index measures the performance of the consumer staples sector in the S&P 500 Index.

S&P 500 Information Technology measures the performance of the information technology sector in the S&P 500 Index.

S&P 500 Materials measures the performance of the materials sector in the S&P 500 Index.

S&P 500 Health Care measures the performance of the health care sector in the S&P 500 Index.

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