The S&P 500 weathered a series of up and down events to finish with a total return of 2.46% during the second quarter and 3.84% year-to-date (YTD). Equity markets and commodities, particularly oil, rallied in April, followed by a sagging S&P 500 in May as Fed officials refused to rule out the possibility of a rate hike in June. Markets approached all-time highs in early June as a surprisingly bad May jobs number (38k vs. 162k consensus) essentially removed the possibility of a Fed rate hike this summer. In the last week of June, the S&P 500 plunged 5% but quickly bounced back in the aftermath of the U.K. Brexit vote that shocked world markets. Gold and commodities continued to rally in Q2, up 24.57% and 9.33% YTD, respectively, on inflation fears in response to increasingly easy global monetary policies. The global rally in stocks and bonds has spilled into 3Q16 as the flood of money from central banks all over the world continued to fuel the market surge during the early weeks of July.

Developed and emerging international equity markets continued to diverge during the quarter. The developed market MSCI EAFE index fell -1.23% during the quarter, adding to losses, to finish down -4.04% YTD. The MSCI Emerging Market index added 0.78% to its surprisingly strong recovery in 1Q16, leading to a 6.52% increase YTD. On a relative basis, global bond markets may have been more volatile than stock markets in Q2. European bonds rallied strongly in March, when the European Central Bank (ECB) announced it would push cash rates further into negative territory. In early June, the ECB incrementally increased its purchases of EU bonds. Rates were pushed even lower after the Brexit announcement as international stock markets fell 8% and investors sought the safe haven of bonds locally and abroad. Even though the S&P 500 rallied back to pre-Brexit levels, U.S. Treasury rates fell to 50+ year lows as foreign investors sought the prospect of higher U.S. treasury yields amidst a global landscape where 30% or more of sovereign bonds sport negative yields.

Economic forecasters continued to lower U.S. and global growth estimates for 2016 in the second quarter. U.S. GDP estimates started the year at 2.5%, were subsequently lowered to 2.1% and have been revised downward again to 2.0%. While housing remains strong, employment is buoyant and consumer balance sheets are in better shape than before the financial crisis, wage increases have not kept pace with out-of-pocket healthcare costs. Furthermore, retail sales (particularly apparel and autos) have missed estimates despite lower gas prices. Since consumer spending makes up 2/3 of GDP, tepid spending results in pocket healthcare costs. Furthermore, retail sales (particularly apparel and autos) have missed estimates despite lower gas prices. Since consumer spending makes up 2/3 of GDP, tepid spending results in pocket healthcare costs.

Proprietary Performance Results

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>2nd Quarter</th>
<th>1 Year</th>
<th>3 Year</th>
<th>5 Year</th>
<th>Since Inception</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focused Equity Fund</td>
<td>2.40%</td>
<td>4.05%</td>
<td>10.45%</td>
<td>11.43%</td>
<td>14.21%</td>
</tr>
<tr>
<td>Aggressive Growth Fund</td>
<td>-2.57%</td>
<td>-4.04%</td>
<td>10.49%</td>
<td>11.88%</td>
<td>8.56%</td>
</tr>
<tr>
<td>Science/Technology Fund</td>
<td>-0.42%</td>
<td>-6.08%</td>
<td>11.91%</td>
<td>11.25%</td>
<td>7.18%</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>2.45%</td>
<td>3.98%</td>
<td>11.60%</td>
<td>12.06%</td>
<td>14.31%</td>
</tr>
<tr>
<td>Russell 2000</td>
<td>3.78%</td>
<td>-6.78%</td>
<td>7.06%</td>
<td>8.34%</td>
<td>13.32%</td>
</tr>
<tr>
<td>MSCI EAFE</td>
<td>-1.25%</td>
<td>-9.62%</td>
<td>2.64%</td>
<td>2.25%</td>
<td>7.26%</td>
</tr>
<tr>
<td>Strategic Income Fund</td>
<td>2.95%</td>
<td>2.16%</td>
<td>6.32%</td>
<td>7.12%</td>
<td>9.72%</td>
</tr>
<tr>
<td>60% Russell 3000 Val / 40% Barclay Agg</td>
<td>3.63%</td>
<td>4.08%</td>
<td>7.52%</td>
<td>8.34%</td>
<td>9.85%</td>
</tr>
</tbody>
</table>

There is no assurance that any of these investment strategies will meet its investment objective. Performance results for each strategy are computed on the strategy’s overall returns. Each strategy and index includes the reinvestment of dividends. Past performance does not guarantee future results. Current performance may be lower or higher than the performance results quoted. *Net of management fees; performance results of SMC Capital and/or its principals as advisor from inception to 2/28/06 and as sub-advisors to CBandT since 3/1/06. **Inception date 12/31/2008. **Inception date 7/1/1989. ***Inception date 3/31/2006. ****Inception date 12/31/2008.
Fixed Income

During the quarter, the Federal Reserve maintained its 0.25%-0.50% range for the Fed Funds rate. Anticipation for another hike was squelched with a dismal employment report (+38k jobs) that kept the Fed on hold in June. Another consideration was the Brexit vote on June 23 and concerns about Britain exiting the EU.

A significant “risk-off” trade followed as the “Leave” vote prevailed 52% to 48%. There were dramatic moves in most global asset classes. Equities fell sharply, particularly in Europe, while “safe assets” such as sovereign bonds performed well. In the U.S., Treasuries, high-grade corporate bonds and municipals performed very well as stocks sold off. Despite a quick recovery in U.S. stocks, bonds continue to rally with Treasury yields resuming their descent to record lows. A growing pool of negative-yielding global debt has boosted the appeal of U.S. securities. According to Fitch, Brexit “pushed the global total of sovereign debt with negative yields to $11.7 trillion as of June 27, up $1.3 trillion from the end-May total”.

We are increasingly concerned about the amount of sovereign debt with negative yields. In May, Fed Chair Yellen said she “would not completely rule out the use of negative interest rates in some future very adverse scenario”. She did note that the tool would need a lot more study before it could be used in the United States.

During the quarter, the 10-yr Treasury fell 0.30% to close at 1.47%. Following the best annual start since 1995, broad-based U.S. investment-grade bond indices returned 2.3% for the quarter, bringing the year-to-date return tally to 5.4%. Longer-term investment-grade bonds (15+ years) have returned an astounding 15% in 2016.

The U.S. high yield market has been especially interesting this year. Equity returns were under pressure through February 11th, with prices down nearly 6%, while the junk bond universe actually yielded in excess of 10% on that day. This quarter, junk bond prices gained another 4%, bringing the price recovery since February to over 12%. In all, returns were 5.9% for the quarter and 9.3% for 2016. Yield spreads remain wide to historical averages at over 6% compared to 7% in March.

Tax-exempt municipal bonds returned 2.7% during the quarter, bringing returns on the year to 4.4%. In June, state and local governments sold $44 billion of fixed-rate debt, the highest since October 2010, taking advantage of the low rates. Tax-exempt securities returned 1.6% during June, buoyed by steady investor inflows and a flight to the safest assets, as discussed above.

We have lowered our outlook for investment-grade and municipal bonds to overvalued, from somewhat overvalued given the record low yields (or near lows). Similarly, we lowered our outlook on international bonds (overvalued) given the growing negative yield universe. In contrast, we still remain positive on high yield though we did lower its ranking closer to fair value. We continue to recommend a tactical underweight to core fixed income in favor of high quality dividend paying stocks and alternative strategies.

Focused Equity

For the second quarter and the six months ending June 30, the strategy returned 2.40% and 2.72%, respectively, versus a 2.45% and 3.82% increase for the S&P 500 Equity Index. For the last twelve months the strategy slightly outperformed the S&P 500, returning 4.05% vs. 3.98% for the index. Since inception, the strategy has narrowly trailed the S&P 500’s annual return of 14.33% by -0.12% with a gain of 14.21%. However, the fund has achieved these results while taking on meaningfully less risk than the S&P 500 with a beta of 0.87 and a standard deviation more than 10% lower over its history, producing annualized alpha of 1.54% since inception.

The energy sector led the index in the second quarter (+11.62%) as oil rallied 26.06%, enabling Spectra Energy (SE +21.16%) and EOG Resources (EOG +15.25%) to stand as two of the top performers in the strategy. A relative overweight in healthcare (16.35% vs. 15.04%) was the top-contributing sector in Focused Equity, returning 8.07% vs. its benchmark’s return of 6.27%. Bristol Myers Squibb Co (BMY +15.62%) lead the group due to increasing approved uses for their immuno-oncology drug, Opdivo, which has been forecasted to generate $20+ billion in revenues by 2020. American Water Works Co. (AWK +23.21%), Crown Castle Intl. (CCI +18.28%), and Ventas (VTR +16.82%) were top performers on an absolute basis as interest rate sensitive sectors rallied along with bonds.

Despite recent contributions to returns, tech giants Apple (AAPL -11.80%), Alphabet (GOOGL -7.78%), and Microsoft (MSFT -6.74%) collectively had the largest negative impact on the strategy during the second quarter following lackluster Q1 earnings results reported by each of these names. CVS Health Corp (CVS -7.32%) stumbled during the period despite a strong Q1 report with uncertainty around pricing/reimbursement models for specialty PBMs (Pharmacy Benefit Manager). MasterCard (MA -6.97%) diverged from its peers in early June as their relatively higher exposure to Europe and Great Britain was punished with Q1 softness in European purchase volumes and the Brexit vote, respectively.

Strategic Income Builder

For the quarter, the strategy (SIB) returned 2.95%, falling behind the blended benchmark return of 3.63%, which is comprised of a 60% weighting to the Russell 3000 Value Index & 40% to the Barclays Aggregate Index. For 12 months, SIB lagged its benchmark (2.16% vs. 4.08%). In January, we cut the equity allocation to 65% from 70% on heightened volatility, but remain overweight stocks due to the record low bond yields. Since inception (1/1/09), the SIB strategy has returned an annualized 9.72%, in line with the benchmark return of 9.85%. The yield generated from the strategy has consistently exceeded that of the benchmark. On a risk-adjusted basis, the strategy has generated a positive alpha of 0.96% annualized with a beta of 0.88. The success of the portfolio is the result of an attractive mix of income producing securities, exposure to global markets and tactical allocation.

For the quarter, our equities returned 3.38% vs. 4.56% for the Russell 3000 Value. Information Technology (-2.8%) stocks were most costly with Financials (+3.9%) being most beneficial. Our significant underweight in Energy (+10.7%) and Utilities (+7.4%) negatively impacted results. Within our tech holdings, Apple (AAPL, -11.8%) disappointed in April, recording its first quarterly sales decline in 13 years. The tech giant saw its iPhone sales drop by 18% on slowing growth in the smartphone market. However, Apple is adding $50 billion to its capital return program, bringing the total to $250 billion. Of that increase, $35 billion is being allocated to share repurchases, with $15 billion to cover dividend payouts, which were recently increased 9.6% from $2 to $2.57. New offerings such as Apple Watch, Apple TV, Apple Music, Apple Pay and Car Play have the potential to generate significant sales long term. In general, financials and especially banks were under pressure due to the decline in longer-term interest rates. Lower rates typically mean a decline in margins and earnings on loans and investments. In contrast, REIT’s tend to perform very well as rates fall. Healthcare REIT holdings include Vencor (+16.9%) and HCP Inc. (+10.4%). Effective August 31st, S&P Dow Jones Indices and MSCI will reclassify and elevate stock-exchange listed real estate companies (including listed equity REITs) from under the Financials Sector to a new 11th headline Real Estate Sector.

The fund’s quarterly fixed income performance of +2.60% compared favorably to +2.21% for the Barclays Aggregate Bond. For 2016, fixed results stand at 4.65% vs. 5.31% for the Barclays Aggregate.

Our tax-free holdings, which make up roughly 12% of our fixed allocation, again lagged, returning +1.5% during the quarter. Our international bond funds returned 3.25% after a modest +0.9% during the 1st quarter. We have cut our allocation to below 6% of fixed income.
and may reduce it further given a growing pool of negative-yielding global debt.

Quarterly alternative performance was -0.6% and we increased our allocation slightly to 4.5%. In general, we believe we can reduce portfolio volatility and enhance returns over time utilizing specific types of alternatives.

**Science & Technology Strategy**

The Science & Technology strategy (SciTech) returned -0.42% for the second quarter vs. the NASDAQ 100 (-1.15%), the broader NASDAQ Composite (-0.23%), and the Lipper Science & Tech Fund Index (-1.00%). For the last 12 months the SciTech fell -6.08% vs. a 1.77% return for the NASDAQ 100, -1.59% for the NASDAQ Composite and -0.96% for the Lipper Science & Technology Index. Since the inception of the fund (3/31/2006), the strategy has returned 7.18% versus 7.34% for the Lipper Science & Tech Index and 7.08% for the S&P 500.

**Leaders:** Telecom was once again the largest contributor to performance during the quarter with American Tower (AMT) and Crown Castle (CCI) returning 12.0% and 18.4% respectively. The outperformance in telecom was due to investors searching for yield with interest rates still at record lows. Healthcare was the second largest contributor of performance, adding 9.1% to the portfolio. The sector rallied over the second quarter as political concerns normalized. This enabled Bristol Myers (BMY +15.7%) to outperform, due, in part, to their flourishing immuno-oncology drug, Opdivo, which continues to be approved for additional indications.

**Laggards:** The fund’s biggest detractors for the quarter were large cap tech names such as Apple (AAPL -11.80%) and Alphabet, formerly Google, (GOOGL -7.63%). Apple fell during the quarter over concerns of an aging iPhone refresh cycle. Alphabet fell after their holiday ad revenues fell short of expectations, resulting in weak earnings. The overall strategy, however, is underperforming for the last twelve months due to the allocation to biopharma names. Despite this, we have maintained the allocation, as most of the names, such as Celgene (CELG -1.46%), Gilead (GILD -8.67%) and Vertex (VRTX +10.58%) are not currently being given credit for their pipelines. These companies have several drugs in development with upcoming progress catalysts.

**Small Cap Composite**

The Small Cap Value Composite returned 2.81% for the second quarter versus a return of 3.78% for the Russell 2000 index. For the year to date, the composite returned 6.96% vs. 2.19% for the benchmark.

The sectors with the highest contribution to relative return in Q2 were Industrials and Energy. A top contributing holding during Q2 was Insepoloy Inc. (NSP, 50%), a professional employment organization (PEO) that provides outsourced human resources to small and medium-sized business. High customer retention and new client wins drove accelerated revenue growth and, in early May, NSP reported quarterly results well ahead of expectations. Another professional employment organization focused on small and medium-size business, TriNet Group Inc. (TNET, +45%), was also a top contributor in Q2. We initiated a position in late Q1 after the stock reached an all-time low. Another positive contributor was SodaStream International Ltd. (SODA, +51%), a maker and distributor of home carbonation systems. SODA began its rally after reporting revenue growth for the first time in seven quarters, led by a resurgence in its Western European market.

The sectors with the lowest contribution to relative return in the Portfolio during Q2 were Materials and Financials. One negative contributing holding during the quarter was SeaWorld Entertainment Inc. (SEAS), owner and operator of theme parks including the SeaWorld and Busch Gardens brands. SEAS reported mixed quarterly results and disappointing initial 2016 guidance. Another bottom contributor during Q2 was Air Transport Services Group Inc. (ATSG, -16%), the world’s largest lessor of Boeing 767s to the cargo transport services market. After strong Q1 stock performance due to solid Q4 operating results and a strategic investment by Amazon into ATSG, investors took profits in Q2. Another bottom contributor during Q2 was PBF Energy Inc. (CBH A, -27%), the fourth-largest independent oil refiner in the United States. PBF fell along with other peers during the quarter as Q1 2016 refining margins missed expectations across the industry and investors lowered expectations for Q2 and Q3.

**Kentucky Municipals- 2Q 2016**

Quarterly bond issuance by Kentucky municipalities was $881 million, down from an extremely robust $2.15 billion in the previous quarter. Sizable issuance last year was attributable to many deals refinancing (refunding) existing debt and this continues given the near record low rates. We watch this very closely as purchasing “refunding” candidates is part of our portfolio management. Competitively awarded deals were $412 million with negotiated deals of $469 million. Deal size averaged $11.4 million with 77 new issues in total.

Bank-qualified (BQ) issuance was $156 million or 18% with non-BQ issuance of $606 million or 69%. For our clients, we tend to utilize non-BQ because yields are typically higher. Taxable issuance actually grew to $119 million or 13%. We prefer taxable municipals to corporates, as credits are more stable and spreads are generally wider. There was also no AMT-subject issuance again this quarter. Visible supply remains robust for the summer with $543 million on the calendar in coming months.

Deals of note included $103 million of issuance by Paducah Electric Board (Underlying rating- Baa1/A-) which refunded a portion of outstanding 2009A debt. Also of note was roughly $40 million of issuance in coming months. Visible supply remains robust for the summer with $543 million on the calendar in coming months.

**Puerto Rico Update**

On July 1st, Puerto Rico skipped a record $911 million of bond payments with the biggest missed payment of $780 million in general obligation bonds. This comes roughly a year after Governor Alejandro Garcia Padilla concluded that the debt is “not payable”. He evoked a local moratorium provision after President Obama signed a bill into law that sets a debt restructuring in motion and shelters the island from liability. The legislation, called Promesa or promise in Spanish, creates a seven member federal board that will begin overseeing its finances. It postpones creditor lawsuits seeking repayment and allows the control board to force reluctant bondholders into court, if needed, to reduce the roughly $70 billion debt load. Assured Guaranty, which made payments on their debt guarantees said, “The Puerto Rico constitution unambiguously states that the Commonwealth’s GO debt is to be paid before all other expenditures, and no funds may be applied to other obligations until the GO debt has been fully paid.”
Outlook

As previously stated, periods of high market volatility should continue in 2016 and will occur with greater frequency as the economy softens, the bull market continues without a significant correction and central banks persist with easy monetary policies. Oil prices, the movement of the U.S. Dollar and differences between U.S. and foreign interest rates will all fuel further volatility this year.

We maintain our Bull/Bear market odds for 2016 at 90/10. We place a 90% probability that oil, the dollar and U.S. equity markets remain in a stable range for the rest of 2016. We see a 10% probability that oil/dollar concerns push markets into Bear market territory (S&P 500 <1710, which represents a 20% decline from the July 11 market peak of 2141). In our opinion, current U.S. economic data and the term structure of interest rates do not support a bear market this year. All but two bear markets since 1950 were associated with recessions (1961 and 1987). Nevertheless, we think data flow will show only mild improvement, leaving the threat on the table that global growth could slide into recession. It is unlikely that the impact of Brexit uncertainty will result in EU recession. Although oil still appears to be in oversupply and the Fed would like to see rates return to normalized levels, we believe tepid economic data will not support a rate increase for the rest of the year.

While market sentiment has proved resilient, we believe we are in the final innings of the business cycle and the bull market. Monetary policy seems to be running out of gas, while political gridlock between conservatives and populists worldwide has resulted in an era of “perma-austerity”. Innovative monetary policy leading to zero and negative interest rates has nursed a global economy in financial crisis to a slow and feeble recovery. The post-crisis business/market cycle at 84 months is the fourth longest since 1900. No Central Banker knows whether this brave new world of monetary policy will end abruptly with a bear market correction or enable markets to limp along for a few years with subpar returns. While monetary policy may continue to prop up global growth rates to the 1%-3% level, we anticipate that global markets will move sideways for a few years before ultimately slipping into recession and a bear market.

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