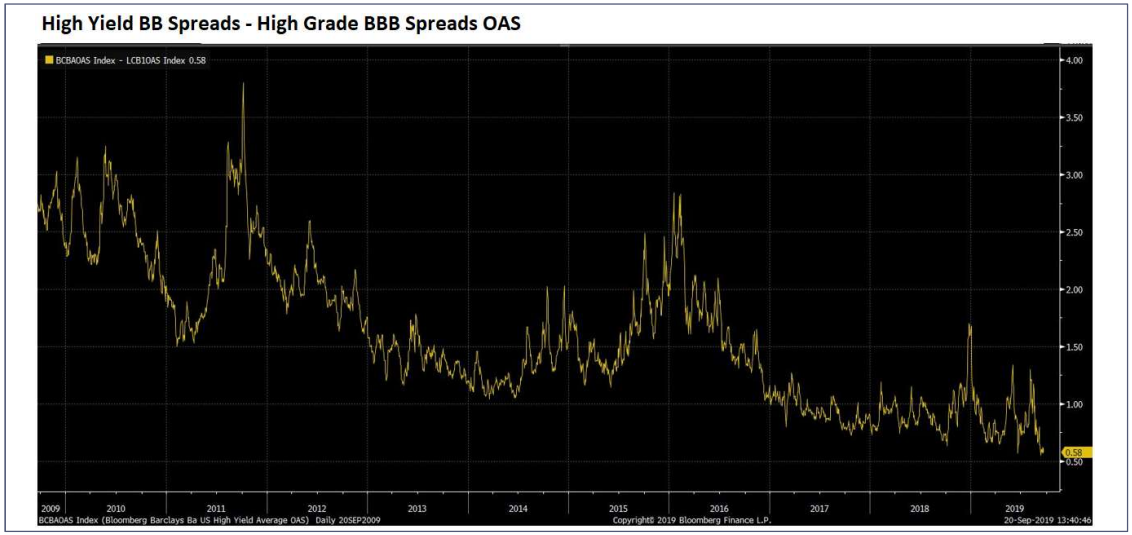
Market Recap

An Unfashionable Rotation in Style

Source: Morgan Stanley, Bloomberg

Following a period of strong relative performance, popular style factors such as Momentum and Low Volatility experienced a sharp reversal in recent weeks as investors aggressively shifted portfolios to less expensive areas of the market. While such reversals are difficult to time, the episode is a good reminder that reversion to the mean is alive and well in the markets (even as more and more money shifts to passive management). Nonetheless, in an environment of low interest rates and sluggish economic growth, the Value factor is unlikely to enjoy a sustained rally absent a pickup in the more cyclical areas of the economy. More importantly, investors would do well to remember that what really matters is price relative to intrinsic value, and that labels such as 'low volatility' don't necessarily assure low risk.

Tightening Yield Spreads



Source: Bloomberg

Investment Grade and Below Investment Grade (aka High Yield or Junk) are the two main classifications of credit quality within the fixed income markets. While investors are correct to assume High Yield bonds pay more income than Investment Grade, the yield difference between the two can occasionally narrow to extreme levels (likely indicative of a market dislocation). Currently, the difference in yield between the lowest rung of Investment Grade corporate bonds (rated BBB) and the highest level of High Yield corporates (rated BB) is just 60 basis points (0.60%), which is the lowest differential in a decade. Historically, when spread relationships between these two bond categories become unattractive, both markets recalibrate by widening back towards the average spread difference. While both areas of fixed income have been rising in value, investors are not being compensated to go down in quality for BBs as much as they have been previously.

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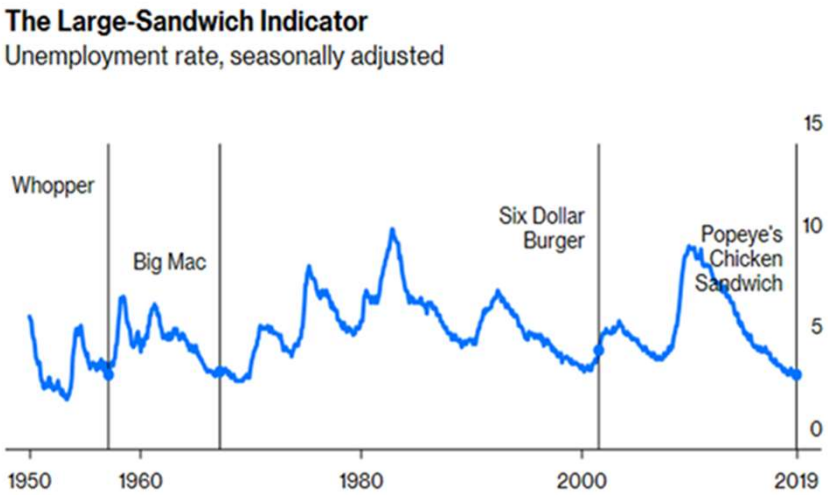
Investing 101: Owners vs. Loaners

Stocks	vs.	Bonds
An equity instrument representing an ownership stake in a company	**Meaning**	A debt instrument with a promise to pay back the principal amount plus interest
Unlimited	**Return Potential**	Limited
Price appreciation & dividends	**Sources of Return**	Interest payments
Relatively high	**Level of Risk**	Relatively low
Business Risk, Market Risk	**Sources of Risk**	Interest Rate Risk, Inflation Risk
Participate in company growth	**Other**	Preferential treatment in event of bankrupcy

Source: Harbour Capital Advisors

The Power of the Premium Sandwich



Source: Bloomberg, Bureau of Labor Statistics

Though understanding the difference between stocks and bonds is an elementary investment concept, it's never too early or late to build (or dust off) a base of financial knowledge. Stocks can be thought of as an ownership stake in a company, entitling stockholders to an ongoing interest in company profits (e.g. dividend payments). Growth in profits is the most important long-term driver of stock prices. Conversely, bond investments are a form of loaning money to companies. The principal loan amount is paid back over a predetermined timeframe, along with interest (similar to a bank loaning money to a consumer to purchase a home). Because these two instruments have different compositions, their risk and reward profiles are unique. Stocks tend to be riskier and hence, generate higher returns (and losses). Bonds tend to hold up better when times get tough, providing some defense within a portfolio. Stocks and bonds each have their role to play within a portfolio, which is why the intelligent investor will hold both.

America loves to eat out, especially when the economy is strong. With low unemployment rates and rising wages, consumers don't mind spending a few extra dollars dining at nicer sit-down restaurants. During such times, traffic tends to slow within the more value-oriented fast-food industry. In response, they tend to role out premium menu items as a means to discretely raise prices and in turn, boost margins. The latest example of this activity is Popeye's new chicken sandwich. Although historical data is a bit murky, some studies suggest that such premium sandwich releases may serve as a leading indicator of unemployment. To play along with the large-sandwich indicator, if unemployment were to unexpectedly rise, we shouldn't be surprised if some spiced up consumers point a finger at Popeye's!

Contact: If you have any questions or comments, please do not hesitate to contact us at 703.992.6164. For more information about Harbour Capital Advisors, please visit our website at www.harbourcapitaladvisors.com.

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