M I D D L E T O N & C O M P A N Y, I N C.

Investment Update

October, 2015

2015 Third Quarter Update

Review: World equity markets fell in the quarter as investors worried that weak economic growth in emerging markets, particularly China, would affect developed markets. Uncertainty about when the Fed will begin raising interest rates also rattled markets. U.S. equities were the best relative performers, down 6.4% for the quarter. International equity markets had a tougher quarter. EAFE and Emerging Markets fell 10.2% and 17.9%, respectively. Investment grade bonds, viewed as a safe haven, rose 1.2%.

Period	3Q15	2Q15	1Q15	YTD
S&P 500	*-6.4%*	*0.3%*	*0.9%*	*-5.2%*
EAFE*	*-10.2%*	*-0.4%*	*4.9%*	*-5.3%*
Emerging Markets	*-17.9%*	*-0.2%*	*2.4%*	*-15.5%*
Barclays U.S. Aggregate Bond	*1.2%*	*-1.7%*	*1.6%*	*1.1%*

*Europe, Australia, Far East   Note: All indices are $ returns

Domestic Economy: Economic growth in the second quarter was strong as evidenced by the 3.9% increase in GDP. However a closer look at the details reveals that there are diverging trends in the economy. Consumption, which accounts for two thirds of GDP, continues at a healthy pace. Consumer spending was up 3.2% in August despite lower gasoline prices as shown by the chart below. Auto sales are at a ten-year high and housing continues to improve. Although growth has moderated, the job market is still improving, mostly due to demand in the services industries.

Real Consumer Spending (% change y/y)

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Manufacturing, however, which accounts for 19% of GDP, is decelerating. The decline in spending in the capital-intensive energy industry is one reason for the weakness. Lower demand in slowing emerging markets is another.

We expect that continuing health in consumer spending will offset sluggish manufacturing, supporting moderate GDP growth of about 2.5% for the year. The risks to our forecast relate more to the health of the global economy than the US.

International Economies: The outlook for the global economy is more mixed. As the Greek crisis has faded from view, the European economic outlook has improved. Retail sales across the major countries are improving at a 2-3% annual rate. The Japanese economy is barely growing, but observers expect the Bank of Japan to provide additional stimulus. The outlook for emerging economies is guarded. While there are still excesses to be worked through, there are glimmers of improvement in China. Real retail sales increased at an 8% annual rate in August. However, other emerging economies, such as Russia and Brazil, which are dependent on commodities, are unlikely to resume growing for some time. In summary, a period of slow growth is ahead for the global economy with some risk that weakness in the emerging economies could drag down the US economy.

Strategy: We expect continued economic growth but are poised to turn more defensive in our stock selection should growth disappoint. Even if that is the case, we believe that U.S. equities will provide the best return opportunities over the coming year. While S&P 500 earnings will be flat this year, mainly due to a decline in energy earnings, we expect 5-6% earnings growth next year as economic growth continues and energy companies stabilize. With corporate cash flows strong, except for energy companies, we expect stock buy backs and dividend increases to continue. The consumer-led recovery appears to be durable and should continue for several years. We anticipate that the Fed will begin to raise interest rates in the coming months, causing bond prices to decline.