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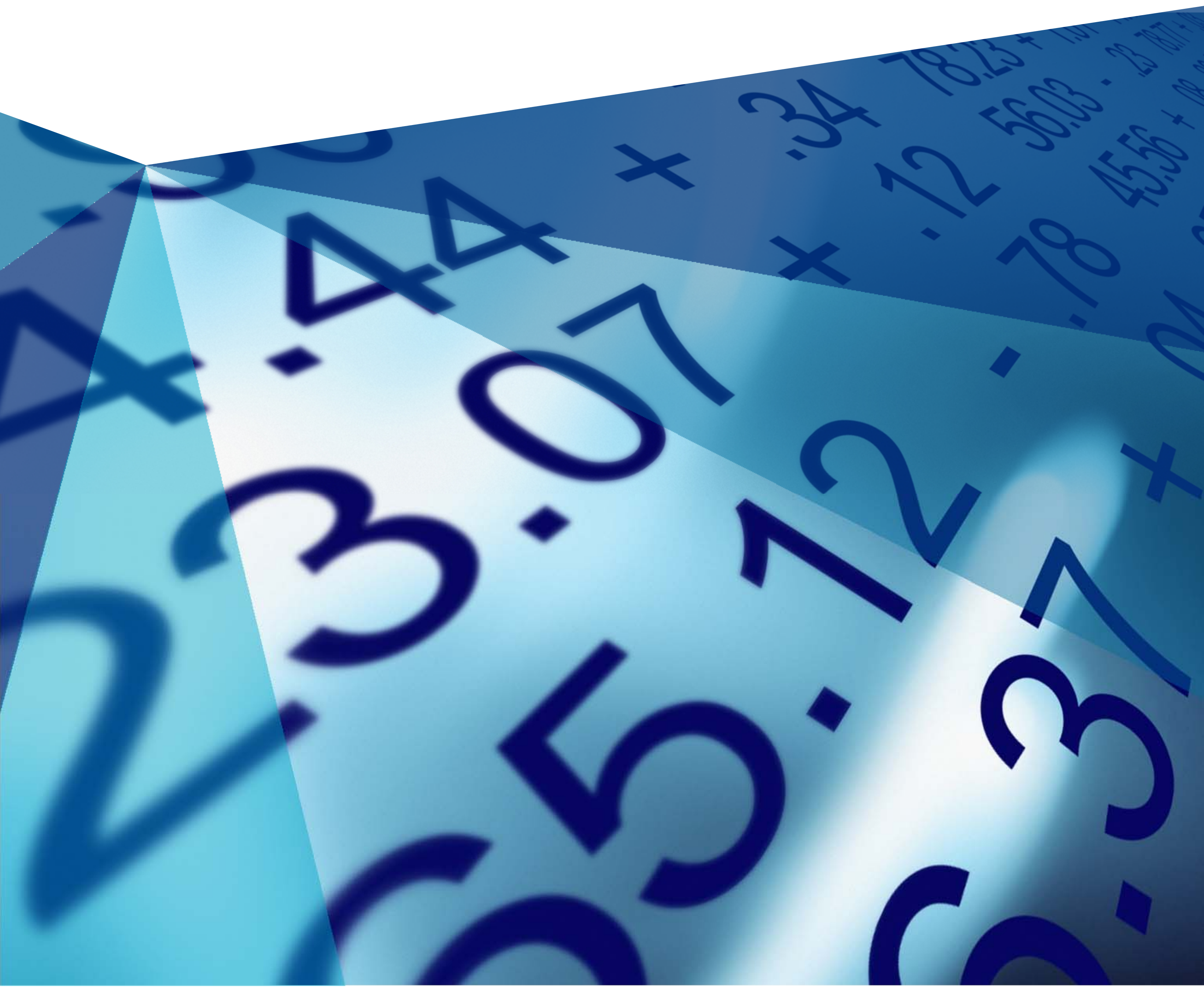
US PERSPECTIVE ON MARKET ASSUMPTIONS AND DYNAMIC ASSET ALLOCATION OUTLOOK

FOURTH QUARTER 2014



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Macro Market Environment

The global growth outlook weakened marginally during the third quarter, and recent market action suggests renewed deflationary fears. While growth in the US and UK is healthy, growth in the Eurozone and Japan is faltering. Despite the slowdown, the global economy is still growing at a moderate pace. Recent statements by Fed officials suggest that the FOMC still believes that inflation risks are contained and that further job growth is needed to reduce slack, suggesting that the Fed will be slow to normalize policy.

Capital Market Assumptions

The yield curve flattened modestly during the 3rd quarter. The yield on the 5-year Treasury increased, while the 30-year Treasury yield declined. This led to a decrease in expected returns for long government bonds. Shorter maturity fixed income returns were relatively unchanged. Credit spreads widened, particularly for lower quality asset classes. The option adjusted spread (OAS) on high yield bonds widened, which increased expected returns. The OAS on investment-grade corporate bonds moved up by a more muted.

20-YEAR ASSUMPTION GEOMETRIC RETURN			
Asset Class	Equil Return[1] 09/30/2014	Current 09/30/2014	Previous 06/30/2014
Global Developed Equities	8.1%	7.6%	7.5%
US Equities	7.9%	6.7%	6.6%
International Developed Equities	8.1%	7.8%	7.8%
Emerging Market Equities	8.8%	9.3%	9.1%
Global REITS	6.7%	6.7%	6.7%
US Treasuries	4.7%	3.6%	3.6%
US TIPS	4.7%	3.7%	3.6%
US I/G Corp	5.9%	4.7%	4.7%
US High Yield Bonds	6.6%	5.3%	5.0%
Non-US Gov't bonds	4.2%	3.5%	3.4%
Emerging Debt Hard Currency	7.5%	5.8%	6.1%
Emerging Debt Local Currency	5.4%	6.8%	6.0%

1) Equilibrium geometric nominal expected return; assumes inflation of 2.5%.

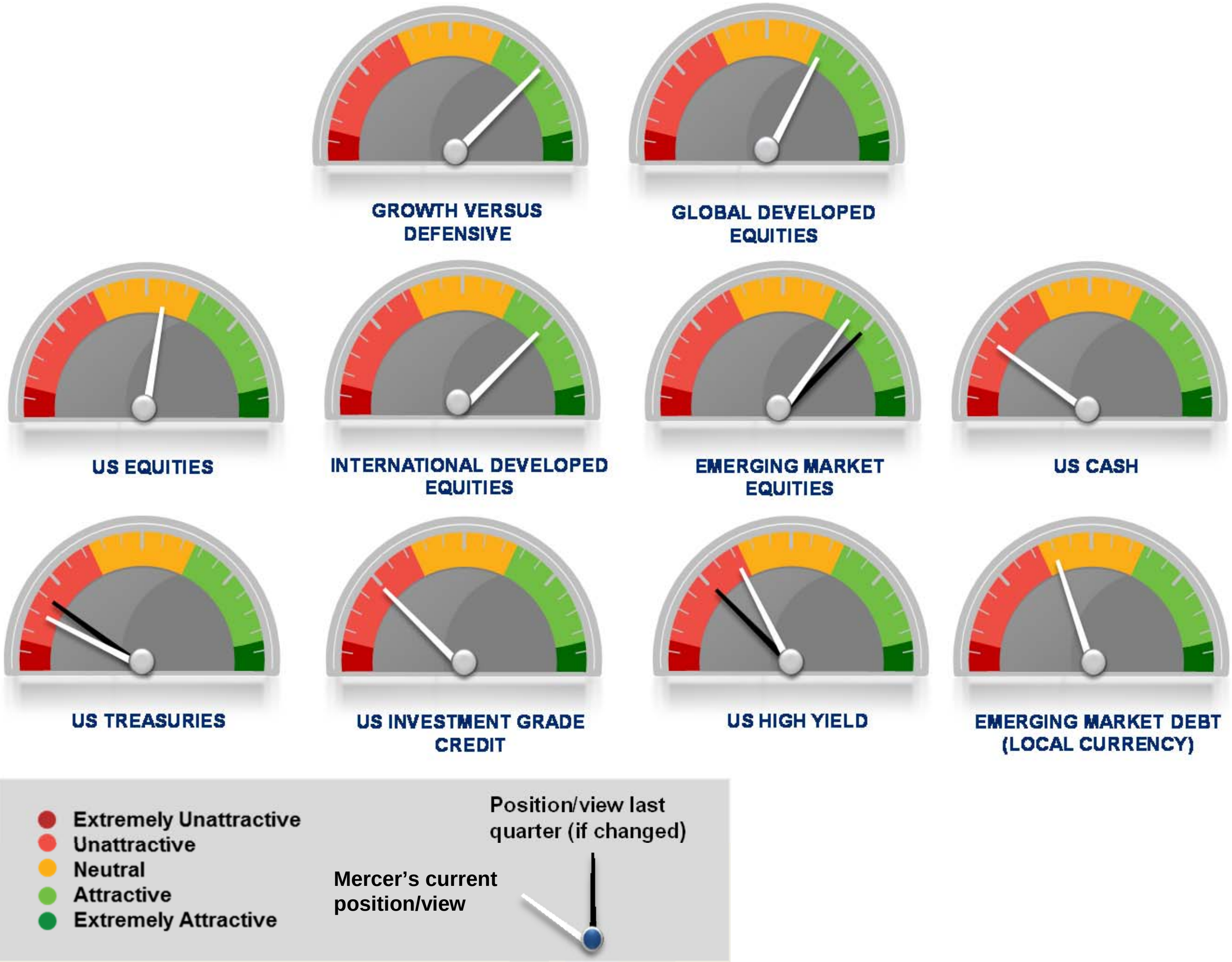
Global equity markets were weak during the third quarter due largely to a stronger dollar. The MSCI ACWI index fell during the quarter, but rose in local currency terms. Valuations were mostly flat on broad indexes, while the poor performance of small-caps pushed their valuations lower during the quarter. Long-term return expectations for equity asset classes were unchanged to slightly higher.

Across emerging markets (EM), we incorporated revised World Bank purchasing power (PPP) estimates for currencies. This resulted in an improvement in currency performance for EM asset classes. For EM equities, incorporating revised PPP estimates increased expected USD returns, although this was partially offset by a reduction in the equilibrium P/E ratio. In aggregate, EM equity return expectations increased. For EM local currency debt, the revised PPP estimates also increased USD returns.

Dynamic Asset Allocation Market Views

- While the outlook for global growth has weakened somewhat of late, growth is still expected to be fairly healthy in 2015, which should be supportive of earnings, and the probability of a global recession appears low. The potential for rate hikes from the Fed in 2015 is likely to lead to higher market volatility, but we still consider monetary policy to be supportive of equities and other risky assets. Furthermore, the ECB and Bank of Japan are likely to ease further.
- The prospective returns on equities remain attractive relative to bonds, particularly overseas. As such, we continue to favor growth assets relative to defensive assets. Short-term turmoil provides long-term investors with an opportunity to bolster equity allocations at more attractive prices.
- The dollar surged during the third quarter, and this is likely to continue. The dollar has advantages over the intermediate-term given the prospects for relatively tight monetary policy and higher economic growth in the US.
- In recent years, weak economic and earnings growth have hurt international developed stocks. Looking forward, international equities have the potential to improve margins, especially with dollar strength. Coupled with more attractive valuations, international equities have upside potential relative to the US. Continued dollar appreciation, however, is a risk for $US investors. This risk can be mitigated through hedging.
- We continue to rate emerging market equities as attractive for the intermediate-term, although short-term outlook is clouded by macro pressures, including weakening Chinese growth, falling commodity prices and Fed policy.
- The further tightening of the labor market in the US will limit the extent to which the Fed is able to defer its first rate hike. Markets are now expecting an increase of just over 25 bps by the end of 2015, which is inconsistent with the steady absorption of excess capacity. In our view, Treasury yields are pricing an overly dovish Fed.
- Given current spreads, we maintain a preference for credit over Treasuries. High yield spreads rose significantly during the quarter and now provide a healthy premium given the benign default outlook.

US DYNAMIC ASSET ALLOCATION DASHBOARD – FOURTH QUARTER 2014



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This document summarizes our views on the market outlook and valuations over a medium-term horizon. We have included views for core asset classes relative to Mercer's equilibrium expectations. We also provide relative valuation views for a number of asset class pairs and styles. Except where otherwise noted, these views are based on conditions as of November 2014. We do not expect clients to make frequent tactical changes to their asset allocation based upon these views. They are provided for discussion purposes and do not provide any assurance or guarantee of future market returns.

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