May Observations on Markets & Volatility

Mixed markets

Comments from Lincoln Investment Advisors Corporation, a division of The Lincoln National Life Insurance Company, regarding trends and themes in market results for May 2015.

May in review

Global capital markets were on the seesaw during the month as U.S. stocks rallied while developed international equities and fixed income sold off. The enduring Greece situation and U.S. interest rate uncertainty crippled investor confidence as the economic recovery became less clear.

- U.S. equity markets continued to add to decent 2015 gains:
  - The S&P 500 increased 1.29% and the DJIA was up 0.95%.
  - The advance was nearly uniform across core, growth, and value stock indexes (Russell 1000 Index: 1.31%; Russell 1000 Growth Index: 1.41%; Russell 1000 Value Index: 1.20%).
  - Small capitalization stocks bounced back after a rough April as the Russell 2000 rose 2.28% during May, leaving YTD returns at nearly 4%.
- U.S. equity sector performance was largely positive during the month despite some dark spots:
  - The largest rallies came from Health Care and Information Technology at 4.53% and 2.31%, respectively.
  - Energy and Telecommunication Services were the laggards as investors pulled assets from these sectors. They lost −4.76% and −1.77%, respectively.
- International capital markets witnessed a broad-based sell-off as investors protected their chips:
  - The EURO STOXX Index was down −1.66%, and the MSCI EAFE Index lost −0.51% during May.
  - Emerging Market equity and debt markets moved in lockstep during the month, and both disappointed investors during the month (MSCI EM Equity Index: −4.00%; JPM EMBI Plus: −0.51%).
- The bond markets were mixed for the month as short-term notes outperformed longer-dated paper (BofAML US Treasuries 3–5yr Index: 0.11%; BofAML US Treasuries 10+yr Index: −1.53%);
  - The 10 Yr. Treasury yield ended the month at 2.13%, up slightly from 2.03% at April’s close.
  - The BarCap US Agg Bond Index slipped into negative territory for the second consecutive month, shedding −0.24%.
  - In their pursuit of higher yields, investors continued to flock to High Yield (BofAML US HY Master II Constrained Index: 0.29%).
  - Income-producing asset classes like domestic and global real estate were penalized by investors as bond yields moved up (FTSE NAREIT Equity REITs Index: −0.22%; FTSE EPRA/NAREIT Dvlp Index: −1.41%).
  - Gold bulls gave back some of their gains from earlier in the year, with the precious commodity losing −3.49% during the month. It closed the month at $1,190/oz

Other big news

Newsworthy items that led investors to greener pastures included:

- May’s employment report showed sustained improvement.
- European Central Bank (ECB) leaders hinted at an increase in bond purchases if inflation data continues to lag.
- Housing data was sturdy as the Case-Shiller Home Price Index, and pending home sales improved month over month.
- M & A activity and announced stock buyback plans provided support for U.S. stocks.

Headlines that shook investor resolve included:

- First quarter GDP data disappointed investors due to another brutal winter and strong U.S. dollar.
- Consumer spending continues to disappoint measured by another flat monthly retail sales data point.
- Durable goods orders posted a red figure of −0.5%.
- The People’s Bank of China lowered its key benchmark rate for the third time in six months.

Volatility perspective

- In the face of the S&P 500 Index rally, the CBOE’s Market Volatility Index (VIX) dropped -4.88% during May.
- Grounds for investor concern in the short term include:
  - Fed’s rate hike agenda
  - Potential Greek exit from Eurozone
  - Quantitative easing slip-up from global central banks
  - Frothy equity and bond valuations
May 2015 market performance*

<table>
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<tr>
<th>Name</th>
<th>Total Ret 1 Mo</th>
<th>Total Ret 3 Mo</th>
<th>Total Ret YTD</th>
<th>Total Ret Annlzd 1 Yr</th>
<th>Total Ret Annlzd 3 Yr</th>
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<th>Risk Currency Std Dev 3 Yr</th>
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<tr>
<td>Dom &amp; Global Real Estate</td>
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<td>0.13</td>
<td>0.77</td>
<td>1.24</td>
<td>1.14</td>
<td>0.80</td>
<td>0.59</td>
<td>0.44</td>
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<tr>
<td>Dom &amp; Global Real Estate</td>
<td>FTSE EPRA/NAREIT De hits TR USD</td>
<td>-0.41</td>
<td>-0.30</td>
<td>-0.18</td>
<td>0.59</td>
<td>1.13</td>
<td>1.26</td>
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<td>0.82</td>
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<td>0.80</td>
<td>0.59</td>
<td>0.44</td>
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<tr>
<td>Commodity/ Materials, etc.</td>
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<td>1.14</td>
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<td>0.59</td>
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*Returns and standard deviation values are as of month-end May 2015.

Index definitions

Indices are unmanaged and unavailable for direct investment. Past performance does not indicate future results. Standard deviation is a statistical measure of the historical volatility of an investment.

Bank of America Merrill Lynch 1–3 Year Treasury Index generally tracks the market for U.S. Treasury securities with maturities of one to three years. Bank of America Merrill Lynch 3–5 Year Treasury Index generally tracks the market for U.S. Treasury securities with maturities of three to five years. Bank of America Merrill Lynch 5–10 Year Treasury Index generally tracks the market for U.S. Treasury securities with maturities of five to ten years.

Bank of America Merrill Lynch 10+ Year Treasury Index generally tracks the market for U.S. Treasury securities with maturities of 10 or more years.

Bank of America Merrill Lynch U.S. High Yield Master II Constrained Index is an unmanaged market value-weighted index of high yield bonds, including deferred interest bonds and payment-in-kind securities. Issues included in the index have maturities of one year or more and have a credit rating lower than BBB-/Baa3, but are not in default.

Barclays Capital Global Aggregate Bond Index covers the most liquid portion of the global investment-grade fixed-rate bond market, including government, credit and collateralized securities.
Barclays Capital U.S. Aggregate Bond Index measures the performance of high-quality, fixed-income securities across the government, corporate, mortgage-backed, asset-backed, and commercial mortgage-backed markets.

Barclays Capital U.S. Government/Credit Index measures the performance of U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year.

Barclays Capital U.S. Long Government/Credit Bond Index measures the performance of all medium and larger public issues of U.S. Treasury, agency, investment-grade corporate, and investment-grade international dollar-denominated bonds with maturities longer than 10 years.

Barclays Capital U.S. Treasury Inflation-Protected Securities (TIPS) Index measures the total return performance of the market for inflation-protected securities issued by the U.S. Treasury.

Bloomberg Commodity Index is a broadly diversified index composed of futures contracts on physical commodities.

Chicago Purchasing Managers Index (PMI) is released monthly and indicates the level of regional manufacturing activity. The index includes data on production, new orders, order backlog, inventories, prices paid, employment, and supplier deliveries.

Citigroup Treasury Bill 3-month Index is an unmanaged index of three-month Treasury bills.


Citigroup U.S. Broad Investment Grade Bond Index, 10+ Years measures the performance of U.S. dollar-denominated bonds issued in the U.S. investment-grade bond market. The USBIG includes institutionally traded U.S. Treasury, government-sponsored (U.S. agency and supranational), mortgage, asset-backed, and investment-grade securities with at least 10 years to maturity.

Citigroup World Government Bond Non-U.S. Dollar Index is a market capitalization-weighted benchmark that tracks the performance of 23 world government bond markets.

Dow Jones EURO STOXX® Index represents large, mid, and small capitalization companies of 12 eurozone countries: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain.

Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange.

Dow Jones Industrial Average includes 100 of the largest domestic and international nonfinancial securities listed on The Nasdaq Stock Market based on market capitalization.

FTSE EPRA/NAREIT Developed Index (formerly named FTSE EPRA/NAREIT Global Real Estate Index) is a global market capitalization-weighted index composed of listed real estate securities in the North American, European, and Asian real estate markets.

HSBC Flash Manufacturing PMI is an estimate of the Manufacturing Purchasing Managers' Index for a country based on a monthly survey of variables such as output, new orders and prices across the manufacturing, construction, retail and service sectors.

J.P. Morgan Emerging Markets Bond Index Plus tracks total returns for traded external debt instruments in the emerging markets. The instruments include external currency-denominated Brady bonds, loans, and eurobonds, as well as U.S. dollar local markets instruments.

J.P. Morgan Government Bond Index (GBII) Global Traded measures the total return from investing in 13 developed government bond markets: Australia, Belgium, Canada, Denmark, France, Germany, Italy, Japan, the Netherlands, Spain, Sweden, UK, and the U.S.

MSCI EAFE Index measures the equity market performance of 21 developed market country indices located in Europe, Australasia, and the Far East. MSCI EAFE Value Index measures the equity market performance of 21 developed market country indices located in Europe, Australasia, and the Far East. Total returns for periods longer than one year are expressed in terms of compounded average annual returns (also known as geometric total returns), affording a more meaningful picture of fund performance than nonannualized figures.

MSCI Emerging Markets Index measures the equity market performance of 23 emerging market country indices located around the world.

MSCI U.S. Prime Market 750 Index represents the universe of large and medium capitalization companies in the U.S. equity market.

MSCI U.S. Small Cap 1750 Index represents the universe of small capitalization companies in the U.S. equity market.

NASDAQ-100 Index includes 100 of the largest domestic and international nonfinancial securities listed on The Nasdaq Stock Market based on market capitalization.
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