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QUARTERLY

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GLOBAL EARNINGS UPDATE

Introduction

Equity markets have produced very attractive returns in recent years, especially in the United States. This positive performance leads some investors to believe that a correction is imminent. We believe that a deeper analysis is needed to determine if current equity prices are justified.

In this *Quarterly*, we review the relationship between economic growth and earnings, and present our analysis of the current state of earnings as they relate to long-term historical trends and current market prices.

Earnings and Economic Growth

Figure 1 shows the annual real economic growth rates for the United States, Core Europe (EMU), and a market weighted average of the eight largest countries in the MSCI Emerging Markets Equity index (Emerging). The figure illustrates that patterns of recovery and expansion after the 2008 recession have been quite uneven. The US has had relatively stable post-recession improvement. Emerging market growth has stayed above most developed countries but has decelerated in recent years. Europe dipped back into recession in 2012 due to the effects of the debt crisis and resulting fiscal austerity, but was able to get back to slightly positive real growth in 2013.

We believe that measures of economic activity are extremely important to equity valuations because the goods and services that are purchased by consumers, businesses, and governments directly impact corporate earnings. This relationship can be observed by comparing nominal GDP growth with broad earnings growth. In the United States, both nominal GDP and adjusted corporate profits have grown by a compounded annual rate of roughly 7% since the end of World War II. We have used this relationship in past research reports to illustrate the long-term link between earnings and economic growth.

Although measures of domestic economic growth are most relevant for a country's equity market, globalization has led to an increase in the exposure of corporations to international conditions. Figure 2 illustrates this point by comparing the global sales of automobiles for three major manufacturers from different countries. In all three examples, the domestic region is the largest market for the manufacturer, but more than half of unit sales occur outside of the companies' home region.

US Economic and Earnings Developments

The relationship between

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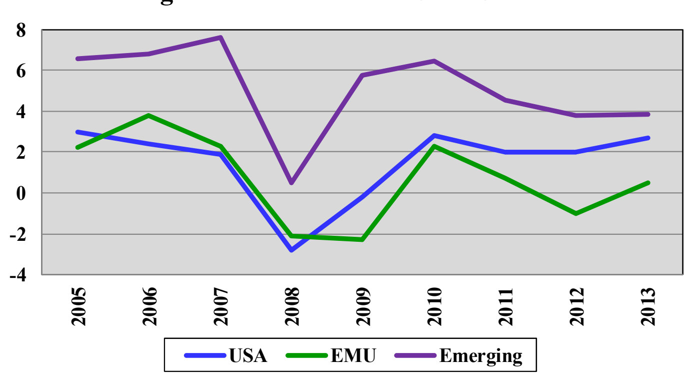
Strategy

- *We reduced our exposure to high-yield bonds during the fourth quarter.*
- *Portfolios are currently overweight foreign equity exposure and broadly underweight bond exposure.*

Figure 1 - Annual Real GDP Growth

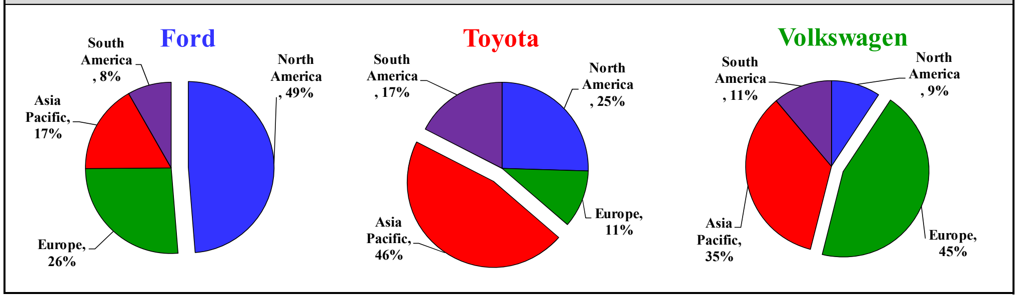


Sources: Bloomberg, MSCI, Stairway Partners

GLOBAL EARNINGS UPDATE - CONT'D

"In all three examples, the domestic region is the largest market for the manufacturer, but more than half of unit sales occur outside of the companies' home region"

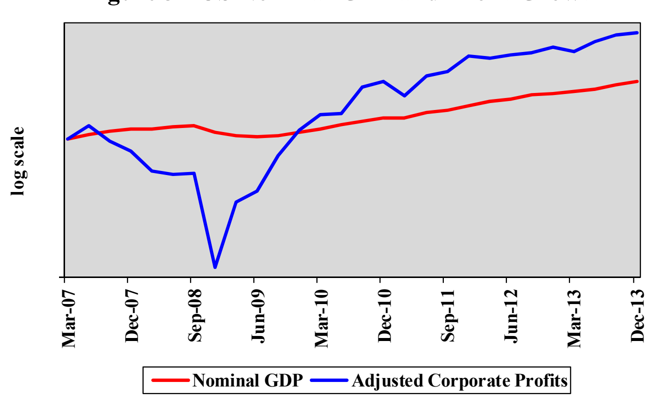
Figure 2 - 2012 Automobile Unit Sales by Region



economic growth and earnings has also been evident in the United States, where the recovery and expansion of the US economy has led to a steady increase in earnings since the end of the last recession. This can be observed in Figure 3, which shows the adjusted US corporate profit growth relative to the nominal growth of the US economy. As is almost always the case, the changes in corporate profits were more extreme than the changes in economic activity.

Although the expansion in corporate earnings in the United States is broadly supported by an expanding economy, earnings for the companies in the S&P 500 and the MSCI USA equity indices are running modestly higher than our long-term trend estimates. As a result, we believe that the rate of earnings growth for US companies is likely to slow in the coming quarters.

Figure 3 - US Nominal GDP and Profit Growth



European Earnings Update

Unlike the United States, earnings for European companies have been contracting since the middle of 2011. This is consistent with the lack of economic growth for the region, which was shown in Figure 1. Figure 4 shows the current earnings for the companies in the MSCI EMU index as they compare to our long-term trend estimates. One of the reasons that we believe European equities will be strong performers going forward is our view that earnings should improve dramatically in the coming quarters as economic growth returns to the region and the lingering effects of the European debt crisis continue to fade.

Emerging Markets Update

The pattern in the growth rates for the earnings of companies domiciled in emerging markets (EM) has been somewhere between the relatively good performance of US companies and the poor performance of European companies.

Before discussing the broad performance of EM equities, it is important to recognize the diversity within the category. All broad equity market indices contain companies that participate in very different types of businesses, from manufacturing to services, and domestically focused to international. However, companies within the US or EMU indices are domiciled within one geographic region and share a common currency. This is not the case for emerging markets. As a result, it is more difficult to observe economic trends for real economic growth and inflation that exist for the broad category of markets. In addition to the diversity of geographic location and currency, there can also be significant issues with the quality of reported data for less developed countries. In order to monitor the economies that broadly represent the emerging markets, we use a weighted average of the eight largest markets in the MSCI Emerging Markets equity index. The countries are weighted so that the regional economic exposure matches the market exposure of the equity index. Specifically, we use China, Korea, Taiwan and India to represent Asia, Brazil and Mexico to represent Latin America, and

(Continued on page 3)

Sources: Ford, Volkswagon and Toyota 2012 annual reports, Burough of Labor Statistics

About Stairway Partners, LLC

Stairway Partners was formed to provide ourselves and our clients with an effective and comprehensive solution for managing wealth, over the long-term. Our disciplined and rigorous approach comes from our collective knowledge in serving large institutional clients over many years.

Our core investment belief is that asset allocation is the single most important determinant of success in any investment plan. The dominant amount of risk and return comes not from your choice of individual investments but from your asset class mix. Stairway Partners focuses our resources on risk management and asset allocation. All of our portfolios utilize customized investment policies to align portfolio objectives with our investment strategy utilizing the global capital markets.

Figure 4 - EMU Earnings

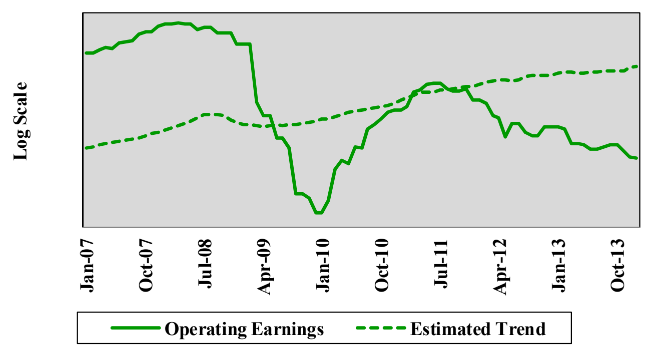
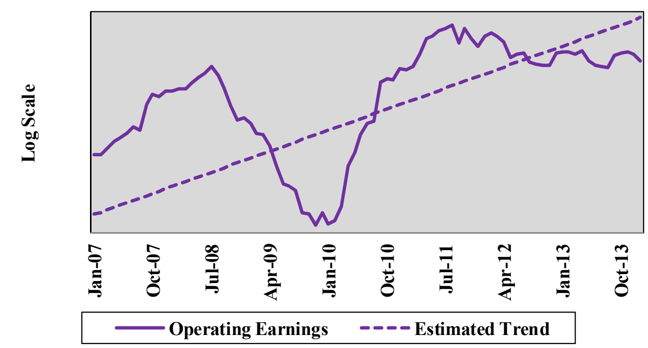


Figure 5 - Emerging Markets Earnings



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South Africa and Russia to represent Europe, the Middle East and Africa (EMEA).

Figure 5 shows that like Europe, EM earnings have been broadly declining since the middle of 2011. However, their rate of contraction has been less extreme and they benefitted from a more robust recovery after the last recession. The result is that the current level of earnings is only modestly lower than our long-term trend estimates. Consequently, we believe that companies in the EM index are likely to experience modestly above-trend growth in earnings in the coming quarters, as Europe recovers and broad global economic growth continues.

Figure 6 - Global Equity P/E Ratios

	Current Values: Most Recent	Current Values: Trend	Average
USA	**18.6**	**20.1**	**20.5**
Growth	22.4	23.2	25.1
Value	15.7	17.2	18.2
EMU	**19.2**	**12.5**	**18.6**
Emerging	**11.8**	**11.8**	**15.6**

Sources: MSCI, Bloomberg, Stairway Partners

Conclusion

Although we believe that earnings are the primary determinant of equity value over time, market prices also play an important role in determining the returns that investors can expect in the future. The last page of this publication contains our return expectations for global equity and bond markets. These expected returns are based on discounted cash-flow models, which explicitly account for current market prices, anticipated future earnings, dividends, market interest rates and risk premiums. Our expected return forecasts are at the heart of our asset allocation process and are used to set strategy across all of the portfolios that we manage.

Another valuation metric for equities, which includes some of the same factors used in our valuation framework, is the P/E ratio. Although we believe a discounted cash-flow model is a superior tool, the more simplistic P/E ratio provides a useful and intuitive measure of current market pricing relative to historical norms. The table in Figure 6 shows how P/E ratios calculated using current reported earnings and our trend earnings estimates compare to the average P/E ratios for the selected markets. The trend-based P/E ratios are broadly in line with our discounted cash-flow models and support our view that European and emerging market equities are attractively priced and should produce positive returns in the coming quarters.

3 Year Annualized Return Estimates for Global Markets

2/24/2014	Total Returns			After-Tax Total Returns		
	Expected	Hurdle	Excess	Expected	Hurdle	Excess
Equities						
United States	**0.1%**	**5.1%**	**-5.0%**	**0.1%**	**4.5%**	**-4.4%**
Large & Mid Cap	**0.8%**	**5.0%**	**-4.2%**	**0.6%**	**4.4%**	**-3.8%**
Growth	-0.2%	5.3%	-5.4%	-0.1%	4.6%	-4.7%
Value	1.8%	4.8%	-3.0%	1.4%	4.2%	-2.8%
Small Cap	**-3.7%**	**5.7%**	**-9.4%**	**-2.8%**	**5.0%**	**-7.8%**
Growth	-5.6%	6.1%	-11.7%	-4.2%	5.5%	-9.7%
Value	-1.7%	5.3%	-7.0%	-1.3%	4.6%	-5.9%
Foreign Developed Markets	**9.3%**	**5.6%**	**3.7%**	**7.1%**	**4.9%**	**2.2%**
EMU	13.2%	5.9%	7.3%	10.1%	5.3%	4.8%
UK	16.4%	5.9%	10.6%	12.5%	5.2%	7.3%
Japan	0.4%	6.0%	-5.5%	0.4%	5.3%	-4.9%
Canada	-2.8%	5.3%	-8.2%	-2.1%	4.7%	-6.8%
Emerging Markets	**25.6%**	**6.8%**	**18.8%**	**19.1%**	**6.1%**	**13.0%**
Fixed Income						
US Aggregate	**-1.3%**	**3.0%**	**-4.3%**	**-1.6%**	**2.4%**	**-4.0%**
US Treasuries						
2 Year	-0.2%	1.8%	-2.1%	-0.6%	1.2%	-1.8%
5 Year	-2.0%	2.3%	-4.3%	-2.0%	1.7%	-3.7%
10 Year	-3.4%	2.8%	-6.3%	-3.2%	2.2%	-5.3%
30 Year	-4.7%	3.0%	-7.6%	-4.1%	2.3%	-6.4%
TIPS						
5 Year	-1.7%	2.4%	-4.1%	-1.7%	1.7%	-3.5%
10 Year	-3.2%	2.9%	-6.1%	-3.0%	2.2%	-5.2%
30 Year	-7.8%	3.2%	-11.0%	-6.3%	2.6%	-8.8%
Municipal	**2.3%**	**2.4%**	**-0.1%**	**2.5%**	**1.7%**	**0.7%**
2 Year	-0.3%	1.8%	-2.1%	0.2%	1.1%	-0.9%
5 Year	-1.3%	2.1%	-3.4%	-0.4%	1.5%	-1.9%
10 Year	0.1%	2.5%	-2.5%	0.8%	1.9%	-1.0%
20 Year	5.6%	2.7%	2.9%	5.2%	2.1%	3.2%
High Yield	**-1.4%**	**3.9%**	**-5.3%**	**-2.2%**	**3.3%**	**-5.4%**
High Quality High Yield	-1.1%	3.1%	-4.3%	-1.9%	2.5%	-4.4%
Emerging Market ($ denomimnated)	**0.2%**	**4.1%**	**-3.9%**	**-0.9%**	**3.5%**	**-4.4%**
Foreign Aggregate	**-2.6%**	**4.5%**	**-7.0%**	**-2.3%**	**3.8%**	**-6.1%**
Foreign Aggregate (hedged)	-2.9%	2.8%	-5.7%	-2.5%	2.1%	-4.6%
Foreign Treasury	**-2.1%**	**4.0%**	**-6.1%**	**-1.9%**	**3.4%**	**-5.3%**
Foreign Treasury (hedged)	-3.1%	2.4%	-5.5%	-2.5%	1.7%	-4.2%
Cash	**1.5%**	**1.5%**	**0.0%**	**0.9%**	**0.9%**	**0.0%**

Notes
1. Foreign market returns assume US dollar as the base currency and are unhedged unless otherwise indicated.
2. All hurdle returns are based on long-term asset volatility. Equity and fixed income hurdle rates include expected cash returns.
3. After-tax total returns assume that all gains and losses are long-term and realized within the investment horizon.
4. After-tax total returns only take into account Federal taxes based on the following tax rates:
   - 43.4% Ordinary Income, 23.8% Qualified Income, 0% Exempt Income, and 23.8% Capital Gains/(Losses)

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