

Market Commentary: June 28, 2016

*A SNAPSHOT OF THE MARKETS
THROUGH THE LENS OF CONVERGEX.*

This presentation is not intended for retail clients.

Stocks retreated further on Monday following the unexpected U.K. referendum result. (Dow -1.50%, NASDAQ -2.41%, S&P 500 -1.81%). Crude-oil futures fell 2.7% to \$46.33 a barrel, and gold futures edged up 0.2% to \$1,322.50 an ounce. Utilities outperformed, while materials trailed the broader market indices. Small-cap stocks declined: Russell 2000 (-3.36%). The VIX dropped 7.41% to 23.85. In economic news, the U.S. advance goods trade deficit widened to \$60.6 billion last month from \$57.5 billion in April. The Markit flash services Purchasing Managers' Index was unchanged at 51.3 in June. Lastly, the Dallas Fed Manufacturing Index came in at minus 18.3 this month compared to minus 20.8 in May.

Marijuana Store Survey and Industry Outlook Q2 2016

Summary: This report marks the 2-year anniversary of our quarterly survey on the legal recreational marijuana market in Colorado. We've picked up a couple more states since then, now covering prices and business developments in Washington and Oregon. We survey numerous stores' managers to track how a new market matures and how its cost structure and product mix evolves. Each state reported downward pressure in pricing, but has seen it steady over the past couple of months. An eighth of retail cannabis in Colorado sells for an average range of \$25 to \$45, but our contacts said they are running more sales of \$25 eighths during the week and \$20 on the weekends. In Washington, we reported the price of a gram dropped to \$10 three months ago; some contacts said it's now as low as \$8. A gram sells for about \$10 to \$15 in Oregon as well. Foot traffic is starting to pick up as we carry forward into summer, as the industry benefits from tourism. As for sales, Colorado stores brought in \$69.4 million during April, setting a monthly record; sales total \$242 million this year thru April. Washington stores garnered \$229.6 million in revenue, and Oregon stores have sold nearly \$60 million. Expect Oregon's figure to jump in the months ahead, as stores can now sell edibles/concentrates/extracts as of this month. Bottom line, Colorado and Washington posted double digit growth in sales relative to 2015 every month of this year. Make no mistake, this is a fast growing industry with massive upside potential with as many as nine states possibly voting on marijuana-related measures this fall. Including California...

Note from Nick: We can't be "All Brexit, all the time" so today we bring to you Jessica's quarterly note on the state of the U.S. marijuana business. Simply put, it is going gangbusters. Read on for the details...

As of July 1st, you can't buy one of retail marijuana stores' top selling products in Colorado: gummy bears. Or gummy worms or chewy candies in the shape of animals or fruits for that matter. Governor Hickenlooper recently signed a bill into law that bans marijuana-infused edibles in shapes attractive to children.

We've conducted a quarterly survey on the recreational marijuana industry in Colorado for two years now, and one of our main contacts said gummies outsell all his store's other products. He doesn't see this change as "too big of a deal," however, as

vendors can make gummies that aren't in kid friendly shapes. So how are cannabusinesses faring in Colorado these days? Here's a breakdown of our usual price/units/product mix analysis:

#1 – Price: Stores can still sell an ounce of recreational cannabis for an average range of \$150 to \$350, and an eighth for \$25 to \$45. Our contacts said they continue to experience price drops, however, due to more competition and as bigger companies put pressure on smaller stores by cutting prices. Some respondents said the lowest they've seen larger players reduce the price of an ounce was to \$100. Most stores run discounts, and our contacts said they have been selling more eighths for \$25 during the week, and even \$20 on the weekends. They don't forecast prices falling too much further. One store said a full price eighth is still \$40, but wouldn't be surprised if it declines to \$30 within the next six months or year.

#2 – Units/Traffic: The average transaction size has dropped slightly to about \$40 to \$50 dollars from \$50 to \$60. One store has successfully brought transaction sizes back up by prepackaging flower in eighths for some strains, rather than just half eighths to encourage customers to buy in larger quantities. Around 150 to 350 customers still visit our contacts' stores each day, although some report there was greater foot traffic six months ago than the past three. This has to do with the time of year, as stores are busiest during the winter and summer since tourists make up about 50% of their customer base. One store even said the trend is moving towards more tourists, speculating that a greater number of locals may have decided to grow their own. All in all, respondents expect a bump in customers as students come back from college.

Stores are also gearing up for July 4th by planning some specials like a buy one edible get another half off sale. Our contacts typically experience an uptick in sales around holidays. July 4th falls on a Monday, so they expect customers to stock up on the prior Friday and Saturday. The biggest day of the year is always on April 20th, the so-called national holiday for marijuana. One of the largest festivals for the day relocated to California this year, but it didn't stop stores from besting last year's sales figures. Dispensaries were eager to beat last year's comp and they did. Not only did our contacts say they outpaced sales from the previous year, but MarketWatch reported retail sales jumped 53% year over year to \$7.3 million on April 20th according to BDS Analytics. Another plus, our contacts said they have been better prepared to deal with such high volumes due to learning from their experiences last year.

#3 – Mix: Our contacts still report a 50/50 split between flower and edibles/concentrates/accessories. They said numerous vendors continue to ask them to try out new products like concentrates or cartridges. The influx of vendors also puts downward pressure on wholesale prices, which contributes to lower prices at their stores. Overall, concentrates and cartridges are still the hottest products growing in popularity due to their discretion and ease of use.

In short, we'll let the numbers do the talking on the success of the marijuana industry in Colorado. Stores brought in \$69.4 million from recreational sales just in April, based on tax data from the Colorado Department of Revenue. That's up 58.2% y/y and marks a monthly sales record since stores first started selling retail cannabis in January 2014. Dispensaries have already generated \$242 million in retail sales from January thru April (latest available data), almost half the sales garnered in 2015 (\$575.8 million) in just the first four months of this year.

So how are the economic and business developments shaping up in Washington and Oregon? Here's the scoop:

- **Prices in Washington and Oregon abated slightly, down to an average range of \$25 to \$50 for an eighth from \$25 to**

\$60 three months ago. Prices continued to contract especially for grams. A gram of recreational cannabis sells for an average of \$10 to \$15, but some stores said it now sells for as low as \$8. One Washington contact said "it used to be a \$10 gram market," but over the past three months it's now "an \$8 a gram market." He also said his store is reluctant to raise prices due to the hefty sales tax of 37% on recreational cannabis. These stores run daily and weekly discounts just like in Colorado, such as "take \$4.20 off an 1/8th or more of the strain of the day!"

In regards to Washington, medical growers and stores are not currently licensed or regulated, unlike the retail market. They will merge on July 1st, in which only recreational stores licensed under I-502 can remain in operation. Those who want products intended for medical use can buy them at retail stores that are medically endorsed. The Washington State Liquor and Cannabis Board (WSLCB) raised the retail store cap of 334 to 556 for the merger, but medical marijuana stores that don't receive a license will have to shut down. Our contacts are generally happy about the merger as they are licensed and would appreciate more defined regulations. We asked the WSLCB what this would mean for prices. They said prices would likely continue to drop as there will still be plenty of licensed stores in operation and more will open; licensed stores will continue to compete against each other with their retail products as opposed to the medicinal products sold by unlicensed stores.

- **Average transaction sizes for both states are similar to Colorado at about \$45.** The number of daily customers is also similar at around 200 on average, although we received a wide range of answers all the way up to as many as 600 per day; many contacts also noted increases in foot traffic over the past month likely due to the time of year. In terms of 420 for Washington, one store manager said it was a "madhouse" and "absolutely crazy." MarketWatch reported impressive figures compared to last year just like Colorado, as the state doubled the amount of sales on April 20th to \$5.5 million according to Headset. They're also getting ready for July 4th. Now it's about beating 2015's comps during this year's holidays. There will be plenty of specials consequently, like a gram of retail cannabis for just \$5 or pre rolls for \$3. In Oregon, one contact expects a successful weekend for the 4th of July because her community's payday is on that Friday.
- **Washington stores' product mix is similar to Colorado in terms of selling about 50% flower and 50% edibles/concentrates.** Our contacts said popular products include vape pens and pre rolls. While medical stores in Oregon have been able to sell flower since last fall (recreational stores don't open until later this year), they haven't been able to sell recreational edibles and extracts until this month. These new options have increased sales at our contacts stores across the board. With that said, some respondents noted the potency is too low. While one dose of cannabis-infused edible can have up to 15 milligrams of THC, the state wants to bring that figure down to 5 milligrams which is half of what's allowed in Colorado. Washington received tourists from Oregon before it could sell edibles, but given the low potency in that state our Washington contacts said they still get customers from Oregon. One Oregon store manager even said he's seen customers walk out of his store and complain that's not what they were looking for in terms of edibles. For Oregon stores, however, they're just thrilled they can sell recreational marijuana with one contact claiming it was "life-saving in terms of business sustainability." The ability to sell edibles is still an added bonus.

Sales at Washington retail marijuana stores are growing at an impressive clip, even though they are outpaced by their Colorado counterparts. So far this year thru May, they've brought in \$229.6 million compared to \$357.6 million last year, according to

data provided by WSLCB. Here are the numbers for each month: January (\$39.6 million, +202% y/y), February (\$42.3 million, +163% y/y), March (\$46.7 million, +119% y/y), April (\$49.1 million, +97% y/y), and May (\$51.9 million, +71% y/y).

As for Oregon, the state's Department of Revenue said it received \$14.9 million in recreational tax payments as of May 30th. Only 57% of the 319 dispensaries in Oregon that have made at least one monthly tax payment have filed a quarterly tax return, however. With a tax rate of 25%, that suggests retail stores gained almost \$60 million in revenue during the first five months of this year. It also implies stores have been bringing in about \$12 million on average each month. By comparison, Colorado stores received \$90.2 million and sales averaged about \$18 million per month during the first five months it was sold legally. Nevertheless, Oregon's figures will likely increase when recreational stores open later this year and now that they can sell edibles, concentrates, and extracts.

Even with money flowing in, the legal marijuana industry has its fair share of challenges. Regulations on products, packaging, and potency limits, for example, keep changing and are continually up for debate. These states still have a lot to figure out as the industry is still in its infancy, which gives stores a level of uncertainty. One of the most pressing issues is that the drug is still illegal on a federal level, making banks largely inaccessible to store operators. One store manager said he would love to accept debit and credit cards, but only makes cash transaction to avoid any complications and puts ATMs in all of his stores. Currently, marijuana is a Schedule I narcotic, but the U.S. Drug Enforcement Agency could reschedule the drug to allow medical use with a prescription or deschedule it to allow recreational use. Some reports suggest the DEA may reclassify the drug this summer. We'll keep you posted.

This fall's elections could put pressure on the DEA. There are as many as nine states in which people will potentially vote on cannabis measures this fall, most likely including California as it secured the necessary number of signatures to put the Adult Use of Marijuana Act on the ballot. Despite the possibility of losing some tourist activity, store managers across Colorado, Washington, and Oregon hope the ballot in California passes this fall. One contact said "every state that checks off another going recreational is a win" in his book and that it's another in line until they get them all. They also said California already has the infrastructure in place since medical marijuana is legal.

In short, continue paying attention to this fast growing industry and we'll keep you updated. If California legalizes recreational marijuana in the fall, it will likely produce a domino effect. And now voters and states can see the benefits from the ongoing successful case studies we laid out in this note. In the words of Donald Trump – also likely on the ballot in November – "It's gonna be huge."

Source:

<http://www.marketwatch.com/story/marijuana-sales-on-420-hit-record-highs-2016-06-14>

U.S. EQUITIES

American Express Co (-3.98%) and JPMorgan Chase & Co (-3.34%) weighed on the Dow Jones Industrial Average (-1.50%); the S&P 500 and NASDAQ fell 1.81% and 2.41%. Medtronic PLC (-1.06%) will purchase HeartWare International Inc (+92.76%) for \$1.1 billion in cash. Dick's Sporting Goods Inc (-2.98%) submitted a bid for 17 Sports Authority stores. The Financial Times said Intel Corp (-2.63%) is considering selling its cybersecurity business.

Important Earnings Today (with Estimates)

- CCL: \$0.39
- NKE: \$0.48
- IHS: 1.48
- FDS: \$1.61

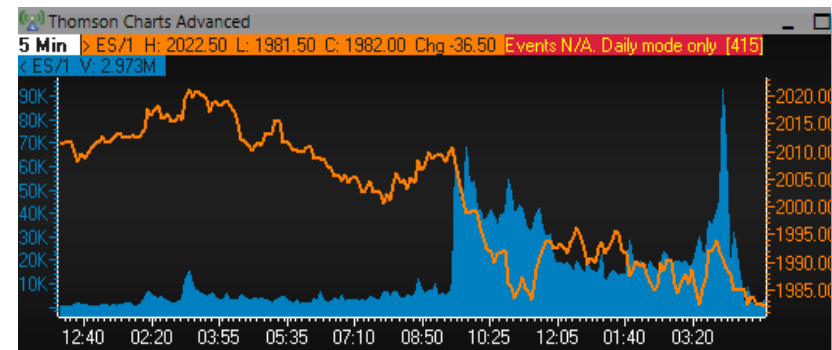
Source: Yahoo Finance

Important Conferences/Corporate Meetings Today:

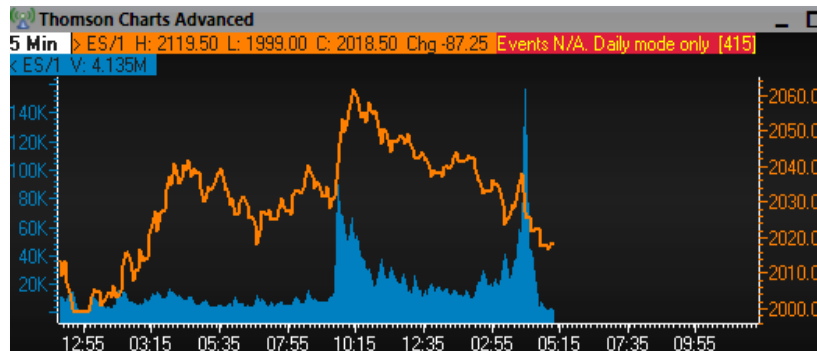
- CFA Institute Des Moines Insurance Conference – *Des Moines*
- Goldman Sachs European Business Services Conference – London
- JPMorgan Inaugural Energy Conference – London
- Stephens Texas Bank Field Trip – Dallas
- Three Part Advisors East Coast IDEAS Investor Conference – Boston
- UBS EMEA One-on-One Conference – London

S&P Futures

One Day (High – 2022.50; Low – 1981.50):



Prior Day ES/1 (High – 2060.00; Low – 1999.00; Close – 2018.50):



Three Day (High – 2060.00; Low – 1981.50):



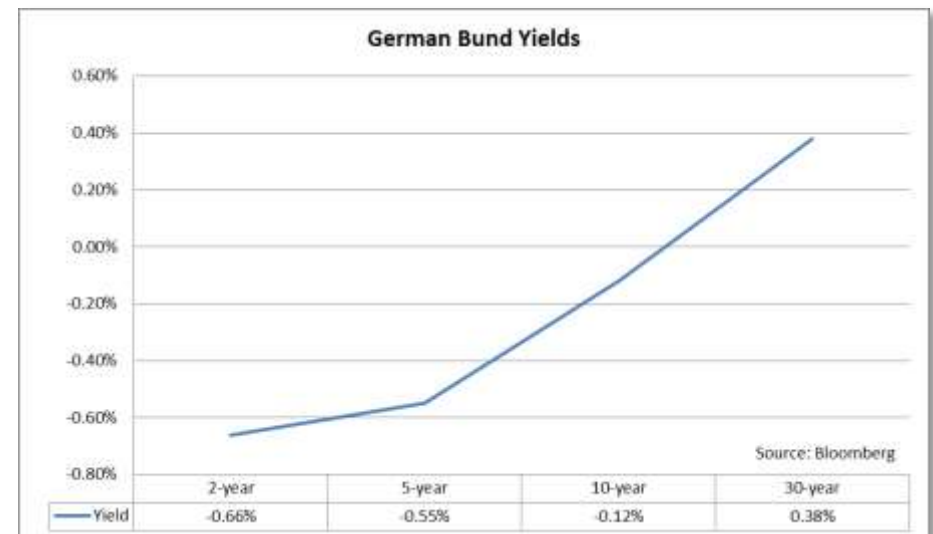
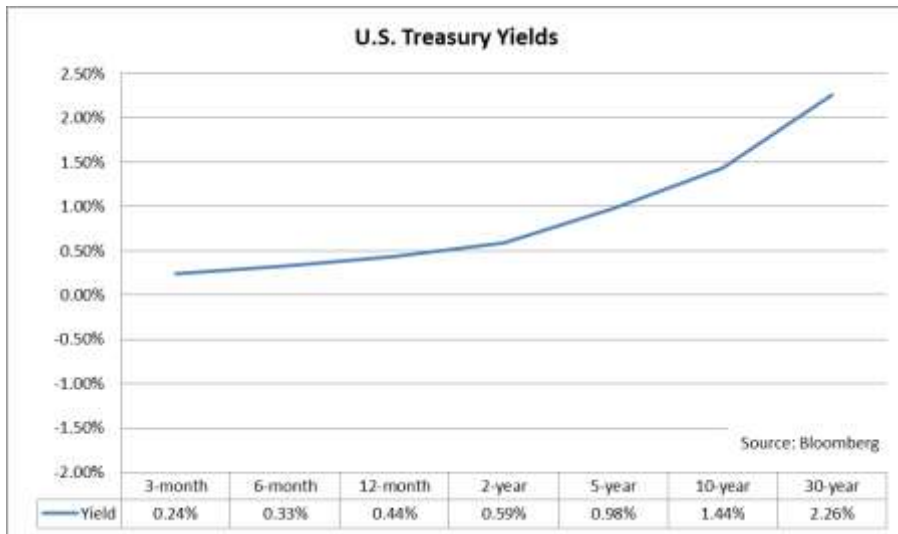
Source: Thomson Reuters

FIXED INCOME

Treasuries gained on Monday after Standard & Poor's lowered the U.K.'s credit rating by two notches to AA from AAA. Yields fell as demand for safe-haven assets continued to increase amid concerns about Britain's exit from the European Union. The 30-year Treasury yield declined to 2.26%, and the 10-year and 5-year yields dropped to 1.44% and 0.98% respectively.

Today's Important Economic Indicators/Events (with consensus estimates):

- Final Q1 GDP (8:30am EST): 1.0%/0.8%
- Corporate Profits (8:30am EST)
- S&P Case-Shiller HPI m/m (9:00am EST): 0.6%/0.9%
- Consumer Confidence (10:00am EST): 93.3/92.6
- Richmond Fed Manufacturing Index (10:00am EST)



Exchange-Traded Funds/Indexes

Prior Day Performance of Largest ETFs by Assets

Name	Ticker	Category	Prior Day Return
SPDRs	SPY	Large Blend	-1.74%
SPDR Gold Shares	GLD	N/A	0.53%
iShares MSCI Emerging Markets Index	EEM	Diversified Emerging Mkts	-1.26%
iShares MSCI EAFE Index	EFA	Foreign Large Blend	-1.92%
iShares S&P 500 Index	IVV	Large Blend	-1.89%
Emerging Markets	VWO	Emerging Markets	-0.75%
PowerShares QQQ	QQQ	Large Growth	-1.33%
Barclays TIPS Bond Fund	TIP	Fixed Income	0.10%
Total Stock Market ETF	VTI	Large Blend	-1.20%
iBoxx Investment Grade Corporate Bond Fund	LQD	Fixed Income	0.07%

Prior Day Top Volume ETFs

Name	Ticker	Category	Shares Traded
SPDR® S&P 500 ETF	SPY	Large Blend	246,686,960
iPath® S&P 500 VIX ST Futures™ ETN	VXX	Volatility	173,332,290
VelocityShares Daily 2x VIX ST ETN	TVIX	Volatility	127,182,098
Financial Select Sector SPDR® ETF	XLF	Financial	117,423,848
ProShares Ultra VIX Short-Term Futures	UVXY	Volatility	108,065,841
iShares MSCI Emerging Markets	EEM	Diversified Emerging Mkts	102,653,705
Market Vectors® Gold Miners ETF	GDJ	Equity Precious Metals	79,026,865
iShares MSCI Japan	EWJ	Japan Stock	75,266,003
VelocityShares Daily Inverse VIX ST ETN	XIV	Volatility	65,019,538
iShares Russell 2000	IWM	Small Blend	59,486,212

Prior Day Top Performers

Name	Ticker	Category	Shares Traded
Direxion Daily Regional Bnks Bear 3X ETF	WDRW	Trading-Inverse Equity	17.82%
Direxion Dly S&P Oil&Gs Ex&Prd Br 3X ETF	DRIP	Trading-Inverse Equity	15.94%
iPath® Pure Beta Energy ETN	ONG	Commodities Energy	15.33%
Direxion Daily S&P Biotech Bear 3X ETF	LABD	Trading-Inverse Equity	12.80%
Direxion Daily Nat Gas Rltd Bear 3X ETF	GASX	Trading-Inverse Equity	12.08%
Direxion Daily Semicondct Bear 3X ETF	SOXS	Trading-Inverse Equity	11.66%
DB Base Metals Short ETN	BOS	Trading-Inverse Commodities	9.92%
Direxion Daily Small Cap Bear 3X ETF	TZA	Trading-Inverse Equity	9.80%
Direxion Daily Hmbltrs&Supls Bear 3X ETF	CLAW	Trading-Inverse Equity	9.72%
DB Commodity Double Long ETN	DYY	Trading-Leveraged Commodities	9.27%

S&P 500 Sector ETFs

Sector	Ticker	1-Day Perf	YTD Perf	Sector	Ticker	1-Day Perf	YTD Perf
Energy	XLE	-3.20%	7.16%	Telecomm	IYZ	-1.98%	8.48%
Health	XLV	-1.31%	-5.07%	Technology	XLK	-2.01%	-3.27%
Industrials	XLI	-2.35%	0.17%	Consumer Discretionary	XLY	-1.81%	-4.34%
Utilities	XLU	0.83%	17.91%	Financials	XLF	-2.85%	-9.99%
Consumer Staples	XLP	-0.23%	4.95%	Materials	XLB	-3.37%	2.42%
Currency	Ticker	1-Day Perf	YTD Perf	Currency	Ticker	1-Day Perf	YTD Perf
Australian Dollar	FXA	-1.59%	0.77%	Japanese Yen	FXJ	0.15%	17.46%
British Pound Sterling	FXB	-3.05%	-10.46%	Swiss Franc	FXF	-0.80%	1.71%
Canadian Dollar	FXC	-0.54%	5.73%	USD Index Bearish	UDN	-0.82%	1.91%
Euro	FXE	-0.57%	0.97%	USD Index Bullish	UUP	0.85%	-2.57%

VIX ETNs

Name	Ticker	1-Day Perf	YTD Perf
iPath S&P 500 VIX	VXX	-0.65%	-16.37%
Short-Term Futures ETN			
iPath S&P 500 VIX	VXZ	1.76%	4.04%
Mid-Term Futures ETN			

Fixed Income ETFs

Bonds	Ticker	1-Day Perf	YTD Perf
Aggregate	AGG	0.42%	4.00%
Investment Grade	LQD	0.42%	6.73%
High Yield	HYG	-1.44%	1.82%
1-3 Year Treasuries	SHY	0.09%	1.09%
7-10 Year Treasuries	IEF	0.86%	7.19%
20+ Year Treasuries	TLT	2.50%	15.42%

Additional ETFs

ETF	Ticker	1-Day Perf	YTD Perf	ETF	Ticker	1-Day Perf	YTD Perf
Gold	GLD	0.53%	24.86%	Crude Oil	USO	-1.84%	1.73%
Silver	SLV	-0.12%	27.90%	EAFE Index	EFA	-1.92%	-10.37%
Natural Gas	UNG	2.64%	-5.77%	Emerging Markets	EEM	-1.26%	0.12%
				SPDRs	SPY	-1.74%	-2.09%

Major Index Changes:

None

ETFs in the News: [Safety ETF Plays Rally On Brexit Concerns](#)

International Market Summary

Asian Markets

Asian markets mostly rose on Monday after falling sharply on Friday following the U.K.'s vote to leave the European Union. (Nikkei +2.39%, HSI -0.16%, ASX 200 +0.47%). In China, the Shanghai Composite Index and Shenzhen Composite Index climbed 1.45% and 2.43% respectively. In Hong Kong, Bank of China added 1.01% and HSBC Holdings lost 2.09%. Property shares mostly fell: Henderson Land Development Co Ltd (+0.12%), China Vanke Co Ltd (-3.83%), and China Resources Land Ltd (-0.12%).

In Japan, Prime Minister Shinzo Abe said he told Finance Minister Taro Aso to watch currency markets and take necessary steps at an emergency meeting between the government and Bank of Japan. Auto stocks were mixed: Toyota Motor Corp (-1.70%), Honda Motor Co Ltd (+0.53%), and Nissan Motor Co Ltd (-2.53%). Technology shares followed suit: Sony Corp (+0.23%), Toshiba Corp (+0.34%), Sharp Corp (-14.41%), and Panasonic Corp (-1.14%). Bank shares dropped: Mitsubishi UFJ Financial Group Inc (-3.00%), Sumitomo Mitsui Financial Group (-1.75%), and Mizuho Financial Group Inc (-2.42%).

In Australia, mining shares gained: Fortescue Metals Group Ltd (+7.95%), Newcrest Mining Ltd (+2.72%), BHP Billiton Ltd (+3.08%), and Rio Tinto Ltd (+2.90%). Bank shares ended mixed: Westpac Banking Corp (+0.14%), Commonwealth Bank of Australia (+0.32%), ANZ Bank (-0.73%), and National Australia Bank Ltd (-0.41%).

Important Economic Indicators/Events (with Consensus estimates):

Japan

- Retail Trade y/y (7:50pm EST): -1.6%/-0.9%

Australia

- HIA New Home Sales m/m (1:00pm EST): -/-4.7%

European Markets

European markets continued to decline on Monday as a slew of banks downgraded U.K. shares. (FTSE -2.55%, DAX -3.02%, CAC 40 -2.97%). In Germany, Deutsche Bank slumped 6.17% after Citigroup lowered its price target for the stock. Commerzbank lost 5.24%. Goldman Sachs reduced its European car sales and production projections, weighing on auto shares: Volkswagen (-7.13%), BMW (-4.35%), and Daimler (-3.07%). In France, bank shares dropped: BNP Paribas (-6.32%), Credit Agricole (-5.97%), and Societe Generale (-8.39%).

In the U.K., the pound declined to a 31-year low against the dollar. Citigroup lowered its price targets for EastJet PLC (-22.31%) and Ryanair Holdings PLC (-13.90%). Goldman Sachs cut its price target for International Airlines Group (-15.92%). Foxtons Group PLC (-22.59%) issued a profit warning. Bank shares finished lower: HSBC Holdings PLC (-2.22%), Barclays PLC (-17.35%), Lloyds Banking Group PLC (-10.26%), and Royal Bank of Scotland Group PLC (-15.10%). Energy shares were mixed: BP PLC (+0.33%), Royal Dutch Shell PLC (+2.07%), and Tullow Oil (-6.00%). Mining shares mostly fell: Anglo American PLC (-4.42%), BHP Billiton (-1.68%), and Rio Tinto PLC (+0.39%).

Important Economic Indicators/Events (with Consensus estimates):

Germany

- Import Price Index y/y (2:00am EST): -5.8%/-6.6%

Additional Reading (Online Blog and News Stories)

(Please click on the titles below to view the links)

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Zero Hedge

Potential outcome from Brexit: [JPMorgan Lays Out "The Worst Case"](#)

Why helicopter money is now more likely: [Deutsche Bank: "There's No Escaping The Fact That This Is A Class War"](#)

[Goldman Cuts Its Government Bond Yield Forecasts](#)

FT Alphaville

Citi on possible scenarios for renegotiating passport rights: [Nice Banking Passport You Had There...](#)

[On The Non-Viability Of An Independent Scotland Staying In The Sterling Zone](#)

A Wealth Of Common Sense

Historical relationship between European and U.S. stock market returns: [Taking Stock of European Equities](#)

The Reformed Broker

Josh Brown on portfolios: [Positioning Vs Construction](#)

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