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## QUARTERLY MARKET REVIEW: JULY-SEPTEMBER 2014

We're happy to report that the U.S. recovery has defied slowing global growth; however, as recovery continues at a moderate but steady pace, volatility has been re-introduced to the world's equity markets. As a result, we continue to stick to the principles of Capital Creation *and* Preservation while Dampening Volatility, with the goal of providing you with the peace-of mind of consistent risk-adjusted returns. We are doing this by taking a balanced, but defensive approach to equity volatility & interest-rate sensitivity that may allow investors to participate in the upside, but equally protects them on the downside.

As we go into the 4th quarter, we still see investment opportunities in both US Equities & Global Fixed Income, as the U.S. defies the global growth trend and the rest of the world continues to repair itself. With this in mind, we will be rebalancing each of our portfolios prior to year-end, while continuing to overweight domestic equities and underweighting international equities. We do this while still keeping some global positions within the portfolio, specifically for their inherent flexibility to hold domestic and/or international securities.

### The Markets

Volatility returned to equities markets in Q3. A strong August was followed by losses in September, when any rallies began to focus around selected winners rather than benefitting stocks across the board. Investors exhibited a decided preference for large caps; the S&P 500 closed above 2,000 for the first time ever and the Dow industrials also set new all-time highs.

The Nasdaq returned to a level it hadn't seen since March 2000 and regained the lead for 2014. However, the Russell 2000, which has struggled for most of the year, fell deeper into negative territory year-to-date, while the Global Dow suffered from political conflicts abroad and concerns about global growth.

Bond investors continued to demonstrate surprising resilience. In early September, the yield on the benchmark 10-year Treasury fell to 2.35%--a level it hadn't seen in more than a year--as prices rose. However, as the Federal Reserve continued to taper its economic support and ramped up discussion of how and when to increase rates, demand began to taper off (though geopolitical anxieties and a strengthening dollar kept the decline in check).

Gold, which started the quarter at roughly $1,320, ended below $1,220. It was hurt in part by a stronger U.S. dollar, which by the end of the quarter had hit its highest level against the euro in almost two years. Dollar strength coupled with weaker global demand also meant lower oil prices; a barrel fell from $107 a barrel to roughly $93 during the quarter, a level it hasn't seen since January.

| Market/Index | 2013 Close | As of 9/30 | Month Change | Quarter Change | YTD Change |
|---|---|---|---|---|---|
| **DJIA** | 16576.66 | 17042.90 | -.32% | 1.29% | 2.81% |
| **NASDAQ** | 4176.59 | 4493.39 | -1.90% | 1.93% | 7.59% |
| **S&P 500** | 1848.36 | 1972.29 | -1.55% | .62% | 6.70% |
| **Russell 2000** | 1163.64 | 1101.68 | -6.19% | -7.65% | -5.32% |
| **Global Dow** | 2484.10 | 2534.47 | -3.22% | -2.73% | 2.03% |

| | | | | | |
|---|---|---|---|---|---|
| **Fed. Funds** | .25% | .25% | .25% | 0 bps | 0 bps |
| **10-year Treasuries** | 3.04% | 2.52% | 17 bps | -1 bps | -52 bps |

Chart reflects price changes, not total return. Because it does not include dividends or splits, it should not be used to benchmark performance of specific investments.

## Quarterly Economic Perspective

After contracting 2.1% in Q1, the U.S. economy grew at an annual rate of 4.6% during the second quarter. The Bureau of Economic Analysis said increases in consumer expenditures, exports, business spending on equipment, and spending by both state and local governments were major contributors to the growth. Meanwhile, after-tax corporate profits also rebounded from their Q1 slump, rising 8.6%.

The Federal Reserve's monetary policy committee continued to unwind its economic support. Its September bond purchases were only $15 billion, and they are scheduled to end in October. The committee also reaffirmed that the key Fed funds interest rate won't increase for a "considerable time" after that. However, a survey of members showed that most now expect steeper increases than previously estimated, with rates hitting 1.4% by the end of 2015 and 2.9% by December 2016.

Despite a slight improvement in August's unemployment rate (6.1%), the number of new jobs added in August was a disappointing 142,000, according to the Bureau of Labor Statistics. The continued slack in the labor market is one reason cited by the Federal Reserve for its caution about raising interest rates.

The housing recovery showed signs of tapering off. New home sales fell in both July and August, and the National Association of Realtors® said a shortage of the cash buyers who had helped boost existing home resales in July cut resales the following month. Housing starts and building permits also slowed in August after a strong July, according to the Commerce Department, while the rate of home price increases in the S&P/Case-Shiller 20-City Composite Index began to taper off.

After a strong July, manufacturing gains began to taper off. The Commerce Department said durable goods orders rose and fell based on orders for commercial aircraft, which hit a record high in July and plummeted a month later; aside from transportation, durable goods orders rose 0.7% in August. Auto production also saw a strong July and weaker August, and after six straight months of gains, the Fed's gauge of industrial production edged downward in August.

By quarter's end, the Bureau of Labor Statistics said falling energy costs had helped cut consumer inflation by 0.2%. That left the annual inflation rate for the previous 12 months at 1.7%, down from Q1's 2.1%. The 1.8% annual inflation rate for final-state wholesale prices also was lower than Q1's 2%. The Bureau of Economic Analysis said both personal income and consumer spending saw gains throughout the quarter.

Conflicts over Ukraine continued to raise concerns about how Russian retaliation for Western sanctions might affect the fragile European economy. A eurozone GDP that essentially flatlined in Q2 and weakness in both Germany and Italy led the European Central Bank to promise more aggressive stimulus measures.

The Chinese economy continued to show signs of slowing in some key areas. By August, growth in industrial production was almost 7% instead of the previous month's 9%, housing sales were down nearly 11% from the beginning of 2014, and HSBC Corp.'s Purchasing Managers' Index remained at 50.2--barely above the level that would represent contraction.

## Eye on the Month Ahead

With October's Fed bond purchases expected to be the last, next month's monetary policy committee announcement will be watched to see if a rate hike is still a "considerable time" away. Global investors will assess whether additional expected support from the European Central Bank is likely to help jumpstart the economy there.

We don’t feel that volatility and headline risk always translates to a crisis; nor do mid-day selloffs always create an immediate rebound. The key points to remember are that we continue to dampen volatility with both diversification and non-correlated assets, when applicable, and look to facilitate the long term creation and preservation of Client Capital. We do this with you and yours in mind and hope you appreciate our diligence, as much as we appreciate the opportunity to do so.

All the best,


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*Data sources: Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation); U.S. Department of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services). Performance: Based on data reported in WSJ Market Data Center (indexes); U.S. Treasury (Treasury yields); U.S. Energy Information Administration/Bloomberg.com Market Data (oil spot price, WTI Cushing, OK); www.goldprice.org (spot gold/silver); Oanda/FX Street (currency exchange rates).*

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*The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The S&P 500 is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy. The NASDAQ Composite Index is a market-value weighted index of all common stocks listed on the NASDAQ stock exchange. The Russell 2000 is a market-cap weighted index composed of 2,000 U.S. small-cap common stocks. The Global Dow is an equally weighted index of 150 widely traded blue-chip common stocks worldwide. Market indices listed are unmanaged and are not available for direct investment.*

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