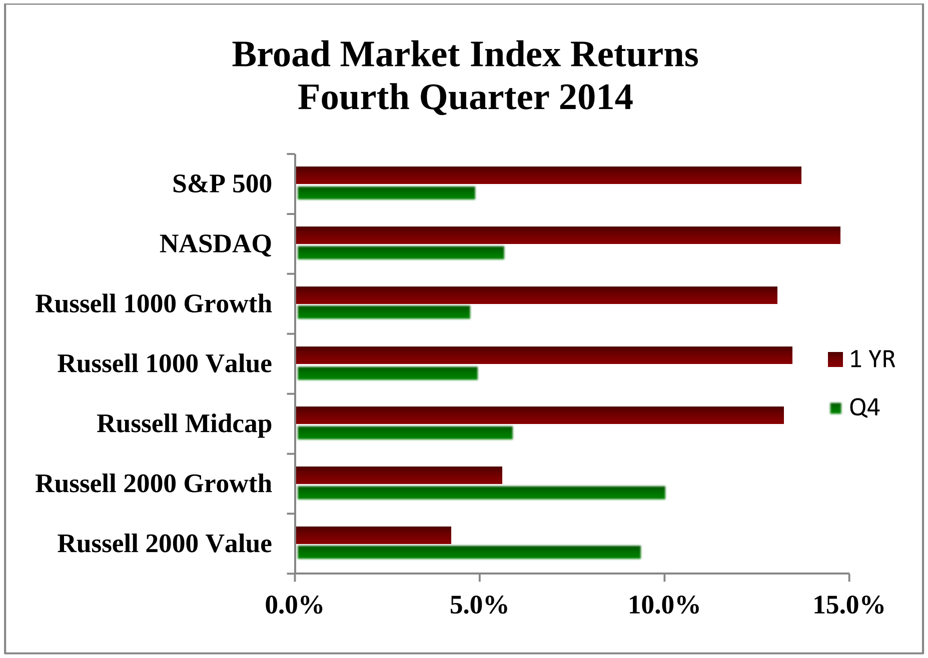
Fourth Quarter 2014 Market Summary

U.S. equity markets had positive returns for the sixth consecutive year and finished with a strong fourth quarter. The S&P 500 was up 4.93% during the quarter while small capitalization companies, represented by the Russell 2000, were up 9.73%. It is interesting to note that US equities have never risen seven years in a row going back to 1874.

There was a wide dispersion among equity sectors during the quarter and for the year. Sectors considered "cyclical" such as industrials, energy, materials and consumer discretionary were relatively weak. Health care, consumer staples and utilities are generally considered "defensive" sectors outperformed as many investors sought high yielding assets due to declining interest rates. Energy stocks continued to be weak because oil prices declined further as oil supply remains high and fears of decreasing demand due to global economic weakness. Because of other geopolitical risks, the U.S. dollar has benefited as a "safe haven" asset and is now trading at a four-year high against a basket of foreign currencies.

The bond market showed mixed performance during the fourth quarter as the Barclays U.S. Aggregate Bond index was positive but some of the credit bond sectors were negative. Bonds had a very good year as the decline in U.S. Treasury rates was surprising to many people. Demand for U.S. Treasuries was strong as U.S. Treasury yields have become relatively attractive compared to European bonds. Municipals, investment grade corporate bonds and long term treasuries were the best performing bond sectors during the year.

While U.S. equity markets have enjoyed one of the longest expansions in history over the past six years, macro conditions continue to be favorable long-term. The U.S. economy continues to grow steadily, corporate profits are increasing, interest rates and inflation remain low. Valuations are higher than average; however, corporate earnings may see a boost from lower energy prices. Foreign equity markets were negative in the quarter and for the year as growth has been lower than expected. Foreign banks in Europe, Japan and China are expected to provide stimulus during 2015 to promote economic production. Due to geopolitical risk and uncertain economies, foreign developed and emerging equity markets have valuations more attractive than in the U.S.



Highlights

GDP

- The Bureau of Economic Analysis released the third estimate of third quarter 2014 real GDP, an annual rate increase of 5.0% from the preceding quarter, revised up from the second estimate.
- The University of Michigan Consumer Sentiment Index final reading for December was 93.6, which was an increase from November. November was 88.8 up from 86.9 in October. Consumer sentiment has increased the past quarter as oil prices have declined and the labor market continues to improve.
- The ISM Manufacturing Index declined slightly during the quarter from 56.6 in September to 55.5 in December. After a slow start to the year the ISM Index has been strong. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish.
- In November, the Conference Board Leading Economic Index increased 0.6% month-over-month to 105.5. The Index has been increasing gradually over the past year showing steady slow growth in the economy.
- The price of WTI Crude Oil was $53.45 at the end of December, which is 41.4% lower than $91.17 at the end of September. The price of Brent Crude Oil decreased 41.6% in the quarter to $55.27.
- In December, the headline CPI came in at 0.8% year-over-year, down from 1.3% in November. Core CPI, which does not include food and energy, had a 1.6% increase. Inflation levels have remained low over the past year and have been less than historical averages and the Fed’s 2% inflation target.

HOUSING

- Preliminary existing home sales decreased in November with an annualized rate of 4.93 million units from 5.25 million units in October. The November annualized rate is 2% above the 4.83 million units in November 2013. Home sales have stalled as home prices have risen over the past year and the expectation for mortgage rates to rise.
- Median existing home sale prices increased slightly during the quarter. The preliminary prices for November were 1.4% higher from the levels of one year ago and have been trending up since the beginning of 2012.
- New home sales were flat in the quarter with a seasonally adjusted annual rate of 438k homes sold in November versus 448k in August. Home sales have rebounded from the lows of May 2010, when 280k new homes were sold. However, new home sales growth has stalled since the start of 2013.
- S&P Case-Shiller 20-City Home Price Index (seasonally adjusted) showed home prices rose 4.5% year-over-year in October. The index has stalled the past six months on a month over month basis.

EMPLOYMENT

- The labor market continued a trend of slightly stronger jobs growth after a slow start to the year. Nonfarm payrolls added 252,000 jobs in December which beat expectations. In the third quarter, nonfarm payrolls averaged 289,000 jobs added per month which was more than third quarter’s average of 239,000 jobs per month.
- Hourly earnings have been increasing since the end of 2012.
- The unemployment rate fell to 5.6% from 5.9% during the quarter.
- Initial Jobless Claims have been decreasing since 2009 and dipped to lows last seen in 2006.

DOMESTIC CORPORATIONS

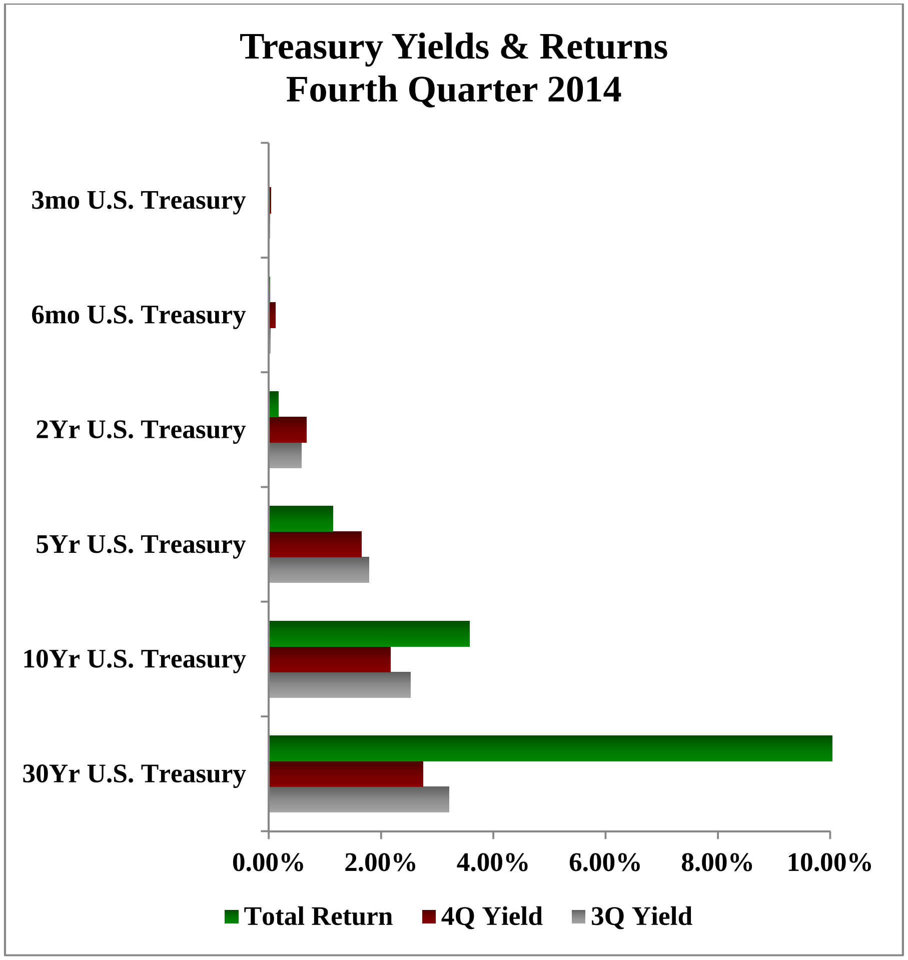
- Corporate operating earnings had a solid year after weather and slower growth contributed to lower earnings in the first quarter. Operating margins are currently at all time highs.
- Forward and trailing P/E multiples have been expanding since 3Q 2011 and are now slightly above historical averages.
- The U.S. dollar has appreciated considerably versus the euro and yen during the past two quarters. If the dollar remains strong, multinationals could see their earnings pressured due to their international exposures.
- The price of oil has decline by fifty percent over the past two quarters. This has significantly hurt energy companies but lower prices should help other sectors such as the consumer industries.

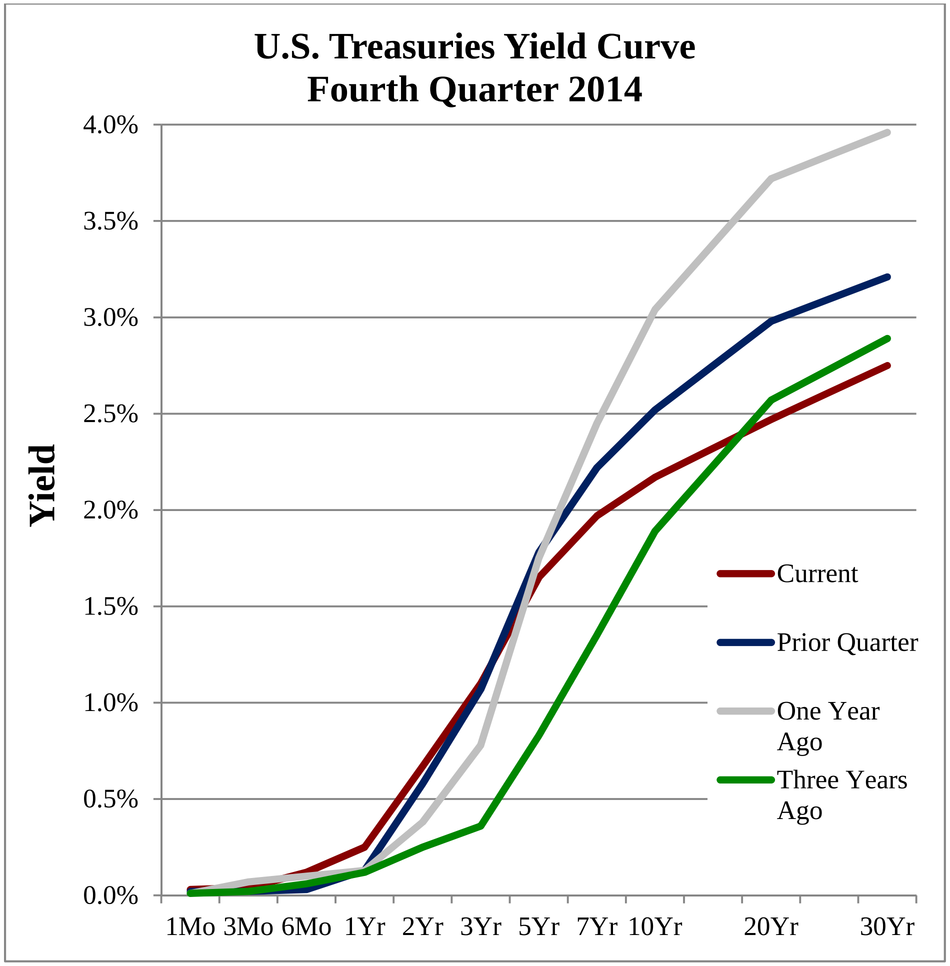
FED POLICY

- In December, the Federal Open Market Committee (FOMC) announced they will leave the federal funds rate at 0% to 0.25% percent. In their statement, the Fed expressed that the fed funds rate will remain at exceptionally low levels as it strives to reach its goals of maximum employment and inflation at 2%.
- The Fed concluded their purchasing of agency mortgage-backed securities and longer-term Treasury securities purchases as there is evidence of improvement in the labor market and moderate growth in the economy.

FIXED INCOME

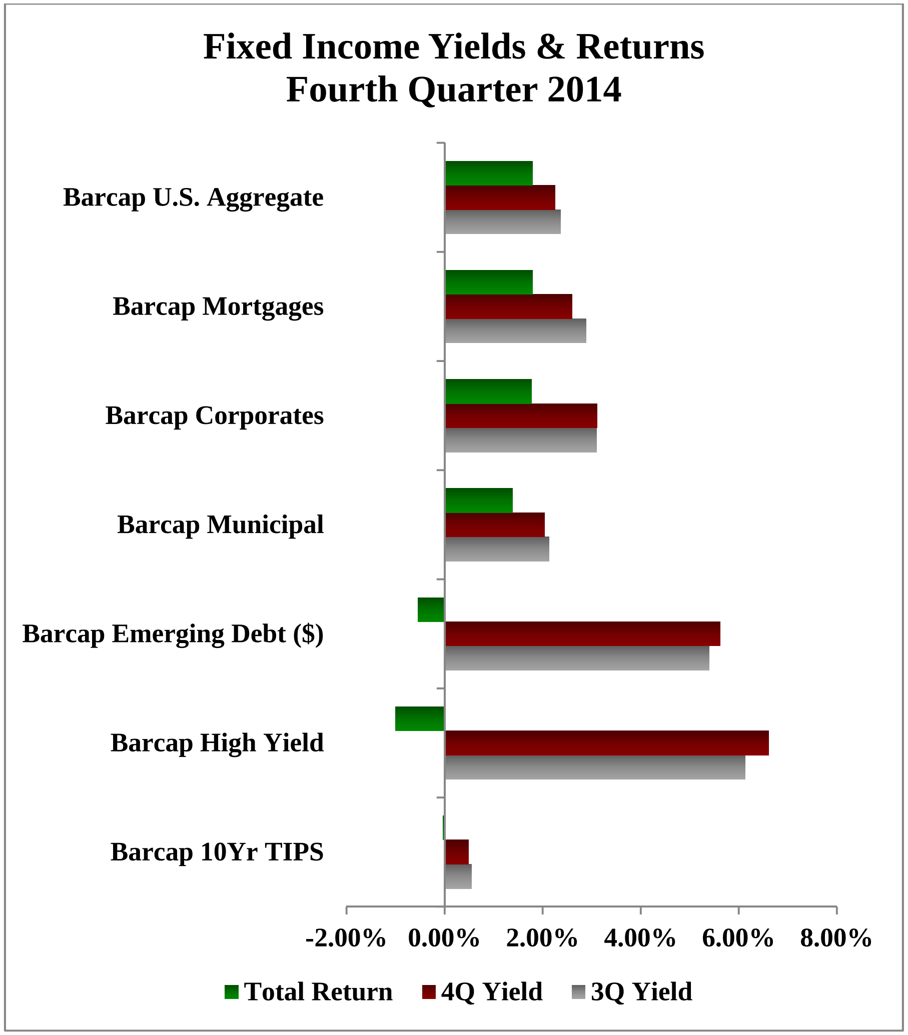
- The yields on longer-term Treasury securities decreased quarter-over-quarter, while yields on shorter-term Treasury securities increased causing the yield curve to flatten slightly. On a historical basis, the yield curve is relatively steep due to the Fed holding down short term rates. A steep curve indicates market participants are not concerned about a recession over the next year.





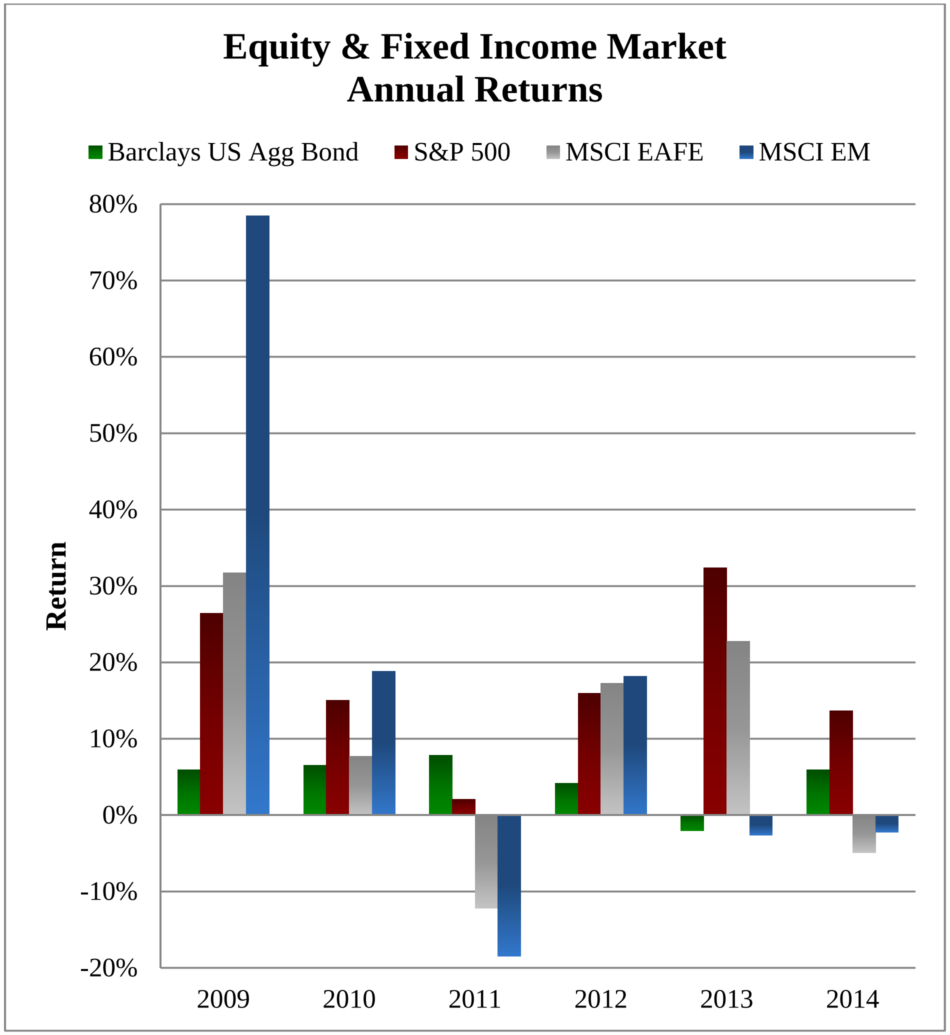
FIXED INCOME (continued)

- Yields in all fixed income sectors except high yield, corporates and emerging debt decreased during the quarter. Fixed income yields remain low due to low interest rates and tight spreads. Mortgages, municipals and corporates had the strongest returns. Emerging market debt and high yield had negative returns in the quarter.



EQUITIES

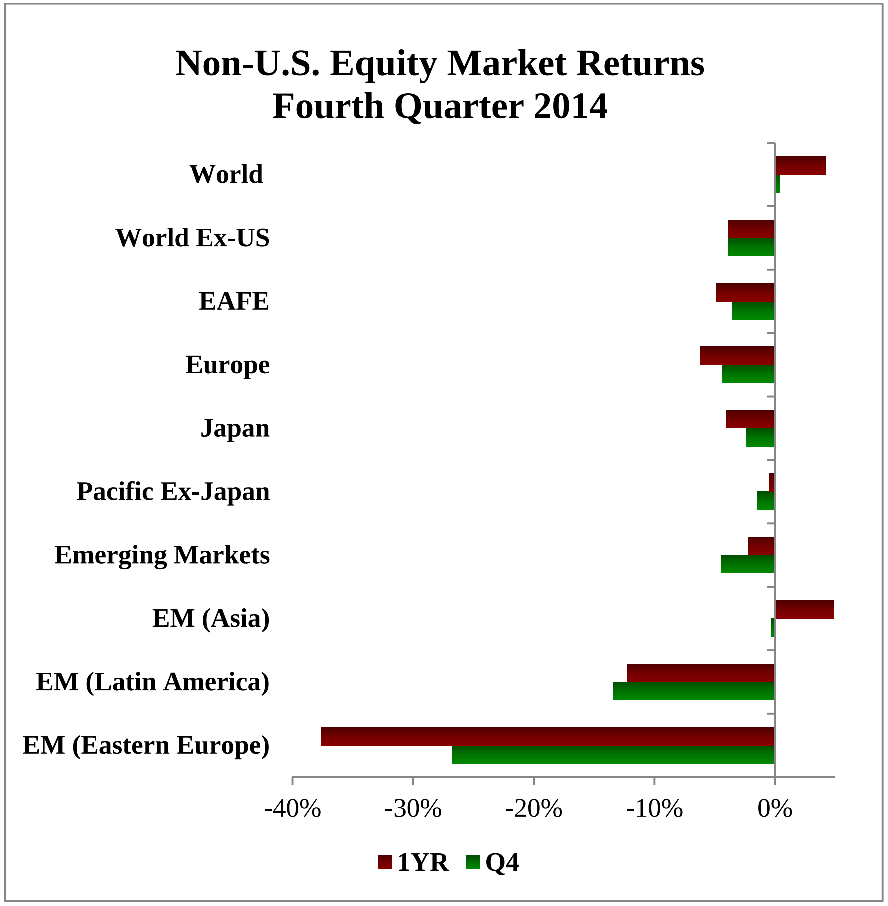
- For the quarter, domestic equity returns were strong; however, international equity returns were negative as investors became concerned with global growth. Performance in the U.S. was positive across the board; however, small capitalization stocks were the best performing, up high single digits. Value and growth stocks performed inline during the quarter.



EQUITIES (continued)

- Developed international stocks performed worse than U.S. domestic equities. The MSCI EAFE index of international markets stocks decreased 3.57% during the quarter. On a year-over-year basis, the EAFE is down 4.9%. Asia ex Japan was the least worst of the international developed markets during the quarter.

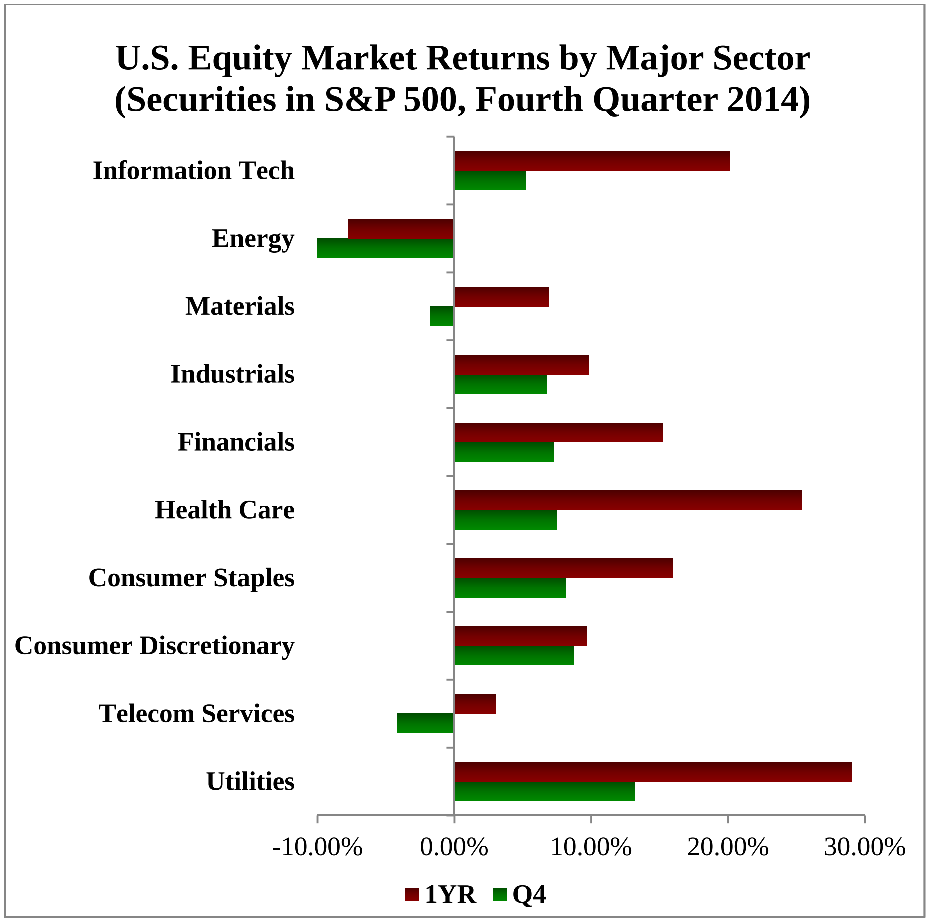
- During the quarter, emerging market stocks performed worse than developed markets but emerging markets performed better on a one year basis. The MSCI Emerging Markets Index decreased 4.5% in the quarter and had a negative 2.19% return in 2014. Returns were stronger in Asia including China but were down significantly in Eastern Europe.



- The Russell 1000 Index of large capitalization stocks posted a total return of 4.88% during the quarter. On a year-over-year basis, the Russell 1000 Index has advanced 13.24%.

- Small capitalization stocks, as represented by the Russell 2000 Index, posted a total return of 9.73% during the quarter. On a year-over-year basis, the index has increased 4.89%.

- Energy and telecom were the worst performing sectors in the quarter while utilities and consumer discretionary were the best performers. Energy companies underperformed significantly as the price of oil decreased by 50% over the past six months.



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