PINION FINANCIAL SERVICES, LLC
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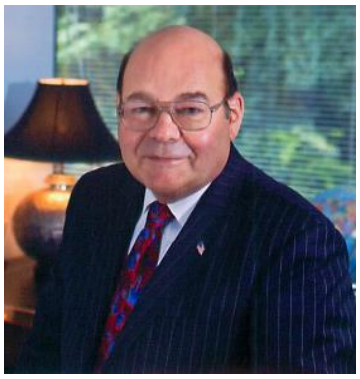
Quarterly Economic Update

Third Quarter 2014

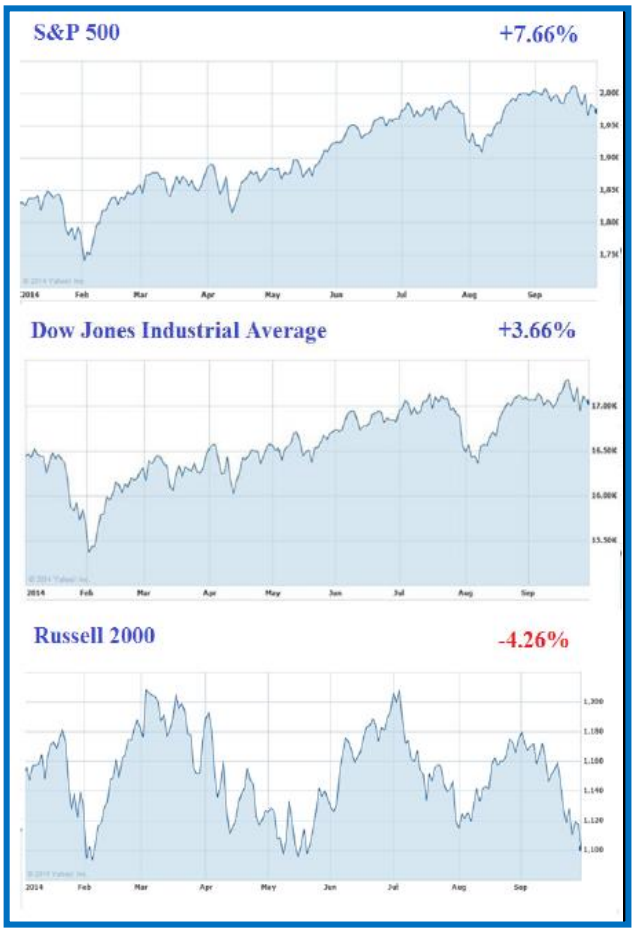


The third quarter of 2014 was very interesting. The overall results for many investors were positive, but while several diverse pockets of the market enjoyed gains, other stocks struggled.The S&P 500 and the DJIA (both of which track larger established companies) continued to outperform small stocks and foreign shares. Through Sept 30, 2014 the S&P 500 was up 7.66%and the DJIAwas up3.66%.By comparison, the Russell 2000 Index (which tracks small stocks) is down 4.26% for 2014.***(Source: Wall Street Journal)***

Many analysts feel that several U.S. big stocks are still more attractively priced than smaller stocks and that this trend could continue."Small stocks are victims of their own success," according to Jack Ablin, Chief Investment officer of BMO Private Bank. "They made a huge move last year and entered into this year overvalued.While there are great small company stocks, small caps in general need to take a back seat to their larger competitors till valuations come back into alignment." In fact, some portfolio managers are fearful that the small cap underperformance has just begun.***(Source: Wall Street Journal 9/29/2014)***

Although caution still remains the top priority for most investors, many analysts feel that the bull could stay in charge for the rest of this year and possibly longer.*Barron's* surveyed 10 top analysts in September, and surprisingly, all of them felt that the upward trend would continue.While several analysts toned down their optimism because of the market's gains, they still feel that we have not reached the market's ultimate peak.They believe that rising corporate profits will continue to lead to increases in large cap stock prices.Having said this, they still caution investors about political tensions and interestrates. ***(Source: Barron's 9/8/2014)***

In a recent interview, Dirk Hofschire, Senior Vice President of Asset Allocation Research at Fidelity Investments, said, "We continue to have a favorable global backdrop for asset prices. It's been a Goldilocks environment where things are not too fast, not too slow, not too warm, not too cold. The U.S. economy has still been making progress, jobs are being created, unemployment is coming down, and many leading indicators still point up." ***(Source: Fidelity.com)***



Recently, volatility has returned to the market and investors are noticing a "see-saw" effect between the bears (who are convinced stock prices will fall) and the bulls (who rush in during market swings to selectively add to their equity positions).Who is right? Only time will tell!

MONETARY POLICY

Many investors are watching the Federal Reserve very closely, and with good reason. The Fed's September bond purchases were only $15 billion and in October

they are moving towards their pledge to end the Quantitative Easing program of buying bonds.This is leavingmany analysts concerned about the upward movement of interest rates.The Fed's key interest rate

Monetary Policy: Five Key Points

1. Large cap stocks performed well while small caps struggled.
2. The Federal Reserve is ending their buy back program.
3. Interest rates are still low and are expected to continue to be around 1% through the end of 2015.
4. Many analysts feel equities are overpriced but may continue to rise.
5. Investors should keep a watchful eye on their equity and bond positions.

target has been pinned at virtually zero since December 2008 (the depth of the financial crisis).

This is not the first time that the Federal Reserve has taken a "whatever it takes" approach to supporting monetary policy.Thirty-five years ago on October 6, 1979, the Federal Reserve, led by Paul Volker, made a revolutionary change in how it handled monetary policy.Faced with double-digit inflation rates, the central bank responded by raising interest rates to 20%.Although this causedother aftershocks, this extreme policywould go on to tame inflation rates.***(Source: Barrons, 10/6/2014)***

Today, as the Fed prepares to wind down its extraordinary Quantitative Easing policy, interest rates are still close to zero. The consensus among analysts is that we are still about a year or so away from the Fed's first interest rate hike, or tightening of the cycleThe Fed and its current leader, Janet Yellen, have been clear in communicating that even when they get to that first tightening, they will probably go pretty slow in raising interest rates.

Many investors are still searching for safe, short-term debt. This demand intensified at the end of the quarter, pushingup bond prices and forcing down yields.The yield on the US Treasury bill on October 2nd reached a negative .01%.***(Source: Wall Street Journal, 9/24/2014)***

While bonds are an important part of many financial plans, this is a good time to be very watchful of all income-oriented investments.Interest rates have remained at historically low levels for quite some time.Global rates continue to remain exceptionally low and that typically reduces the risk of a swift upwardmovement in U.S. interest rates.

It is anyone's guess when the Fed will raise interest rates and by how much.On a positive note, Federal Reserve Chairperson Janet Yellen stated that she sees interest rates continuing around 1% until the end of 2015.

PRICE–TO–EARNINGS RATIO

Comparing P/E – 2000, 2007, 2014

Based on many metrics, the S&P 500 stock index is cheaper today than at prior peaks in 2000 and 2007.

	2000	2007	2014*
S&P 500	1527	1565	2003
Trailing 12-mo. Earnings	$51.02	90.06	111.83
Trailing 12-mo. P/E	29.9	17.4	17.9
Forward 12-mo. P/E	25.1	15	15.6
Net Debt/Ebitda	3.4	3.4	1.4
Price/Book Value	5.4	3.0	2.8
Dividend Yield	1.1%	1.8	1.9
10-year Treasury Yeild	6.2%	4.7	2.4
S&P 500 cos. With higher dividend yields than 10-year Treasury yield	6%	7	32

*As of 8/31/2014 Ebitda = Earnings before interest, taxes, depreciation, and amortization.

Source: Bank of America Merrill Lynch

According to a Barron's survey in September, P/E ratios were one of the main criteria used by 10 top analysts to measure equity valuations.They felt that with macroeconomic data improving and profitability broadening out, a case could be made that the market's P/E ratios were extended but not outrageous.They viewed U.S. stocks as neither cheap nor expensive, considering the low level of interest rates."Stocks offer less compelling value than a few years ago," says Savita Subramanian, head of U.S. Equity and Quantitative Strategy atBank of America Merrill Lynch."But if anything, there's an upside risk to my view."***(Source: Barron's, 9/1/2014)***

Steven Auth, Chief Investment Officer of Federated Investors, is more bullish. "The U.S. economy is accelerating, and so are earnings," he said, adding that his market views have been right on for the past two years. ***(Source: Barron's 9/1/2014)***

However, John Campbell, a Harvard economist who collaborates with Robert Shiller(a Nobel laureate in economics who is also a noted P/E watcher) feels that based on today's P/E measurements, stocks are overpriced.***(Source: New York Times)***

While the P/E ratio can be informative, you can see that not even the experts always agree on what it means. It is therefore important not to base a decision on this measure alone.

THE ECONOMY

Positive economic news during this quarter included the following:

- The U.S. labor market is improving at a faster rate.***(Source: Bureau of Labor Statistics)***
- Core consumer inflation has slowed to 1.9% year over year. ***(Source: Fidelity.com)***
- Personal consumption is still growing at a relatively modest 4% (nominal) year-over-year pace. ***(Source: Bureau of Economic Analysis)***

In addition to this good news, of course, there were still some concerning factors. The main one was the housing sector, which remains in a soft patch, even though leading indicators are showing signs of slow improvement. Sales activity remains at historically weak levels, and prices have flattened over the past three months.Construction starts and permit issuance remain at low levels, though they rose in July and remain in an upward trend.(***Source: Core-Logic, Haver Analytics)***

INFLATION

The rate of inflation is something that is always monitored by the Fed and Investment professionals. Many investors are also concerned that inflation might start to decrease dramatically and actually cause a very unusual dilemma: deflation.This has already taken hold in many different European countries.The European Central Bank cut interest rates significantly and stimulated bank lending—moves that were specifically aimed at reversing this trend before other countries might encounter this problem. ***(Source:Wall Street Journal 6/6/2014)***

CONCLUSION

Volatility seems to have returned to the equity markets and past 4th Quarters have seen their share of market swings. Analysts are focused on earnings, the Fed, the economy and stock valuations. However, individual investors still have to look at their own situations first.It is important to be cautious, but it is just as important to determine your own personal risk or "worry" level.That's where we can help.

Now is good time to ask yourself:

1. ***Has my risk tolerance changed?***
2. ***What are my investment cash flow needs for the next few years?***
3. ***What is a realistic return expectation for my portfolio?***

Your answers to these questions will govern how we recommend investment vehicles for you to consider.We can help you determine which investments to avoid and how long to hold each of your investment categories before making major adjustments.For example, if your cash flow needs have changed for the next few years, you might consider different investments than someone who has limited to no cash flow needs.

We continually review economic, tax and investment issues and draw on that knowledge to offer direction and strategies to our clients.
We pride ourselves in offering:

- consistent and strong communication,
- a schedule of regular client meetings, and
- continuing education for our team on the issues that affect our clients.

A good financial advisor can help make your journey easier.Our goal is to understand our clients' needs and then try to create a plan to address those needs.We continually monitor your portfolio. While we cannot control

financial markets or interest rates, we keep a watchful eye on them. No one can predict the future with complete accuracy, so we keep the lines of communication open with our clients.Our primary objective is to take the emotions out of investing for our clients. We can discuss your specific situation at your next review meeting, or you can call to schedule an appointment. As always, we appreciate the opportunity to assist you in addressing your financial matters.

P.S. Under normal conditions, Fed tightening wouldn't be too much of a worry.Since 1983, the Standard & Poor's 500 Index has averaged a 4.4% gain during the 6 months before a hike, and another 7.7% during the six months following it, according to Strategic Research Partners.The only problem:These aren't normal.

Financial Facts

HSH.com found wide variance in the salary needed to afford the principal and interest payments on a median-priced home in 27 metropolitan areas

$29,789 The pay needed in Cleveland was the lowest
$137,130 San Francisco was the most expensive city
$50,546 Philadelphia's cost was at midpoint
$89,789 New York's was higher than Los Angeles'

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Sources: Barron's; New York Times; Core-Logic-Haver Analytics; Bureau of Economic Analysis-Haver Analytics; Fidelity; Bureau of Labor Statistics; Wall Street Journal; HSH.com;