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Annual Market Review 2014

Dear Clients and Friends,

We are happy to enclose your 4th quarter and annual 2014 investment performance report for the period ending on December 31, 2014. We've just entered the New Year, making it the perfect time to revisit 2014 and share some thoughts on what we see ahead as we continue down the road in 2015.

Overview

The United States emerged from 2014 as the best house on a troubled block. Civil war in Ukraine, a slowing Chinese economy, a stagnant Europe worried about potential deflation, a new recession in Japan, the threat of a new Russian economic meltdown triggered by plummeting oil prices--it all made an improving situation at home look even brighter by comparison.

Even apart from the troubles overseas, the United States by almost any measure was stronger than it's been in years. The labor and housing markets improved, corporate profits were solid, Congress managed to avert another government shutdown, and the Ebola threat had little impact domestically. All in all, it was a Goldilocks economy: not too hot, which could have brought on higher interest rates from the Federal Reserve, and not too cold, which let the Fed end the QE3 bond purchases begun in the wake of the 2008 financial crisis.

That domestic strength fueled more gains for domestic equities than had been envisioned for the fifth year of this bull market. The S&P 500 ended 2014 up more than 200% from its March 2009 low, and the Dow saw its sixth straight yearly gain. However, in the coming year, investors will almost certainly be faced with the start of long anticipated interest rate increases. Though the Fed has promised patience in implementing rate hikes, higher borrowing costs and a strong dollar that makes U.S. goods more expensive overseas could create a headwind for domestic corporations. The question is whether that wind might blow the economy off its current promising course or will merely keep the game interesting.

Market/Index	2013 Close	As of 9/30	As of 12/31	Month Change	Q4 Change	2014 Change
DJIA	16576.66	17042.90	17823.07	-.03%	4.58%	7.52%
Nasdaq	4176.59	4493.39	4736.05	-1.16%	5.40%	13.40%
S&P 500	1848.36	1972.29	2058.90	-.42%	4.39%	11.39%
Russell 2000	1163.64	1101.68	1204.70	2.68%	9.35%	3.53%
Global Dow	2484.10	2534.47	2501.66	-2.71%	-1.29%	.71%
Fed. Funds	.25%	.25%	.25%	0 bps	0 bps	0 bps
10-year Treasuries	3.04%	2.52%	2.17%	-1 bps	-35 bps	-87 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.

Snapshot 2014

The Markets

- **Equities:** After a discouraging start, large-cap domestic equities spent much of the year climbing to new heights. Though they didn't come close to matching last year's fireworks, the S&P 500 and Dow industrials set 53 and 38 new record highs respectively during the year. However, little of that love spilled over to the small caps. The Russell 2000, which had soared in 2013, had trouble scaling the proverbial "wall of worry" and spent much of 2014 either flat or down before a Q4 rally returned it to positive territory. The Nasdaq proved the strongest of the four indices; by December it had come within 242 points of its all-time closing high of 5,048.62, set in March 2000. Beset by weakness worldwide, the Global Dow barely managed a positive return for the year.
- **Bonds:** The bond market confounded those who had feared bond prices would suffer from the unwinding of Federal Reserve support. Challenges overseas lured investors to the safety of U.S. Treasuries; prices rose as the benchmark 10-year yield dropped more than 3/4ths of a percentage point, especially after the threat of an imminent Fed rate hike faded and falling oil prices threatened the economies and currencies of several oil-dependent countries.
- **Oil:** A drop in crude prices that began in July accelerated in Q4 after Saudi Arabia chose market share over profit by deciding not to cut supplies. Prices promptly plummeted to levels not seen since the depths of the financial crisis, falling roughly 45% from the July high of $107 a barrel. The plunge in oil prices helped fatten consumers' wallets but renewed concerns about oil-dependent economies.
- **Currencies:** Falling oil prices coupled with the expectation of higher interest rates helped boost the U.S. dollar, which rose almost 11% over the course of the year. The dollar also benefitted from interest rates abroad, some of which were even lower than those for Treasuries. The strong dollar raised new concerns that countries and foreign corporations hurt by lower oil prices might have trouble repaying debt in currencies that were substantially weaker against the U.S. dollar.
- **Gold:** After plummeting in 2013, gold managed to stabilize a bit last year. The precious metal ended the year at roughly $1,180--not far from where it began in January despite a spring rally prompted in part by the crisis in Ukraine.

The Economy

- **Unemployment:** Improvement in the U.S. job market was slow but steady. The unemployment rate ended the year at 5.8%, its lowest level since July 2008 and better than last December's 6.7%. According to the Bureau of Labor Statistics, the unemployment rate is now down 4.2 percentage points from its October 2009 high of 10%. And after a slow start, job creation accelerated; by December, the number of new jobs added during the previous 12 months was the highest it's been since April 2006.
- **GDP:** After a slump during the first quarter, when the U.S. economy contracted by 2.1%, by Q3 the U.S. economy was growing at its fastest pace in 11 years. The Bureau of Economic Analysis said the 5% annualized growth of gross domestic product outpaced Q2's 4.6% and represented the strongest growth since Q3 2003's 6.9%. After-tax corporate profits also were up, rising 2.8% from Q2 and more than 5% from a year earlier.
- **Inflation:** Inflation remained well under historical averages, which allowed the Fed to postpone any interest rate hike until 2015. By December, the Bureau of Labor Statistics said consumer inflation for the previous 12 months stood at 1.3% while wholesale prices gained 1.4% over the same time. The lower gas prices that kept inflation in check also helped spur retail sales and consumer spending.
- **Housing:** The most recent home prices measured by the S&P/Case-Shiller 20-City Composite Index were up 4.5% from a year earlier, and the National Association of Realtors® said that by November, new home sales were slowing but still up 2.1% year over year. However, both year-over-year figures were lower than in previous months, and slippage in both housing starts and building permits suggested that the pace of gains may be slowing.
- **Manufacturing:** Manufacturing was a fundamental component of the economy's strength during the year. The Federal Reserve said that by the end of the year, usage of the nation's industrial capacity had finally reached its long-term average. Meanwhile, higher exports helped shrink the U.S. trade deficit to $43.4 billion.
- **International markets:** Economic problems overseas contributed to the Fed's caution with interest rates. Though the European Central Bank cut a key interest rate to -0.1% and continued to say it was prepared to take stronger measures to try to avoid potential deflation, Europe entered the New Year still waiting for additional stimulus. In Japan, two consecutive quarters of contraction marked an official recession, calling so-called "Abenomics" into question. Meanwhile, faced with growth that had slowed to 7.3% by Q3, China's central bank cut two key interest rates to try to stimulate domestic consumption; it also agreed to work with the United States to cut greenhouse gases. Finally, President Obama took steps to reestablish diplomatic relations with Cuba, though ending the trade embargo would require congressional action.

Forecast 2015

LPL Researcher's has identified significant elements that will be in transit in 2015 includeds:

- The U.S. economy continues its transition from the slow gross domestic product (GDP) growth of 2011 – 2013 to more sustained, broad-based growth. Ongoing progresses in the labor market, an uptick in wage growth, and continued improvement in consumer and business spending have propelled an uptrend in U.S. economic output. We believe inflation — which has historically accelerated as the economy moves into the second half of the business cycle — is poised to continue proceeding higher, but only modestly so.
- Central banks around the world will also be on the move in 2015. In the United States, the economy is likely to continue to travel toward a point where the Federal Reserve (Fed) will begin raising interest rates, albeit gradually, for the first time in nine years. The Eurozone and Japan — the world's second and fourth largest economies, respectively — could benefit, as central banks in those regions embark on more aggressive policy actions aimed at restarting and reaccelerating their long-dormant economies.
- Washington shifts from a relatively quiet 2014 to take a bigger role in 2015. The Republican takeover in the Senate and approaching debt ceiling limit might provide the opportunity for some movement out of the gridlock that has plagued Washington in recent years.

Against this backdrop, LPL forecast the following:

- We expect the U.S. economy will expand at a rate of 3% or slightly higher in 2015. This forecast matches the average growth rate over the past 50 years, and is based on contributions from consumer spending, business capital spending, and housing, which are poised to advance at historically average or better growth rates in 2015.
- Tempered by increasing levels of volatility, stocks may be poised to advance 5 – 9%. We believe continued economic growth, benign global monetary policy, and a more favorable policy climate from Washington indicate that the powerful, nearly six-year-old bull market should continue. This forecast is in-line with the average stock market growth of 7 – 9%, since WWII. Supported by improved global economic growth and stable profit margins in 2015, we expect earnings per share growth for S&P 500 companies of 5 – 10%.
- We expect flat bond market returns. With sustained improvement in economic growth, slowly rising inflation, and the approach of the Fed's first interest rate hike, bond prices are likely to decline in 2015. We believe high-yield bonds and bank loans with their attractive yields can help investors manage this challenging bond market.

Cautiously Optimistic

The fundamentals that have fueled equity gains in recent years remain in place. Even as the Fed ended its controversial bond-buying program last October, the fed funds rate is expected to remain at historically low levels through at least the end of 2015 and possibly beyond.

Moreover, the European Central Bank continues to unveil a more ambitious plan in the works, as it battles a severe disinflationary environment. Simply put, central bank generosity has historically been a tailwind for stocks.

While we are cautiously optimistic, let's not get carried away. Let's keep a balanced approach. Let's adjust our approach when changes in your personal situation or goals make our current stance less than optimal.

While strong fundamentals remain in place, risks never disappear, even in a diversified portfolio. We can manage but not eliminate risk.

What could create volatility in 2015?

1. The year ended with oil near $50 per barrel. I recently saw a story in Reuters that noted $150 billion in energy projects around the globe face the axe. That means there will be winners and losers at current prices, though the net gain to the economy should be positive.

   Meanwhile, Russia is undergoing a wrenching adjustment, as its energy-dependent economy must adapt to the new reality. The Russian ruble has fallen sharply this year, and Russia's central bank said its economy could shrink by as much as 4.7% in 2015 if oil averages $60 a barrel.

   A 1998-like crisis that briefly walloped stocks doesn't appear to be on the horizon, but any contagion that seeps out of Russia could create volatility at home.

   Then there has been the steep selloff in junk bonds tied to the energy sector. While Treasury and investment grade yields fell last year, high-yield debt rose. Some of the rise can be blamed on expectations the Fed will eventually raise interest rates, which could crimp some highly-leveraged borrowers. But a big part of the increase can be blamed on default fears in the energy patch amid a re-pricing of risk in high-yield energy bonds. If concerns were to seep into other sectors of the junk bond market, we could see a spillover into stocks.
2. Pressure the market faces early this year: Greece is has recently elected a new very far left leaning president. While political leaders on the left favor staying in the euro-zone, they want to renegotiate the terms of the Greek bailout. Markets rarely enjoy grappling with an added layer of uncertainty.
3. Slowing growth in China and Europe's tepid recovery could dampen growth at home. Odds are fairly low as the U.S. simply isn't dependent on overseas demand to drive its economy. So far, U.S. growth has accelerated in the face of global jitters.

4. Will we get volatility around the Fed's first rate hike in nearly a decade? There are no guarantees when it comes to Fed policy, but if U.S. employment and economic growth continues at the current pace, the Fed has signaled rates will start rising in 2015. Although it is doing its best to telegraph its intentions, markets could get jittery in the interim.
5. Emerging market anxieties. A stronger dollar and a Federal Reserve that is expected to begin raising rates could pressure developing countries that have sold bonds in greenbacks instead of their local currencies, forcing them to repay loans in more expensive dollars. Foreign reserves (akin to a rainy day fund) could minimize any pressure, but it's something that bears watching.
6. Liquidity is like oxygen to the market. A brief surge in U.S. Treasury prices and the steep but short-lived stocks selloff in October can be partly blamed on a temporary lack of liquidity. Some cite well-intentioned regulations put in place after the 2008 financial crisis.
7. Cyber-attacks. North Korea's alleged attack on Sony quickly comes to mind. It's impossible to forecast, but the outside chance of a big event can't be completely discounted.
8. Geopolitical fears. War or geopolitical instability has historically caused short-term losses. Whether the Arab spring, Russia's incursion into Ukraine, or the rise of ISIS (ISIL) in Iraq, heightened uncertainty is not a friend of investors.

Bottom line

We've always stress the importance of being comfortable with your portfolio. As we've talked about in our meetings, our goal is to help you mitigate that risk. But you must be comfortable with the level of risk you're taking as we set out to meet your objectives. If you are not, let's talk and recalibrate.

Stick to the plan. Markets rise and markets fall, but unless there have been changes in your circumstances or you've hit milestones in your life, such as retirement, stay with the plan. By itself, a record high in stocks isn't a good reason to bail out of stocks.

Communicate and meet with us. If you believe your circumstances have changed, please contact us for a review and to assess what changes we should make to your client profile. We should plan to meet at least once a year to in person, by telephone or web meeting to review your client profile, your financial planning and review your investments. We are here to assist you in any way we can. Our mission is to help you in reaching your goals and objectives.

I hope you've found this review to be educational and helpful. Let me emphasize, it is our job to assist you! If you have any questions or would like to discuss any matters, please feel free to give us or any of our team members a call.

As always, we're honored and humbled that you have given us the opportunity to serve as your financial advisor.

We hope this finds you and your family doing well. We continue monitor your portfolio making changes where necessary and seek out attractive investment opportunities, while remaining watchful for risks.

Sincerely,

Scott E. Bordelon

Scott E. Bordelon, CFP®, AAMS®
President

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) and Barron's (S&P 2014 total return); U.S. Treasury (Treasury yields); U.S. Energy Information Administration/Bloomberg.com Market Data (oil spotprice, WTI Cushing, OK); www.goldprices.org (spot gold/silver); Oanda/FX Street (currency exchange rates). All information is based on sources deemed reliable, but no warranty or guarantee is made as to its accuracy or completeness. News items are based on reports from multiple commonly available international news sources (i.e. wire services) and are independently verified when necessary with secondary sources such as government agencies, corporate press releases, or trade organizations. Much of the commentary contained herein was prepared by Broadridge Investor Communication Solutions, Inc. and LPL research. Neither the information nor any opinion expressed herein constitutes a solicitation for the purchase or sale of any securities, and should not be relied on as financial advice. Past performance is no guarantee of future results. All investing involves risk, including the potential loss of principal, and there can be no guarantee that any investing strategy will be successful.

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 2000 U.S. small-cap common stocks. The Global Dow is an equally weighted index of 150 widely traded blue-chip common stocks worldwide. The U.S. Dollar Index is a geometrically weighted index of the value of the U.S. dollar relative to six foreign currencies. Market indices listed are unmanaged and are not available for direct investment. Economic forecasts set forth may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

High-yield bonds are subject to higher interest rates, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price. Stock investing involves risk including loss of principal

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