INVESTMENT OVERVIEW

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Economic & Markets Summary: 1st Quarter 2015

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The Economy

The most recent read on broad US economic growth showed a deceleration in the final quarter of 2014. Real gross domestic product (GDP) -- which measures the value of all goods and services produced in the United States of America -- increased at an annualized rate of 2.2 percent in the fourth quarter of 2014, according to the most recent estimate released by the Bureau of Economic Analysis. This pace of growth represents a slow-down from the prior two quarters, which saw growth of 5.0 percent in the third quarter and 4.6 percent in the second quarter. For the full-year 2014, real GDP increased by 2.4 percent.

Corporations felt the effects of the slowdown during the final months of 2014. The Commerce Department reported that after-tax corporate profits fell by 3 percent from the prior quarter. This was the largest quarterly drop in profits since the first quarter of 2011. Partly to blame for the weakness is a strengthening US dollar. According to the *Wall Street Journal* the dollar has risen by 28 percent against the euro since last May, and over the past year the WSJ Dollar Index is up by 19 percent. As the dollar strengthens it makes goods produced in the United States more expensive, and thus less competitive, on a global scale.

Consumers, however, continued to spend at the fastest pace since the first quarter of 2006 as real personal consumption expenditures increased at 4.4 percent. There appear to be two major factors influencing the willingness of consumers to spend. The first is the job market, which has continued to expand over the past several months. In February, total non-farm payroll employment rose by 295,000. Over the past 12-months, monthly gains in non-farm payrolls have averaged 266,000. In addition, the unemployment rate fell to 5.5 percent. This is the lowest level for the headline unemployment number since May 2008 and is down from the peak of 10 percent during the depths of the recession in 2009. The other factor aiding consumers has been the rapid decline in energy prices. The average retail price of a gallon of fuel is currently $2.45 compared to an average price of $3.57 one year ago. The U.S. Energy Information Administration estimates that the average household will spend about $550 less on gasoline in 2015 compared with 2014.

Interest Rates

Interest rates ended the quarter lower with interim moves driven by concerns over weak global economic growth countered by relatively stronger U.S. growth and anticipated interest rate moves by the Federal Reserve. The yield on the 10-year US Treasury note declined in January and early-February due to concerns over global economic growth. The 10-yr yield fell to a low of 1.64 percent in late-January, the lowest since May 2013. During the month of February and continuing through the early part of March yields rose, hitting a peak of 2.24 percent on March 6th following the most recent release of the monthly employment situation by the Bureau of

Labor Statistics. Since early-March yields have drifted downward, trading below 2 percent over the final two weeks of the quarter.

The FOMC met twice during the quarter, in January and March. The FOMC's statement following the March 18th meeting removed the language stating that *"the committee judges that it can be patient in beginning to normalize the stance of monetary policy."* Instead, the committee stated that it is unlikely that they will increase rates at the April meeting, but they *"anticipate that it will be appropriate to raise the target range for the federal funds rate when it has seen further improvement in the labor market and is reasonably confident that inflation will move back to its 2 percent objective over the medium term."* The Fed last raised interest rates in 2006 and has kept the target range near zero since December 2008. However, odds remain low for a rate hike occurring this summer with futures markets pricing in a 6 percent likelihood of a June increase.

Treasury yields for various maturities as of 3/31/15 compared to year-end 2014 and 2013 are displayed below.

	Treasury Bill	**Treasury Notes & Bonds**			
	3 mo.	2yr.	5 yr.	10 yr.	30 yr.
03/31/15	0.02%	0.56%	1.37%	1.92%	2.54%
12/31/14	0.04%	0.67%	1.65%	2.17%	2.75%
12/31/13	0.07%	0.38%	1.74%	3.03%	3.97%

The total return numbers for various fixed income indices over the last twelve months are displayed below (data from Bloomberg).

52 Week Returns (as of 03/31/15)			
Barclays Capital US Aggregate	5.72%	Merrill Lynch US High-Yield	2.05%
Merrill Lynch US Treasury Int-Term	3.44%	Merrill Lynch US Municipal Index	6.90%
Dow Jones Corporate	3.84%	JP Morgan EMBI Global	4.08%

Stocks

After falling -3.0 percent in January and rising +5.75 percent in February, the S&P 500 closed out the month of March -1.58 percent lower, leaving it slightly positive so far in 2015 (+0.95 percent). The Dow Jones Industrial Average and the S&P 500 both set record closing highs in early-March (18,288.63 – Dow; 2,117.39 – S&P 500), while the NASDAQ composite breached the 5,000-level on a closing-basis three times during the month. The last time the tech-heavy NASDAQ closed above 5,000 was fifteen years ago in March 2000 when it peaked at the end of the late-1990's tech bubble at an all-time closing high of 5,048.62. On an intra-day basis, the NASDAQ would need to surpass 5,142.52 to reach new all-time highs.

Foreign and emerging market stocks staged a turn-around during the first quarter with both the MSCI EAFE and Emerging Markets (EM) indexes outperforming the S&P 500 after underperforming three out of the past four calendar years (2011, 2013 & 2014). Small-cap stocks performed well during the quarter with the Russell 2000 index rising by 4.32 percent, while growth stocks out-performed value stocks.

Below is a table which displays various equity index returns for the quarter.

Equity Indices	**1st Qtr. 2015**
S&P 500	0.95%
Dow Jones Industrial	0.33%
NASDAQ	3.86%
S&P 500 Growth	2.47%
S&P 500 Value	-0.69%
Russell 2000 (small-cap)	4.32%
MSCI/EAFE (developed international)	5.04%
MSCI/EM (emerging markets)	2.22%

As US equity markets continue to set new all-time highs, investors must confront the fact that overall valuations are no longer priced at levels that will provide the sort of future returns that have been experienced over the past few years. According to Morningstar®, the S&P 500 *"carries a Shiller price/earnings ratio of 27.7x; higher than 79% of all monthly readings since 1989. The Shiller P/E uses a 10-year average of inflation-adjusted earnings in the denominator. Alternatively, the S&P 500 is trading at 18.4x trailing peak operating earnings, which is higher than 77% of monthly readings since 1989. In both cases, such high valuation levels have historically been associated with poor subsequent five-year total returns and an elevated risk of a material drawdown."* Based on current valuation levels it is important that individuals and institutions evaluate their return assumptions over the next several years. Investors are wise to proceed with a bit more caution from today's levels.

The following table details S&P 500 sector returns for the quarter.

Return by Stock Sector	**1st Qtr. 2015**
1. Health Care	6.53%
2. Consumer Discretionary	4.80%
3. Telecommunications	1.54%
4. Consumer Staples	0.99%
5. Materials	0.99%
6. Information Technology	0.57%
7. Industrials	-0.86%
8. Financials	-2.05%
9. Energy	-2.85%
10. Utilities	-5.17%

Source: Bloomberg

Sector returns were mixed during the first quarter. After leading the market on the upside in 2014, Utilities have been the worst performing sector YTD, declining by over -5 percent. Energy stocks also suffered negative returns as the price of crude oil remains under $50 per barrel as of the end of the quarter. Health Care and Consumer Discretionary stocks were the leading sectors with returns of +6.53 percent and +4.80 percent, respectively.

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