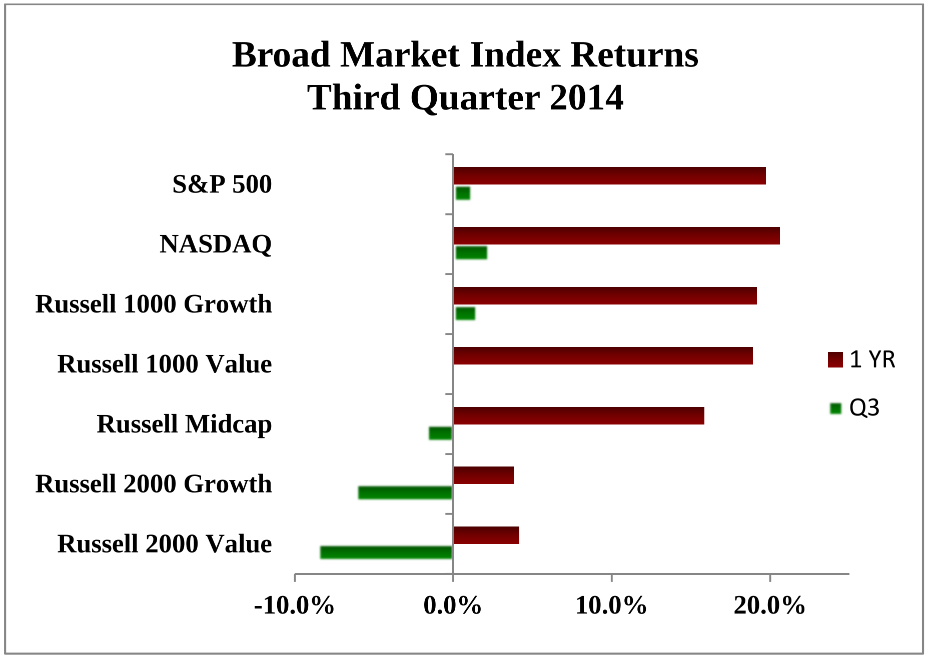
Third Quarter 2014 Market Summary

While the S&P 500 was up slightly, the rest of the equity markets were generally down during the third quarter. The S&P 500 hit a new all-time high on September 18th but slid along with the rest of the equity markets during the second half of the month as investors speculated that the Federal Reserve will be forced to increase interest rates sooner than their public comments indicated. Investors are already acting as if the interest rate hike cycle has started as performance for small cap stocks and consumer cyclical stocks turned negative starting in July. These two equity categories typically underperform during periods of rising interest rates because consumers and small companies are extremely sensitive to the cost of borrowing money.

Growth stocks outperformed value stocks during the quarter, reversing the trend seen during the first half of the year. Technology and health care stocks, typically classified as growth, led the way during the quarter, while value industries including utilities and energy were both negative during the quarter. Energy stocks were particularly weak because oil prices declined as Middle East oil production has remained stable, the fear of supply disruptions has subsided and the U.S. dollar has strengthened. 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 third quarter as the Barclays U.S. Aggregate Bond index was slightly positive but many bond sectors were slightly negative. For much of the year, U.S. bond prices have been surprisingly strong because U.S. Treasury yields have become relatively attractive compared to European bonds.

While the equity and bond markets have been more volatile in the past month, the U.S. economy continues to grow steadily. There had been some concern that job growth slowed in September, but the 248,000 increase in payrolls that was recently reported easily exceeded expectations and the prior two month payroll numbers were also revised higher. Consumer spending in August came in above expectations and spending numbers were revised upwards for the prior two months.



Highlights

GDP

- The Bureau of Economic Analysis released the third estimate of second quarter 2014 real GDP, an increase of 4.6% versus first quarter 2014, revised up from the second estimate.
- The University of Michigan Consumer Sentiment Index final reading for September was 84.6, which was an increase from August. August was 82.5 up from 81.8 in July. Consumer sentiment has leveled off the past twelve months after trending up the previous few years.
- The ISM Manufacturing Index rose during the quarter from 55.3 in June to 56.6 in September. After a slow start to the year the ISM Index has rebounded. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish.
- In August, the Conference Board Leading Economic Index increased 0.2% month-over-month to 103.8. The Index has been increasing steadily over the past year showing steady slow growth in the economy.
- The price of WTI Crude Oil was $91.17 at the end of September, which is 14% lower than $106.07 at the end of June. The price of Brent Crude Oil decreased 14.7% in the quarter to $94.67.
- In August, the headline CPI came in at 1.7% year-over-year, down from 2.0% in July. Core CPI, which does not include food and energy, decreased to 1.7%. 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 August with an annualized rate of 5.05 million units from 5.14 million units in July. The August annualized rate is 5% below the 5.33 million units in August 2013. Home sales have stalled as home prices have risen over the past year and mortgage rates are expected to rise.
- Median existing home sale prices increased during the quarter. The preliminary prices for August were 4.8% higher from the levels of one year ago and have been trending up since the beginning of 2012.
- New home sales increased in the quarter with a seasonally adjusted annual rate of 504k homes sold in August versus 458k in May. Home sales have been trending up since August 2011, when 292k new homes were sold. However, new home sales growth has stalled since the beginning of 2013.
- S&P Case-Shiller 20-City Home Price Index (seasonally adjusted) showed home prices rose 6.7% year-over-year in July. The index has stalled the past four months on a month over month basis.

EMPLOYMENT

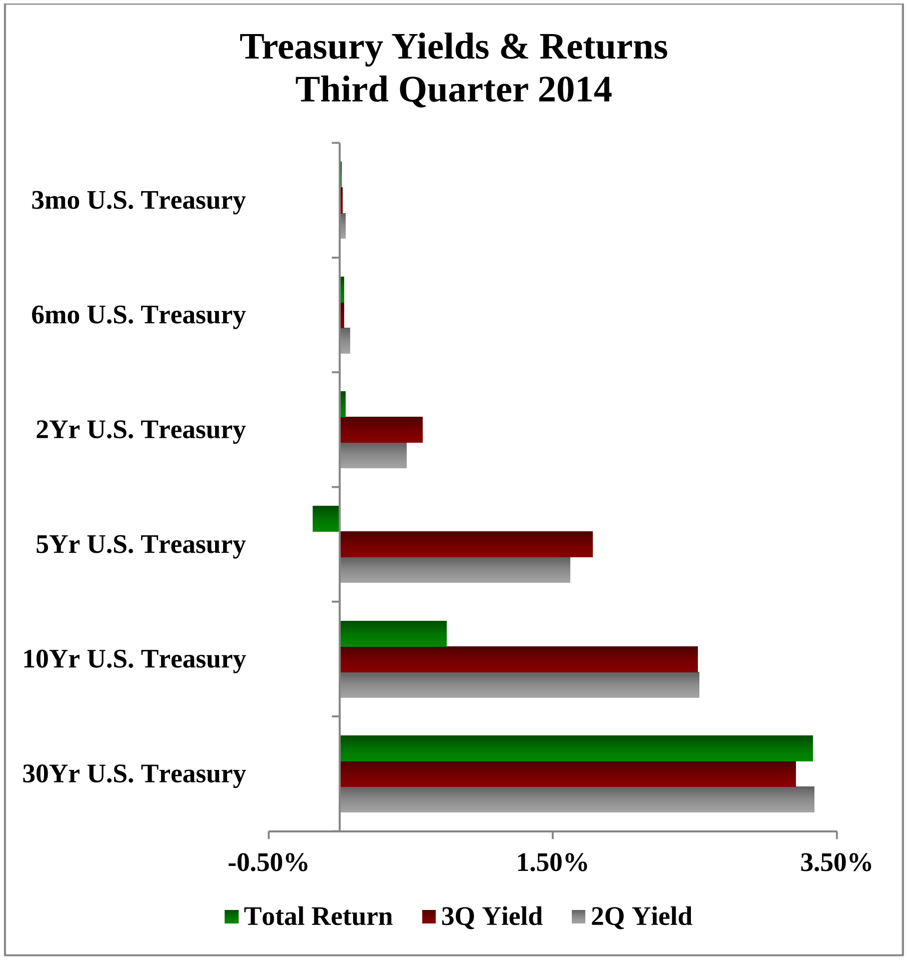
- The labor market continued a trend of slightly stronger jobs growth after a slow start to the year. Nonfarm payrolls added 248,000 jobs in September which beat expectations. In the third quarter, nonfarm payrolls averaged 224,000 jobs added per month which was less than second quarter’s average of 267,000 jobs per month.
- Hourly earnings have been increasing since the end of 2012.
- The unemployment rate fell to 5.9% from 6.1% during the quarter.
- Initial Jobless Claims have been decreasing since 2009 and dipped to lows last seen in 2006-2007 timeframe.

DOMESTIC CORPORATIONS

- Corporate operating earnings rebounded in the second quarter 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 near historical averages.
- The U.S. dollar appreciated considerably versus the euro and yen during the quarter. Currency movements had negative effects on energy and materials companies along with other global cyclicals. If the dollar remains strong, multinationals could see their earnings pressured due to their international exposures.

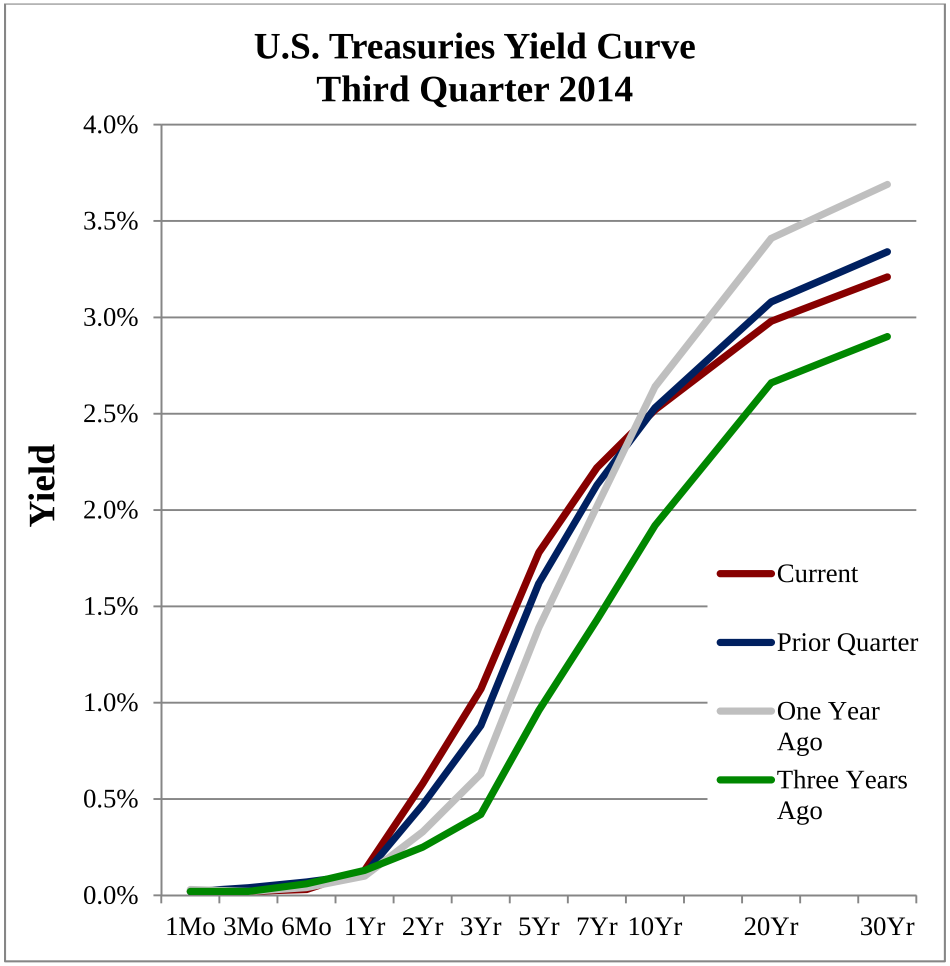
FED POLICY

- In September, 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 continued their tapering of agency mortgage-backed securities and longer-term Treasury securities purchases. They will reduce total purchases by another $10B, to $15B per month. The Fed is expected to cut purchases to zero in October.



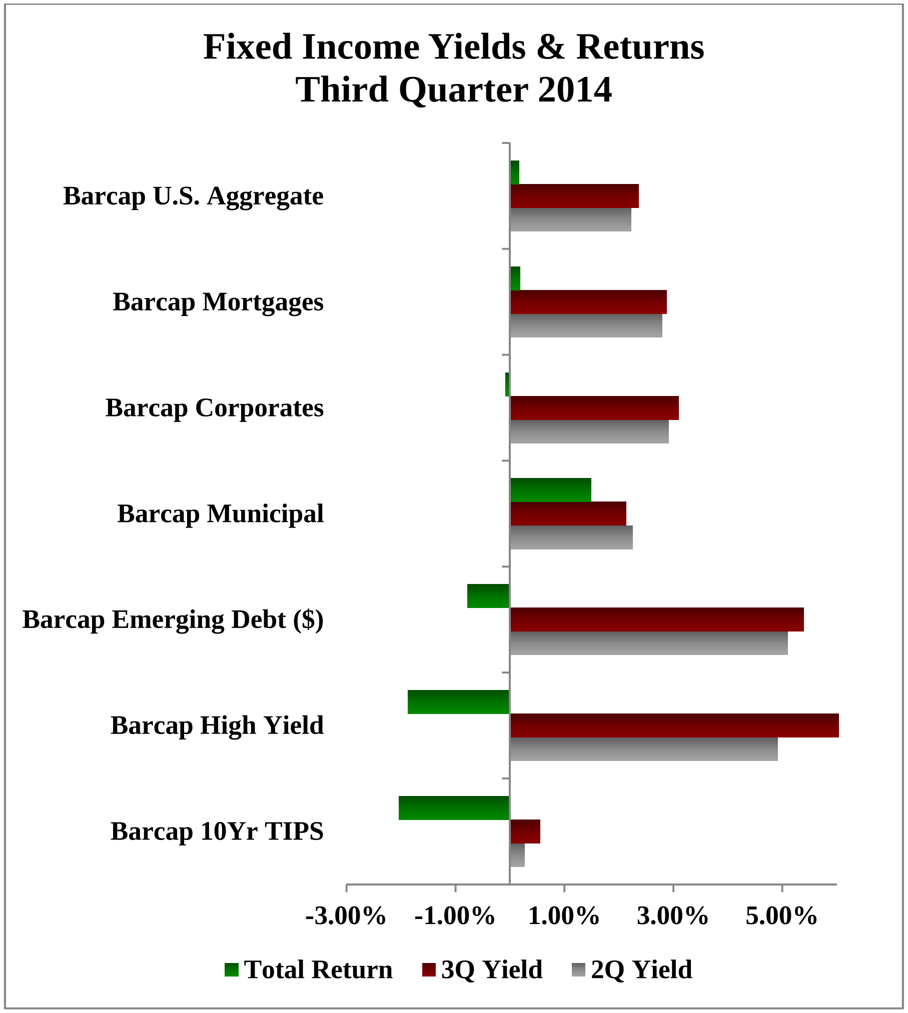
FIXED INCOME

- 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.



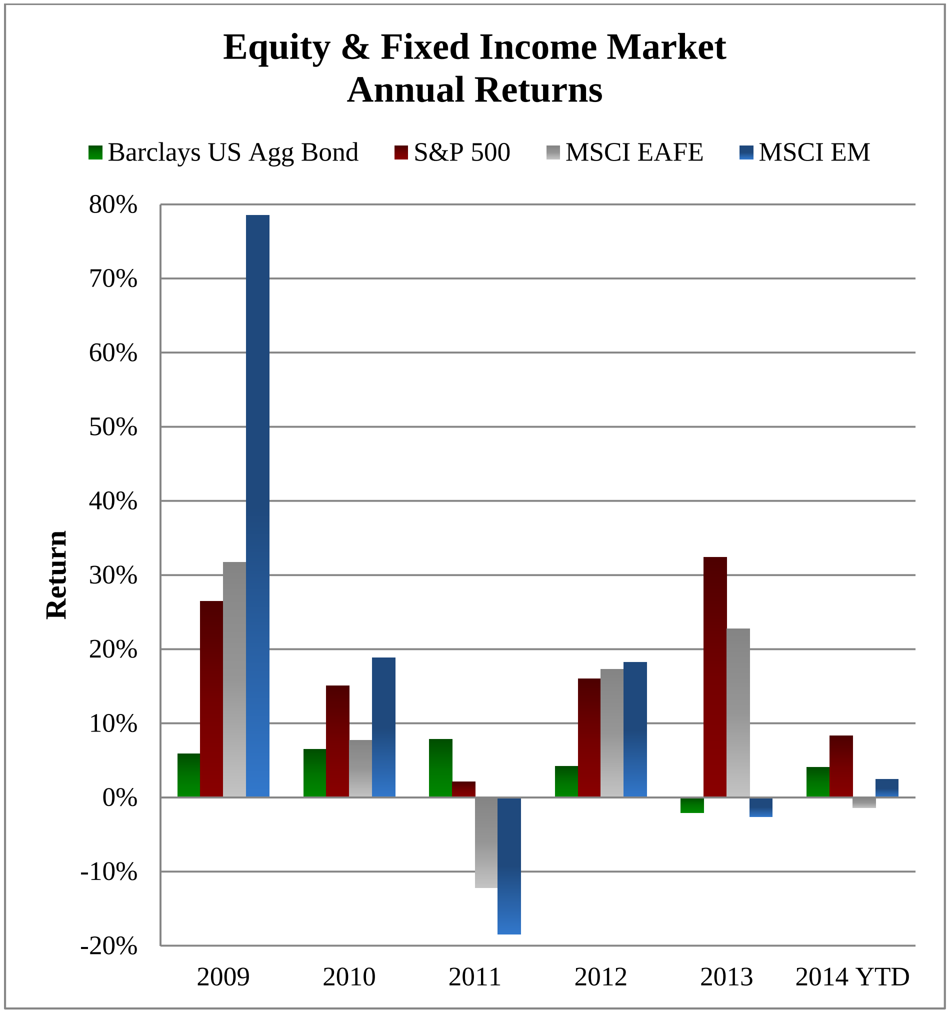
FIXED INCOME (continued)

- Yields in all fixed income sectors except municipals increased during the quarter. Fixed income yields remain low due to low interest rates and tight spreads. Fixed income returns were weak this quarter. Emerging Market Debt, High Yield and longer-term US TIPS had the weakest returns. Municipals was the only sector with a return greater than one percent.



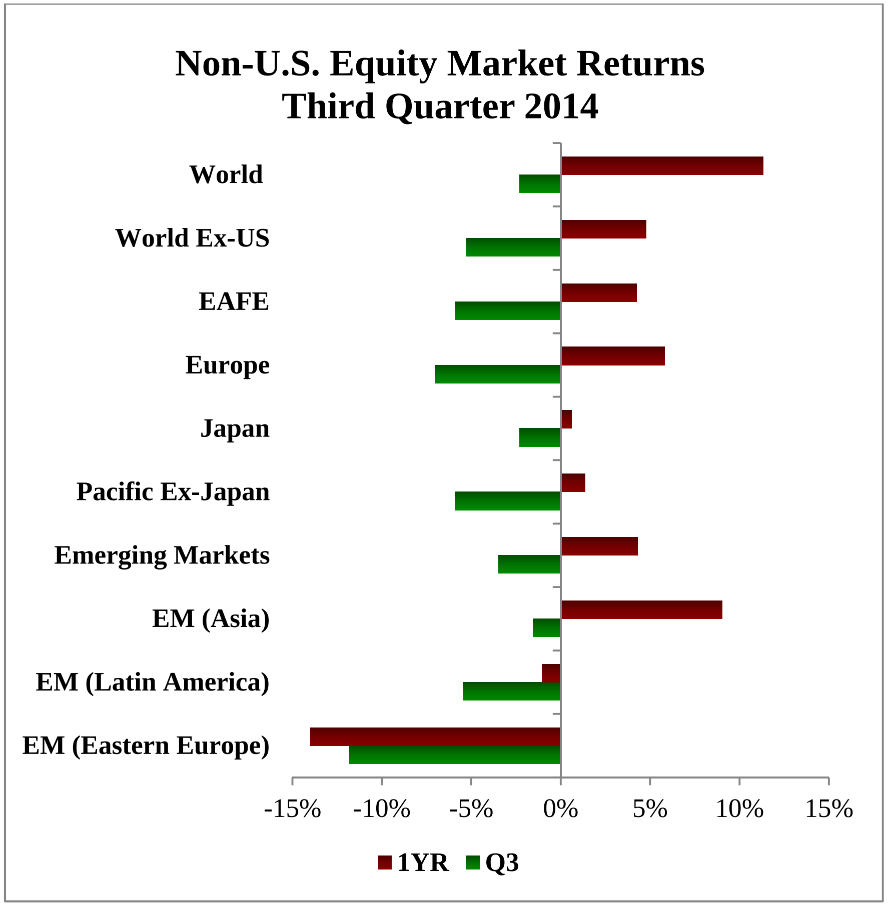
EQUITIES

- For the quarter, equity returns were weak as investors became concerned with global growth. In the U.S., large capitalization stocks had a small positive return while mid and small capitalization stocks had significant negative returns. Growth stocks performed better on a relative basis than value stocks during the quarter. The equity markets saw increased volatility in the quarter.

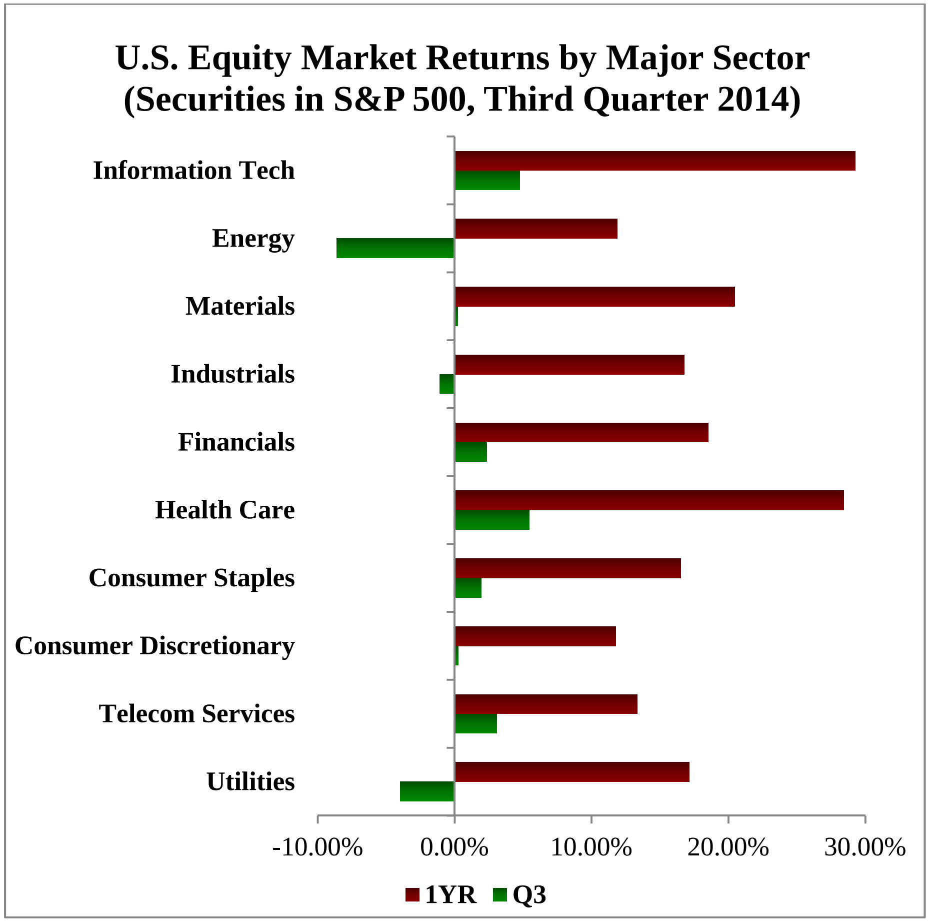


EQUITIES (continued)

- Developed international stocks performed worse than U.S. domestic equities. The MSCI EAFE index of international markets stocks decreased 5.88% during the quarter. On a year-over-year basis, the EAFE is up 4.2%. Japan was the least worst of the international developed markets during the quarter.
- During the quarter, emerging market stocks performed better than developed markets and now are ahead on a one year basis. The MSCI Emerging Markets Index decreased 3.49% in the quarter but has increased 4.30% on a year-over-year basis. 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 0.65% during the quarter. On a year-over-year basis, the Russell 1000 Index has advanced 19.01%.
- Small capitalization stocks, as represented by the Russell 2000 Index, posted a loss of 7.36% during the quarter. On a year-over-year basis, the index has increased 3.93%.
- Energy and Utilities were the worst performing sectors in the quarter while technology and health care were the best performers. Energy, specifically oil, and consumer discretionary companies underperformed due to worries about the consumer and global growth.



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