2014 First Quarter ReView of the Markets

Index	1st Qtr Return
S&P 500	1.8%
MSCI World Ex US	0.8%
Barclay's Bond Index	1.8%
Consumer Price Index	0.5%

Investment Commentary

Coming off the heels of 2013's high-flying equity performance, the first quarter of 2014 saw subdued growth in both international and domestic stock markets. Volatility which was largely absent throughout 2013 resurfaced, but the S&P 500 closed the first quarter up 1.8%. Non-U.S. markets ended the quarter up by 0.8%. Much of the economic data that led to equity market pessimism was blamed on the severe weather in the Northeast. At this time, it is not clear whether or not that was truly the case, but economic data does appear to be rebounding, albeit slowly. In addition to economic data, both international and domestic equity markets were impacted by geopolitical issues between Ukraine and Russia. However, it bears mentioning that only one non-financial event in history has caused equity markets to remain lower a full twelve months later (the British evacuation of Dunkirk in 1940).

The increased equity market volatility served as a tailwind for fixed income. The yield on the 10 year U.S. Treasury note began 2014 at 3.0% and ended the quarter at 2.7%. The lower yields reflect the belief held by many investors that the U.S. economy could be headed for a meaningful slowdown. Lower quality bond yields are closer to high quality bonds than the historical average (this is referred to as a "tight spread"). However, default rates among high-yield borrowers are extremely low and somewhat justifies the low yields.

Economic Outlook

Since the beginning of 2014, we have expected moderate, single digit domestic equity market returns for the year. Unlike 2013, multiple expansion is unlikely to drive a significant portion of overall return. While some are calling for stronger GDP growth in the United States and some are forecasting an economic slowdown, we are confident that economic growth will continue at 2% to 3% for the year.

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Unlike earlier points in this recovery, we believe corporate capital spending will contribute meaningfully to growth. Companies are being pressured to reinvest in their businesses as opposed to hoarding cash, or returning cash to shareholders through share repurchases or increased dividends. From a shareholders perspective, a growing company reinvesting in the business should be the most beneficial use of cash. Regarding interest rates, whether or not our expected level of economic growth occurs will be a key driver of interest rates. To this point, growth has been generally slower than overall consensus (although right in line with our forecasts) which has been one of the factors holding down interest rates. Based on various metrics that impact inflation, we believe, as we have for a while, that inflation will stay in a range of 2% to 3% for the foreseeable future.

Internationally, Europe will continue to slowly recover. We believe the European Central Bank is both willing and able to facilitate growth in the region, even though recovery could take a long time. Emerging markets, specifically those with large current account deficits, are likely to continue to struggle with headwinds including commodity prices and the exodus of capital as other global investment opportunities appear more favorable.

Investment Strategy

Given the economic environment and current valuations, we do not see a meaningful shift in our blend of domestic versus international equities in the near future. Based on our expectation of slow but continued economic growth we maintain that, on a risk-adjusted basis, U.S. equities offer an attractive risk/reward profile.

Federal Reserve Chair Janet Yellen hosted her first policy meeting and subsequent press conference late in the quarter. During the question and answer period, she gave firm guidance that the Fed's plan to decrease bond purchases is likely to continue along their pre-determined path. She also reaffirmed that the Fed was likely to raise rates about six months after the taper ends in late 2014. Based on this and economic growth expectations, we are maintaining our relatively short duration position with respect to fixed income allocations. There will come a time when we will significantly increase portfolio duration, however, at present we see no compelling evidence that fixed income investors are being adequately compensated to do so.

In investing, there are always issues that must be considered. Currently, these issues include employment, how high levels of worldwide public debt will be sorted out, and a potential slowdown in China as well as other emerging markets. We are constantly weighing these risks and the likelihood of the risks materializing into potentially disastrous scenarios. Risks which could lead to meaningful downside are one of the most important differentiations in the composition of our investments in the risk profiles from "1" to "5". It is, however, important to note the distinction between short-term news and the long term analysis that underlies our investment decisions. While we always pay attention to the shorter-term flow of information and its effects on markets, we are not apt to act solely as a result of these developments.

Finally, it is important to remember that intra-year equity market volatility is common and indeed, should even be expected. As unbelievable as it may seem, research shows that the probability of a peak-to-trough drawdown in the S&P 500 of 5% in any given year is 95%. The probability of a 10% drawdown is 57%[1]. That is the "price that one pays" to achieve long term returns greater than risk free returns which are presently extremely low. In light of this, we continue to maintain well diversified portfolios in the interest of helping our clients achieve and maintain financial independence, unaffected by the unexpected.

Disclosure: Historical performance results for investment indices and/or categories have been provided for general comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of any investment management or financial planning fees, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your account holdings correspond directly to any comparative indices. Past results are not indicative of future results.

[1] Source: Goldman Sachs