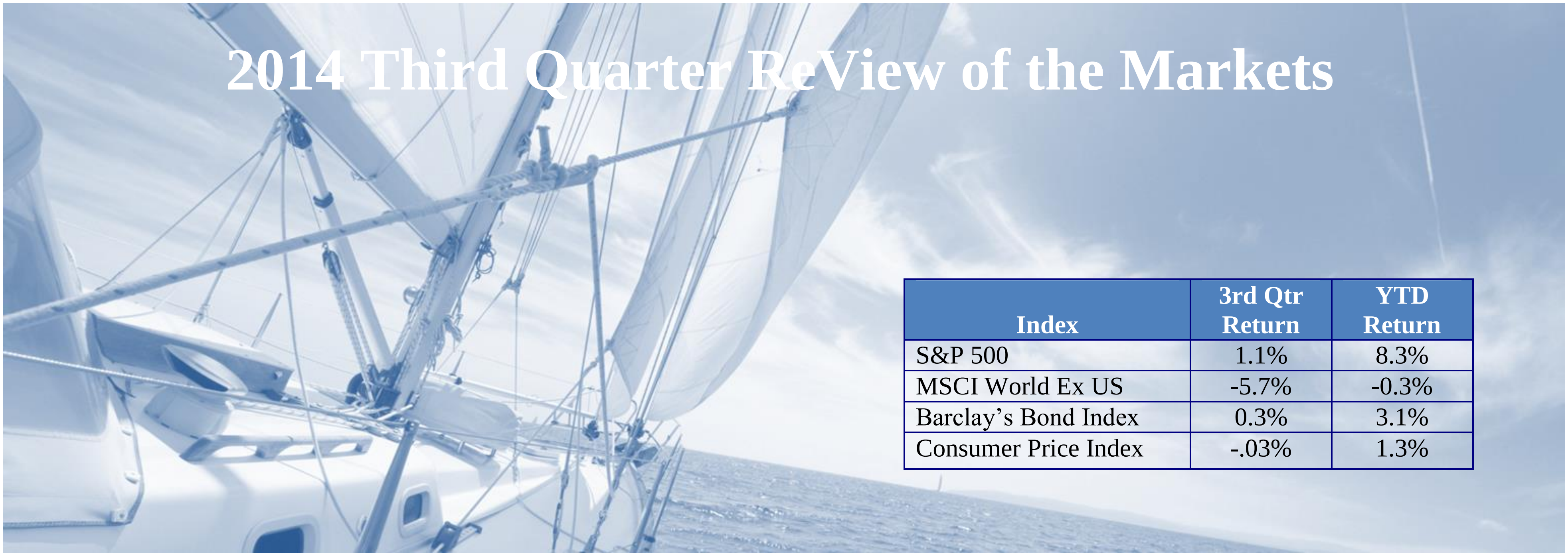

2014 Third Quarter ReView of the Markets

Index	3rd Qtr Return	YTD Return
S&P 500	1.1%	8.3%
MSCI World Ex US	-5.7%	-0.3%
Barclay's Bond Index	0.3%	3.1%
Consumer Price Index	-.03%	1.3%

Investment Commentary

Global equity markets throughout the third quarter were generally lower, although there were signs of strength in large-cap U.S. stocks. Familiar concerns persisted in financial media including speculation on changes in Federal Reserve policy, ISIS violence, and lack of confidence in global economic growth.

International stocks declined during the period with the MSCI World ex USA down over 5%. A strengthening U.S. Dollar should be beneficial for many international companies, but long-term structural and demographic issues continue to cause problems in foreign economies and markets. The European Central Bank ("ECB") unveiled a plan to stimulate the economy. Despite this, most of the quarter's losses came after the announcement reflecting a lack of confidence in the ECB's ability to foster economic growth in the Eurozone.

U.S. equities were generally positive for the quarter. However, there was a large degree of divergence between large and small-cap American companies. The S&P 500 posted a small gain for the quarter, while small-cap indices were down over 7%. Due to a combination of their inherently volatile nature and our opinion that these small-cap companies have been expensive, our clients have had minimal exposure to them throughout 2014 and only our most aggressive clients have had a small dedicated allocation to small-caps.

Volatility surfaced in the fixed income markets, with the 10 year U.S. Treasury, widely considered to be the benchmark relative to which all other bonds are priced, finishing the quarter at 2.5%. The 10 year Treasury has shown no signs of coming close to the 3% yield that it reached late last year and is well below long-term averages. Since the end of the quarter, the 10 year yield briefly dropped below 2%, a sizeable move on a relative basis.

Economic Outlook

Today's investment climate is reflective in large part of divergent central bank policies. The Fed will end its bond buying program this month, and has not given indications that their "mid-2015" interest rate hike will be postponed. The rate hike is not a foregone conclusion, however, as the Fed is monitoring inflation, wages, and employment as it decides when it should allow rates to rise. Inflation has been below the Fed's target of 2%, suggesting that an increase in rates could be delayed. Wages and employment have continued to improve, suggesting that the economy continues to recover. We continue to expect modest GDP growth, between 2% and 2.5% annually, in the U.S. In our eyes, this relatively stable economic positioning makes the U.S. attractive vis-à-vis international markets.

This is in contrast to the ECB which has only just begun their stimulus to provide liquidity in the region. Indeed the scope of the ECB's stimulus program has been criticized because it is not clear that it will be large enough to have a meaningful impact on Europe's weakening economy.

As mentioned, U.S. interest rates have been volatile, but somewhat range-bound this year. Given the global interest rate landscape, we believe this will be persistent. While the Fed is coming to the end of its bond buying program, we believe that strong foreign demand for U.S. Treasuries due to even lower foreign yields will provide sufficient demand to hold U.S. rates at low levels. The German 10 year bond, seen as a European benchmark, ended the quarter below 1%. We do not believe this very low yield accurately reflects risk in the Eurozone, but is instead driven by the central bank's monetary policy and by a lack of confidence in economic growth. The only country to exhibit growth over the last few years has been Germany, but even they have shown signs of an economic slowdown.

Investment Strategy

In light of the above, our portfolios continue to reflect a strong bias to domestic stocks, especially extremely large-cap, dividend-paying, companies. Importantly, valuations are near long-term averages, meaning that while U.S. stocks might not be as cheap as they were earlier on in the recovery, they certainly haven't reached worrisome levels. We could see a scenario in which international equities continue to sell off while U.S. equities decline less, or potentially advance. However, it's difficult to picture a scenario in which foreign equities appreciate without some participation from U.S. equities. We think this risk vs. reward profile strongly argues for overweight exposure to domestic equities, insofar as equities are appropriate for a given risk profile.

The interest rate landscape continues to shock many investors who have waited in vain for yields to rise over the last several years. We believe this environment will likely persist for the near future. In this light, we use fixed income as a buffer against a downturn in equity markets. However, the potential opportunity cost between fixed income and equity returns is considerably larger than has historically been the case. For these reasons, we have continued to utilize publicly available alternative investment strategies, such as equity market neutral, long/short equity, and absolute return, which are generally less volatile than stocks but have potential for returns greater than fixed income.

As we have written in the past, equity markets have experienced a 5% correction in 95% of years and a 10% correction in 57% of years. Such a correction should not be unexpected, especially as volatility returns to markets. Across all asset classes and risk profiles, our aim continues to be your financial independence, regardless of market fluctuations and cycles. Feel free to contact us to discuss your unique individual situation and our strategy at any time.

THE FINANCIAL ADVISORY GROUP, INC.