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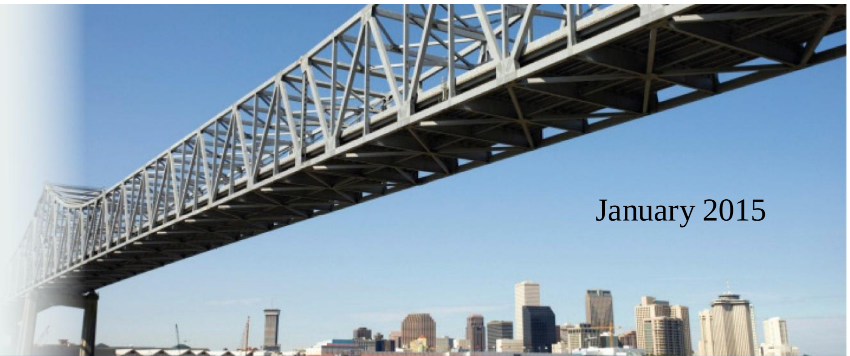

January 2015

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Economic Comments

Christmas came a bit early this year with good news from both the Federal Reserve Bank and the U.S. Commerce Department. At its mid December meeting, the Federal Open Market Committee expressed optimism that the American labor market was continuing to improve. Nonetheless, concerns were raised over the too low rate of inflation which continues to run meaningfully beneath the bank’s target. With November’s modest 1.2% increase in the personal consumption expenditures price index, the Fed’s preferred inflation gauge, inflation has now undershot the bank’s target of 2% for 31 consecutive months. On balance though, economists were cheered by the Fed’s perspective.

The other unexpectedly good news came from the Commerce Department as it revised upwards its estimate of third quarter economic growth to 5% - the strongest rate of increase in 11 years. Critical to this advance was an acceleration in consumer spending due to rising household income and reduced consumer energy expenses. Despite the first quarter’s unexpected contraction, the American economy is anticipated to grow by 2.5% for the full year. Expectations for the coming year are even stronger with 2015 projections for as much as 3.0% growth.

Looking at the year’s latter half, several key economic stories stand out. One of the bigger occurrences was the enormous decline in petroleum prices since late summer. Unusually, the large price drop occurred amidst relative stability for both the global economy and the oil industry’s supply and demand situation. Usually, large energy price swings occur against a backdrop of global volatility - not in this case though. From the late summer highs, oil prices have declined by almost 50% at year-end to $53.46/barrel for the U.S. benchmark, West Texas Intermediate crude.

The apparent drivers of this move appear to have been slow global economic growth (and associated tepid weak global energy demand), large increases in shale oil production and, most surprisingly, Saudi Arabia’s refusal to play its long established role as the world’s swing producer. Despite U.S. energy production having increased markedly in the last 5 years, the U.S. still appears to be a net winner from oil’s recent dramatic decline.

For U.S. consumers, who use an average of 600 gallons/year, the $1.00+/gallon price decline represents additional income of more than $50/ month - a noticeable amount to many families still financially strapped from after effects of the Great Recession. Moreover, the broader American economy benefits from lower energy prices as most of the money that would otherwise be spent overseas to buy petroleum is now being spent domestically.

The other big story to close

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Economic Comments continued from cover

out the year was the resurgent dollar; the greenback has now hit its highest levels in more than a decade as compared to most major currencies. The impetus behind this substantial appreciation is straight forward - the relatively robust U.S. economy and its central bank which is preparing to raise interest rates. This stands in stark relief to the economic weakness of most other major economies and their central banks which are considering and/or pursuing additional monetary easing.

While making imports less expensive for American consumers, the dollarôs recent gain does raise the concern that the global economic weakness could become an insurmountable drag on continued U.S. prosperity. Furthermore, with foreign buyers paying more for U.S. products, overseas competitors gain a price advantage over U.S. manufacturers. Additionally, U.S. corporationsô overseas profits will be reduced when translated back into U.S. dollars.

Notwithstanding these currency related concerns, we are encouraged by several other recent pieces of economic data. At the yearôs close, the University of Michigan's final consumer sentiment index reading was up appreciably from Novemberôs already strong reading. Driving the improved mood was the continued strengthening of the labor market and the recent decline of gas prices. Additionally, the Institute for Supply Management's December reading was a historically robust 55.5. The yearôs average reading of 55.8 was the strongest since the 2007-2009 recession.

Finally, reduced inflation expectations could provide the Fed with additional flexibility in its actions. While oilôs decline has accentuated this shift, bond prices now imply inflation expectations over the next 5-10 years of only 2.14%/year - down sharply from last Januaryôs forecast of 2.65% annual inflation.

As we look forward, low inflation and sagging commodity prices have historically been a signal of weak underlying global demand. We believe that the key economic issue for 2015 is whether our nationôs economy can build on its recent advances in the face of economic headwinds from overseas. At this stage, we are optimistic that Americaôs economic engine will be able to overcome these challenges abroad.

For the upcoming year, one thing we do anticipate is an eventful, if not interesting, economic rideð whether from the ongoing Ukrainian crisis, the renewed economic turmoil in Greece, or new cyber attacks from North Korea, or even other new crises, the future will continue to provide us with more unanticipated surprises.

Analyst Corner

The most popular search engine for the internet has become so dominant that the word google has become a commonly used verb. Since going public in mid 2004, Google Inc. (NASDAQ: GOOG) has profited enormously through its sale of advertisements embedded in its search engineôs results. With a 75+% share of all internet searches, the company is both an enormous and very consistent cash generator. However with its strong growth over the last decade, even today there remains a large imbalance between the time consumers spend online and the relatively small amount of money dedicated to internet advertising. As a result, we foresee a strong tailwind in support of Googleôs continued domination of internet advertising. In addition, the company, almost despite itself, has accumulated net cash equal to almost 15% of its total market value. For these and other factors, we believe that you would have to *search* far and wide for another stock to produce the attractive returns that we foresee with Google!

Market Comments

After more than 50 record closes during the year, Wall Street ended 2014 within inches of all time highs. For the year, the S&P 500 clocked an almost 13.7% increase - the 3rd consecutive year with an advance of more than 10%. Now 70 months old, the current market is the fourth longest bull market on record since World War II. Heading up 2014ôs performance was the boring utility sector which advanced almost 29% as investors re-evaluated the sector in the face of diminished interest rates and reduced inflation expectations. The marketôs laggard, in the face of the sharp drop in petroleum prices, was the energy sector with a decline of almost 7.8%.

Confounding expectations, the fixed income market provided an unexpected surprise as bond prices also rallied appreciably during the year. With effectively ALL forecasters agreeing that 2014 would see a secular shift towards rising long term rates, the 30-year U.S. Treasury bucked expectations as its yield decreased by almost 1.25 percentage points to 2.75% at year-end. Analysts did have the story right - the job market strengthened and the Fed discontinued its QE3 program, but the bond market defied conventional wisdom. The driver behind this yield decline appears to have been overseas investors seeking high yielding U.S. bonds in lieu of the anemic rates available locally.

Despite analystsô missed fixed income call of 2014, expectations are that the Federal Reserve will implement its first rate increase in nine years by mid year. This has investors concerned. After years of painful anticipation of rising short-term rates, it appears that the time is finally upon us. With the markets having had a long period to brace themselves for this eventuality, Wall Street should not panic.

Several recent studies have highlighted that historically the stock market has clocked solid gains during periods where the Fed has been raising short term rates. This unexpected answer is somewhat counter intuitive as rising rates should place meaningful downward pressure on stocks. The answer is fairly straight forward - the Fed typically raises interest rates only when the economy is healthy. With the economy growing and jobs plentiful, investors are naturally more optimistic. The end result is that markets typically rally despite this potential dampening effect .

Besides the concern over rising rates, pundits have also raised issue with the marketôs overall valuation. The price earnings multiple of the S&P 500 recently sat at 19.7 - appreciably higher than the historical average of 16.9 since 1936 but below the average of the past 20 years of 22.5 (excluding the final quarter of 2008). The real question behind these numbers is what are the practical ramifications for the market moving forward. While the market is richly priced on many historic measures, consideration should also be given that short term interest rates have not historically been 0.0% nor have longer term inflation expectations been as low as they are today. The net result is that when factoring in these two issues, there is still opportunity for additional market advances in 2015. That being said, and after three years of robust returns, any gains are likely to be more modest - possibly only providing investors with single digit returns.

On a broader basis, we continue to hold to our core belief that investors should assume only those risks necessary to achieve their longer term goals. Beyond that, they should try mightily to ignore the marketôs day to day ups and downs and remain focused on their long term needs and objectives.

Performance as of 12/31/14

	Close	Month	1 Year
DJIA	17,823.07	0.12%	10.05%
S & P 500	2058.90	-0.25%	13.69%
NASDAQ Comp.	4736.05	-1.16%	13.40%

	Year end yield	Prior Year end yield
10 yr. U.S. Treasury	2.17%	3.03%

Planning Thoughts

Whether or not you have a taxable estate, estate planning is extremely important. The centerpiece of a good estate plan is a well crafted will. Through this document, you insure that your final wishes are honored and that your possessions are given to the people and/or organizations that you choose and you want.

In addition to a will, there are several other key documents that should also be prepared, namely powers of attorney and advanced medical directives. Through the power of attorney, you determine what individual you are going to grant legal authority to control your affairs and how broad, or limited, these powers will be. With the advanced medical directive, you are determining what medical measures you would like taken to prolong your life. While these are all difficult decisions, better that they are done in advance than being faced with making these decisions in an emergency, or, worse still, being unable to make them.

One added wrinkle awaits parents of young adults. Once the young adult becomes 18, and even if their parents are still financially and emotionally supporting them, their parents no longer have any automatic legal say over their adult childrenôs healthcareð even in an emergency. One way to address this potential issue is by executing an advanced medical directive where the child names their parent as their healthcare proxy. As always, if you need or would like to discuss any of these issues further, please do not hesitate to call us!

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