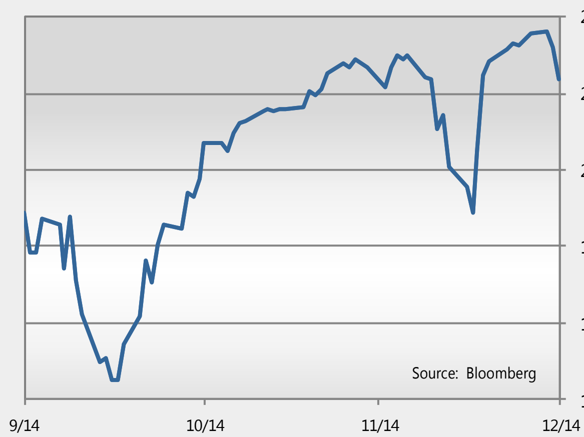
fourth quarter 2014

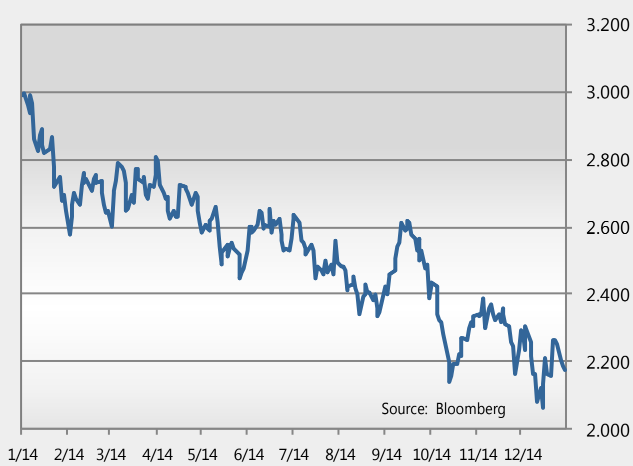
INVESTMENT *perspective*

The fourth quarter of 2014 closed on a positive note for U.S. equities and fixed income. Despite a significant uptick in volatility that resulted in the S&P 500 twice declining by 5%, the index returned 4.9% for the quarter and 13.7% for the year. Yields on fixed income securities continued to defy most market prognosticators with the 10-year Treasury yield ending 0.85% lower than at the start of the year. The decline aided the Barclays U.S. Aggregate index to a 1.8% return for the quarter and 6.0% for the year.

S&P 500 Index (9/30/14 - 12/31/14)



10-Year Treasury Yield (1/1/14 - 12/31/14)

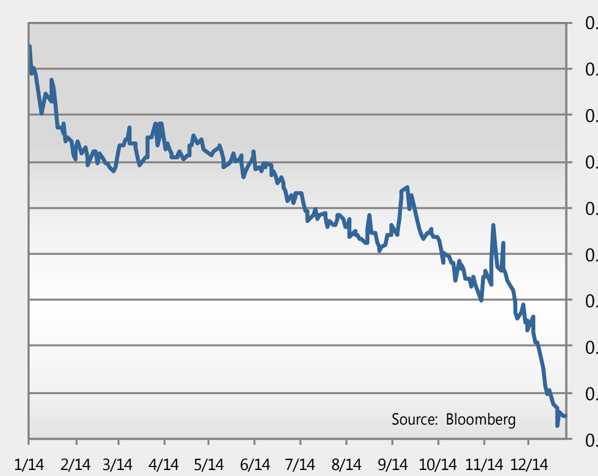


We anticipate market volatility to continue as capital markets adjust to shifts in central bank policy occurring globally and as credit market fundamentals begin to reflect a modest deterioration, specifically the below investment grade universe.

Equity markets have generated strong results the past two years and we expect the stock market will consolidate the most recent gains prior to a material advance higher. The equity advance has been supported by very generous credit market conditions, and equities will continue to take their cue from the credit market. While the credit environment should continue to support equity valuations, we expect credit markets to progressively become less accommodative as we progress through 2015. Corporate balance sheets are no longer improving and the high yield market will need to contend with rising defaults, especially within the energy sector. This will likely lead to increased volatility and modest deterioration in credit availability. The aforementioned adjustments in credit fundamentals could increase volatility in the equity markets.

The driving force behind the fixed income rally was a combination of weak economic growth in Europe, Japan, and China, coupled with a 50% decline in the price of oil. In addition, despite the general decline in rates in the U.S., demand remains strong for U.S. fixed income as domestic yields remain very attractive relative to European and Japanese bonds.

Japanese Government Bond 10-Year Yield (1/1/14 - 12/31/14)



Once all of the data are compiled, it is likely the U.S. economy expanded 3% in 2014 and employment gains accelerated to 240,000 per month versus 195,000 in 2013, leading to an unemployment rate of 5.7%, the lowest since 2008. Given this solid backdrop, the Federal Reserve has telegraphed its intention to begin the "rate normalization" process, which likely means raising the Fed Funds target rate by 0.50% in the second half of 2015.

Given current valuations in the equity market and the prospect of the Fed moving off its zero interest rate policy, there is a heightened possibility of a near term correction in equities. We welcome any correction as an opportunity to make attractive investments. While the nature of the bull market is changing, there are still individual stocks that will perform well despite the increasing market headwinds. This positive outlook continues to be stock-specific and not reflective of opportunities in specific industries, regions of the world, or broader market indices.

Within taxable fixed income portfolios, we continue to favor financial over non-financial sectors, as stricter regulatory oversight benefits credit improvement. We are also seeing some value in the credit of select large integrated energy companies. We remain positioned with a shorter duration than our benchmarks and maintain our overweight to the corporate sector. Within the corporate space, we will look to take advantage of any opportunities that develop between individual bonds and sectors.

Municipal bonds had another solid year in 2014 as yields on municipals declined relative to Treasury bonds. With state government finances continuing to improve due to rising tax revenues, municipal bonds remain attractive.

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