

MARKET COMMENTARY

January 15, 2015

Stocks fell 1% during the final session of the year, erasing a December gain, yet optimism over the economy, rising corporate earnings and cooperative policy from the Federal Reserve helped the S&P 500 score double-digit 2014 returns. Equity valuations were remarkably resilient despite intense market volatility, primarily driven by dire overseas events. Recall the stark headlines ranging from Russia's incursion into Ukraine, an Ebola outbreak and renewed Middle East conflict by the ISIS terrorist army. Global valuations have been most recently challenged by the bear market in oil. Caused by burgeoning U.S. shale oil production and OPEC's refusal to trim output, crude oil has fallen to a five-year low of \$53.27 per barrel, down 40% during the quarter (-45% YTD). While the events threatened to derail the equity bull market, they were unequal to the strength in America. U.S. job growth has continued to expand and the economy surged by 5% during the third quarter, the fastest growth pace since the same quarter in 2003. The S&P 500 has advanced for an eighth quarter, the longest rally since the 14-quarter rally that ended in 1998.

Small-cap U.S. companies widely outperformed large-cap stocks during December and the quarter. The Russell 2000 Index, a broad measure of small-cap equity performance, rose 2.9% last month, surged 9.7% during the fourth quarter and finished 2014 near an all-time high, up 4.9% for the year. The Russell Mid Cap Index rose just 0.2% in December, gaining 5.9% during the quarter and nearly matched the annual performance of the S&P 500, up 13.2%.

Value outperformed growth last month, last quarter and for the year. The Russell 1000 Value Index rose 0.6% in December and 5% during the 4Q, whereas the Russell 1000 Growth Index lost 1% and rose 4.8% for the same two periods respectively. For 2014, the Russell 1000 Value Index advanced 13.5%, edging out the 13.1% return on the Russell 1000 Growth Index.

Utilities (+13.2%), Consumer Discretionary (+8.7%) and Consumer Staples (+8.2%) displayed the most strength last quarter, while Energy (-10.7%) stumbled. Utilities (+29%) also took the top prize for best 2014 sector

performance, followed by Healthcare (+25.3%) and Technology (+20.1%). Telecom (+3%) gained the least, while Energy (-7.9%) was the only YTD laggard.

Developed markets outside the U.S. and Canada, as measured by the MSCI EAFE Index, continued to underperform the U.S. during the month (-3.5%), quarter (-3.6%) and year (-4.9%). For its part in the index, Europe's STOXX 600 returned 7.9% in 2014, including dividends. The MSCI Emerging Markets Index also slumped last quarter (-4.5%), creating a 2.2% YTD loss.

The Barclays U.S. Government Bond Index rose 0.1% last month, slightly building its quarterly return to 1.9% and its 2014 advance to 4.9%. Ten-year Treasury yield fell by 18 basis points last quarter to 2.17%, extending its 2014 yield loss to 87 basis points. Below-investment grade high-yield corporate bonds lost 1.5% last month, trimming their YTD gain to 2.5%, as measured by the Barclays U.S. Corporate High Yield Index. Investment grade bonds, as measured by the Barclays U.S. Aggregate Bond Index, gained 1.8% last quarter, extending YTD returns to nearly 6%. The Barclays Municipal Bond Index rose 1.4% during the 4Q, capping a 2014 surge of 9.1%.



SUMMARY OF MAJOR ECONOMIC INDICATORS

INDICATOR	LAST REPORT DATE	VALUE*	6-MO. TREND	COMMENTS
U.S. Real GDP (ann. rate) *	Q3 2014	5.0%	↑	The final estimate for Q3 real GDP was revised higher to 5.0% over the last year. The increase in economic growth reflected contributions from all four primary sectors.
Real GDP Growth Outside the U.S.	Q3 2014	Ann.	↓	Q3 reports for developed countries showed continued signs of anemic economic growth. Japan officially entered recession and the euro area barely grew. China's growth (7.3%) declined further and continued at a sub-8% pace.
Non-Farm Employment Growth	Dec 2014	252,000	↑	The U.S. economy added 252,000 jobs, compared with an average of 246,000 over the last 12 months. There was a positive revision of 42,000 jobs in the previous month.
Unemployment Rate	Dec 2014	5.6%	↓	The unemployment rate declined in December, as the number of unemployed persons fell. Over the last 12 months the unemployment rate has declined 1.1 percentage points.
ISM Manufacturing Index	Dec 2014	55.5	↑	Manufacturing activity fell 3.2 percentage points, however, remains in expansion. 11-of-18 industries reported growth. The Price Index and New Order Index slowed due to falling prices.
ISM Non-Manufacturing Index	Dec 2014	56.2	↑	Non-manufacturing activity decreased 3.1 percentage points in December as 12-of-17 industries reported growth. This is the 59 th consecutive month of growth in the non-manufacturing sector.
Capacity Utilization	Nov 2014	80.1	↑	Capacity utilization increased 0.8 percentage points in November. With this reading it is at its long-run average. This level of efficiency is synonymous with rising wages and investment.
Consumer Price Index (CPI, NSA)	Nov 2014	-0.5%	↔	CPI decreased by 0.5% in November, mainly due to the continued fall in oil prices. Year-over-year inflation dropped to 1.3%, as the annual inflation rate has remained consistently below 2%.
Producer Price Index (Finished Goods, NSA)	Nov 2014	-1.0%	↔	PPI declined 1.0% in November, as the decline in energy prices continued. The year-over-year change declined to 1.1%, leading to continued weakness in consumer prices going forward.
Leading Economic Indicators Index (LEI)	Nov 2014	0.6%	↑	LEI rose in November, as all indicators pointed to continued moderate growth. The biggest challenge going forward is the lack of wage growth.
10-year Treasury Yield	Dec 2014	2.17%	↔	The 10-year Treasury yield decreased by 1 basis point in December. Worries over slower growth, deflationary pressures and a stronger US dollar may be impacting bond yields.

*NOTE: The "Value" column shows the most current level or change over the prior month or quarter.

GLOBAL CAPITAL MARKETS: RETURNS AND PRICE LEVELS

	December Close	December	Year-to-Date	1 year	3 years	5 years
US Indices						
Dow Jones 30	17,823	0.12%	10.04%	10.04%	16.29%	14.22%
S&P 500	2,059	-0.25%	13.69%	13.69%	20.41%	15.45%
Nasdaq	4,736	-1.09%	14.75%	14.75%	23.60%	17.19%
Russell 2000	1,205	2.85%	4.89%	4.89%	19.21%	15.55%
International Indices						
MSCI EAFE (Developed)	6,405	-3.44%	-4.48%	-4.48%	11.56%	5.81%
MSCI EM (Emerging)	1,921	-4.56%	-1.82%	-1.82%	4.41%	2.11%
US Fixed Income						
Barclays US Aggregate	---	0.09%	5.97%	5.97%	2.66%	4.45%
Barclays US TIPS	---	-1.02%	4.43%	4.43%	0.55%	4.26%
Commodities and Real Estate						
DJ UBS Commodity Index	104	-7.63%	-17.01%	-17.01%	-9.43%	-5.53%
Crude Oil (\$/bbl)	---	\$53.27	\$98.42	\$98.42	\$98.83	\$79.36
DJ US Select REIT	8,425	1.80%	32.00%	32.00%	16.10%	16.99%

Sources: Bloomberg, MSCI. Non-US index returns are shown in US Dollar terms and are considered to be currency unhedged. Total returns include dividend and income accruals and price changes. Returns for three and five years are annualized and assume the reinvestment of interest and dividend payments. Investors cannot invest directly in any of the above indices. The performance of any index is not indicative of the performance of any investment and does not take into account the effects of inflation and the fees and expenses associated with investing.

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