Market Commentary

2ND QUARTER 2014

Economic Summary

It's amazing to step back and see how the markets have changed in the last several years. Just over 5 years ago, the Dow Jones Industrial Average bottomed out at 6,547 on March 9, 2009. Many market participants were scared. The economy was in shambles because of the financial crisis of the preceding few years. It was the second major stock market collapse of the decade (with the internet bubble implosion occurring from 2000 to 2002 being the first). Many investors could not handle any more losses and they pulled out. It all seems like ancient history. Some of those who stayed invested (or better yet, increased their equity investments at that point of maximum pessimism) have been greatly rewarded. Warren Buffett's maxim, "Be fearful when others are greedy and greedy when others are fearful" certainly proved accurate during this period. On June 30, 2014, the Dow Jones Industrial Average closed at 16,826 – near an all-time high. A few days into July, it closed above 17,000 for the first time.

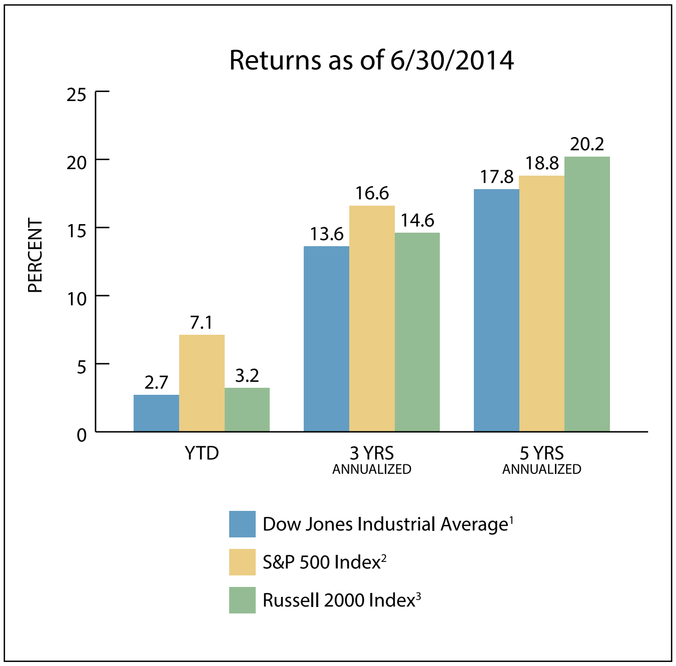

Chart 1

The aggregate wealth of the U.S., including stock and real estate holdings, recently passed $81 trillion, which is up from $55 trillion in 2009. It is not surprising that individuals and companies with large asset holdings and the risk tolerance to have stayed in the market have celebrated greatly during this period. CHART 1 shows the performance of three stock indexes over three different time periods. Clearly, equity investors have done very well over the last 5 years.

Throughout this five year period, the U.S. economy has

Past performance does not guarantee future results.

[1] The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.
[2] The S&P 500® Index is a capitalization weighted unmanaged index of 500 widely traded stocks, created by Standard & Poor's. The index is considered to represent the performance of the stock market in general.
[3] The Russell 2000® Index is an unmanaged index of the smallest 2,000 stocks in the Russell 3000® Index. You cannot invest directly in an index.

Economic Summary (CONTINUED)

experienced one of the weakest expansions in history. In fact, during the first quarter of 2014, the economy actually contracted 2.9%. Second quarter GDP is expected to have bounced back nicely, but nonetheless, this expansion has been mediocre at best. The Federal Reserve's extended zero interest rate policy (ZIRP) and multiple rounds of quantitative easing (QE) are attempting to stoke the economy right through any potential recession. The jury is out on whether that will work. All we know for sure is that the economy has not rapidly grown over the past 5 years during the Fed experiment and failed economic policies of the current administration. While there are some signs of the economy finally picking up steam, we do not expect robust growth in the economy or the stock market in the near future.

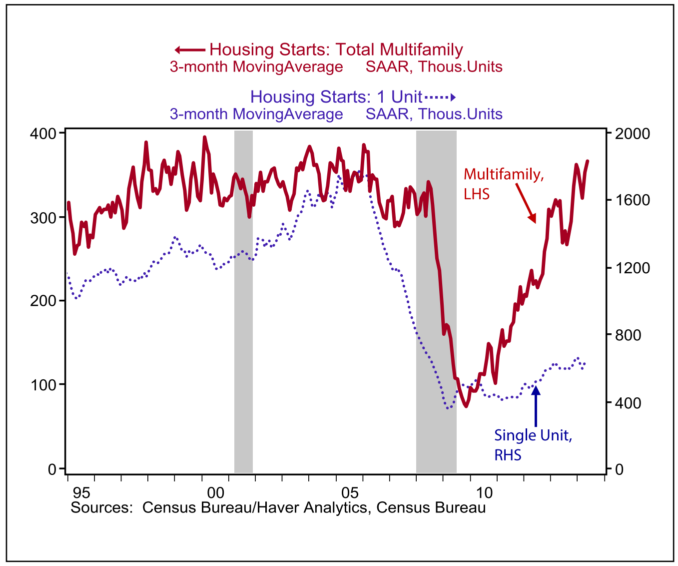

Chart 2

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS", JULY 1, 2014

The Fed's two policy objectives remain to lower unemployment and increase inflation from current levels. Inflation, at least as measured by the government, is essentially non-existent. Strangely, though, the government's measure of inflation takes out "volatile" food and energy prices. For most people, these two categories of expenses are very real and prices in these two areas have risen dramatically. Reported inflation and interest rates in general will eventually rise again. If they rise slowly and because the economy is doing well, that could prove positive for stocks. If rates rise dramatically or from an external shock, the stock market could see increased volatility. The Fed will try to increase rates on their schedule, but as we know from history, the market forces may drive interest rates higher before the Fed actually lifts them.

The U.S. economy is not taking off, but is experiencing solid, persistent growth. Housing starts are still low (CHART 2), and a pickup in housing would be good for consumer spending and the economy in general. Real

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Economic Summary (CONTINUED)

wages continue to be stuck in neutral (CHART 3). Manufacturing activity within the U.S. continues to grow as many companies take advantage of the United States' growing supply of domestic oil and gas. Although it has taken 76 months, total employment levels finally have exceeded their prior peak. The Fed's extreme intervention in the financial markets will hopefully continue to unwind so the economy can operate based on economic fundamentals of supply and demand.

Equity Outlook

In our opinion, the stock market continues to be the best source of generating positive real returns. The recent strong performance of equities causes us to be prudently cautious at this point. Therefore, we have taken some profits in our portfolios by trimming equity holdings that have grown to be oversized positions. In some cases, we sold entire positions completely if the stocks reached our estimate of fair value. Cash balances have grown, as we have not reinvested all of the sale proceeds. Valuations and opportunities will continue to drive portfolio decisions.

The uncertainties in the world are great (*they always are!*). Domestically, Obamacare will experience more problems as insurance renewal rates rise and more problems appear, mid-term election results could rattle the markets, inflation and interest rates could rise and the economy could stumble. Internationally, Russia continues to be aggressive, Syria and Iraq continue to decline into terrorist-controlled states, Iran continues to develop its nuclear capabilities and U.S. foreign policy is apathetic at best, pathetic at worst. Europe shows signs of modest economic growth and China's economy has not ground to a halt, as many have feared. Despite these uncertainties (*perhaps because of them*) we feel the stock market continues to be the best source of investment returns.

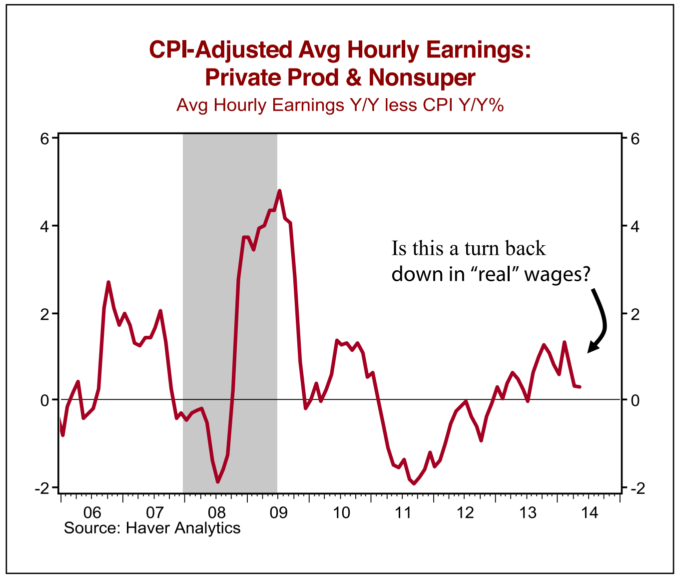

Chart 3

SOURCE: STRATEGAS RESEARCH PARTNERS
"ECONOMICS BALANCE SHEET", JUNE 30, 2014

Inflation is represented by the U.S. Consumer Price Index (CPI), a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living. Indexes do not incur fees and it is not possible to invest directly in an index.

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Closing Thoughts

Recently, the Wall Street Journal turned 125 years old. They published an article titled, "Free People, Free Markets" on July 8, 2014 that encapsulates the benefits of our capitalist system and the resiliency of our great country. One poignant excerpt is included here:

"These lessons include that markets – the mind of free millions – allocate scarce resources more efficiently and fairly than do committees in Congress; that the collusion of government with either big business or big labor stifles competition and leads to political cynicism; that government will be respected more when it does a few things well rather than too many poorly; and that innovation and human progress spring not from bureaucratic elites but from the genius of individuals."

This quarterly commentary started by reviewing the markets over the last five years and ends with the WSJ article reviewing the last 125. Let us hope and pray that in the years ahead, the power of the free markets can be unleashed so the U.S. can once again experience the prosperity and growth that develop from pro-growth policies.