Market Commentary
Q4 2013

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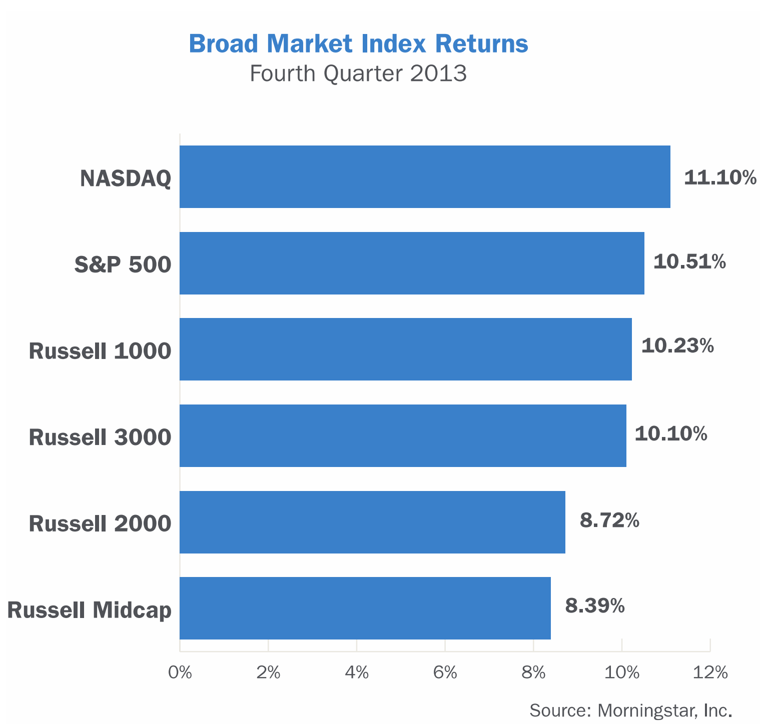
THIS IS A SAMPLE QUARTERLY REPORT LETTER THAT WE SEND TO OUR CLIENTS.

We saw very divergent pictures in the stock and bond markets this year. The stock market had a phenomenal year. All major stock indices, with the exception of emerging markets, produced double digit returns. In fact, the S&P 500 was up over 32% for the year and 10% in the fourth quarter alone. The bond market was a completely different story, as many areas of the bond market experienced losses for the first time since 1999.

The Economy

The economic environment in the fourth quarter was one defined by slow but steady improvement in many segments. The gains were enough to both underpin a continued rise in the stock market and prompt the Federal Reserve ("Fed") to finally decide to implement a tapering of its quantitative easing program. Perhaps the most encouraging trend in the economic data was the improvement in the employment situation, which saw a rise in the number of jobs added during the quarter, as well as a decline in the unemployment rate to 7.0%. Employment, of course, has been one of the key metrics the Fed has used to determine the aggressiveness of its policies. Inflation also remained benign during the quarter and continues to be below the target rate of 2% established by the Fed. After a dip in October and November, consumer confidence rebounded sharply in December to its highest levels since June. Previously one of the primary drivers of the economic rebound, housing took a breather during the quarter in part due to a rise in mortgage rates.



Globally, the situation in the eurozone continued to slowly emerge from its recession that saw unemployment rates reach record highs. The region has been balancing tight fiscal policies

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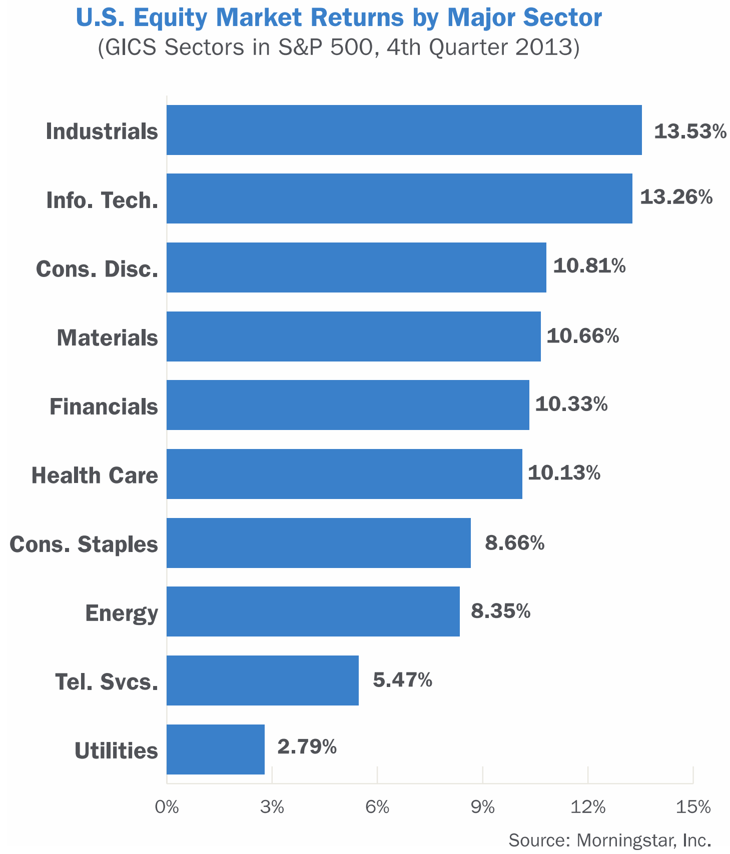
with loose monetary policies by the European Central Bank (ECB) in an effort to stabilize its economy. The result has been that internal demand has stagnated somewhat, and that future growth will come from exports. Many economists believe that the eurozone will expand in 2014 for the first time since 2011.



The sluggish growth which has prevailed for the past several quarters in developed markets economies has had a negative effect on emerging economies. After a somewhat slow start to the year, China's economic growth ended the year near its projected growth estimates. The country's policymakers have attempted to offset the global slowdown with monetary and fiscal stimulus. However, one of the risks for the outlook for China and the Asia-Pacific region generally is China's overheated property market.

The employment situation, one of the Fed's key indicators for current economic conditions, showed marked improvement in the fourth quarter. The November payroll data (the latest available) exceeded expectations, and there was a modest upward revision in the net results from September and October. The net effect was an increase in the average number of jobs added per month over the prior quarter. The upbeat employment situation is one of the primary reasons the Federal Open Market Committee (FOMC) opted to scale back its quantitative easing program at its December meeting. Most economists believe that employment gains will steadily increase in coming quarters and that the unemployment rate will decline to perhaps 6.8% by the end of 2014.

As opposed to recent quarters, there was a formal change to Fed policy during the fourth quarter, with the Fed announcing at its December meeting that it would begin tapering its quantitative easing program. The tapering will begin in January and be modest at the outset—the current

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monthly purchases of $85 billion of government and mortgage-backed securities will be scaled back to $75 billion. At the same time, the Fed stated that it will maintain its extremely low fed funds rate target of 0%-0.25% for an extended period of time.

Highlights

GDP

The Bureau of Economic Analysis released the third estimate of the third quarter 2013 real GDP, a seasonally adjusted annualized rate of 4.1%, up from the 2.5% annualized growth of the prior quarter. The acceleration was driven by a slowdown in imports and a pickup in state and local government spending; but inventory buildup was a crucial component, which does not bode well for the fourth quarter data. Domestic corporate profits grew by 1.9% (non-annualized) during the quarter, which was lower than the 3.3% rate of the second quarter. The profit gain was paced by domestic corporations, with non-financial companies posting the biggest advances. Inflation remains relatively benign, but did accelerate during the quarter, with the personal consumption expenditures (PCE) index of prices gaining 1.9% during the quarter. Many economists believe that with growth picking up in the third quarter and with the employment situation improving, the economy is poised to accelerate in 2014 and post a breakout year. The one thing that many economists cite as still lacking is sustained consumer confidence.

HOUSING

During the fourth quarter of 2013 the housing segment took a breather from the gains posted in prior quarters, with the rise in mortgage rates dampening homebuyer confidence. Existing-home sales for November (the latest monthly data available) advanced at an annualized rate of 4.9 million units, below the 5.4 million unit rate posted in August. In addition, the rate has declined each of the past three months. The inventory of existing homes remained tight, however, with 5.1 months of supply. Existing-home prices also continue to rise, albeit at the slowest rate since November 2012, with the median price up 9.4% from a year ago. In the new-home segment, the NAHB Housing Market Index, a measure of homebuilding activity, ended the quarter at a level of 58, the same as the previous quarter, and the highest point since 2005. Many housing analysts had expected new-home sales to slump due to the rise in mortgage rates, but homebuilders expect that any decline will be only temporary and that a renewed pickup may be in store for 2014.

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EMPLOYMENT

The employment situation showed the beginnings of what could be a turnaround in the fourth quarter, posting improving and better-than-expected payroll gains. The breadth of the gains was broad-based, spanning many private sector segments. The November payroll report, the latest available, showed a gain of 203,000 jobs, above consensus expectations of a gain of 185,000. There were also revisions from prior months, but they were relatively minor. The average number of jobs added for the three months ended November was 193,000, a promising pickup from the prior quarter. Accompanying the payroll gains in November was a decline in the unemployment rate to 7.0%, as distortions related to the government shutdown from the prior month were reversed. November's gains were fairly well-dispersed, with 63.5% of industries adding jobs, the largest increases coming in retail, transportation/warehousing and professional/business services. Despite the upbeat news, the labor force participation rate remained at 63%, which indicates that the downward trend has not yet been broken. Nevertheless, economists are generally optimistic about employment in 2014, with the consensus expecting a continued acceleration in job creation to about 230,000 per month, and a decline in the unemployment rate to about 6.8%.

FED POLICY

The Federal Open Market Committee (FOMC) at its December meeting decided to begin tapering of its quantitative easing program, a decision long-awaited by market participants. The FOMC announced that beginning in January it would reduce the amount of monthly purchases from $85 billion to $75 billion, with the reductions split equally among government and mortgage-backed securities. At the same time, the FOMC stated that the fed funds rate will remain at its current very low target level of 0%-0.25% well beyond the point at which the unemployment rate falls below the 6.5% target. Many analysts interpret this strong interest rate guidance as offsetting the impact of the reduced tapering. In its statement, the FOMC indicated that tapering will occur in measured steps, with the implication being that no course of action has been pre-determined. Speculation has already begun that another reduction will be announced following the FOMC's January meeting, which is likely Ben Bernanke's last as Chairman. As far as the Fed's expectations of inflation, its forecast for average inflation over the next few years doesn't exceed 2%, which gives further support to its aggressive monetary policy.

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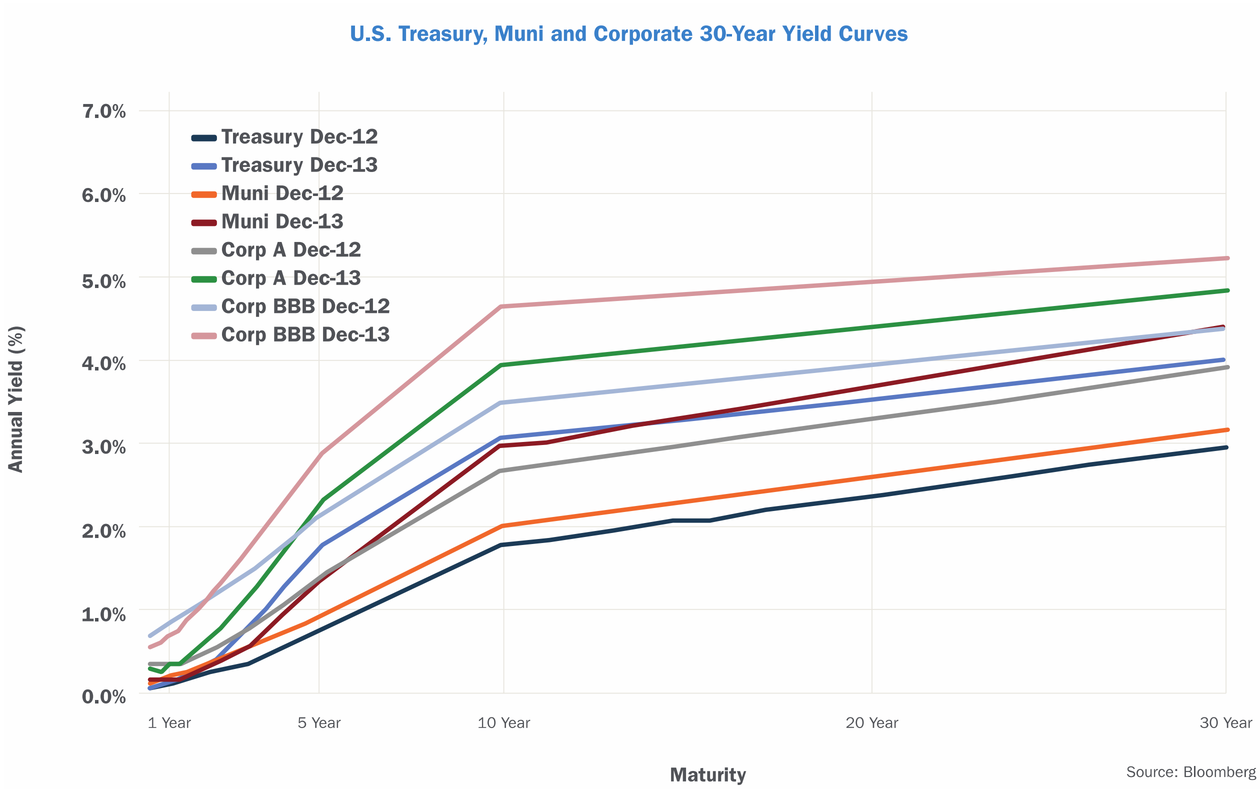
Interest Rates

During the fourth quarter, fixed-income securities stabilized somewhat, recovering from the previous quarter's volatile—and declining—performance. The cause of the poor performance earlier in the year, anticipation about the Fed's tapering plans, had been discounted by the market when the actual announcement came, and while the timing caught investors somewhat by surprise, the level of tapering did not.



Consequently, the result was a flattening of the yield curve, with a rise in short-term rates relative to intermediate- and long-term rates. During the quarter, performance was strong in October following resolution of the government shutdown, but weaker in both November and December as economic data showed improvement and the Fed's tapering plans came into focus.

With this environment as a backdrop, yields overall were generally higher, particularly on the short-to-intermediate segment of the yield curve. Inflation expectations remained consistent during the quarter, with the Fed's gauge of five-year forward inflation expectations closing at 2.63% on December 31st, essentially unchanged from September 30th.

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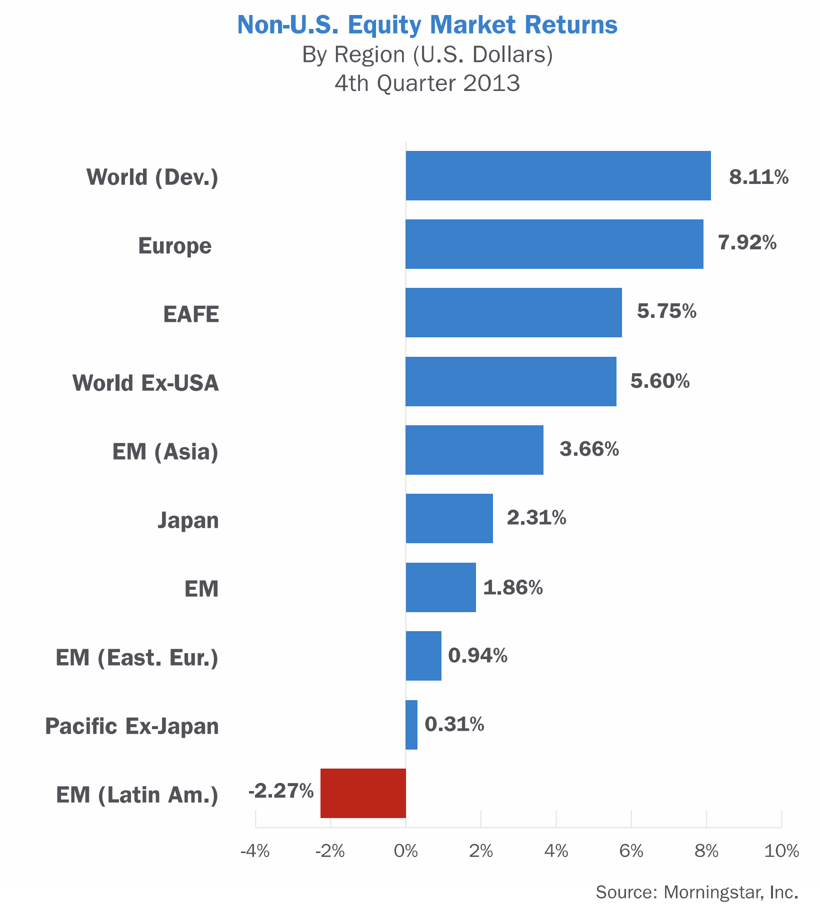
In terms of total returns, fixed-income securities had mixed results in the quarter, with many credit indexes generating modest gains but government securities-related indices booking losses. For the entire year, fixed-income suffered its worst losses since 1994. The Barclays U.S. Aggregate Index delivered a total return of -2.0% for the full year, its first loss since 1999. Internationally, the Barclays Global Aggregate ex-US Index fared even worse, declining -3.1%. The Barclays U.S. Corporate High Yield Index managed to post a +7.4% gain for the year.

Equity Markets

Within a generally favorable backdrop that included modest gains in the employment situation, improving economic data, a resolution to the budget impasse and government shutdown, and continued monetary aggressiveness, domestic equities once again posted sharp gains during the quarter. The broad indices advanced in each month during the quarter, establishing, and finishing out the year near, record highs. The entire year was a resounding success for investors, with stocks (represented by the S&P 500 Index) booking the largest annual gains since 1995. The year was also marked by relatively low volatility, as the S&P 500 had declines in only two months (June and August). For the quarter the S&P 500 gained +10.5%, and for the entire year the index posted a strong advance of +32.4%.

As with recent quarters, sector selection was very important, as the ten primary economic sectors posted a wide range of results. The industrials sector was the strongest performer during the quarter, with a gain of +13.5%. The health care sector was the best performer over the entire year, advancing +41.5%. Two economically sensitive sectors, consumer discretionary and materials, also had healthy gains



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during the quarter, with returns of +10.8% and +10.7%, respectively. Information technology was another strong performer, generating a gain of +13.3%. The utilities, telecom services, and energy sectors brought up the rear on a relative basis, with gains of +2.8%, +5.5%, and +8.4%, respectively.

For the quarter, the Russell 1000 Index of large-capitalization stocks posted a +10.2% total return. Within the large-cap segment, growth stocks and value stocks had comparable performance, with growth having a slight advantage. For the entire year, the Russell 1000 gained +33.1%. Small-capitalization stocks, as represented by the Russell 2000 Index, underperformed large caps during the quarter, ending with a total return of +8.7%. The full-year gain for the Russell 2000 was +38.8%. Growth stocks slightly outperformed value stocks within the small-cap segment. The Nasdaq Composite, dominated by information technology stocks, generated a return of +11.1% during the quarter and +40.1% for the entire year. The Dow Jones Industrial Average of 30 large industrial companies gained +10.2% during the quarter and posted a healthy +29.7% gain for the year.

International stocks had a difficult time keeping up with U.S. equities during the fourth quarter. After outperforming in the third quarter, international stocks reverted to the underperforming status that had been the situation for several consecutive prior quarters. While the situation in the eurozone has for the moment at least quieted down, and expectations are for a return to growth in 2014, there are no real signs that the region’s economic growth rate will meaningfully accelerate in the near future. The MSCI EAFE Index of developed markets stocks advanced +5.8% during the three months ended December 31st. For the full year the EAFE Index gained +23.3%. International developed markets stocks underperformed U.S. stocks (as represented by the S&P 500) by more than 9% in 2013. As in the previous quarter, one of the regions performing particularly well on a relative basis was Europe, which continued to experience economic stabilization. The MSCI Europe Index ended the quarter higher by +7.9%. As with the past several quarters, emerging markets stocks lagged, with Latin America continuing to perform poorly on a relative basis. The MSCI Emerging Markets Index generated a return of +1.9% for the quarter but over the full year posted a decline of -2.3%.

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Looking Forward

One of the questions frequently heard is whether stocks are due for a sell-off because of the strong gains delivered in 2013. With stocks generating their best year since 1995, investors wonder whether it may be a good time to take profits. History would suggest that there may be some follow-through on 2013's performance. Since 1926, there have been nine years in which the S&P 500 has ended with a price return greater than 30%. Stocks gained ground the following year six times, with an average gain of +21.5%. In three of the following years stocks declined, with an average drop of -9.5%, but one of the declines (in 1937) resulted from austere fiscal policy conditions, which aren't an issue in the current environment.

Providing support to the idea that stocks may not be primed for a significant decline is the economy's uptrend and the fact that valuations are not extended. The U.S. economic outlook is positive, with many economists expecting the economy to expand in 2014 at the fastest pace in more than a decade. The debt ceiling will need to be raised again in February, but the recent budget deal is a sign that Congress seems determined to avoid another round of last-minute brinksmanship. Perhaps the situation bearing watching most closely is how the Fed continues to maneuver the unwinding of its aggressive monetary stimulus. The prospects for equity markets improve if it can reduce the amount of stimulus without significantly undermining global growth.

That all being said, remember the market is inherently unpredictable. We have now had two very strong years of gains, and the recovery since the market bottomed out in 2009 has been quite remarkable. While we are hoping the market can extend its upswing in 2014, we also would not be surprised to see a pullback, given the strong returns in 2012 and 2013. We all know it often doesn't take much for the market to reverse directions. All in all, we think 2014 could be a very interesting year.

As we close the book on 2013 and move into 2014, we want to remind you to please contact us if there are any changes to your financial situation or if you feel your asset allocation is no longer appropriate for your situation.

And remember…

> *What lies behind us and what lies before us are tiny matters compared to what lies within us.* --Ralph Waldo Emerson