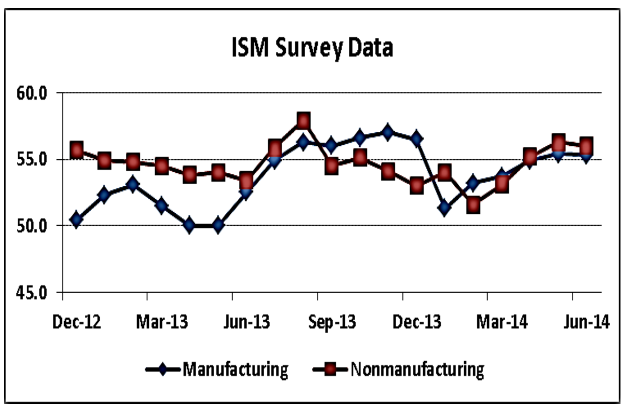
Investment Update
Second Quarter, 2014

Markets Summary
After the relatively high volatility at the start of the year sparked by Russian/Ukrainian tensions, during the second quarter global equity markets moved higher with much lower volatility. The S&P 500 index now stands approximately 25% above its October 2007 pre-financial crisis high.

Total Returns	1q 2014	2q 2014	2014
S&P 500	1.8%	5.2%	7.1%
S&P Mid Cap	3.0%	4.3%	7.5%
S&P Small Cap	1.1%	2.1%	3.2%
MSCI All Country World	1.2%	5.2%	6.5%
MSCI EAFE Developed Markets	0.8%	4.3%	5.1%
MSCI Emerging Markets	-0.4%	6.7%	6.3%

During the second quarter, yields for US Treasury bonds in the 1-5 year maturity range were relatively unchanged while longer-term Treasury bond yields dropped again. For the quarter, Barclays' intermediate investment-grade bond index returned +1.2% (+2.3% YTD) and its long investment-grade index returned +4.9% (+11.8% YTD). The decline in longer-term yields led to substantial price appreciation for longer-term bonds, boosting their returns.

Equity Market Commentary
Not surprisingly, equity markets shrugged off the news of the US economy shrinking by almost 3% during the first quarter. Negative headlines were widely expected given the unusually bad winter weather in January and February, and most data (see Institute for Supply Management data at right) from March onward has been pointing to a relatively quick rebound once the weather improved.



What was more surprising was how the broad equity markets virtually ignored the unexpected flare-up of an Islamist insurgency in Iraq during June, despite the threat posed to regional oil production and the attendant spikes in the prices of oil and gold.

There are several factors that may explain this disconnect. As a practical matter, the early successes of ISIS/Islamic State could be difficult to maintain, let alone consolidate, given the small numbers of committed fighters that appear to be involved. That is not to say that the possibility of fundamentalist control of some part of Iraq and Syria is not troubling, or that a situation where the US may be forced to ally with Iran is a happy one. But perhaps markets see less of a threat to the stability of the region and to the world's energy supplies than might have been inferred from the first news of the insurgency's rapid victories. Perhaps markets are also beginning to consider that US and Iranian cooperation in countering the threat could ultimately lead to an improvement in US/Iran relations, which would be a long-term positive.

Also, this may be one of the first Middle Eastern events to have less global impact than in years past due to the fact that North America's surging energy production is fundamentally altering energy markets. Although much of this new production is bottled up in North America at least for now, the global market for energy is influenced by all sources of supply. With vast new discoveries from unconventional sources, particularly in North America, the Middle East's production becomes less important.

Finally, a relatively benign macroeconomic background, with the key feature of very low short-term interest rates, may be encouraging investors to downplay current risks like ISIS/Islamic State in Iraq and separatists in Ukraine. In the US and Europe, continuity of central bank policy has kept surprises to a minimum. While the Federal Reserve continues to wind down quantitative easing and is on track to end its bond buying by October, which we think is a long-term positive, the Fed is expected to continue to maintain very low short-term rates for the time being because of relatively slow growth in the US and what are seen as structural unemployment issues. The European Central Bank is maintaining very low short-term rates and appears willing to consider bond buying if necessary to nurse Europe's halting recovery along. In China, economic growth seems to be stabilizing at approximately 7.5% per year and several years of relatively tight monetary and fiscal policy may be ending as bank reserve requirements have recently been eased and corporate and value-added tax rates have been cut.

<u>Outlook</u>

There has been no significant change to our outlook compared to the first quarter. We still expect the US economy to accelerate from the first quarter and end the year growing at a faster pace than in 2013. Global growth is also expected to improve versus 2013, with Germany leading a modest European recovery and China stabilizing. India's BJP party has the opportunity to initiate real reforms and reignite growth there.

Earnings growth for S&P 500 companies is still expected to be in the 8-9% range for 2014 and 10-11% for 2015. Based on these earnings expectations, stocks are reasonably valued and still relatively attractive versus bonds. Within the bond markets, municipal bonds offer high tax bracket investors attractive after-tax yields. We continue to prefer relatively short maturities given our expectation that interest rates will trend higher over the next few years.

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