"Fortune favors the prepared mind."

Louis Pasteur

Good fortune has certainly shined on investors, particularly those investing in the equity markets. For the past five years many equity markets have performed well above historic averages. While we believe that conditions remain positive for equity markets, we also believe repeating these elevated results for the next five years may be a challenge. In this paper we address the recent performance of the U.S. Equity markets within an historic perspective and review expectations for the coming years.

Asset Class Returns: October 2009 to September 2014

The chart to the right demonstrates the decisive performance advantage held by U.S. equities over all publicly traded asset classes over the last 5 years. Returns on U.S. equities have exceeded their long-term average of 10% by a wide margin.

Diversification, the primary tool in reducing portfolio risk, has only served to decrease overall performance during the last 5 years. A simple U.S. only portfolio (stocks and bonds) would have outperformed any account diversified into other geographical areas or asset classes. Given this, should investors be looking to increase their U.S. equity exposure? Let's take a brief look at recent 5 year periods.

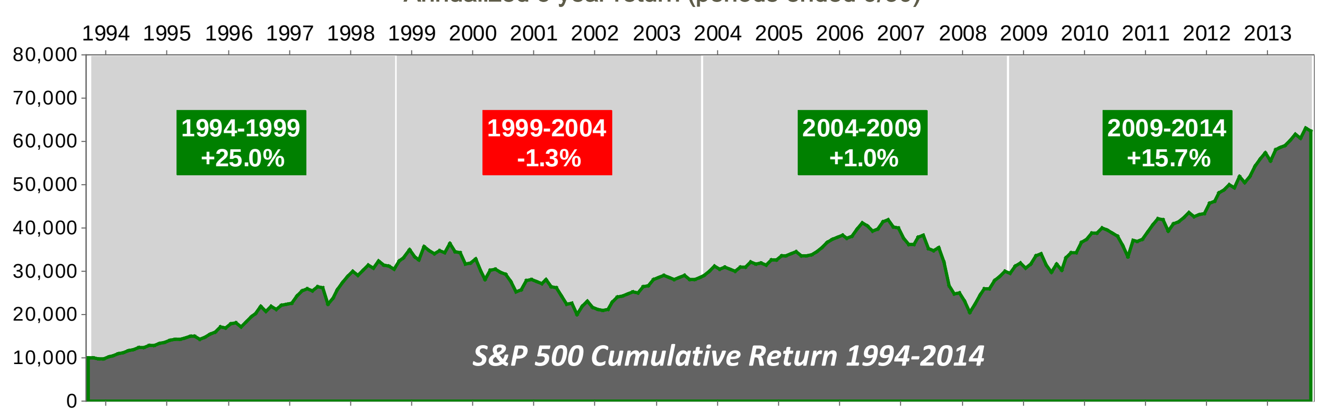
Annualized 5 year return (9/30/2014)

Asset Class	% Return
U.S. Large Cap Equities	**15.7**
U.S. Small Cap Equities	**14.3**
International Market Equities	6.5
Equity Hedge Funds	7.4
International Emerging Market Equities	4.8
U.S. Fixed Income	4.1
Hedge Fund of Funds	4.3
Gold	3.1
CPI	1.7
Commodities	1.3
U.S. Treasury Bills	0.1

US Equity Market Cumulative Return: October 1994 to September 2014

The chart below demonstrates that if you had invested $10,000 in the S&P 500 in 1994, and left it there to compound, you would have accumulated over $60,000. Over the twenty years ended September 30, 2014 the annualized return was 9.6%. However, as the chart shows, if you break the returns into five year segments the results vary greatly. From 1994-1999 the annualized return was +25.0% and for 2009-2014 the annualized return was +15.7%, both excellent periods for equity investors. The two other five year segments, 1999-2004 and 2004-2009, had annualized returns of -1.3% and 1.0% respectively. Over the 10 year period ended in 2009 the market provided a disappointing return of -0.2% annualized, often referred to as the "lost decade" for stock investors.

Annualized 5 year return (periods ended 9/30)



Potential returns going forward

U.S. Equities

While we believe that the US equity market will still offer positive real returns over the near and long-term ,we expect them to moderate from the recent past levels of the last five years. Early in 2014 we began orienting clients toward "single digit" return expectations for equities. Through September, the market has provided an 8% return, although early October results brought that number down to 4% year to date. We have experienced increased volatility and rapid rotation among stocks based on market capitalization and market sector.

From a fundamental perspective, earnings growth for U.S. companies has been rapid since the 2008-09 recession, helping to propel stocks. Margins have risen because of very low increases in wage and commodity costs and today are at record highs. Mirroring the climb in earnings' growth, equity valuations rose from well below long-term averages, to somewhat above those averages. This virtuous cycle was the reason for the 15% annualized return on US stocks starting in 2009. Since margins are now already very high, earnings growth going forward should not be much faster than revenue growth, which recently has been in the 3-5% range. Therefore, to forecast a continuation of the past five year annualized return in the US equity market seems improbable. We should be very happy to see a rate that approaches the long-term average, which, should inflation remain subdued, would provide an attractive real rate of return.

International Equities

In the rest of the world, challenges to growth remain very apparent not only in Europe and Japan, but also in a number of emerging economies. China is slowing as that country transitions from an over-reliance on debt creation to a more sustainable model, and commodity oriented countries, such as Brazil and Russia, are restricted by excess supply and consequently weak commodity prices.

Fixed Income

Interest rates on bonds are at record lows globally. Our opinion is that interest rates will eventually move higher with the return from high quality bonds expected to be low.

Alternatives

Returns from hedge funds have been disappointing in recent years, as betting against the market has been a losing battle. However, the ability to short should provide more of a benefit in a market with moderate returns and increased volatility. We expect the relative performance for highly specific strategies and skilled managers will improve in this environment.

Conclusion

Looking forward we believe revising return expectations lower, to more moderate levels, is appropriate and prudent in an historic context and given the current market environment. That is not to say that returns will be disappointing, but we are skeptical that the U.S. equity markets will continue the exceptional returns of the past five years. Assuming inflation remains at (or near) current levels, real returns to investors have the potential to remain near historically high levels.