WIMMER ASSOCIATES

QUARTERLY REPORT

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A LETTER FROM KATHY

Dear Friends,

Over the past five and a half years, the US Federal Reserve has undertaken three different rounds of quantitative easing (QE), which constituted buying up most of the US Treasury debt auctions and many billions of mortgage backed securities. The intent of the policy (also known as "Financial Repression") was to keep long-term interest rates low so that homeowners and businesses alike would be afforded the ability to refinance existing indebtedness at lower rates. With lower interest expense, many households and corporations have been able to markedly improve their respective financial profiles. While some alarmists feared that the QE policy would lead to high inflation, the actual effect of quantitative easing had a minimal effect on the consumer price index (CPI). While QE did not lead to wage or food price increases, the policy did lead to rising home prices and a multi-year honeymoon with the stock market.

With the announced end of the Fed's purchases of long-term securities in September, after a year of "tapering", the stock market has been reintroduced to volatility. The Fed's QE policy has served as a floor under the stock market for the past five years. The removal of the policy has already led to striking mood swings in the price of stocks. Although blue chip stock prices have recently dipped as much as 9% below their all time highs, there have been no "corrections", i.e., a drop of 10% or more, in the past three years. These calm markets have been an historical abnormality with corrections occurring every twelve to eighteen months. We are looking at a return to normalcy, which invariably includes greater volatility.

We consider the ending of QE as a net positive, because it indicates that the Fed believes that the US economy can now stand on its own. QE also had the effect of forcing conservative bond and CD investors into riskier equities in an effort to maintain income. While long-term interest rates may not immediately rise in the wake of the Fed's removal of support, the return to a "normal" bond market should be welcomed by savers and investors alike, who may now dial back on exposure to riskier assets. Yet, the Fed continues to be supportive of the economy by maintaining a near-zero interest rate policy (NZIRP) for short term interest rates. We do not see any signs of a major correction in the stock market, as the economy continues to grow at a moderate pace, job growth is moving higher and the Fed has signaled that short-term interest rates will stay low through well into the middle of 2015.~

Cordially,

Kathy Wimmer, CFA, CIC
President

KEY FACTS FOR 2014

- *Annual gift exclusion $14,000*
- *Estate, gift and generation-skipping tax exemption $5,340,000*
- *Highest marginal estate tax rate 40%*
- *IRA contribution limits $5,500, plus another $1,000 for those over fifty*
- *SIMPLE IRA and 401(k) contribution limits $12,000, plus another $2,500 for those over fifty*
- *401(k) contribution limits $17,500, plus another $5,500 for those over fifty*
- *SEP IRA contribution limits 25% of compensation, max of $52,000*
- *Top Federal tax rate is 39.6% on income over $406,750 (single filers)*

INSIDE THIS ISSUE:

Third Quarter 2014

The third quarter of 2014 saw the broad-based S&P 500 index rise by 1.1% as stock price gyrations increased markedly towards the end of the period. As mentioned above, the removal of QE by the Federal Reserve reintroduced volatility to the marketplace after a prolonged, post-recession hiatus. Other factors affecting market unease included the outbreak of a few Ebola cases in the States, a decline in the pace of growth in China, as the country transitions from an export driven titan to a consumer driven society, Japan's recovery sputtering into recession in the aftermath of a consumer tax increase and the unwelcome possibility that Europe may be suffering a third recession in the same number of years. The US economy remains a beacon of light among dimming prospects for many countries throughout the world. It seems that the US has done much of the heavy lifting to get its economy back on track, while poor demographics shackle Japan (aging population) and China (the result of the one child mandate). Europe has made little progress in reforming its labor laws, which makes it nearly impossible for corporations to restructure and has the ill effect of keeping highly educated young people out of the workforce. Russia's annexation of Crimea and the active destabilization of eastern Ukraine is penalizing Russian companies with sanctions and crimping valuable economic ties with Western Europe.

The declining economic prospects of the developed world outside the US are reflected by the 5.4% decline in the MSCI EAFE index versus the modest gain the S&P 500 index. The third quarter also highlighted a divergence in performance between large capitalized equities as reflected by the S&P 500 index (which hit new record highs during the third quarter) and small or micro-capitalized companies, as illustrated by the Russell 2000 index which fell 7.4% in the period. It is not unusual to see investors rotate away from riskier smaller companies to large "caps" as the economic cycle matures. Sector differences also manifested in the third quarter as energy stocks declined in the face of rising supply from the US shale revolution, moderating and declining demand in slowing economies and a strong US dollar, which makes oil purchases dearer to foreign buyers as barrels are uniformly priced in US dollars. Technology stocks, as measured by the Nasdaq Composite Index, edged up 1.9% during the third quarter, up a respectable 19.1% compared to the same time last year. Biotechnology continued to see regular price swings throughout the third quarter of the year, but still managed to generate a healthy 7.2% gain during the period and a stellar return of 64.5% over the previous twelve months, as measured by the iShares Nasdaq Biotechnology Fund ETF, or simply, the IBB index.

Most commodities saw price declines over the third quarter as slowing economies in China, Brazil and Europe led to excess supplies of crude oil, copper and gold. The growing strength of the US dollar partially offset the decline in commodity prices, as many commodities are strictly traded in US dollars. The strength or rising value of the US dollar is a result of the relatively healthy state of the US economy, the end of the Federal Reserve's QE policy of "financial repression", and the acceleration of quantitative easing by the European Central Bank and the Bank of Japan. "Goldbugs" have long held investments in the precious metal, believing the Federal Reserve's loose monetary policy would lead to inflation and a debasement of the value of the dollar. However, poor wage growth over the economic recovery and an overhang of product inventories rendered inflation concerns moot, while the relative strength of the US economy among developed countries has led overseas investors into US stocks and bonds and our appreciating currency. Consequently, the price of gold continues to languish behind returns offered in the stock market.

Supported by modest long-term mortgage rates, the housing market also benefited from the improving balance sheets of individual Americans, creating more potential homebuyers who could meet underwriting criteria. The latest home price data available, as measured by the S&P/Case-Shiller 20 City Index, showed the pace of home price gains slipping in August to a year-over-year gain of 5.6%,

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THIRD QUARTER 2014 (CONTINUED FROM PAGE TWO)

down from a gain of 6.7% in July over the previous twelve months. While home price gains moderated in August, S&P's David M. Blitzer states that "other housing data perked up. September figures for housing starts, permits and sales of existing homes were all up. New home sales and builders' confidence were weaker. Continued labor market gains, low interest rates and slower increases in home prices should support further improvements in housing."

Speaking of labor gains, the national unemployment rate fell to 5.9% during the third quarter of 2014 and has subsequently fallen to the 5.8% level. Nine months of continuous job gains of 200,000 or more should cheer the American consumer. Yet, consumer confidence continues to be muted. The unemployment rate does not reflect two key factors: *First*, the job participation rate of 62.7% in September is at its lowest rate since 1978. While baby boomers retiring and falling out of the work force is clearly a facet of today's lower participation rate, discouragement among the unemployed at job prospects that promise lower wages, hours and/or benefits has also led to a decline in job applications, which decreases the overall job participation level. *Second*, the employment cost index reflecting wages and salaries continues to lag various measures of inflation, especially, food and shelter, which both rose 3.0% year-over-year as of September 30, 2014. According to the US Bureau of Labor Statistics, "Wages and salaries increased 2.1 percent for the 12-month period ending September 2014, compared with 1.6 percent in September 2013."

The Purchasing Managers' Index (PMI), which registers economic activity in the manufacturing sector, rose in October for the 66th consecutive month. The PMI climbed to 59% in October, up 2.4% from September, reflecting lower commodity prices, especially oil and natural gas, and increased holiday orders. Any PMI reading above 50% reflects positive manufacturing activity; anything below reflects negative growth or recession.

"The US economy remains a beacon of light among dimming prospects for many countries throughout the world."

After having peaked near $108 per barrel this June, oil prices have declined 25% to a little below $80 per barrel. *The Economist* reports that "A 10% change in the oil price is associated with around a (positive) 0.2% change in global GDP", according to Tom Helbling of the IMF. Doing the math, one extrapolates that global consumers should have an extra $1 trillion in their pockets should oil prices stabilize at their current level and global GDP should rise by 0.5% on an annual basis. The decline in oil prices has proven to be a boon to oil dependent importers like China, Japan, India and the United States. Conversely, the economies of oil dependent exporters, such as Russia, Venezuela and Argentina, are suffering from budget deficits and weakening currencies, making critical imports more expensive. Meanwhile, no tears are being shed by SUV drivers and US consumers as lower gas prices act as a tax cut by increasing one's disposable income. Lower oil prices also are a net gain to the poor, who can reallocate gas expenses to food, education or other areas. Globally, the broad economic benefits of lower oil prices are significant. More specifically, agricultural economies benefit disproportionately, because farming is energy intensive. Lower energy prices translate into significant savings in the cost of fertilizer and electricity to pump water.

There is some question whether the United States "shale revolution" may be endangered, because US shale oil production is relatively expensive compared to traditional Middle Eastern oil-well supplies. It appears that most US oil production remains economical as long as West Texas Intermediate stays above $US 60 a barrel, which is a good $18 below the current market price. However, as oil prices continue to decline, US oil producers will be forced to become more efficient with drilling techniques and seek discounts from oil service companies and suppliers of rigs, pumps, pipes and valves to remain economically viable (profitable).~

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We strive to optimize our clients' financial well being by coordinating investment decisions with other professionals in the fields of taxation and estate planning.

THE FED STOPS *"SPIKING THE PUNCHBOWL"*

Former Federal Reserve Chairman William Chesney Martin famously spoke of the Fed's role in tempering inflation by raising short term interest rates. Chairman Martin stated that the Fed "is in the position of the chaperone who has ordered the punch bowl removed just when the party was really warming up." Conversely, quantitative easing (QE) i.e., the central bank's policy of buying $4.5 trillion of US government debt and mortgage backed securities in order to lower long term interest rates, might best be characterized as the Fed "spiking the punchbowl" with rocket fuel. With the announced end of QE, both the bond and stock market may be in for a volatile period of adjustment as investors digest whether the economy can stand upright on its own, or not, after imbibing five and an half years of monetary stimulus that spiked asset appreciations. We welcome the return of a "normal" bond market, where debt instruments compete with equities on the basis of market risk rather than on "extraordinary measures" undertaken by the Federal Reserve to suppress interest rates. There may be a slight hangover for investors as US markets adjust to the "new normal", but we are confident that we are well positioned for continued growth versus fellow developed countries in Europe and Asia.~