2014 4th Quarter

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PERFORMANCE WEIGHTED ASSET ALLOCATION REPORT

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ADVISORS' THOUGHTS

2014 was a **good year to be invested in high quality stocks and bonds** in the US. During this economic expansion, **historically low interest rates on cash accounts remained close to zero last year**. In this low interest rate environment, we are pleased to report the **positive returns for your accounts in 2014**.

The **strength** of the global equity market was in **large cap US stocks**. The **S&P 500 gained 11.39%** last year, as noted in the Benchmark Returns table, with the expanding US economy overshadowing **weakness in many other parts of the world.** These global concerns shifted investor dollars to the US and away from the rest of the world resulting in **negative stock returns in most** broad based measures of **foreign stock** performance.

The **MSCI EAFE international stock index** experienced a **loss of 7.35%** in 2014. This difference between US and foreign stock returns is rather large, although not unprecedented. **Emerging market stocks also suffered losses** in 2014 with the **MSCI Emerging Market index declining 4.63%**.

Your accounts were invested largely in **US stocks over foreign** and **that contributed substantially to the positive performance** you achieved. Also contributing to your positive returns were investment grade bonds.

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BENCHMARK RETURNS THROUGH 12/31/14

	3 Mo.	6 Mo.	12 Mo.
DJIA	4.58%	5.92%	7.52%
S&P 500	4.39%	5.03%	11.39%
Russell 2000	9.35%	0.98%	3.53%
MSCI EAFE	-3.86%	-10.00%	-7.35%
MSCI Emerging Markets	-4.88%	-8.99%	-4.63%
Barclays Inter-term Bond	1.53%	1.49%	3.18%
Barclays Long-term Bond	8.03%	10.76%	23.30%

Source: Wall Street Journal and Morningstar Principia
Does not include reinvestment of dividends

DJIA: A price weighted average of 30 stocks.

S & P 500: A market value weighted index of 500 stocks.

Russell 2000: A market value weighted index of 2000 stocks.

MSCI EAFE: A stock market index designed to measure the equity market performance of developed markets outside US and Canada.

MSCI Emerging Markets: A stock market which captures large and mid cap representation across 21 Emerging Market countries..

Barclays Capital Treasury Intermediate-Term Bond Index: An index comprised of US Treasury securities with maturities between 2 and 10 years.

Barclays Capital Treasury Long-Term Bond Index: An index comprised of US Treasury securities with maturities of 10 years or longer.

Increased global oil production with weakening demand outside the US has led to a substantial **decline in oil prices**. The impact of changing oil prices on the global economy run deep and wide with no simple answer as to whether a large drop in oil prices are "good" or "bad". We will discuss below some of the **positive and negative effects**, but first an overview of the decline in price.

The chart on Page 3 illustrates the volatile nature of **oil prices and their direct relationship on the price of unleaded gas**. In June of last year, the price of **Brent crude oil reached** over **$110 per barrel** and has **since fallen over 50%** to trade **below $50** in early January. This precipitous decline has been matched by an equally large decline in the price of **unleaded gas**. In **June of 2014**, the national average of unleaded gas was over **$3.60 per gallon** (the West Coast near $4.00 per gallon), and **today** it stands very close to **$2.10 per gallon**.

US Impact

For most of us in the US, the direct impact of **falling oil prices is a decrease in the amount we pay for gas**. If this lasts a while, it can be a **huge boost to the US consumer.** For example, the Federal Highway Administration reports that the average 35 to 54 year old drives **15,291 miles per year**. In addition, the EPA reports the average fuel economy for a new car is **24.1 MPG**. If over the course of the next year one paid **$3.60 per gallon**, they would spend **$2,275 on gas** while if gas stayed down at the current level of **$2.10** per gallon they would only be spending **$1,327**, for a **savings of $948.** Furthermore, the **savings for many car owners is probably much greater as the average fuel economy for older cars is less than the new models.**

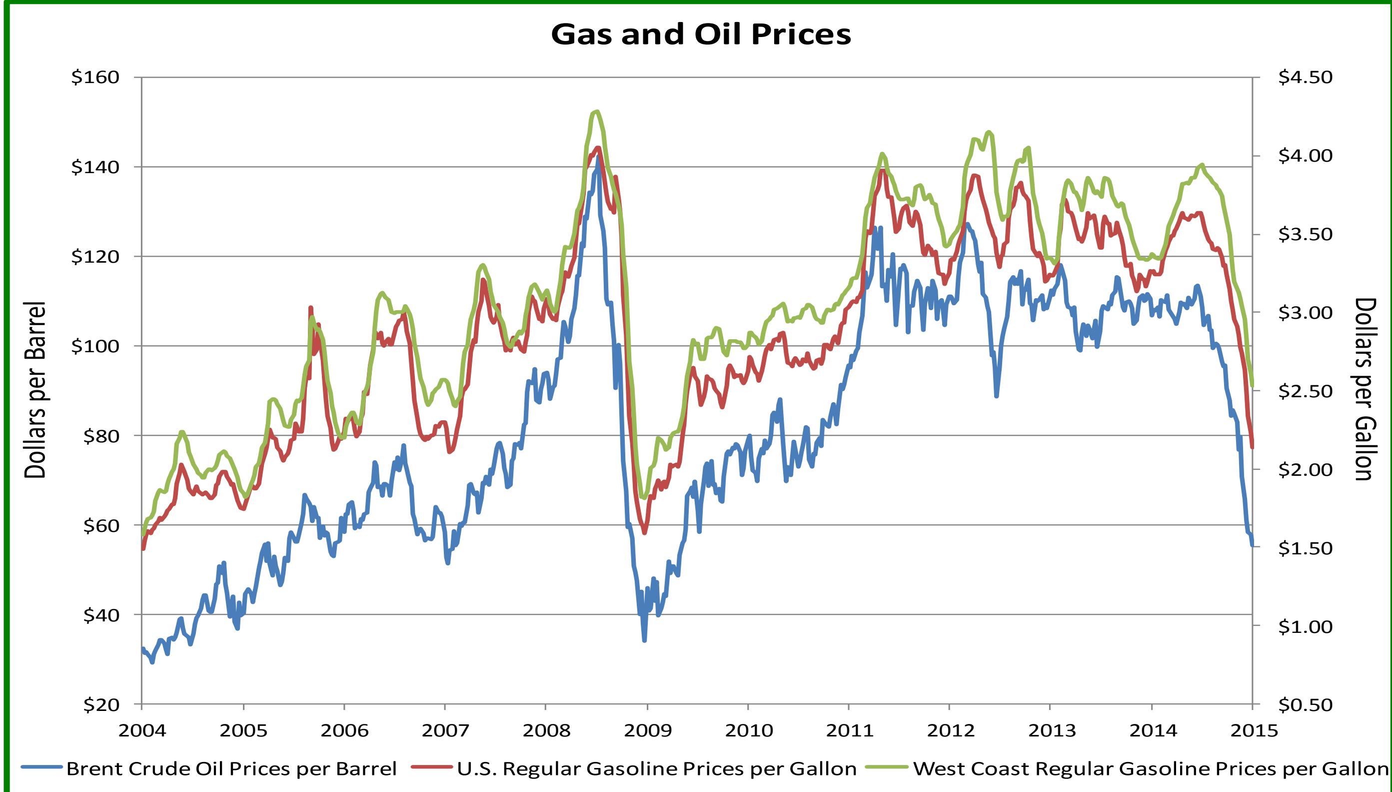
The direct savings of paying less at the pump is not the only way the consumer benefits. The cost to **travel by air may also decrease** since the largest input cost for air travel is fuel. This lower input cost for fuel is imbedded in the transportation cost of all products being shipped. **From agricultural products to electronics, the cost of shipping has been coming down.** Since the US economy is roughly 2/3 consumption, the benefit of lower oil prices and **the resulting lower cost for fuel are significant**.

There are however important **negative aspects** to the US economy when oil prices decline. The **energy sector has been one of the strong growth engines** for the US in the past few years in places like the Dakota's and Texas. Strong **job growth in these regions is now threatened** by the sudden decline in oil prices. For example, in early January US Steel announced it would idle plants that made steel pipe and tubing for oil and gas exploration in Ohio and Texas laying off 756 workers.

In addition to the more obvious threat to employment, there are **impacts to the financial markets.** Oil and gas exploration are highly capital intensive businesses. And while some projects are lower risk, many come with significant risk to those who finance them. The **fast growing sector of the high yield bond market** (below investment grade) **for the past three years has been energy**. As oil prices rose, more and more production capacity was financed and came online. However, projects in the US Shale boom that were very profitable at $80-$100 per barrel may now struggle to break even at current prices. **A growing concern of possible bankruptcy with some firms has lead to a decline in the high yield bond market.**

Global Impact

As important as oil is to the US economy, in many parts of the world its importance is far greater. Numerous countries and regions including Canada, Russia and of course the Middle East receive a significant portion of their revenue from oil. This



economic trouble from **falling oil revenue is also contributing to political instability**.

Russia in particular has **suffered significant setbacks.** It has been reported that **oil and gas revenues fund approximately half of the country's fiscal spending**. The ruble (Russian currency) has fallen precipitously against the dollar.

Even before the currency drop, Russia has been under **political pressure over** their actions in **Ukraine**. A number of countries, including the US, have **responded to Russian actions by imposing sanctions against some wealthy individuals and entities**, along with specific sectors of the economy. Russia in turn has responded with sanctions of their own. Although less in the headlines in recent weeks, **the dispute over Ukraine is ongoing**.

This political and economic uncertainty has led **investors to re-think their desire and at what price they will pay for Russian assets.** In response to new Russian regulations, **Microsoft and Google are considering pulling out of Russia**. Other US tech giants such as **Adobe Systems** have **already left Russia.** In addition, numerous western private equity firms are ending plans to acquire assets in Russia. Well regarded Blackstone Group has not renewed its contract to seek direct investments in Russia.

Going Forward

The magnitude and duration of the decline in oil and fuel prices is difficult to know. The impact of this decline varies greatly between those who benefit from lower prices on the consumption end to those who benefit from higher prices on the production end. On balance, **it appears that if prices stabilize at a new low level the majority of individuals and businesses in the US will benefit.** This will probably occur after a period of adjustment for financial markets and the energy sector.

Hines Global REIT

For those of you who owned the Hines Global REIT **we recommended you redeem your shares** in December. With **nearly 50% of their portfolio in overseas investments**, the Hines Global REIT's performance will be influenced by global economic conditions. **Weak economic activity in most of Europe** will impact real estate prices in those countries. In addition, **holdings in Russia may be severely impacted** by the economic and political problems the country is facing. Given the illiquid nature of a non-traded REIT, we recommended the change.

For several years now, it has been **anticipated that US interest rates would begin to rise**. However, once again 2014 surprised most forecasters with **declining and not rising interest rates**. **Long dated government bonds had spectacular returns** with the highly volatile Barclays Capital Treasury Long-Term Bond Index gaining 23.3%. This return was almost entirely from capital appreciation and not indicative of a typical bond mutual fund. A **more representative measure of high quality bond performance** is the **Barclays Capital Treasury Intermediate-Term Bond Index**. Its total return for last year was **3.18%**.

At the beginning of 2015, the same trend in the global economy appears to be in place, that being the **US is much stronger than most overseas economies**. At some point, the financial markets will begin to forecast a change and foreign stock markets will begin to match or exceed the US. For now, **we continue to maintain the overweight in US stock to foreign** and have the bond portion of your accounts positioned in short/intermediate bonds to minimize the impact if interest rates were to rise.

US Job Market Improving

The **US job market continues to show overall strength.** On January 9th, the Labor Department reported that nonfarm payroll **added a seasonally adjusted 252,000 jobs in December**.

More importantly for all of 2014, the **US added nearly 3 million jobs, its strongest showing since 1999**. This contributed to the decline in the US **Unemployment Rate to 5.6%**, as reported separately by the Bureau of Labor Statistics.

Although job growth has been solid, **wage gains remain modest** with **average hourly earnings for all private-sector employees rising 2%** last year. Tepid wage gains have been a major factor in the low inflation rate. This has allowed the Federal Reserve to be patient in raising interest rates and may allow them to move slowly once they do start to raise rates. **Current job market** characteristics have been the **right mix to continue the US expansion through job gains without causing inflation to overheat**.

Phased Mailing Schedule for 2014 Client Tax Reporting

The IRS **Forms 1099** for your NPB Brokerage accounts held at Pershing will be mailed on either **January 31st** or **February 28th**.

The latter date will be for those accounts that include certain equities and REITs.