2014 1st Quarter

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PERFORMANCE WEIGHTED ASSET ALLOCATION REPORT

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ADVISORS' THOUGHTS

2014 has started with **positive returns for your investment accounts**, and for the last twelve months those returns have seen high single digit or low double digit returns depending on your specific investment objective. After the strong performance in the stock market of 2013, investors have entered this year with the question of whether the market will be able to continue higher or whether we are due for a pause or even a downturn. Performance in the first few months of this year seems to reflect this debate.

At the **end of 2013 the S&P 500 sat at an all time high** of 1,848.36 and then started the year by **declining in January and by February 3rd** stood at 1,741.89, **down 5.8%**. It then began to climb in February and by the end of the month had reached a new all time high and continued to climb in March. By the **end of the first quarter the S&P 500** stood at 1,872.34, **up 1.3% for the year**, as noted in the Total Return table. This type of back and forth struggle with the potential to move higher based on an improving economy is a more likely pattern than the constant rise seen last year.

Around the world, foreign stock markets are less synchronized with the US and each other as more and more the performance is being driven

TOTAL RETURN THROUGH 03/31/14

	3 Mo.	6 Mo.	12 Mo.
DJIA	-0.72%	8.78%	12.89%
S&P 500	1.30%	11.35%	19.32%
MSCI EAFE	0.00%	5.36%	14.42%
MSCI Emerging Markets	-0.80%	0.73%	-3.89%
Barclays Inter-term Bond	0.69%	-0.33%	-2.14%
Barclays Long-term Bond	6.72%	3.57%	-4.11%
SPDR Gold Shares	6.45%	-3.57%	-20.44%
iShares Silver Trust	-1.76%	-8.90%	-31.34%

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.

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.

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

SPDR Gold Shares: An exchange traded fund that represents the price of gold.

iShares Silver Trust: An exchange traded fund that represents the price of silver.

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March 26, 2014 the **article, "Attention Suckers, Please Send Us All Your Money"** appeared in Financial Advisor Magazine from Bloomberg News columnist Barry Ritholtz. It discussed the acquisition by social media giant Facebook under the direction of Chief Executive Mark Zuckerberg, of a company by the name of Oculus VR, Inc. for $2 Billion of cash and stock. This wasn't particularly big news as just a month earlier Facebook bought a text messaging service called *WhatsApp* for a much larger price of $19 Billion. However, **the way Oculus was originally funded makes this story particularly noteworthy**. Furthermore, how could one not be a little curious when a professional trade publication has an article with such a catchy title as "Attention Suckers, Please Send Us All Your Money"? We think the information that follows is a ***MUST READ* for anyone who is tempted to "invest" over the internet** in a start-up company.

In August 2012 an almost nonexistent company **Oculus went to the internet and using a site called Kickstarter raised money** for development of its virtual reality headset. The offer over the internet was if you contributed $10 you could get a Thank You letter from the Oculus team. If you kicked it up to $25 you got the letter and a T-shirt. But the real group was those who put up $300. They were promised a "developer kit" with a prototype headset and access to the software to develop games built in the headset. All told, **over 9,500 people provided funding** to the company through the site Kickstarter for a **total of over $2,400,000**. This was between August and September of 2012. **Twenty months later Oculus**, still in the development stage and without a product on the market, **was bought for $2 Billion by Facebook**.

Those original contributors put up .12% of $2 Billion and our initial thought was they made the investment gain of a lifetime. The kicker is – **none of the $2.4 million sent to the company by those 9,500 people was an INVESTMENT in Oculus nor were they an INVESTOR**. They were all "Founders," "Funders," "Contributors" or whatever you want to call it, but not shareholders in Oculus. In other words, they agreed to send in their money to help a new business for the Thank You letter, the T-shirt, or the Starter Kit and were promised nothing more. How does a company raise $2.4 million and give up no equity interest? And secondly, how could the people rationalize sending in the money without a promise of an equity position?

We wonder if all 9,500 people understood that they were receiving no ownership interest. Maybe the word on the website proposal of a "Funder" was misconstrued by some people as "Investor." It appears that in the age of being instantly connected with each other over the internet, the understanding of the written word may still have some importance.

This raising of money so easily from the public has been made possible through the potential of instant mass communication using the internet. The concept has come to be known as *crowdfunding*.

According to Wikipedia, **"Crowdfunding is the collection of finance to sustain an initiative from a large pool of backers – the "crowd" – usually made online by means of a web platform."** There is no limit as to what type of group or individual may seek backing.

They **can be for a philanthropic cause, a political campaign, a commercial cause** (such as creating and selling a product, funding a movie or paying for a band to go on tour) **or for financing a start-up business**. There are even individuals who ask for funding of a personal cause such as to pay for a trip they want to take.

Today there are a **large number of platforms** such as Kickstarter, ArtistShare, Pledgie, SellaBand, and Indiegogo that have come into being in the last few years **that post listings for these different types of causes**. They raise money for all kinds of different activities that have nothing to do with investing.

If one is to help finance a cause they should have a proper understanding of what they can expect in return. This is based on the kind of funding they are agreeing to provide.

The first kind is donation based – Backers donate money to support a cause. Sometimes they receive a thank you or a gadget, but in any case, the pledge is essentially a gratuity.

The second kind is award based crowdfunding in which the backer receives an award with a clear monetary value like tickets to a concert, or the first edition of a book to come out, or a prototype of the virtual headset as was done in the case of Oculus for $300.

The third type is credit based fundraising. This is one in which the backer lends the money and receives an interest rate in exchange. This money is pledged as a kind of credit loan.

The fourth type is equity based crowdfunding in which the backer receives shares of a company in exchange for the money invested.

What has caught our attention is the fact that **crowdfunding has moved into lending and equity types of funding**. **The Jumpstart Our Business Startups (JOBS) Act** that became law April 5, 2012 **allows exemptions to certain security laws** for small businesses in order **to facilitate the ease of raising capital**. Specifically it created an exemption to permit securities-based crowdfunding. It also created a new entity – funding portal – to allow internet-based platforms or intermediaries to facilitate the offer and sale of securities without having to register with the Securities and Exchange Commission (SEC) as brokers.

In October of last year the **SEC put out proposed rules** for public comment to permit companies to offer and sell securities through the JOBS Act. Under these proposed rules:

- A company would be able to raise a maximum aggregate amount of $1 million through crowdfunding offerings in a 12-month period.

- Investors, over the course of a 12-month period, would be permitted to invest up to:

    - $2,000 or 5 percent of their annual income or net worth, whichever is greater, if both their income and net worth are less than $100,000.
    - 10 percent of their annual income or net worth, whichever is greater, if either their annual income or net worth is equal to or more than $100,000. During the 12-month period, these investors would not be able to purchase more than $100,000 of securities through crowdfunding.

What jumps out in looking at these rules is that one is **no longer talking about a nominal amount of money** such as a maximum of $300 as in the case with Oculus. Instead the **amount that any one investor can invest could be as large as $100,000**. For these amounts of money one should be very thorough in their due diligence of the investment. Furthermore, with a maximum raise through crowdfunding of $1 million in a twelve month period, the kinds of companies that will raise capital this way are truly small companies. **By the very nature of their small size, these will be businesses with a high degree of risk**.

Debate and opinions about the JOBS Act and allowing companies to raise capital through crowdfunding appear quite varied. In fact, even the **former SEC Commissioner Mary Schapiro was very much against it** in a March 13, 2012 letter. She was concerned that this might be a violation of a number of securities laws. **We are** also **concerned that numerous under-informed people will be misled through investment scams** that raise capital through crowdfunding. People being swindled out of their money has been happening since the beginning of time, but today due to the internet it is much easier for that to happen.

We are hopeful that more good than bad will come from the JOBS Act permitting businesses to raise capital through crowdfunding. In this world of instant information from the internet, the **principle of doing your due diligence remains as true today as before**.

by their local or regional economy. As a whole, performance in **international stock markets continued to lag the US**. The MSCI EAFE was flat for the first three months of 2014 while the MSCI Emerging Markets declined 0.8%.

Somewhat surprisingly, government bonds did well. Surprising because it is widely anticipated that interest rates will be rising over time and bond prices will fall in a rising interest rate environment. For the first quarter of 2014 there had been just enough concern, causing interest rates to decline. These concerns have ranged from the weak US economic expansion, slowing growth in some emerging market countries such as China, as well as geopolitical concerns over Ukraine. With this backdrop, the Barclays Intermediate Term Bond rose 0.69% and the Barclays Long Term Bond rose a strong 6.72%, although both were still decidedly negative over the past twelve months.

Key to the US stock market performance will be the health of the US economy. Since the end of the last recession in June 2009, the economy has improved stubbornly slow. The nation's jobless rate stands at 6.7%, the highest on record for recent expansions at this stage of the business cycle. Closely tied to this, the Gross Domestic Product has grown only 1.8% on average since the recession, about half the pace of the previous three expansions.

Although it has lacked the robust recovery we all hope for, there **may be some positives that can be taken from the slow progress**. One such positive is the length of the recovery. The National Bureau of Economic Research, which tracks the length of business cycles, determined that the US economy began expanding in June of 2009, about 58 months ago as noted in the Table to the right. This is the average length recovery for previous expansions since World War II. Furthermore, with **no sign** of the typical **overheating economy** that causes the Federal Reserve to implement a restrictive monetary policy, this **expansion may have much further to run**.

On the job front it appears we are at a positive inflection point where **stronger job growth may begin**. The initial claims for jobs benefits have continued to trend lower in recent months. A **slowdown in layoffs is the precursor to an increase in hiring**. On April 12th the Labor Department published the four-week moving average of **initial claims for jobless benefits** which **fell to 312,000 claims**. This is the **lowest level since October 2007**, prior to the last recession. For companies to grow they will need to hire.

The US economy has long been regarded as a consumer driven economy with approximately two thirds of our GDP being consumer spending. The latest numbers on retail sales shows a consumer that is willing to spend. In April the US Census Bureau released advanced estimates of **US Retail and Food Service Sales for March**, seasonally adjusted, **increased a robust 1.1%** from February. More **importantly they increased 3.7% over the past year suggesting a healthy consumer.**

We continue to monitor the economy and the stubbornly slow expansion. The **US economy appears to be positioned for an increase in the growth rate** with consumers continuing to spend and the job market improving. If these improvements continue, we would anticipate the stock market to continue to do well.