CORE EQUITY REVIEW

Third Quarter 2014

A "TINA" Stock Market

PERFORMANCE COMMENTARY

On May 22, 1980, Conservative British Prime Minister Margaret Thatcher, in the Daily Telegraph, opined that free markets, free trade, and capitalist globalization were necessary to stem the advances of socialism and return the United Kingdom to prosperity. Her strong declaration, "There is no alternative," morphed into the acronym TINA which became the rallying cry of neoliberalism….and her nickname.

Today, in a period of global geopolitical disruptions and erratic economic recoveries, investors, here and abroad, are attracted to the stability of the US stock and bond markets, also sensing "there is no alternative."

The resultant positive investment flows from abroad and a preference for equities by US investors have caused our financial markets to steadily advance in the face of subpar domestic economic growth and the ending of the Federal Reserve's extended period of unconventional easing. There are few signs of this trend reversing or of a quelling in the rallying cry of the bulls, "TINA."

Equity returns, as measured by the S&P 500, in the third quarter were +1.1%, bringing the year to date advance to +8.3%. During the quarter, strength was in large capitalization, quality companies with healthcare and information technology leading. Weakness was seen in energy (soft oil prices) and utilities (rising interest rate fears).

			Periods Ending September 30, 2014				
	QTR	**YTD**	**1 Yr**	**3 Yrs**	**5 Yrs**	**7 Yrs**	**10 Yrs**
Core Equity Composite - NET	**1.9**	**6.1**	**18.6**	**22.8**	**16.8**	**9.9**	**11.2**
Russell 1000	0.2	6.4	16.7	20.7	13.6	4.1	6.3
S&P 500 Index	1.1	8.3	19.7	23.0	15.7	6.0	8.1

Composite performance is reported NET of fees and expenses. Please refer to the disclosures at the end of this report.

Performance figures for periods one year and longer are annualized.

PORTFOLIO COMMENTARY

The rails have been very strong all year having benefitted from both the economic recovery and more directly from the boom in US energy. Oil must and will be shipped via rail for the next several years until pipelines can be built. **Union Pacific (UNP)** was a leading contributor to total portfolio returns in the first quarter followed by **Canadian Pacific (CP)** with CP up 15% and UNP up 9%. **American Movil (AMX)**, which we added to the portfolio late in Q1, was up 21% in the recent quarter. They are selling assets in Mexico and redeploying them in other high growth, global markets. **United Continental (UAL)**, which was added to the portfolio in Q2, responded well to increased demand, high load factors, firm fares and trending lower fuel costs. Accordingly, it rose 14%, while **Microsoft (MSFT)** advanced 11%.

Detracting from returns, **Corning (GLW)**, which was the leading performer in Q1, continued to consolidate and was down 12% in the quarter. The company reported strong revenues, but sales of Gorilla glass for mobile devices was lower than expected and the stock has been pressured over concerns of sales to Apple and possibly others. We have written that we are investing in GLW for its ability to transform glass from a rigid to a flexible bendable state. This will redefine the use of glass and provide major new marketing opportunities. **FMC Corp (FMC)** and **Deere (DE)** were both under pressure on concerns of a slowdown in sales to the agriculture sector. FMC was down 20% and DE 9% in the quarter. FMC's decline was due to a late, wet spring and decreased fertilizer demand. DE fell on lower crop prices leading to slower equipment sales. While demand for LEDs continues to expand, **CREE (CREE)** was down 18% on concerns of price competition from Chinese manufacturers of low end LED's leading to margin concerns. **Qualcomm (QCOM)** was off 6% in the quarter.

PORTFOLIO ACTIVITY

We have been using **Vodafone (VOD)** as a source of cash for the purchase of new names and we sold the tag end of our 1% position in the quarter.

MARKET COMMENTARY

After advancing for over five years, there is a supposition among forecasters that the bull market has reached maturity and they have begun to warn of its imminent demise. While the premise of TINA is still bullishly reflected in their equity weightings, guardedly they search for reasons to reverse course and seek the safety of reduced exposure.

In our second quarter commentary, we addressed their perception that rising interest rates would abort the economic recovery and bring an end to the bull market. Our conclusion was that, while interest rates would rise over time, the ascent would be moderate and economic risks minimal. Easy foreign central bank policies, global fund flows and the diverse nature of US bondholders' investment objectives would combine to dampen the degree of the upward move.

Lately, cautious investors are becoming increasingly fearful of an impending and potentially meaningful decline in corporate profitability. With operating margins at a cyclical high of nearly 9.5% and tepid top line revenue growth, the concerned feel a reversion something closer to the mean margin of 6% is on the horizon; a scenario not friendly to the economy or the equity market.

However, an analysis of the major cost components determining corporate profitability does not affirm the fears of imminent, deleterious escalations.

1. Labor: In spite of the recent drop in the unemployment rate, wage inflation pressures do not appear to be threatening. Presently, the interaction between the weakness of labor unions, economic globalization, domestic underemployment and innovation/productivity improvements provides headwinds to rapid wage rate acceleration.

2. Raw Materials: The combination of sub-par global growth and new supplies (especially US energy) should keep commodity prices well contained.

3. Interest Cost: The outlook for moderately rising interest rates combined with a lengthening of the duration of debt on corporate balance sheets should mitigate any sharp cost escalation.

4. Taxes: While there is growing pressure from the government on corporate tax abuses, there is a general understanding that the relatively high US corporate tax rate is non-competitive on a global basis. So dramatic tax code changes are not currently anticipated. Eventual reform would not reduce corporate payments and most likely would be accretive to the Treasury; but not meaningfully so.

Over the next few years, prospects for the trends in the "costs of doing business" do not appear to be worrisome. With stable profit margins and moderately growing revenues, the outlook is for a continuation of a historically high level of absolute profit generation. This will have a very positive impact on American corporations:

1. The building excess cash flows can be employed in share buy backs, increased dividends and merger and acquisition activities.

2. Already strong balance sheets can be fortified.

3. An acceleration of business expansion can occur through increased capital spending and new hiring.

4. The anticipated ongoing decline in energy prices, as the result of the dramatic growth in US energy production/conservation, can continue to exert an increasingly positive influence on our inflation, growth and employment, balance of trade, and global manufacturing competitiveness.

The simulative effects of these financial and operating improvements bode well for the overall economy and stock market. Thus, we maintain our positive stance on the US equities.

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Performance results are calculated internally using Advent portfolio accounting software. Accounts are included in each composite and its performance at the beginning of the first full calendar month in which the account is fully reflective of the investment strategy. Performance and index valuations and calculations include cash and cash equivalents and also include the reinvestment of dividends, interest and other earnings and are computed and stated in US dollars. All performance figures for periods one year and greater are annualized. Returns are weighted for the size of each underlying account. Net returns are reported net of management fees and commissions. A client's return will be reduced by our advisory fees and other expenses a client may incur in the management of the client's portfolio. Our advisory fees are disclosed in our Form ADV 2A. Also, there is a compounding effect of advisory fees over time on the value of a client's portfolio. As an example, the deduction of investment management fees would reduce the annualized return for the five years ended December 2013 from 19.4% to 18.7%. Actual investment advisory fees incurred by clients may vary.

The **S&P 500 Index** is an unmanaged index generally considered to be representative of the US stock market as a whole. The **Russell 1000 Index** is an unmanaged index that measures the performance of the large-cap segment of the US equity universe. These indices are unmanaged and include the reinvestment of dividends and earnings. Individuals cannot invest directly in any of these indices.

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