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Second Quarter 2014

All Together

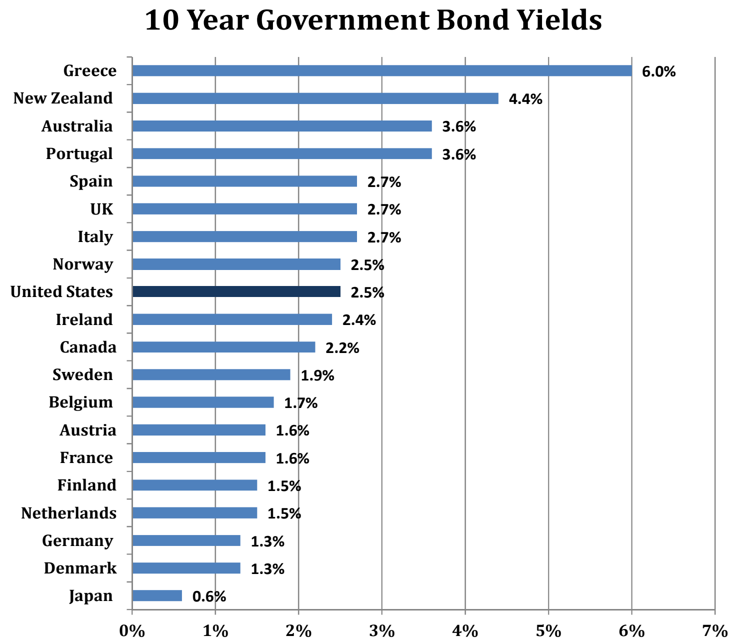
The final revision to first quarter US gross domestic product was released on June 25th at -2.9%, quite a drop from the initial estimate of 0.1%, the second estimate of -1.0%, and it was the first negative quarter since 2011. On the other hand, employment and wage growth have been fairly steady year to date, credit has been expanding at a faster pace, and liquidity conditions remain accommodative, albeit with gradual tapering of Treasury and mortgage purchases by the Fed. Unlike the selective, value driven rotation experienced in the first quarter, investors bought everything in the second quarter- stocks, bonds and commodities (see table below). The relentless, some would say indiscriminate, search for yield led the charge, strengthening bids for long dated US Treasuries, European sovereign debt, Real Estate Investment Trusts (REITs), Master Limited Partnerships (MLPs), global utilities, and income stocks. Gold and oil also performed well, as geopolitical concerns about Ukraine, Iraq and, lately, missile attacks on Israel from both Lebanon and the Gaza Strip heightened. Only twice in the last twenty-four years have all major asset classes ended the first half of a calendar year higher.* In our opinion, this rare phenomenon reduces the chance for meaningful diversification when conditions change, raising the utility of cash in today's portfolios.

	INDEX PERFORMANCE IN 2014	
Index	**Second Quarter**	**Year to Date**
MSCI US REIT	7.00%	17.69%
S&P Global 1200 Utilities	7.11%	16.51%
Alerian MLP	14.18%	16.31%
Barclays US Treasury: 20+ Year	5.06%	13.19%
S&P 500	5.23%	7.14%
MSCI All Countries World	5.04%	6.18%
MSCI Emerging Markets	6.60%	6.14%
S&P GSCI (Commodities)	2.69%	5.71%
Barclays US Credit	2.71%	5.70%

Total Returns. Sources: BlackRock®; Bloomberg

Most investors feel comforted that central banks are buying with them, acquiring the same long duration yield assets like government bonds and mortgages, holding down discount rates used to value equities, and trying to promote credit creation. The reality is that the end goals are different: the Federal Reserve Bank, the European Central Bank, and the Bank of Japan would like growth and inflation to increase, while a buyer of long dated sovereign debt, mortgages or utilities would like to see growth and inflation moderate, or even decrease. In this way, investors are betting against the house, assuming that the extreme stimulus efforts of the various monetary authorities will be either unsuccessful or, daring to dream, modestly successful and not disruptive. It has become fashionable for pundits to project a slow and steady, low volatility investment backdrop for years to come, rationalizing ever higher multiples.

While yields and supply were declining in the Treasury markets this year, investors submitted $3.4 trillion of bids for the $1.12 trillion of US government notes and bonds sold, the second highest "bid to cover" ratio on record. Yet price action in the first half of 2014 outside income markets has in fact given a nod to inflation. Energy stocks, commodities, TIPS (Treasury Inflation-Protected Securities), and gold have all rallied, while consumer stocks, industrials and financials have lagged. Given where "risk free" yields are today (see graph right), and the level of investor appetite, we are indeed concerned that some yield buyers may find themselves in a liquidity trap. We have been gradually reducing MLP weightings in most of our strategies this year, and keeping fixed income maturities at conservative durations. Even though inflation is more likely to appear on our shores before Europe's, we have to admit that ten year US Treasuries seem like a screaming bargain compared to government securities issued by France or Germany. The country with the most monetary stimulus relative to the size of its economy? Japan, which yields the least.



Special Note to our Clients and Friends: We are pleased to announce that Lea Ann Knight has joined our Firm as Director of Financial Planning. She will be working closely with clients to design and implement their financial and estate plans. Before joining us, Lea Ann was the founding member of Garrison/Knight Financial Planning, LLC. Earlier in her career, she was variously a Chief Administrative Officer at Morgan Stanley, the Controller for the Guggenheim Museum in New York, and a Senior Manager for Deloitte & Touche LLP. She earned her AB from Stanford University and is a CFP® professional. Together with our strategy summaries, please find enclosed Lea Ann's introductory note on financial planning, to be followed by more topical publications and updates in the coming months.

Robert G. Scott
Chairman & CEO

David H. M. Baker, CFA
Chief Investment Officer

**** Source: Strategas***
Source of table on first page: BlackRock and Bloomberg
Source of graph on second page: Thomson Reuters; Eaton Vance. Yields on 6/30/2014
Source of data not specifically cited: Bloomberg

North American Management

Lea Ann Knight, CFP®
Director of Financial Planning

Do You Need Financial Planning?

Many of you may have put together a financial plan along with your estate documents at some point in your history with North American Management. As you may know, financial planning is as much a *process* as an event and now could be the time to update or create a new plan to preserve and grow your wealth.

Not sure if this applies to you? Here's a quiz to help:

If you know the answers to all ten of the following questions, your financial plan is probably in great shape. But if one or more of these leave you wondering, it might be time to give us a call.

1. **Can I maintain my current lifestyle for the rest of my life?**

   If you live into your 90s with inflation at 2-3%, it's not just what you are spending today but what you are going to need as you get older. Cash flow projections can help you determine how much you can afford to spend and how much you need today to make it last.

2. **Have I reviewed my estate documents in the last five years?**

   Tax laws change, family circumstances change. If you haven't reviewed your estate documents (will, trusts, powers of attorney) within the last five years, now is a good time to make sure they are still reflective of your wishes.

3. **How much am I going to need for health care and long term care as I age?**

   It is estimated you may spend as much as $300,000 out of pocket for medical care between age 65 and 90. And long term care costs in continuing care and assisted living facilities can be as high as $20,000 per month. You want to make sure any cash flow projections have included allowances for these medical and long term care costs.

4. **Are my children and grandchildren prepared for the wealth I will leave them?**

   We are often reluctant to share the details of our financial information with our children, but that can leave them unprepared for sudden wealth. A strategy to financially educate your heirs can lead to preserving wealth across multiple generations to come.

5. **Do I have a tax-efficient strategy for my annual charitable giving?**

   Planning ahead for charitable giving each year can lead to tax savings. Using your Required Minimum Distribution and low basis stock (rather than cash gifts) could provide opportunities to avoid additional taxes.

Continues on reverse

6. **Have I taken advantage of all the ways to transfer what I don't need to my children and grandchildren?**

   While trusts are a key component of efficient wealth transfer, Roth IRA conversions and using the annual gifting exclusion can provide additional opportunities for reducing your taxable estate.

7. **Am I using all of the tax-deferred and tax-free opportunities to reduce my income taxes <u>now</u>?**

   Maximizing contributions to employer retirement plans, health savings accounts and flex spending accounts can reduce the amount of taxes you pay while you are working.

   Contributions to college savings accounts and certain life insurance policies can also reduce or delay income tax down the road.

8. **Do I know how much of my monthly spending is fixed and how much is discretionary?**

   Knowing how much of your spending is really fixed versus discretionary allows you to plan for the unexpected and reduces the risk of running out of money later in life.

9. **If I am under 65, am I planning to optimize my Social Security benefits?**

   There are 83 different combinations of Social Security benefits you and your spouse can claim. Each year you wait to take benefits between 66 and 70, your benefit increases by 8%. Make sure you know which combination makes sense for your needs and your tax bracket.

10. **Do I have a succession plan in place for my business?**

    If your business is a significant part of your net worth, you will want an easy way for your heirs to monetize the value when you are gone. Life insurance policies and employee stock plans are just two mechanisms to transfer this part of your estate effectively.

How did you do on the quiz?

These are just a few ideas we would be happy to discuss with you when considering your financial planning needs. Please contact your Relationship Manager if you would like to explore any of these ideas in more detail.