

Capital Market Review and Outlook

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Visit us online
jicinvest.com

Office
2714 N. Knoxville
Peoria, Illinois 61604
t 309.674.3330
tf 877.848.3330
f 888.301.0514



Johnston Investment Counsel
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Executive Summary

Executive Summary

Capital Market Returns

- For stocks, 2013 will go down as one of the better one-year returns in history. U.S. stocks dominated developed and emerging markets.
- For other asset classes, 2013 returns were pretty poor as both bonds and commodities had negative returns.

Economic Conditions

- Most indications are that the economy will continue its slow and stable progress. Consumers and businesses appear to be healthy, but not to the point where economic growth will overheat.
- The unemployment rate is declining and business appear to be hiring. Inflation is expected to rise, but not significantly.
- Real estate conditions have improved (sales, prices, and construction).
- The FED has announced that it will start to reduce its stimulus but will be “data driven” on how quickly changes are made. While interest rates rose in the intermediate- to long-term maturity segments during 2013, they did not move too much in the shorter maturity segments. This will probably start to change during 2014.

Stock Market

- Mid- and small-cap stocks outperformed large stocks during 2013. Growth slightly outperformed Value.
- Valuations have risen to ten-year highs. While perhaps not significantly overvalued, it is difficult to say the U.S. market is undervalued.
- While valuation is poor short-term predictor, it does seem to provide insights on longer-term expectations. Current valuation levels suggest extremely modest future stock returns.

Bond Market

- High yield bonds were the only bond segment (except cash) that had a positive return during 2013. This was the first negative return for the U.S. bond market since 1999 and the lowest calendar-year return since 1994.
- Intermediate- and longer-term yields rose by about 1% during the year. Bonds with maturities below four years still do not provide a yield above the rate of inflation.
- JIC expects continued poor performance from bonds. We believe it will be difficult to “earn your coupon” -- regardless of quality. Another negative return year is a possibility.

Asset Class Returns

<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>Annualized Returns</u>	
					<u>3 Year</u>	<u>5 Year</u>
U.S. Stock 28.3%	U.S. Stock 16.9%	U.S. Bond 7.8%	U.S. Stock 16.4%	U.S. Stock 33.6%	U.S. Stock 16.2%	U.S. Stock 18.7%
U.S. Commodity 18.9%	U.S. Commodity 16.8%	U.S. Inflation 3.0%	U.S. Bond 4.2%	U.S. Inflation 1.2%	U.S. Bond 3.3%	U.S. Bond 4.4%
U.S. Bond 5.9%	U.S. Bond 6.5%	U.S. Stock 1.0%	U.S. Inflation 1.8%	U.S. Cash 0.1%	U.S. Inflation 2.0%	U.S. Inflation 2.0%
U.S. Inflation 2.8%	U.S. Inflation 1.4%	U.S. Cash 0.1%	U.S. Cash 0.1%	U.S. Bond -2.0%	U.S. Cash 0.1%	U.S. Commodity 1.5%
U.S. Cash 0.2%	U.S. Cash 0.1%	U.S. Commodity -13.3%	U.S. Commodity -1.1%	U.S. Commodity -9.5%	U.S. Commodity -8.1%	U.S. Cash 0.1%

Economic Conditions

Executive Summary: Economic Conditions

General Economy & Financial Conditions

- The U.S. economy continues its slow but steady improvement. A variety of “future focused” indicators all suggest that, economic activity will improve. The indicators do not suggest such rapid growth that the economy is in danger of overheating. There appears to be little chance of a near-term recession.
- Financial conditions seem to have normalized. Loan officers are willing to make consumer loans and are also seeing higher demand.

Consumer

- The consumer appears to be in relatively good shape. Retail sales and personal consumption expenditures are rising at a reasonable level. However, growth in real disposable income is quite modest.
- Since the Great Recession, the consumer has done much to improve their balance sheet. Debt as a percent of disposable income is at the lowest level in over a decade.

Business

- Current business conditions as well as expected new orders suggest continued growth and improvement in the business segment of the economy.

Labor

- While the unemployment rate remains too high, it has declined significantly during the past few years. Unemployment is currently in the 7% range with expectations that it will continue its descent during 2014.
- Businesses have been hiring and the continued employment outlook (the net percent of employers hiring) is improving.

Real Estate

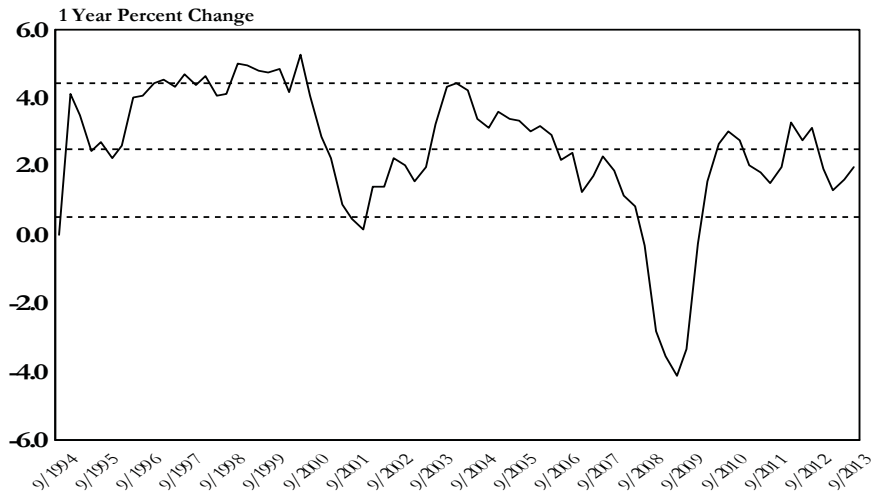
- Real estate activity has clearly picked up. Both sales and prices have been increasing. Housing starts have also picked up which is another positive sign for the general economy.

Summary

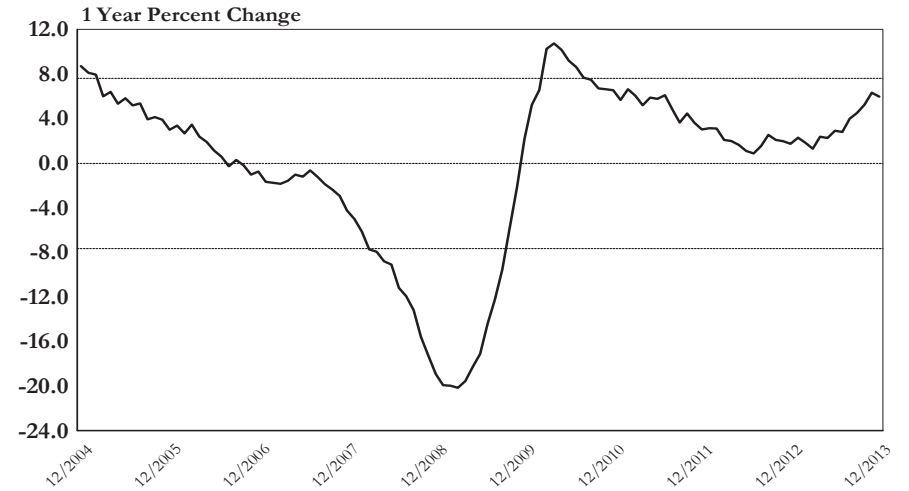
- There is little doubt that the economy is improving for both consumers and businesses.
- In response, the Federal Reserve has indicated it will start to reduce some of the extra stimulus it has had in place for the economy. This is a good and necessary measure.
- We take the FED at its word -- that it will be gradual in its approach. Reducing some stimulus, evaluating the impact over several months before deciding if the next stage is necessary. It does not appear the FED wants to risk taking stimulus away too soon and jeopardize the current positive economic conditions.

Economic Conditions: General Economy

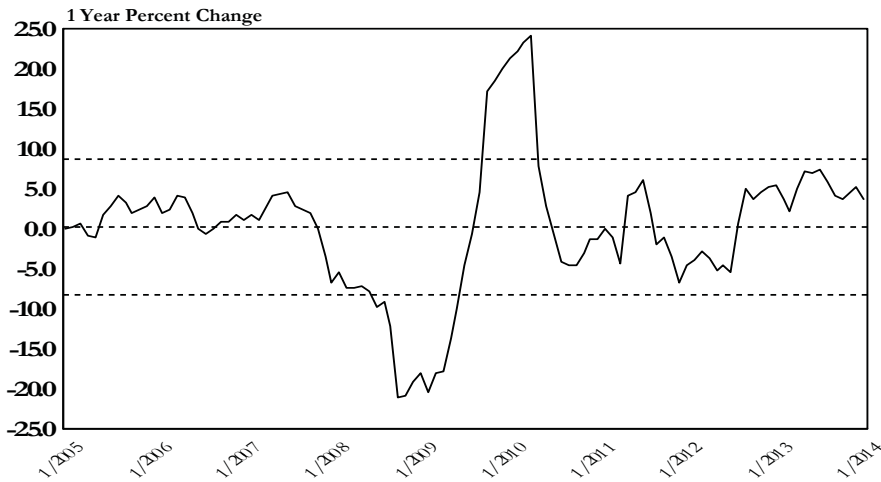
Gross Domestic Product



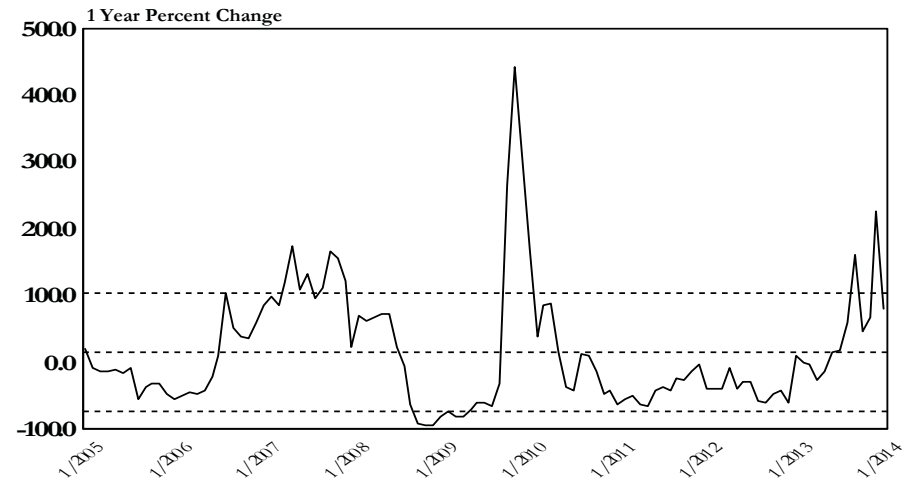
Leading Economic Indicators



ECRI Weekly Leading Index



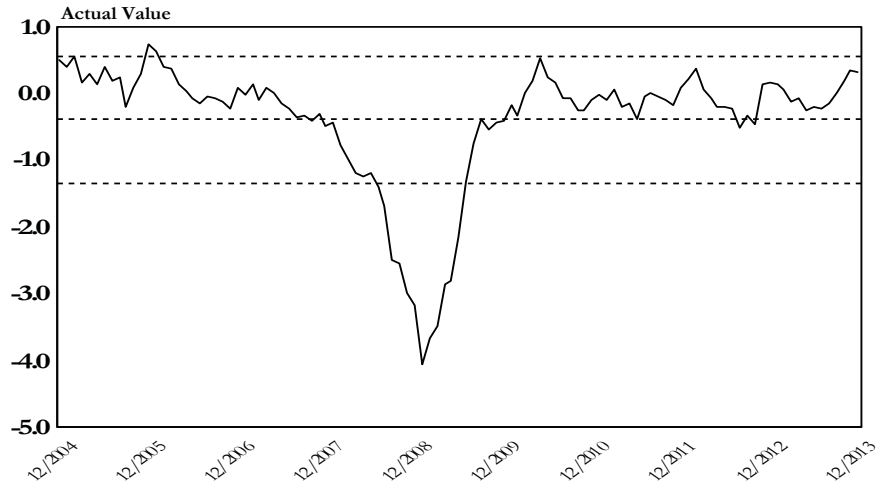
Baltic Dry Index



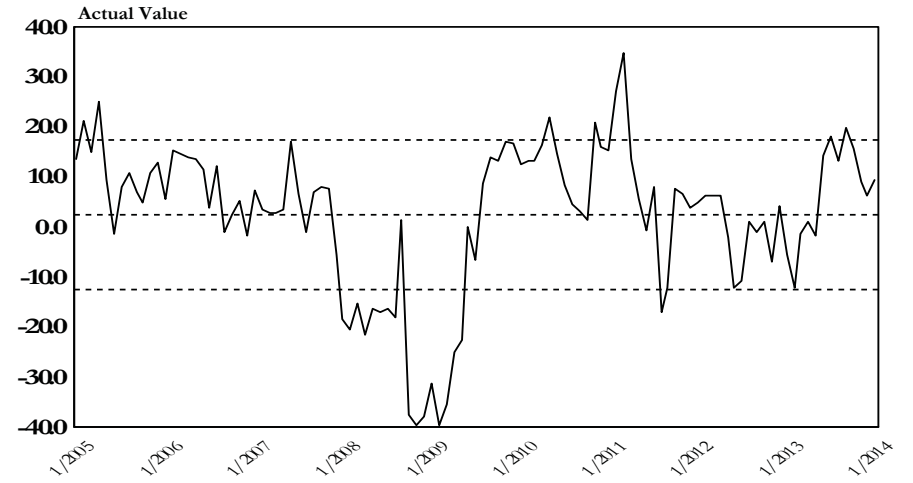
- The charts on the next two pages all tell a similar story. The U.S. economy appears to be steadily improving as nearly all indicators are above their respective historical average. However, it does not appear that economic growth is so robust that the economy is in danger of overheating.

Economic Conditions: General Economy (continued)

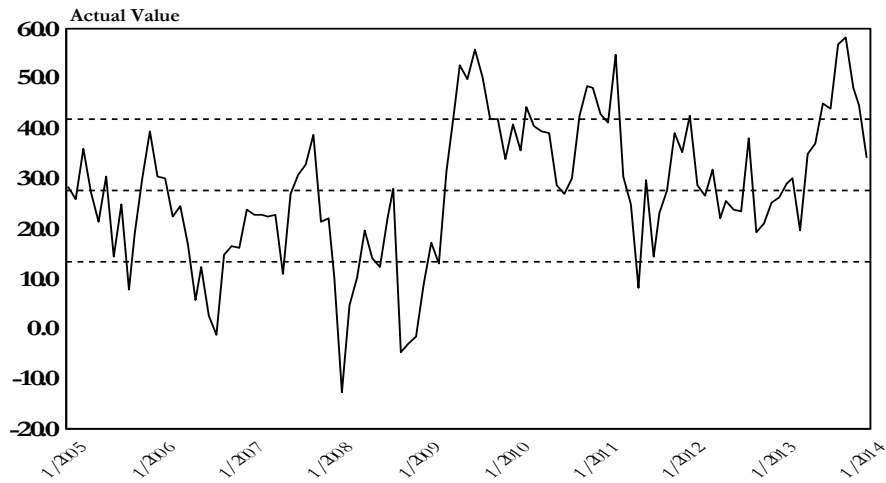
Chicago Fed: National Activity Index - 3 Month Moving Avg



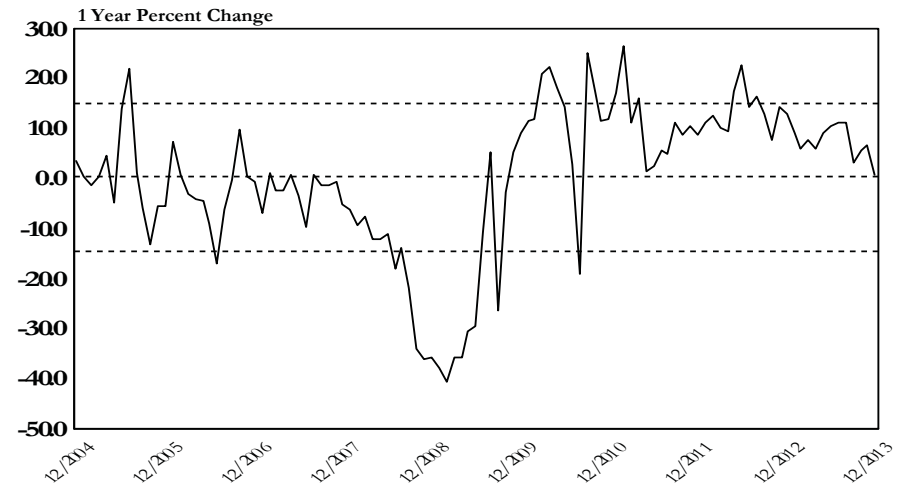
Fed: General Activity - vs. Prior Month (Diffusion)



Fed: General Activity - 6 Months Ahead (Diffusion)

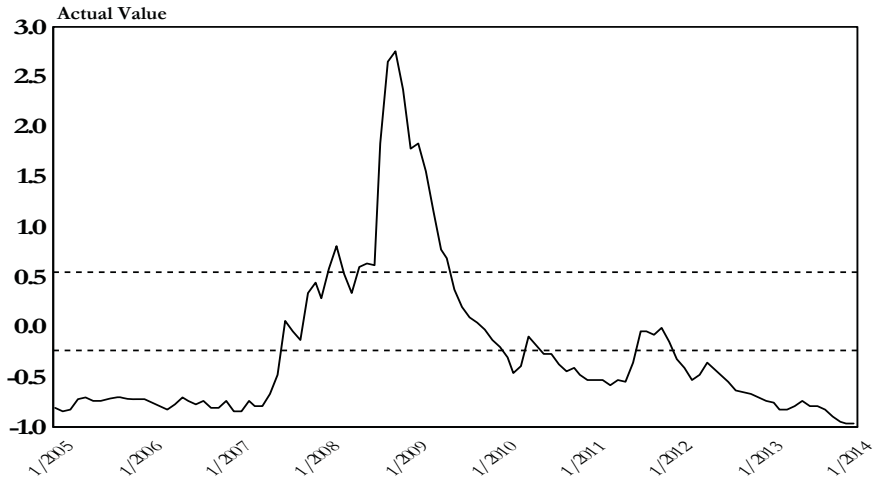


Auto and Light Truck Sales

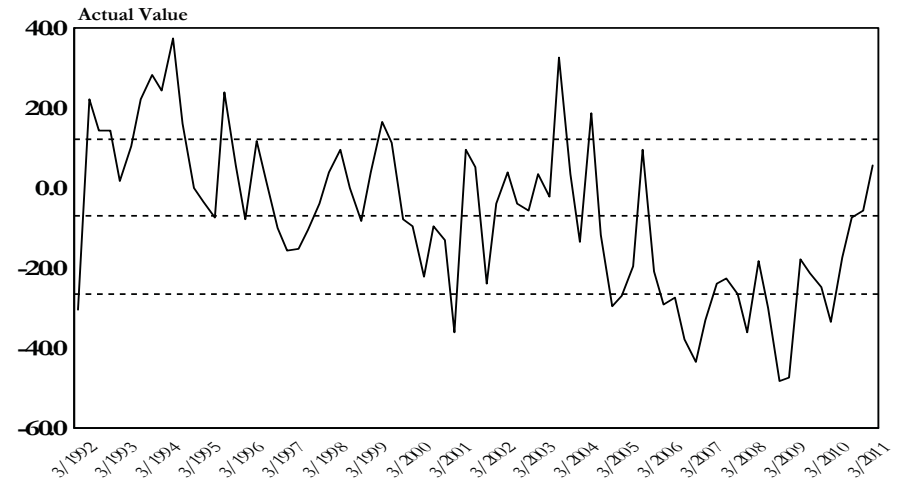


Economic Conditions: Financial Conditions

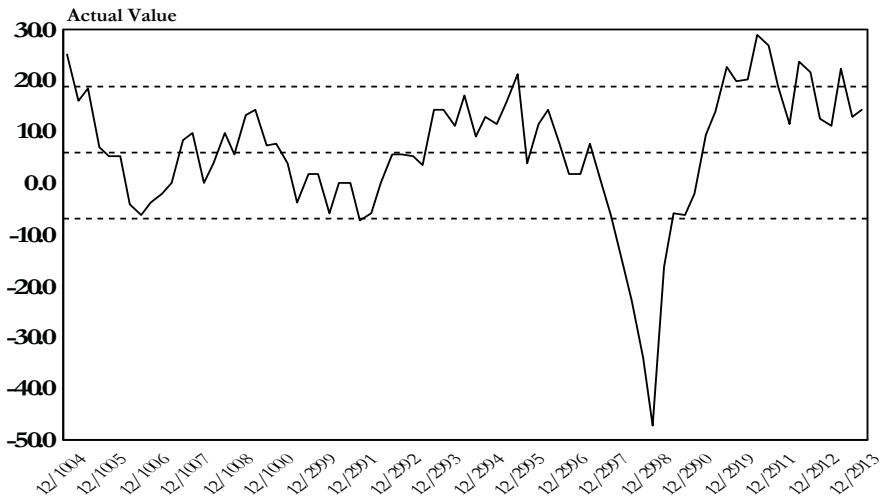
Chicago Fed: National Financial Conditions Index



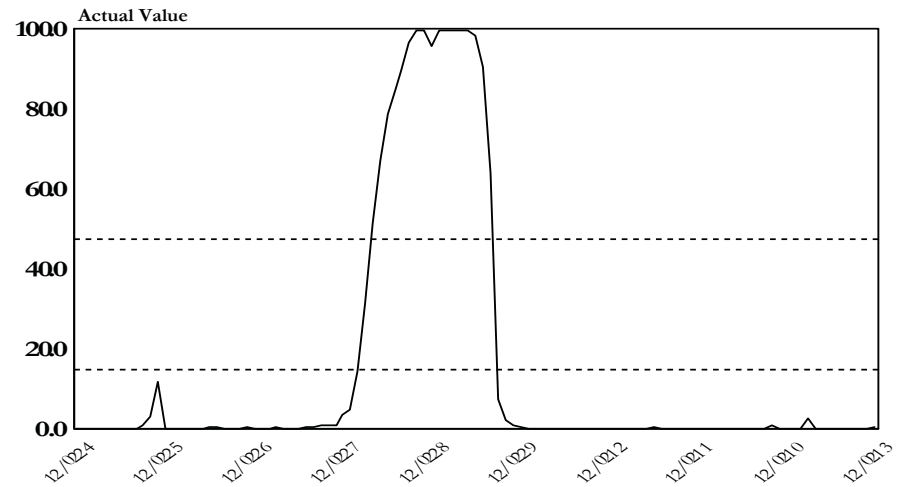
Loan Officer Net % Stronger Demand for Consumer Loans



Loan Officer Net % Willingness to Make Consumer Loans



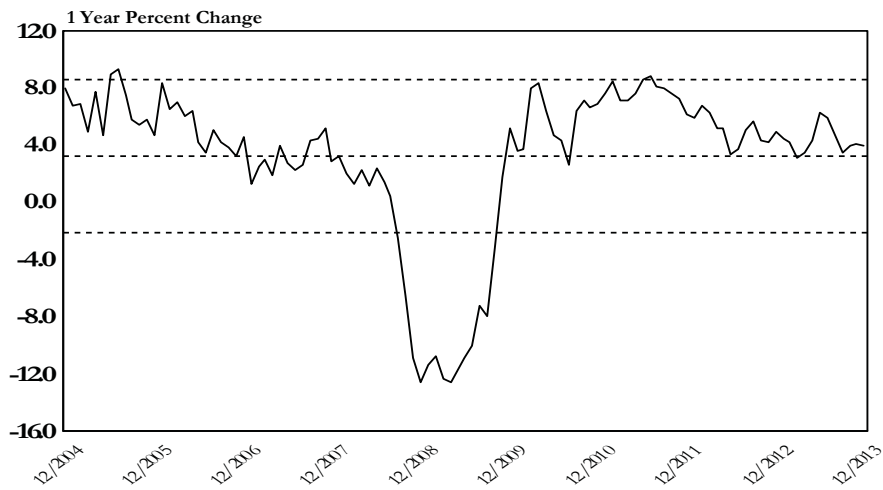
U.S. Recession Probabilities



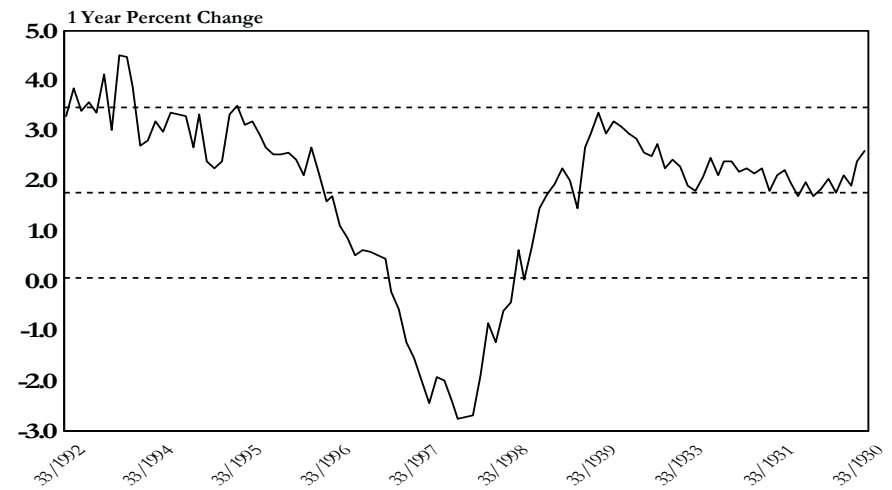
- Financial conditions appear to have returned to “normal”. In fact, it appears that there is significant demand as well as the willingness to make consumer loans.
- The probability of a near term U.S. recession appears to be remote.

Economic Conditions: Consumer

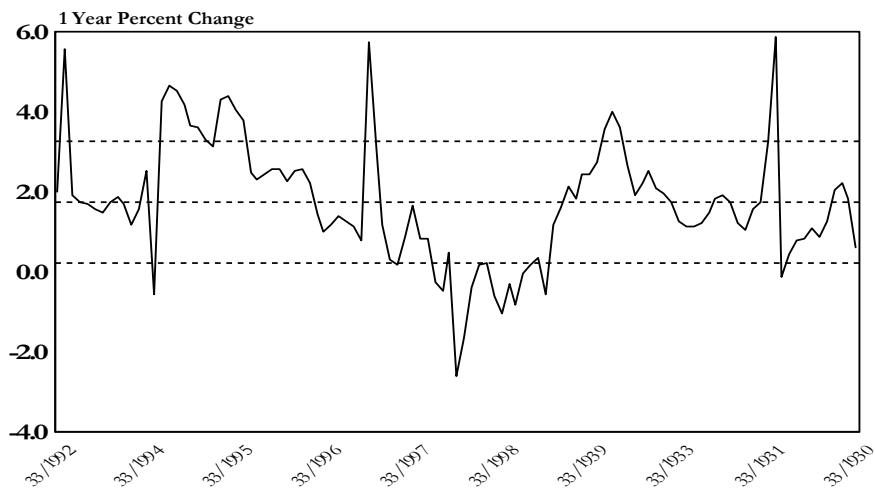
Retail Sales



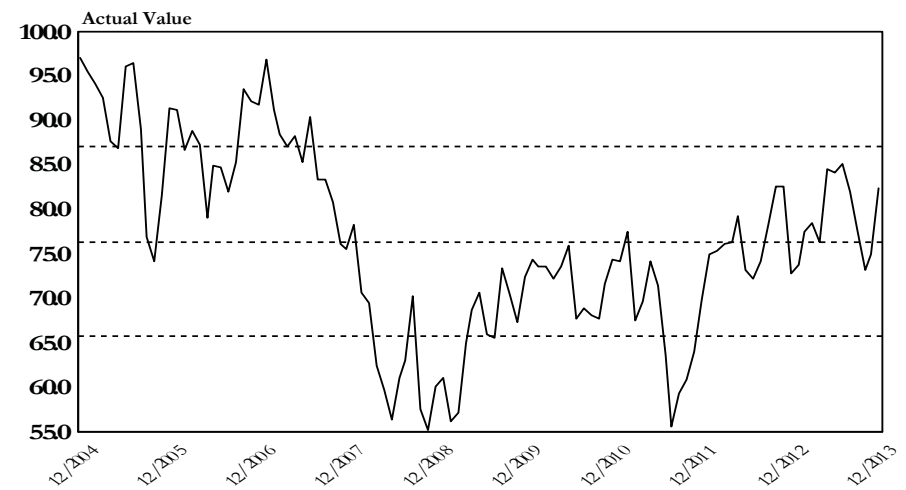
Real Personal Consumption Expenditures



Real Disposable Personal Income



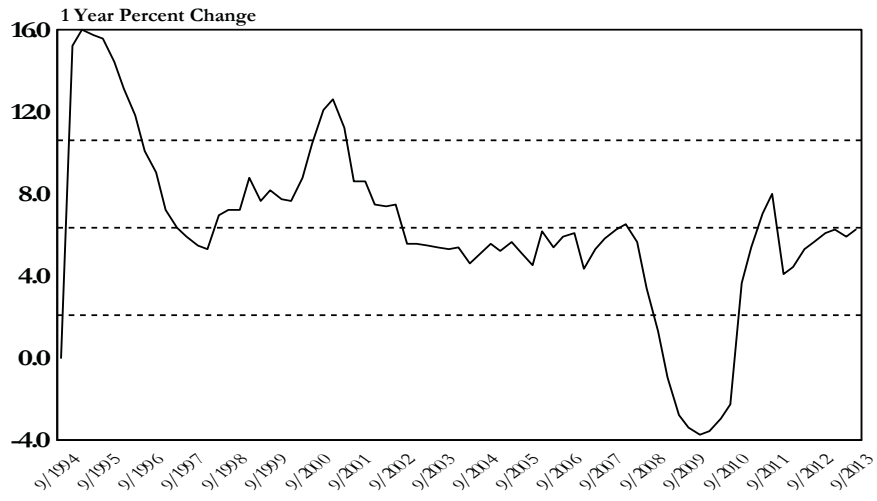
Consumer Sentiment



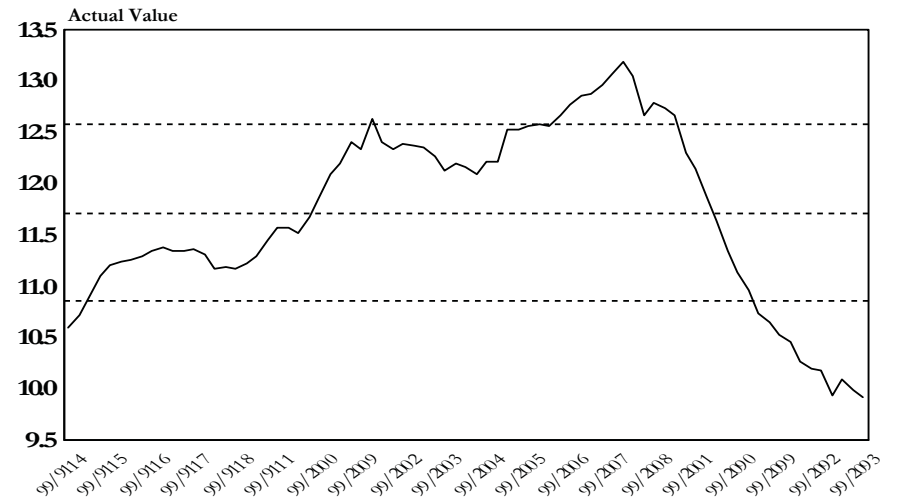
- The consumer appears to be in reasonable shape. Retail sales and personal consumption expenditures are growing at a slightly above-average rate. However, growth in real disposable personal income remains quite modest. While consumer sentiment has improved, it remains nowhere near the levels prior to the great recession.
- Since the financial crisis, the consumer has significantly reduced their debt (as a percent of disposable income).

Economic Conditions: Consumer (continued)

Household Consumer Credit Debt Outstanding

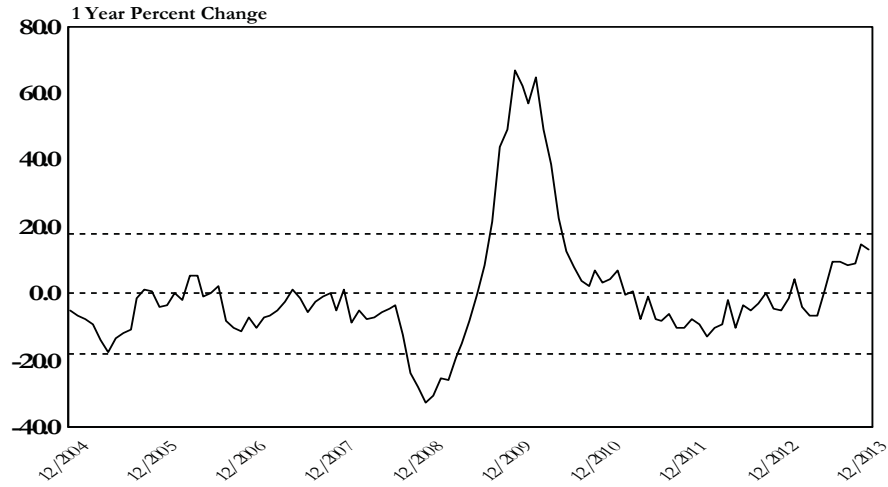


Household Debt As Percent Of Disp. Income

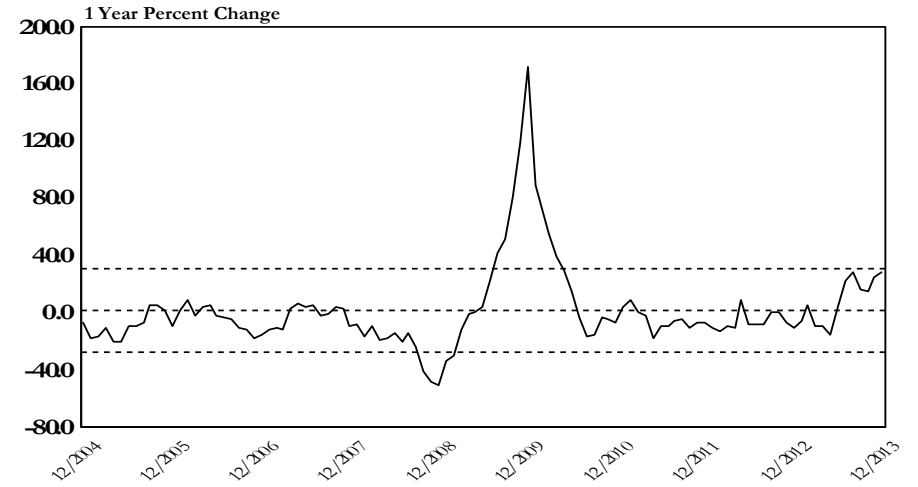


Economic Conditions: Business Conditions

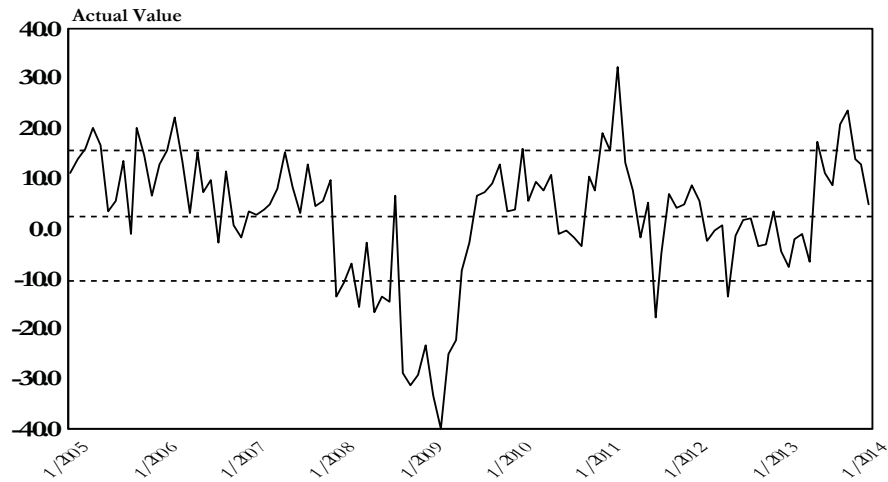
ISM Manufacturing: Purchasing Managers Index



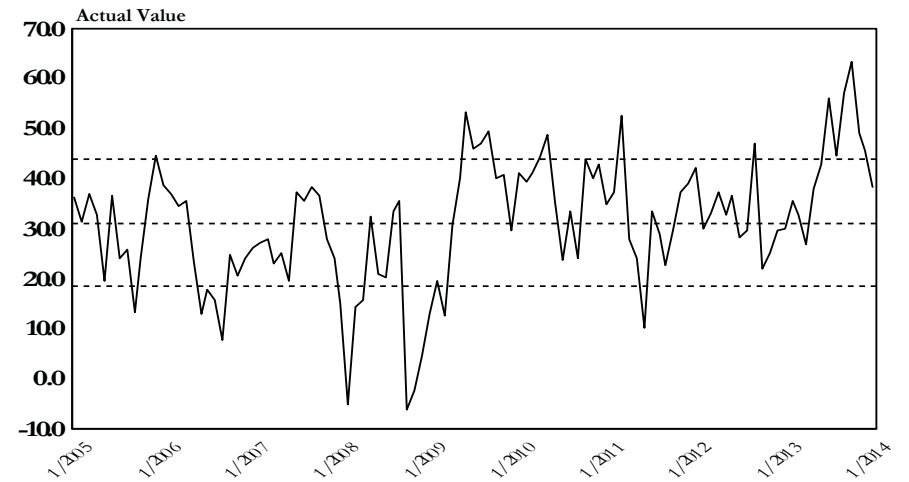
ISM Manufacturing: New Orders Index



Phili Fed: New Orders - vs. Prior Month (Diffusion)



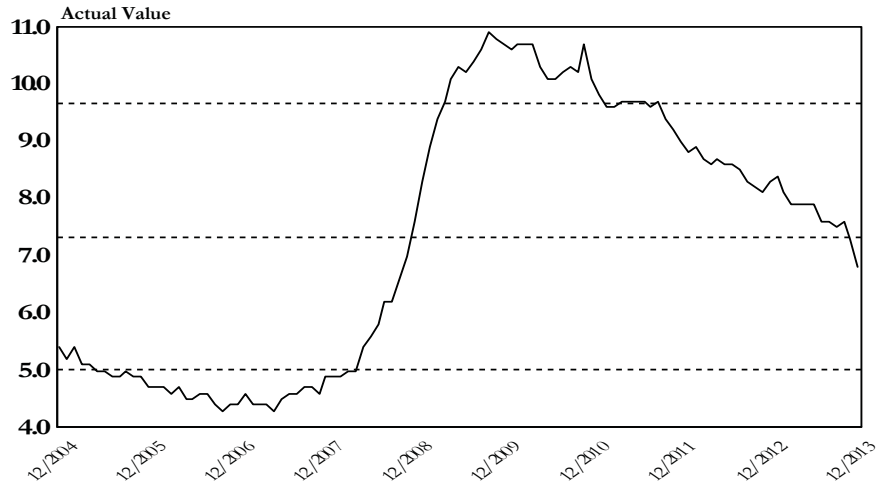
Phili Fed: New Orders - 6 Months Ahead (Diffusion)



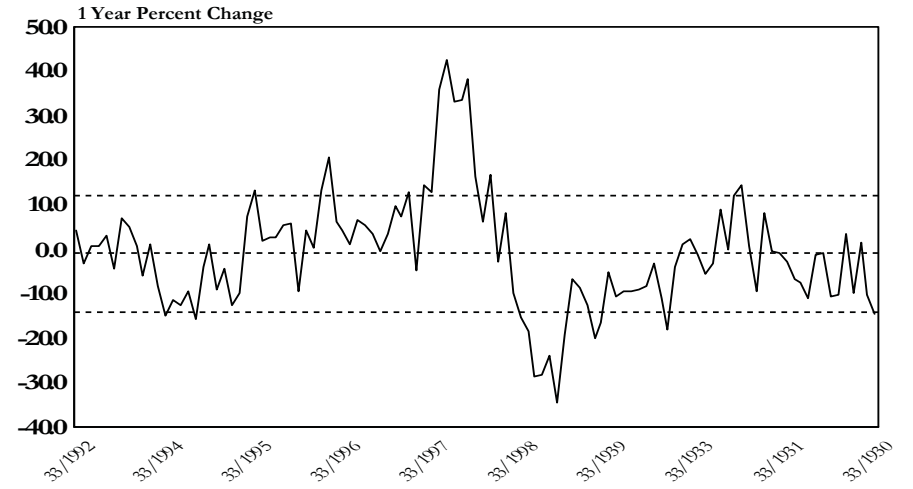
- Current and expected business conditions (as measured by new order indices) point to continued improvement in the general economy.

Economic Conditions: Labor

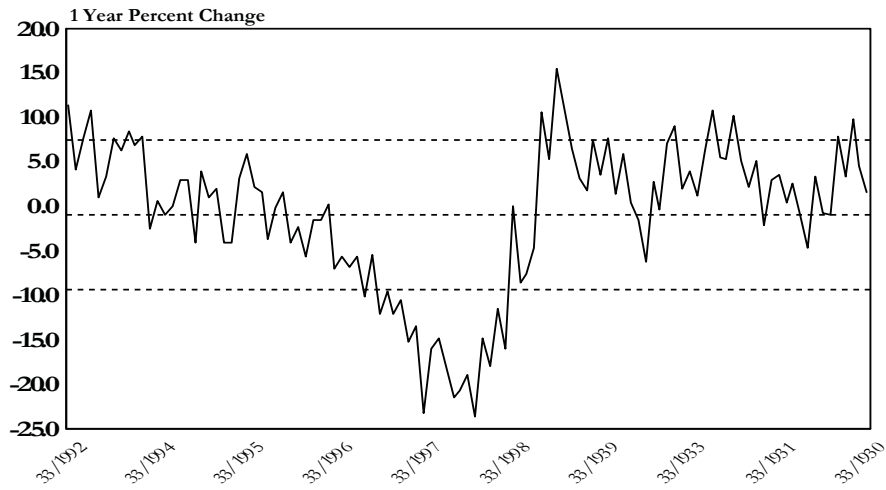
Unemployment Rate



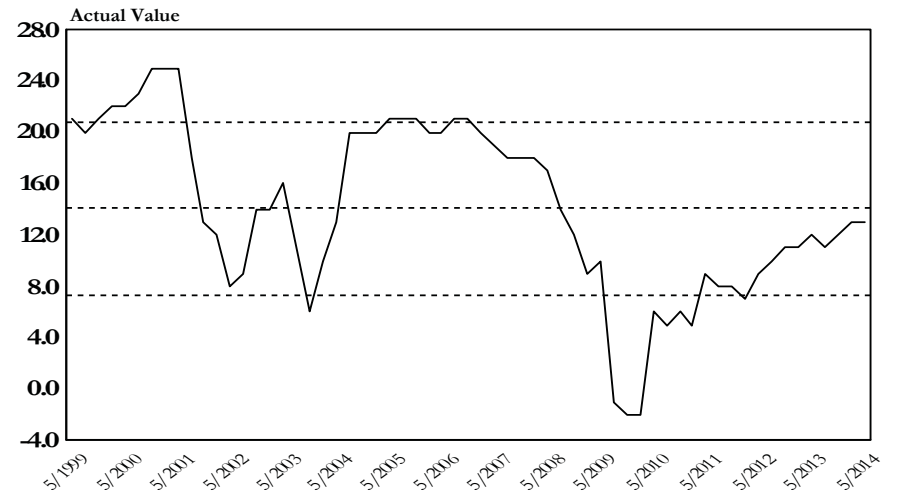
Layoffs and Discharges: Total Nonfarm



Hires: Total Nonfarm



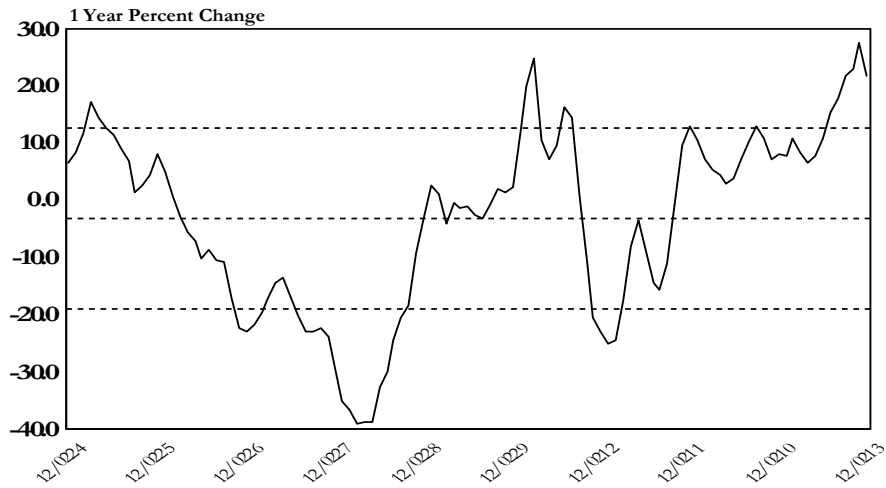
Manpower Employment Outlook (Net % Hiring)



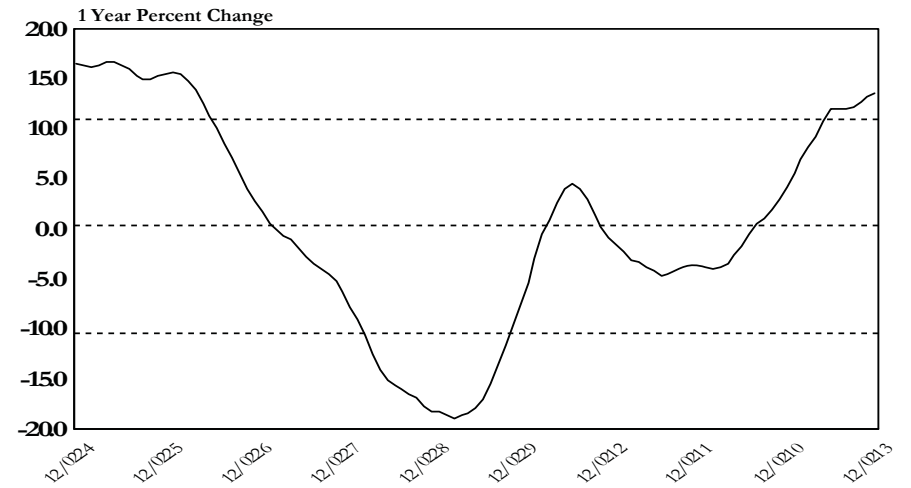
- There has been continued and steady improvement in the labor market.

Real Estate

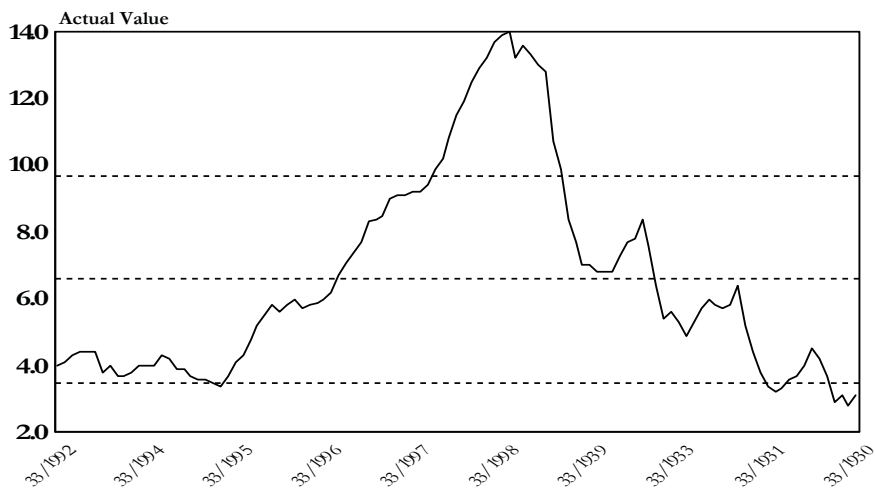
Case Schiller Sales In 20 Largest Markets



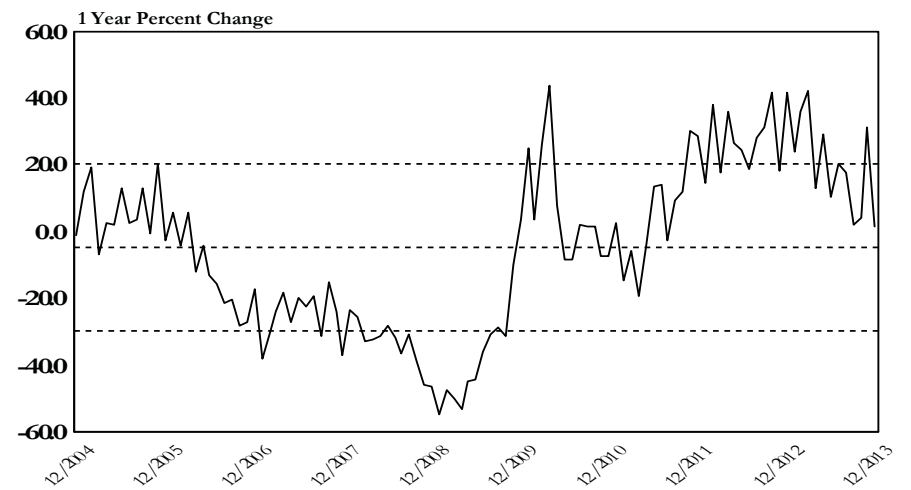
Case Schiller Home Price Index: 20 Largest Markets



Median Number of Months on Sales Market



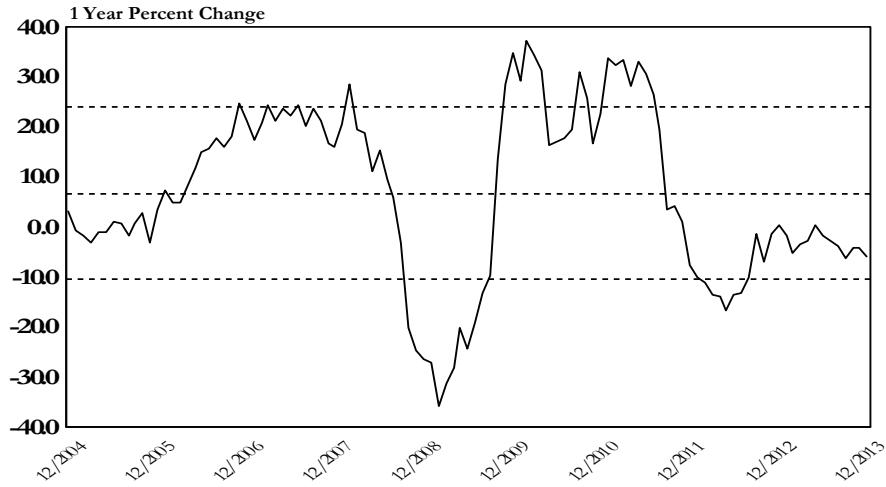
Housing Starts



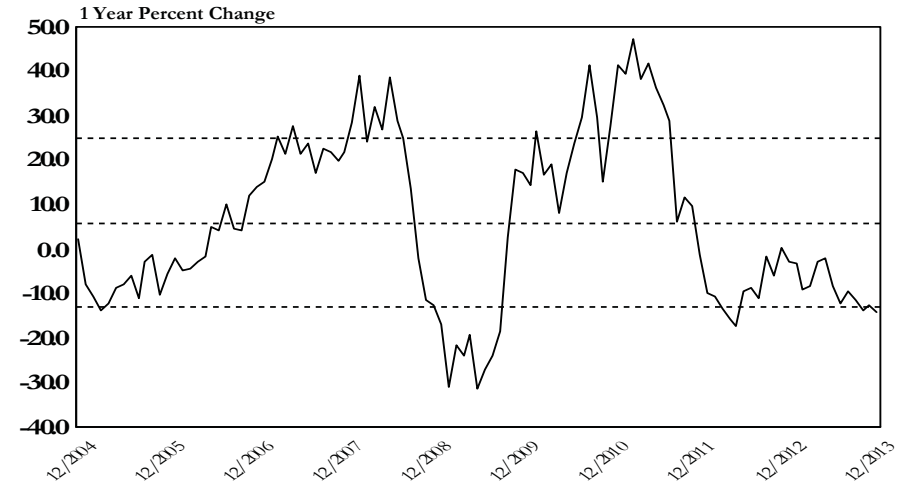
- Real estate, on a variety of factors, has clearly picked up. Sales, but perhaps more importantly, prices have been increasing.
- The length of time it takes to sell a home has fallen to ten-year lows -- probably a sign of improved demand. Housing starts have also picked up which is a good sign for the general economy.

Commodities

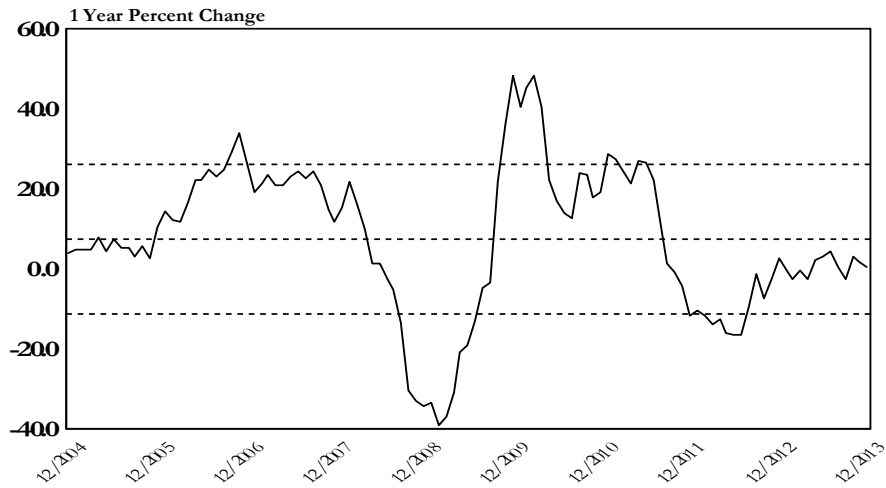
CRB Commodity Spot Index



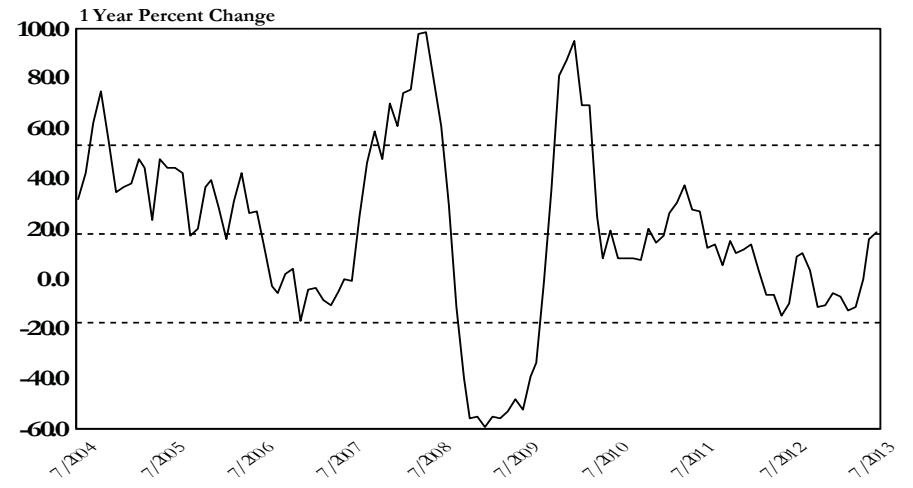
CRB Foodstuffs Spot Index



CRB Raw Industrials Spot Index



Spot Oil Price (West Texas Intermediate)



- While individual commodities may be more volatile, the broad commodity index did not experience dramatic price changes during 2013.

Stock Market

Executive Summary: Stock Market

Observations

- What a year in the stock market! During nearly all of 2013, the stock market was either going up or staying level. The biggest decline for the year (from the markets highs) was -6% (which is quite unusual).
- During 2013, U.S. stocks returned 33.6%, substantially outperforming developed international returns of 22.8% and the emerging market return of -5.0%. The difference between U.S. stock returns and emerging markets is one of the largest on record. By company size, the smaller the company the better the performance. Micro-cap stocks returned 55.8%, small stocks returned 38.8%, mid-cap stocks 34.8%, and large stocks 33.1%. By investment approach, growth stocks had a slight edge over value stocks (34.2% versus 32.7%). However, within the developed international markets, value stocks outperformed growth stocks.
- JIC believes that any short term forecast of stock market returns should be met with a great deal of skepticism. There are simply too many variables and unknowns that can affect short-term returns. With that said, trends can be an extremely powerful force and the current trend seems to be up.
- However, valuation does matter. While not providing particularly meaningful insights into short-term market movements, valuation does seem to provide more useful information on what investors could expect over a multi-year period.
- Valuations today are higher than during the Great Recession (not surprising) and are either approaching or exceeded their ten-year highs. In addition, investor optimism for stocks seems to have grown while stocks “fear factor” has significantly declined.
- While valuations are higher, that does not necessarily mean they are extreme (and we do not believe they are).
- Future stock returns are comprised of essentially three things: dividend yields, future earnings growth, and changes in valuation multiples. It is much easier to have higher future stock market returns if you start from low valuation levels and move toward higher valuation levels (the wind would be at your back).
- At current valuation levels, JIC does not believe multiple expansion will provide much future support for stock returns. JIC believes earnings growth and dividend yields will be the key drivers of future stock market returns.
- Assuming 2014 consensus earnings are achieved, JIC believes it will be difficult for mid- and small- stocks to exhibit any significant positive returns without multiple expansion to the 20x earnings range. Large stocks do not require the same level of multiple expansion to produce positive returns.
- Using history as a guide, JIC evaluated subsequent five year stock returns when the starting point was current valuation levels (using normalized earnings). While there are a few exceptions, most subsequent five-year stock returns near existing valuations are in the -5% to 5% range -- significantly below long-term averages.
- JIC believes that, at existing valuation levels, investors should moderate their longer-term stock market return expectations (over a multiple-year period) to the low-to-mid single digits. Unfortunately, we do not know the pattern (or the timing) of how these returns will be achieved. While most investors prefer gradually rising markets each year, it seems that the market has a tendency to grow to excess and then have a more meaningful correction.

Broad Stock Market Returns

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>Annualized Returns</u>	
						<u>3 Year</u>	<u>5 Year</u>
	Emerging Market 74.5%	U.S. Real Estate 28.5%	U.S. Real Estate 8.7%	U.S. Real Estate 17.8%	U.S. Stock 33.6%	U.S. Stock 16.2%	U.S. Stock 18.7%
	Dev. Intl Large 31.8%	U.S. Stock 16.9%	U.S. Stock 1.0%	Dev. Intl Large 17.3%	World 26.7%	World 11.5%	U.S. Real Estate 16.7%
	World 30.0%	Emerging Market 16.4%	World -5.5%	U.S. Stock 16.4%	Dev. Intl Large 22.8%	U.S. Real Estate 9.5%	World 15.0%
	U.S. Real Estate 28.6%	World 11.8%	Dev. Intl Large -12.1%	World 15.8%	U.S. Real Estate 2.5%	Dev. Intl Large 8.2%	Dev. Intl Large 12.4%
	U.S. Stock 28.3%	Dev. Intl Large 7.8%	Emerging Market -20.4%	Emerging Market 15.1%	Emerging Market -5.0%	Emerging Market -4.5%	Emerging Market 12.1%

Stock Market Returns By Company Size

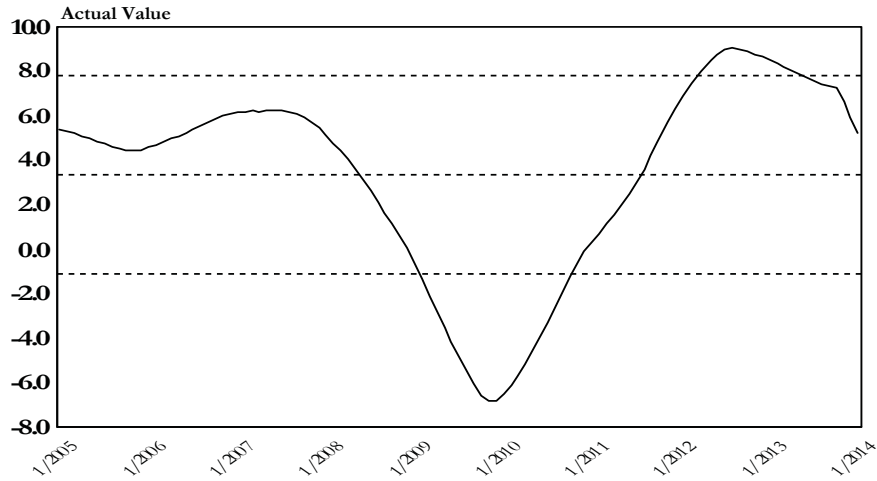
					<u>Annualized Returns</u>	
<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>3 Year</u>	<u>5 Year</u>
Emerging Market 74.5%	U.S. Micro 32.6%	U.S. Real Estate 8.7%	U.S. Micro 23.4%	U.S. Micro 55.8%	U.S. Micro 20.3%	U.S. Micro 27.4%
U.S. Micro 45.2%	U.S. Real Estate 28.5%	U.S. Large 1.5%	U.S. Real Estate 17.8%	U.S. Small 38.8%	U.S. Large 16.3%	U.S. Mid 22.4%
Dev. Intl Small 43.2%	U.S. Small 26.9%	U.S. Stock 1.0%	Dev. Intl Large 17.3%	U.S. Mid 34.8%	U.S. Stock 16.2%	U.S. Small 20.1%
U.S. Mid 40.5%	U.S. Mid 25.5%	U.S. Mid -1.5%	U.S. Mid 17.3%	U.S. Stock 33.6%	U.S. Mid 15.9%	U.S. Stock 18.7%
Dev. Intl Large 31.8%	Dev. Intl Small 19.4%	U.S. Small -4.2%	Dev. Intl Small 16.9%	U.S. Large 33.1%	U.S. Small 15.7%	U.S. Large 18.6%

Stock Market Returns By Investment Approach

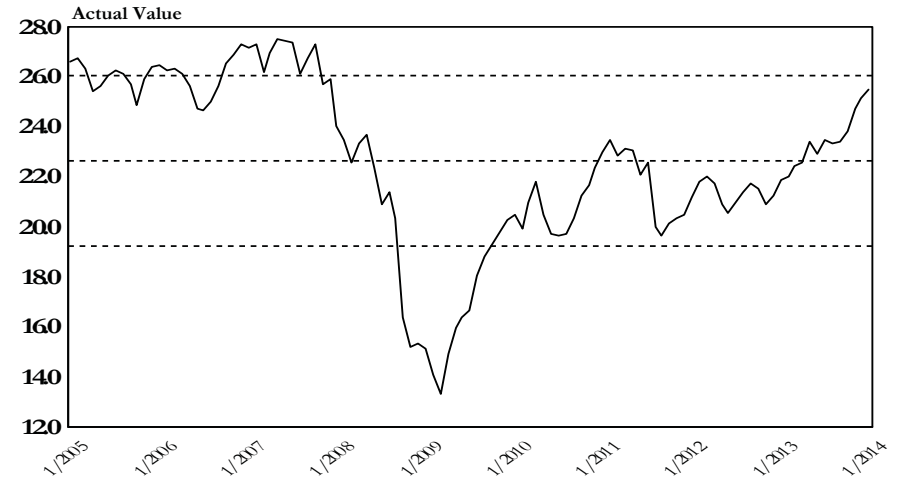
					<u>Annualized Returns</u>	
<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>3 Year</u>	<u>5 Year</u>
Emerging Growth 79.8%	Emerging Growth 18.3%	U.S. Growth 2.2%	Emerging Growth 20.1%	U.S. Growth 34.2%	U.S. Growth 16.5%	U.S. Growth 20.6%
Emerging Value 79.4%	U.S. Growth 17.6%	U.S. Value -0.1%	Dev. Intl Value 17.7%	U.S. Value 32.7%	U.S. Value 15.9%	U.S. Value 16.7%
U.S. Growth 37.0%	Emerging Value 17.0%	Dev. Intl Growth -12.1%	U.S. Value 17.5%	Dev. Intl Value 23.0%	Dev. Intl Value 8.3%	Emerging Growth 14.8%
Dev. Intl Value 34.2%	U.S. Value 16.2%	Dev. Intl Value -12.2%	Emerging Value 17.2%	Dev. Intl Growth 22.6%	Dev. Intl Growth 8.0%	Emerging Value 13.3%
Dev. Intl Growth 29.4%	Dev. Intl Growth 12.2%	Emerging Value -20.0%	Dev. Intl Growth 16.9%	Emerging Growth -0.4%	Emerging Growth -2.2%	Dev. Intl Growth 12.8%

Stock Market

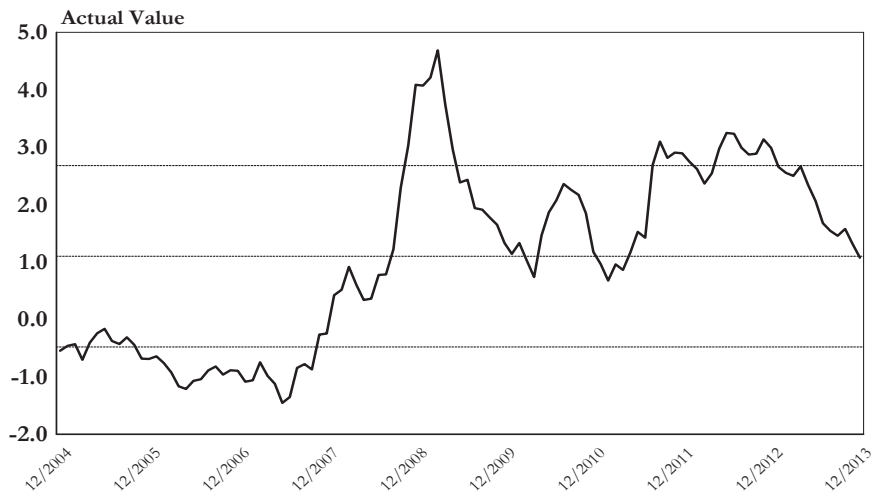
1-Year S&P 500 Earnings Growth Using 10-Year Average Real Earnings



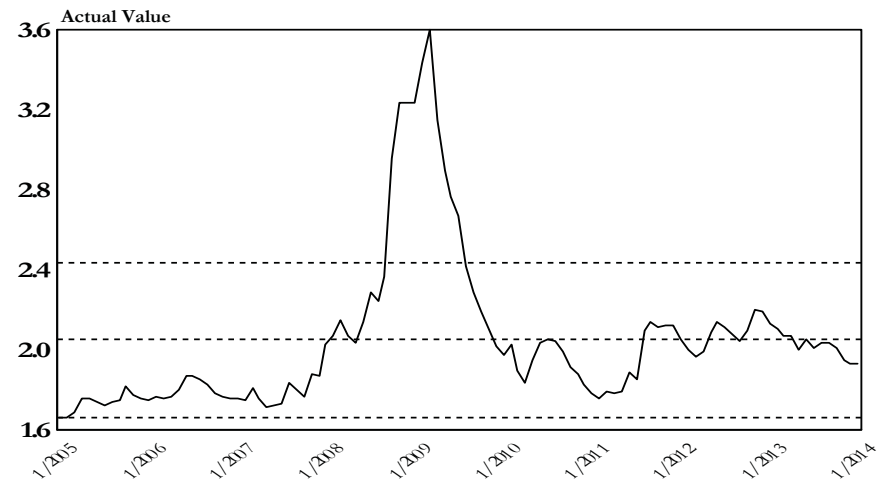
S&P 500 PE Using 10-Year Average Real Earnings



Earnings Yield Using 10-Year Average Real Earnings Less 10-Year Treasury Yield



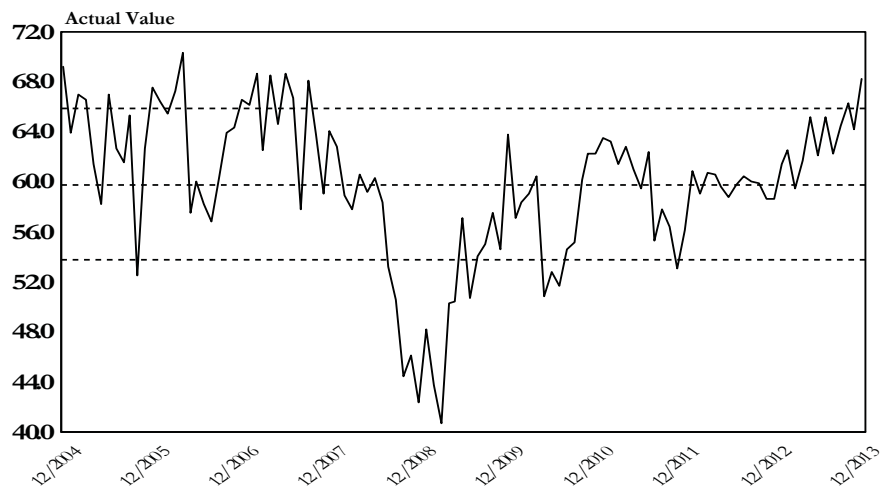
SP500 Dividend Yield



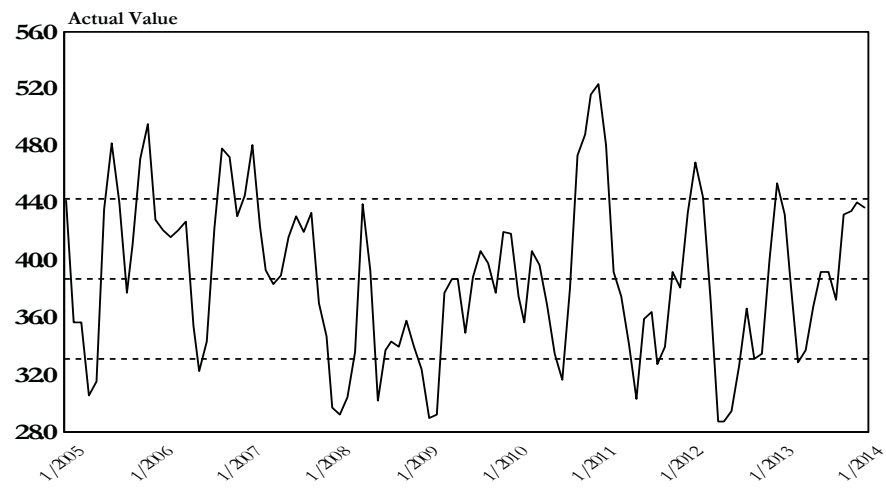
- Valuation multiples, using 10-year normalized earnings, have risen significantly from the lows of 2008. In fact, they are approaching their 10-year highs.
- Investors also compare the earnings yield (the inverse of the price/earnings ratio) to the yield of other investments. JIC subtracted the 10-year Treasury yield from the earnings yield. The current result is essentially at the 10-year average. However, if the 10-year Treasury were at “normal” levels, this chart would likely show the stock earnings yield much closer to the bond yield -- implying a less attractive valuation.

Stock Market (continued)

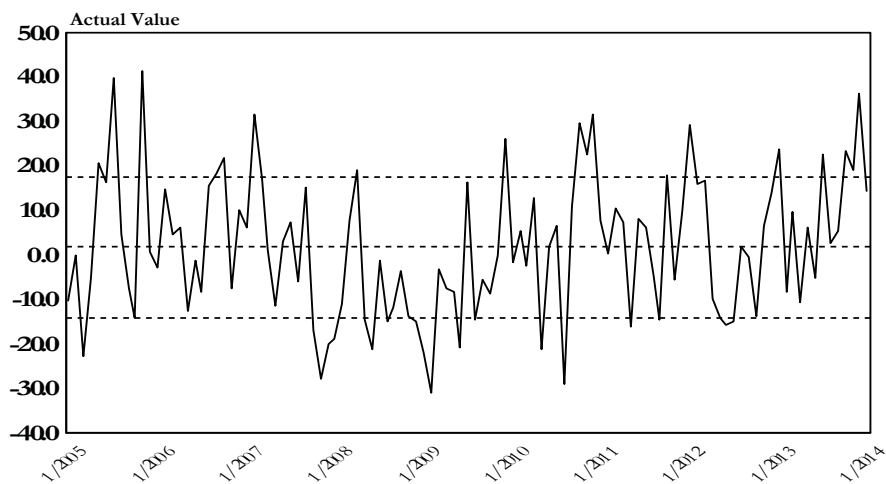
AAII Survey: Stock Allocation



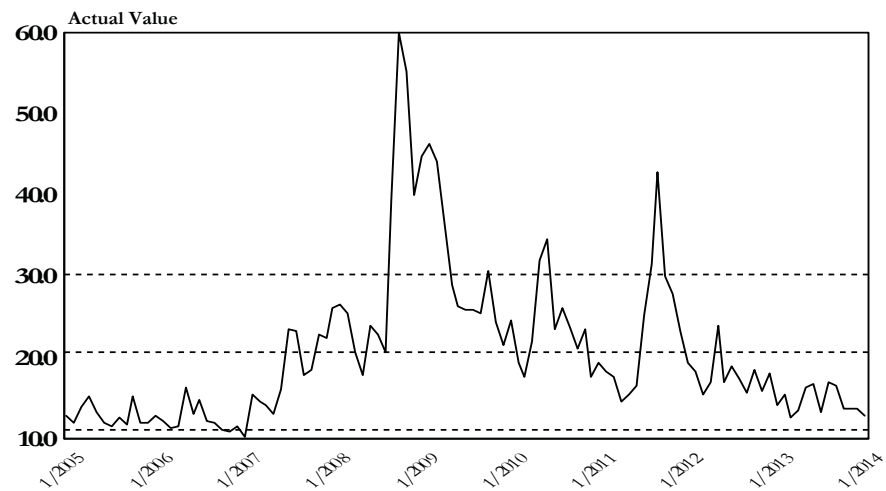
AAII Percent Bullish 8-Week Average



AAII Bull/Bear Investor Sentiment Spread



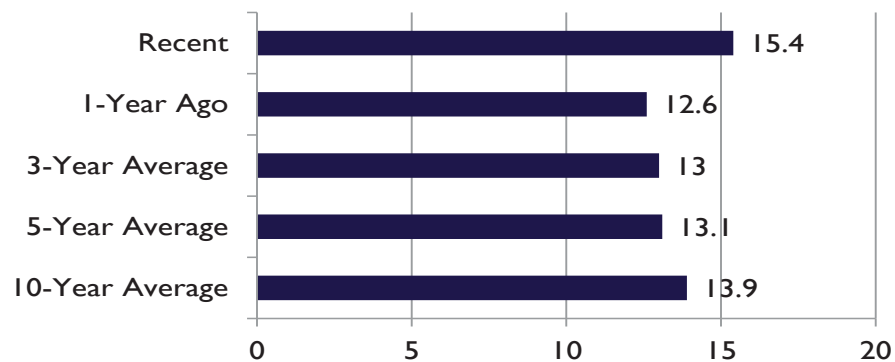
CBOE Volatility Index



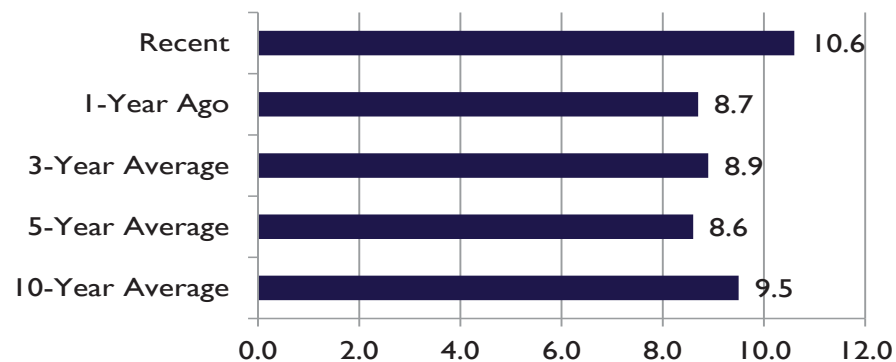
- The various AAII charts all provide a similar message - that the individual investor is clearly more upbeat about stocks. In addition, their optimism is at higher than normal levels (plus one standard deviation from the average).
- The volatility index is an estimate of future stock market volatility. At present, the volatility index has declined to the lowest levels since before the financial crisis. It appears investors are relatively complacent about the expectations of future stock market volatility.

Stock Valuation Measures: SP 500 Index

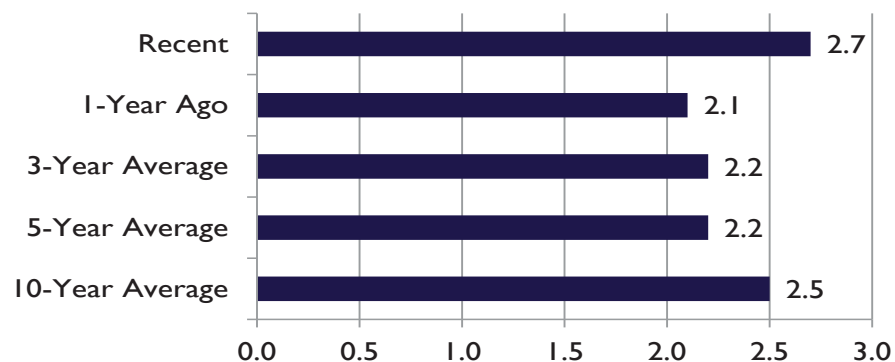
Price to Earnings



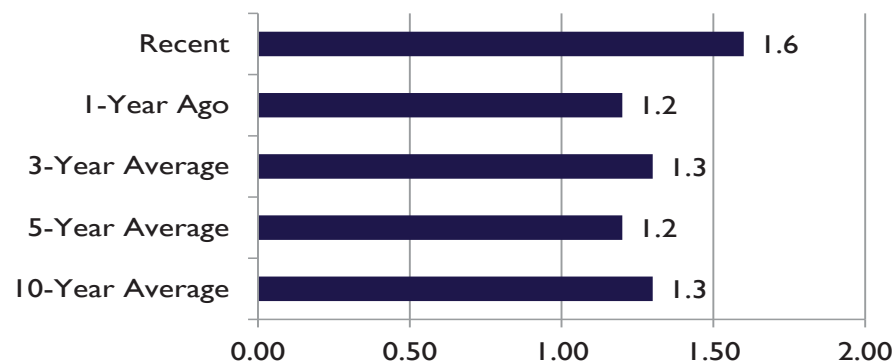
Price to Cash Flow



Price to Book Value

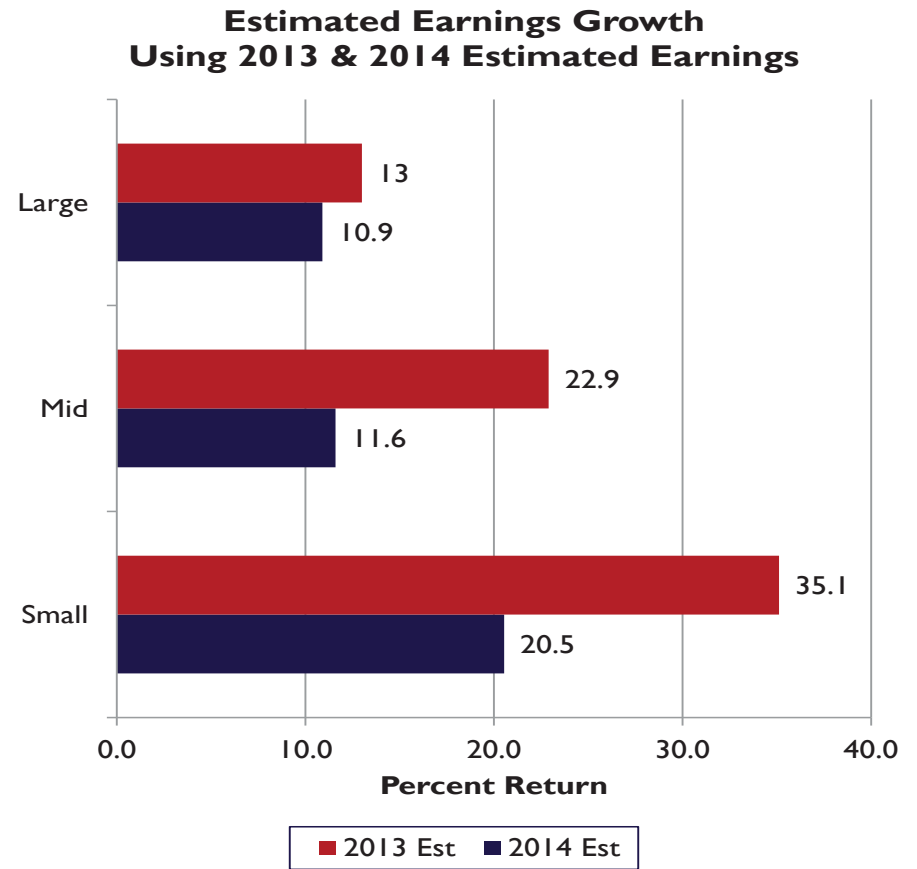
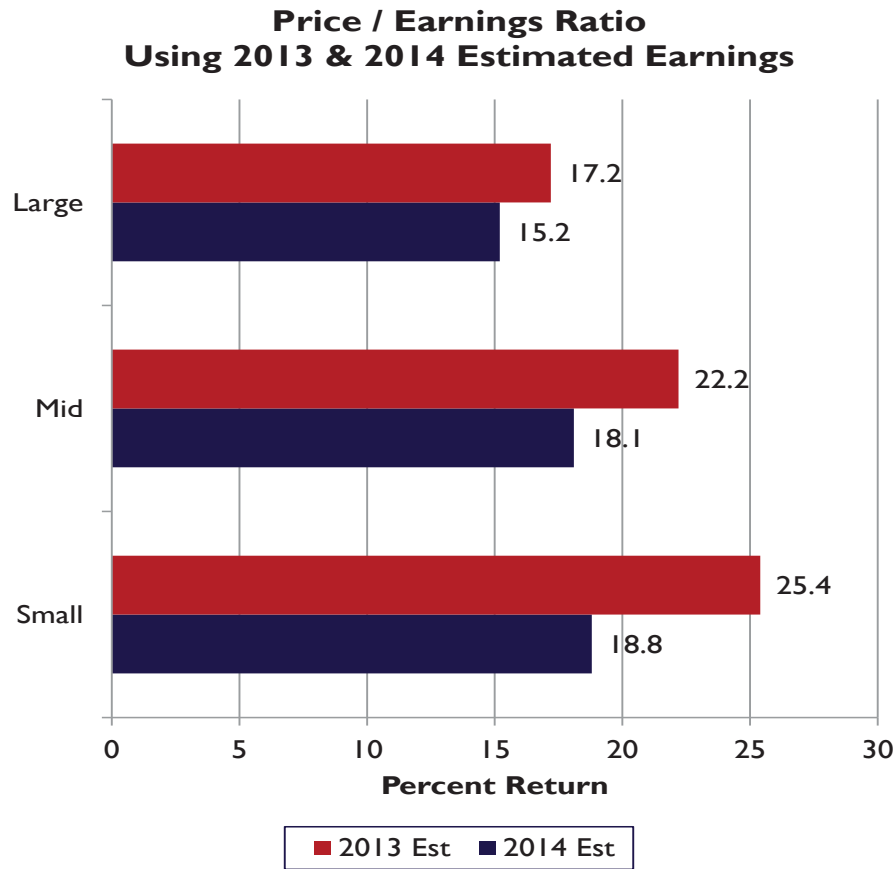


Price to Sales



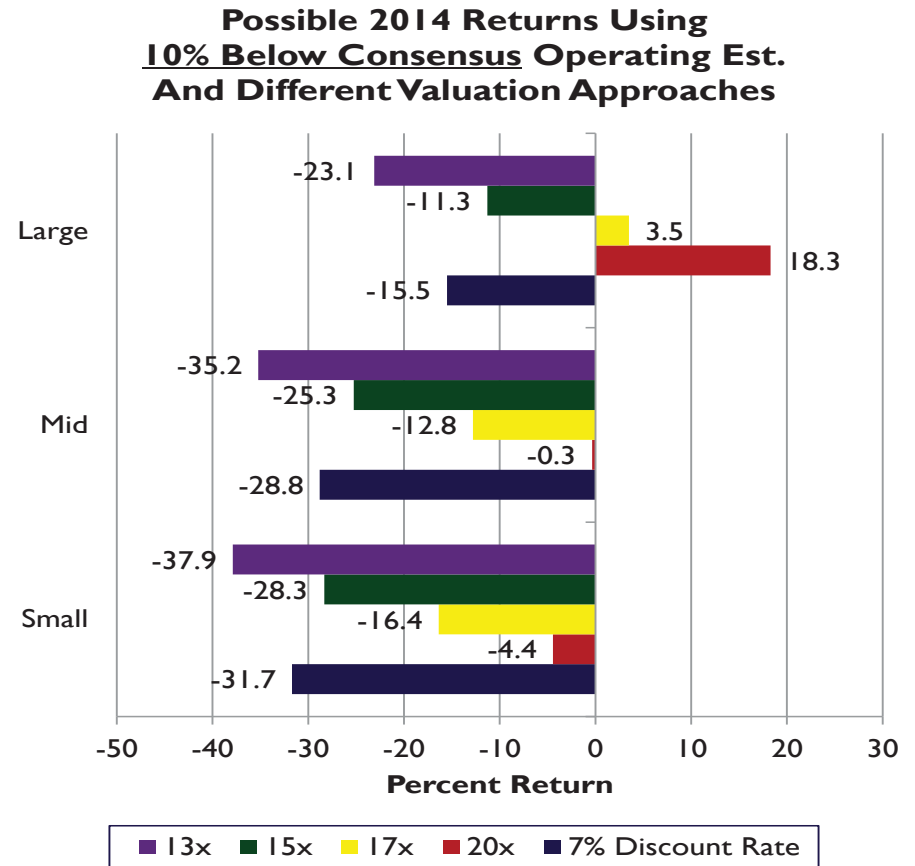
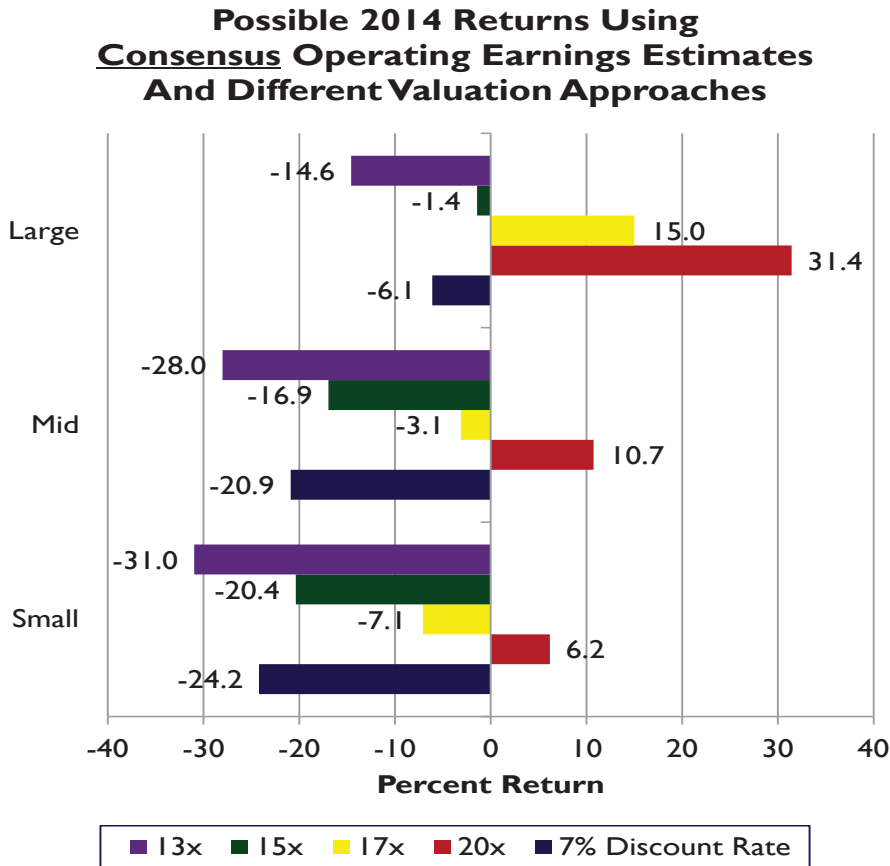
- Current valuations, based on a variety of measures, are above their 10-year averages. This does not necessarily imply significant over valuation (compared to full market history).
- JIC believes it is difficult to make the case that the current stock market is significantly undervalued. In addition, JIC believes continued stock market multiple expansion is less likely.

Price / Earning Multiples & Expected Earnings Growth By Company Size



- Price/earnings ratios for large-company stocks are significantly below those of mid- and small company stocks.
- 2014 expected earnings growth is expected to be reasonably strong. However, we are skeptical that small stocks will produce nearly twice the earnings growth of large-and mid-company stocks.

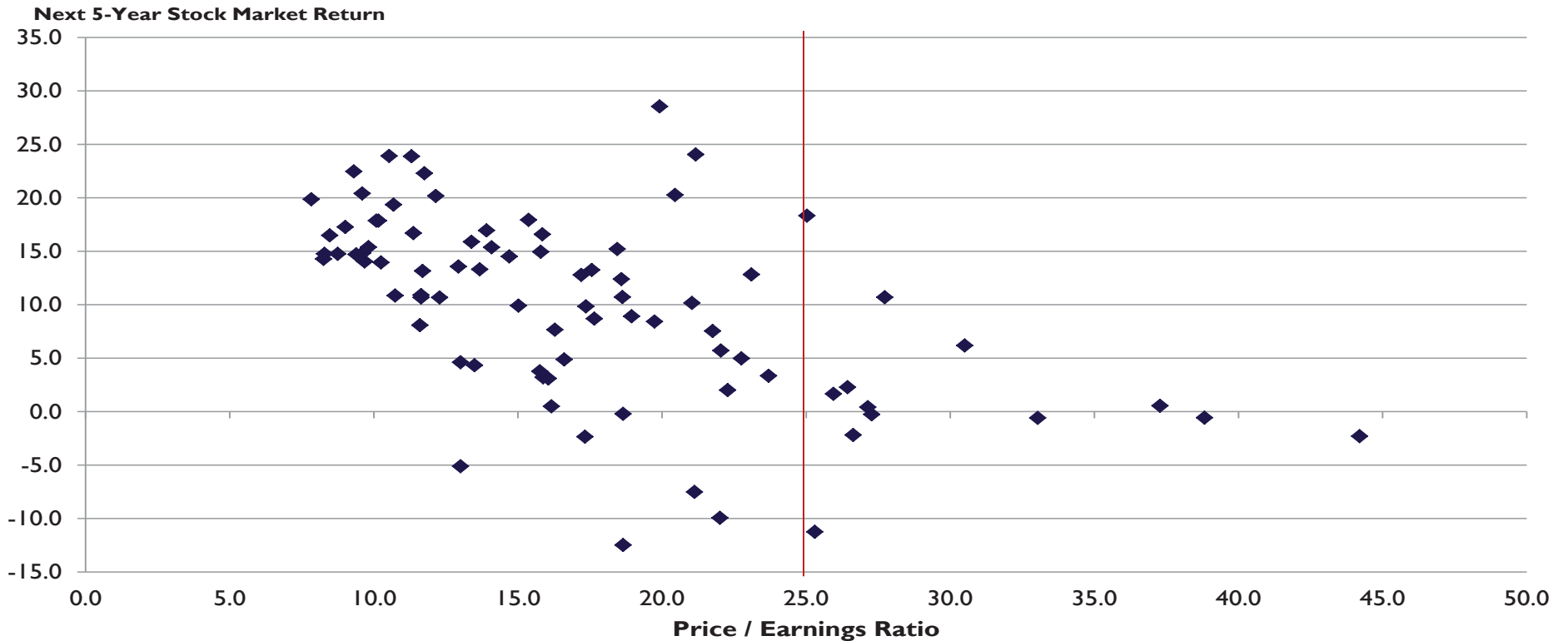
Possible 2014 Stock Returns By Company Size (Consensus & 10% Below Consensus Estimates)



- Assuming consensus earnings are achieved during 2014, it will be difficult for mid- and small-cap stocks to produce positive returns without multiples expanding to 20 times earnings. Large stocks could produce positive returns without the same level of multiple expansion.
- Often times, as the year progresses, earnings estimates are reduced. If 2014 consensus earnings were reduced by 10%, it would be extremely difficult for mid-and small company stocks to produce a positive return. Large stocks may be able to have positive results, but multiples will have to remain above 17x earnings.

PE Ratio vs. Next 5-Year Stock Market Returns

**Price / Earnings Ratio (10-Year Normalized Earnings) vs. Next 5-Year Stock Market Return
Calendar Year Data (1926 to Present)**



- This chart plots the price/earnings ratio (using 10-year normalized earnings) on the horizontal axis with the subsequent five-year stock market return on the vertical axis. The vertical red line shows the current normalized price/earnings ratio.
- While there are exceptions, most of the future 5-year returns at existing valuation levels are generally between 5% and -5%.
- Historically speaking, future five-year returns have tend to be higher when valuation levels are much lower.

Other 30% Plus Return Years, Valuation Levels, & Subsequent 5-Year Returns

Year	Year Ending Return	Year-End Normalized P/E Ratio	Next 5-Year Return
1927	37.5%	18.7x	-12.5%
1928	43.6	25.3	-11.2
1933	54.0	12.3	10.7
1935	47.7	16.2	0.5
1936	33.9	21.1	-7.5
1938	31.1	15.8	3.8
1945	36.4	15.0	9.9
1950	31.7	11.3	23.9
1954	52.6	15.8	15.0
1955	31.6	18.9	8.9
1958	43.4	17.4	9.9
1975	37.2	10.3	14.0
1980	32.4	9.4	14.7
1985	32.2	11.7	13.2
1989	31.5	17.7	8.7
1991	30.5	18.4	15.2
1995	37.6	25.0	18.3
1997	33.4	33.0	-0.6
2013	32.4	25.2	???

- This chart shows years (since 1926) in which the stock market returned above 30%. It also shows the price/earnings ratio as of that year-end (using 10-year normalized earnings) and the next five-year stock market return.
- With the exception of 1995 (the beginning of the internet bubble) future 5-year returns have not been particularly strong with price-earnings ratios at existing levels. Of course, history can only be a guide and is not necessarily a predictor.

Bond Market

Executive Summary: Bond Market

Observations

- Investment-grade bond markets did not perform well during 2013. U.S. bonds, municipal bonds, and developed international bonds all produced negative returns for the year. The one exception was the high-yield bond market which returned 7.4%.
- The U.S. bond market return of -2.0% was the first negative return since 1999, and the lowest calendar-year return since 1994. Bond returns typically do not perform well in rising interest rate environments.
- During the year, investment-grade bond yields (with maturities above three or four years) increased by approximately 1%. While bond yields are above inflation in the intermediate- and longer-term maturity segments, they remain below inflation in the shorter maturity segments (producing a negative real return).
- JIC believes it is prudent to expect further increases in interest rates. Conventional financial wisdom suggests bond investors seek to earn a return above the rate of inflation.
- Recent inflation has been “well contained” and has generally been below 2%. In addition, future inflation expectations, while higher than 2%, are within a reasonable range of 2.5% to 3.0%. In short, the market does not currently expect dramatically higher inflation.
- High-yield bond yields have declined to a 10-year low (and are extremely close to a historical low). While the quality spread (the yield pickup by investing in high-yield bonds over treasuries) is 4%, that is low by historical standards.
- Given a stable to strengthening economy, JIC believes high-yield bonds will continue to outperform investment grade bonds. However, JIC expects much lower future high-yield bond returns (compared to the last three-year return of 9.3%). During the next few years JIC believes it will be difficult for most bond investors -- including high yield bond investors -- to “earn their coupon” as we expect some depreciation as the result of rising interest rates.
- JIC expects to maintain a below target bond allocation, keep a shorter-maturity portfolio, as well being broadly diversified within the various bond segments.

Broad Bond Market Returns

<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>Annualized Returns</u>	
					<u>3 Year</u>	<u>5 Year</u>
Emerging Bond 29.8%	Emerging Bond 12.2%	U.S. Inflation Protected 13.6%	Emerging Bond 17.4%	U.S. Inflation 1.2%	Emerging Bond 6.1%	Emerging Bond 11.7%
U.S. Muni 12.9%	Dev. Intl Bond 6.8%	U.S. Muni 10.7%	U.S. Inflation Protected 7.0%	U.S. Cash 0.1%	U.S. Muni 4.8%	U.S. Muni 5.9%
U.S. Inflation Protected 11.4%	U.S. Bond 6.5%	U.S. Bond 7.8%	U.S. Muni 6.8%	U.S. Bond -2.0%	U.S. Inflation Protected 3.5%	U.S. Inflation Protected 5.6%
U.S. Bond 5.9%	U.S. Inflation Protected 6.3%	Emerging Bond 7.3%	U.S. Bond 4.2%	U.S. Muni -2.6%	U.S. Bond 3.3%	U.S. Bond 4.4%
Dev. Intl Bond 3.9%	U.S. Muni 2.4%	Dev. Intl Bond 5.9%	U.S. Inflation 1.8%	Dev. Intl Bond -5.1%	U.S. Inflation 2.0%	Dev. Intl Bond 2.4%

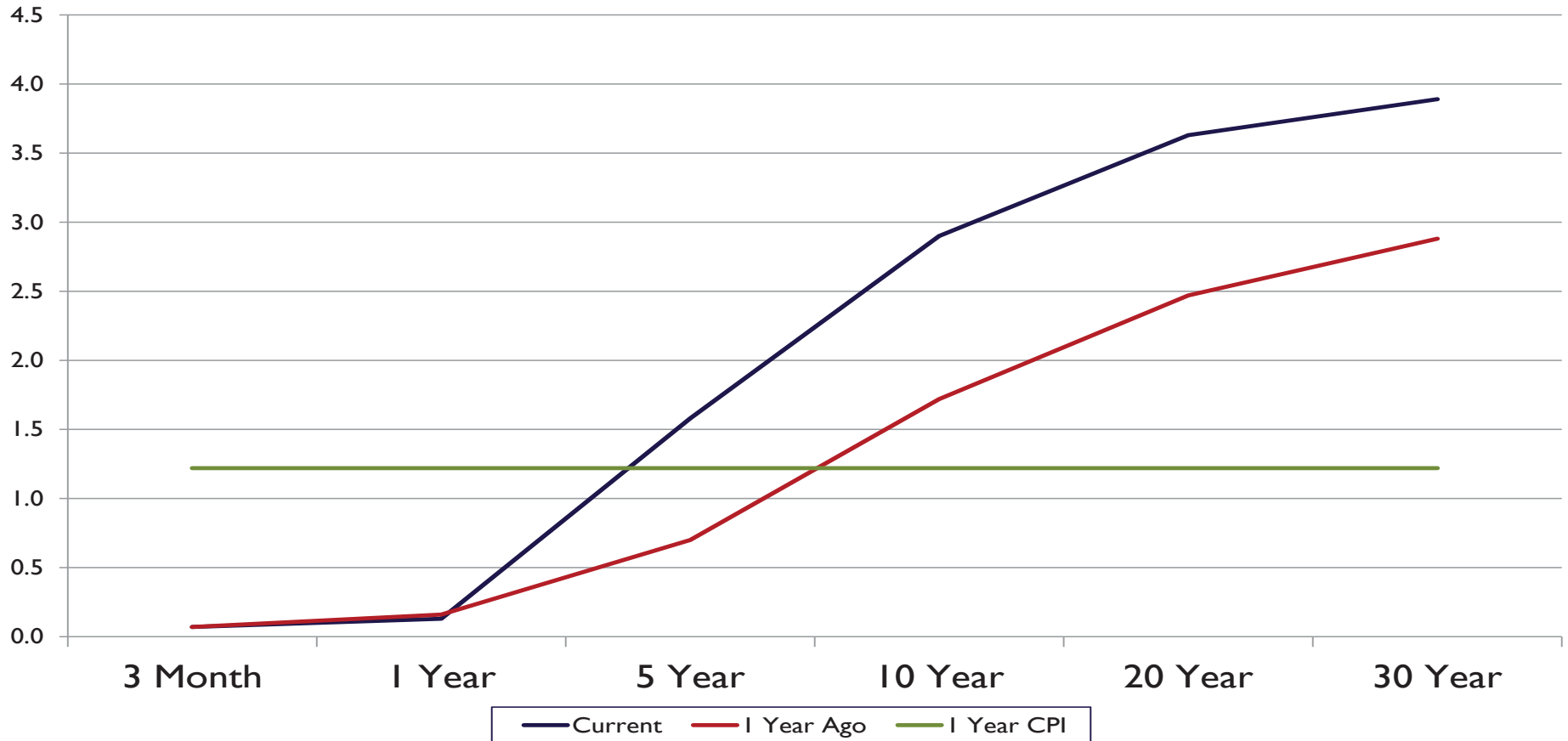
Bond Market Returns By Quality

					<u>Annualized Returns</u>	
<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>3 Year</u>	<u>5 Year</u>
U.S. High Yield 58.2%	U.S. High Yield 15.1%	U.S. Muni 10.7%	U.S. Muni High Yield 18.1%	U.S. High Yield 7.4%	U.S. High Yield 9.3%	U.S. High Yield 18.9%
U.S. Muni High Yield 32.7%	Emerging Bond 12.2%	U.S. Muni High Yield 9.2%	Emerging Bond 17.4%	U.S. Bond -2.0%	U.S. Muni High Yield 6.8%	U.S. Muni High Yield 11.8%
Emerging Bond 29.8%	U.S. Muni High Yield 7.8%	U.S. Bond 7.8%	U.S. High Yield 15.8%	U.S. Muni -2.6%	Emerging Bond 6.1%	Emerging Bond 11.7%
U.S. Muni 12.9%	U.S. Bond 6.5%	Emerging Bond 7.3%	U.S. Muni 6.8%	Emerging Bond -5.3%	U.S. Muni 4.8%	U.S. Muni 5.9%
U.S. Bond 5.9%	U.S. Muni 2.4%	U.S. High Yield 5.0%	U.S. Bond 4.2%	U.S. Muni High Yield -5.5%	U.S. Bond 3.3%	U.S. Bond 4.4%

Bond Market Returns By Sector

<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>Annualized Returns</u>	
					<u>3 Year</u>	<u>5 Year</u>
U.S. Corporate 16.0%	U.S. Corporate 8.5%	U.S. Inflation Protected 13.6%	U.S. Corporate 9.4%	U.S. Cash 0.1%	U.S. Corporate 5.1%	U.S. Corporate 7.9%
U.S. Inflation Protected 11.4%	U.S. Inflation Protected 6.3%	U.S. Government 9.0%	U.S. Inflation Protected 7.0%	U.S. Mortgage -1.4%	U.S. Inflation Protected 3.5%	U.S. Inflation Protected 5.6%
U.S. Mortgage 5.9%	U.S. Government 5.5%	U.S. Corporate 8.4%	U.S. Mortgage 2.6%	U.S. Corporate -2.0%	U.S. Government 2.7%	U.S. Mortgage 3.7%
U.S. Cash 0.2%	U.S. Mortgage 5.4%	U.S. Mortgage 6.2%	U.S. Government 2.0%	U.S. Government -2.6%	U.S. Mortgage 2.4%	U.S. Government 2.3%
U.S. Government -2.2%	U.S. Cash 0.1%	U.S. Cash 0.1%	U.S. Cash 0.1%	U.S. Inflation Protected -8.6%	U.S. Cash 0.1%	U.S. Cash 0.1%

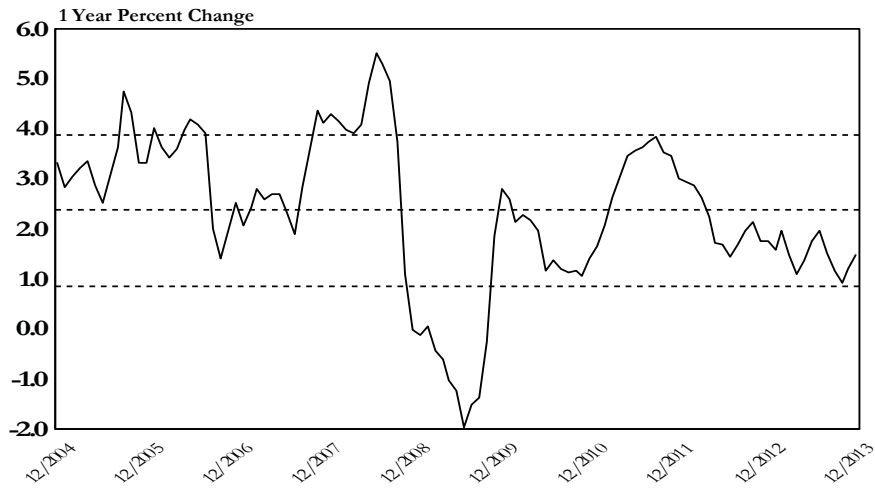
Treasury Yield Curve vs. Inflation



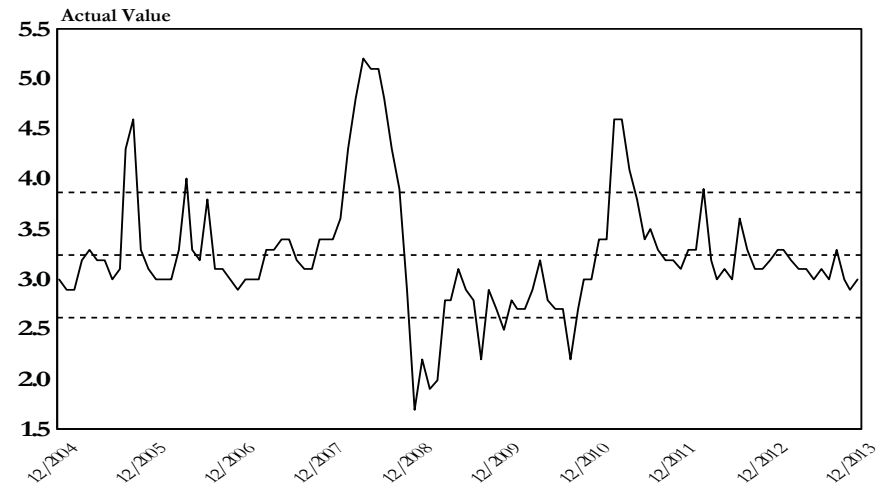
- Compared to a year ago, Treasury interest rates with more than one year to maturity have substantially risen (by approximately 1%).
- However, even with the rise in interest rates, Treasury yields with one- to four- years to maturity are still below the rate of inflation -- producing negative real returns. Eventually, all interest rates should rise to provide a return above the rate of inflation.

Interest Rates

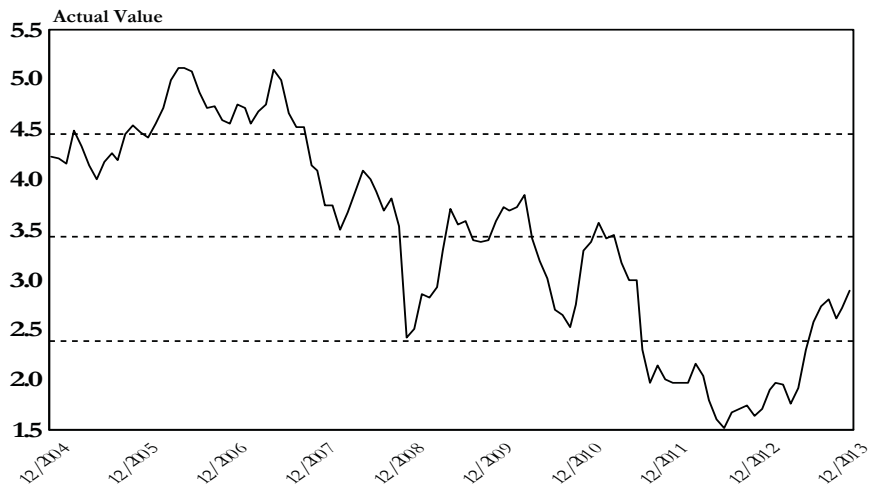
Consumer Price Index



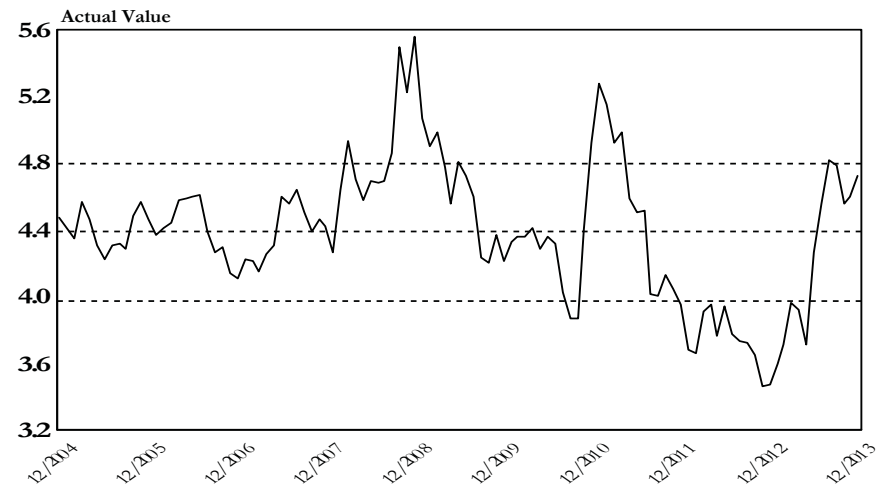
University Of Michigan Inflation Expectations



10 Year Treasury



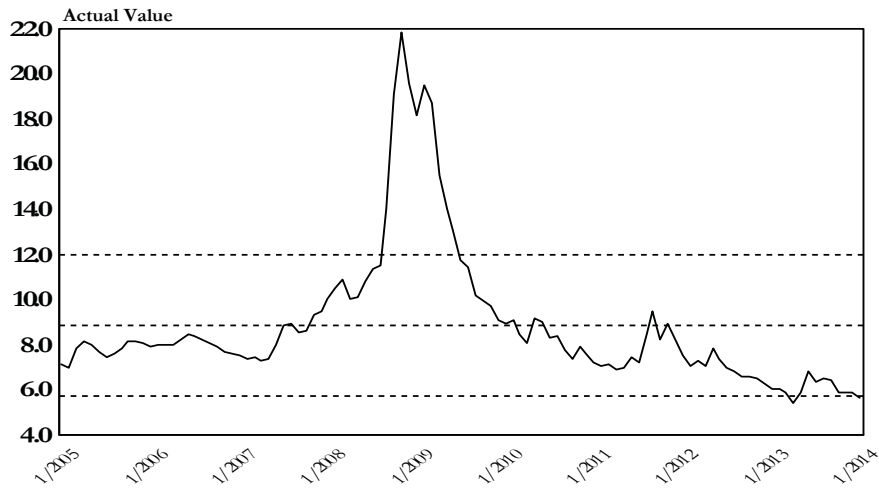
Bond Buyer 20-Bond Municipal Bond Index



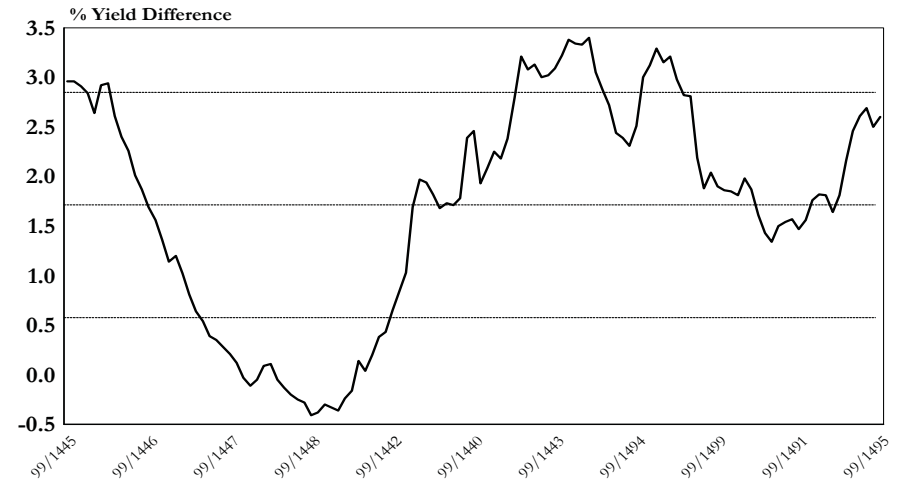
- Recently, inflation has been below 2%. In addition, while inflation expectations are higher, the market certainly does not expect “runaway” future inflation (probably in the 2.5% to 3.0% range).
- During the first half of 2013, interest rates rose quickly in response to the Fed’s initial tapering comments. Both treasuries and municipal bonds increased by approximately 1% during the year.

Interest Rates (continued)

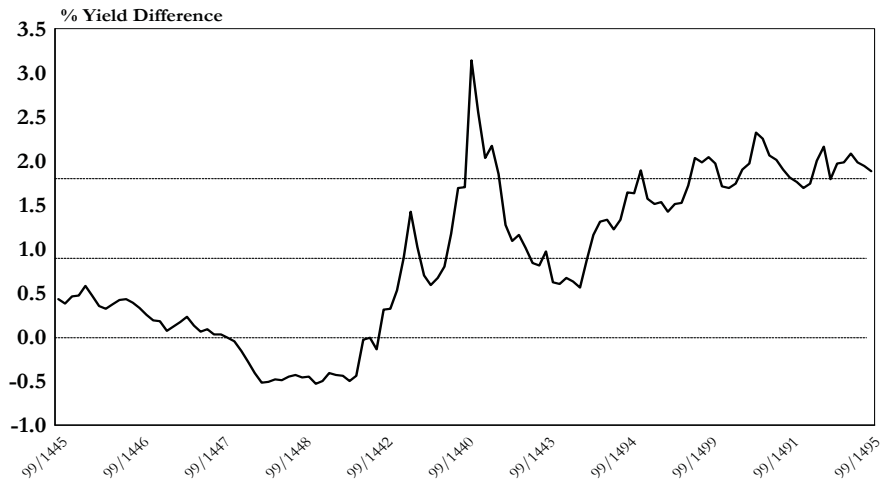
ML High Yield



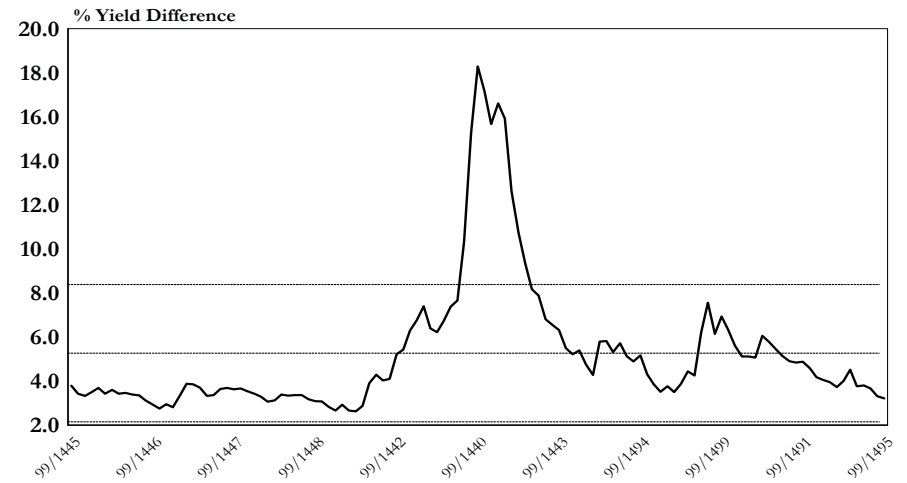
10 Year Treasury Less 1 Year Treasury



Bond Buyer 20-Bond Municipal Bond Index Less 10 Year Treasury



ML High Yield Less 10 Year Treasury



- Yields on high-yield bonds declined from over 20% during the financial crisis to 10-year lows (currently around 6%). The “quality spread” (high-yield bond yields less 10-year treasury yields) has declined substantially as well, but is still over 4%. Although, this is a result of treasury yields that remain abnormally low.
- Given the uncertainty with state and local budgets, municipal bond yields, relative to treasuries, are significantly above their ten-year historic average.