objectivity²

WEALTH MANAGEMENT

of

RAYMOND JAMES®

2014 Market Commentary

Summer Update

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Rosenberg on Increased Correlations:

"All major asset classes (even those historically inversely correlated with each other) are up on the year—gold prices are up 9.7%, industrial commodities up 8.1%, the 10 year Treasury note +6.4%, Developed World Equities +4.8%, and Emerging Markets +4.3%. This is the broadest rally since 1993—another period when the Fed underwent a prolonged four-year easing cycle after a real estate and credit debacle...only to be followed by an unexpected vigorous tightening cycle the following year." David Rosenberg "Weekly Buffet w/ Dave July 4, 2014

Rosenberg Inflation Statistics

- *CPI Inflation has risen to a 2.3% annual rate, the highest since Aug 2013, and a +50% rate of increase since the end of last year*
- *Core services index is up 3.6%, which is the strongest reading since January 2008. This index is not representative of the things you see like clothing, autos & electronics but instead in the things you can't see like transportation, communications, cable , restaurants, lodging, recreation, cable, health, rent and many others—which account for 60% of the pricing pie*
- *Airfares rose 2.6% MoM in April and movie, concert & theater tickets have tripled in 2014 to 3.6% YoY rate*
- *Ground Beef is up 16.5%, bacon 16.4%, eggs 10.5% , oranges 28.5%, and even wine is up 5.8%*

A Period of Transition

Deflationary Forces of the Past vs. Inflation on the Horizon

Our work suggests that we are in a period of transition in Global Markets. A period perhaps similar to 1997 or 1998, where markets were fully valued, words of caution were falling on deaf ears, and the markets continued to move higher. The primary concern on investors mind then, as it seems now, was not losing capital, but missing out on opportunities to make more money. Our biggest challenge is to continue to instill the virtues of patience in our portfolio management. Patience is not only akin to a buy and hold strategy, it is also the patience to wait for better opportunities, or entry points, when markets become extended or overvalued. It is this kind of patience we are exercising now, in the face of expanding valuations and rising geopolitical threats. Selling stocks, buying bonds or building up cash in 1999 seemed at the time to be comical, but ultimately proved to be a prudent strategy. We feel that investors are largely facing the same psychological dilemmas today; keep up with the crowd or dare to be different?

It is our view that the Fed is continuing to fight an unnecessary deflationary battle by keeping in place ultra loose monetary policy, even in the face of data that suggests inflationary pressures are building in the global economy.

Patience is the state of endurance under difficult circumstances, which can mean persevering in the face of delay or provocation without acting on annoyance/anger in a negative way. It is also used to refer to the character trait of being steadfast.

“Dare to Be Great”

The astute institutional investor Howard Marks of Oaktree Capital Management penned a piece in 2006 titled “Dare to be Great” . This piece outlined his thoughts on what investors have to do to have long term success and we think it is equally as relevant today as it was then:

“In the 2006 memo, I borrowed two quotes from Pioneering Portfolio Management by David Swensen of Yale. They’re my absolute favorites on the subject of institutional behavior. Here’s the first:

> ***Establishing and maintaining an unconventional investment profile requires acceptance of uncomfortably idiosyncratic portfolios, which frequently appear downright imprudent in the eyes of conventional wisdom.***

“Uncomfortable idiosyncratic” is a terrific phrase. There’s a great deal of wisdom in those two words. What’s idiosyncratic is rarely comfortable….and in order for something to be comfortable, it usually has to be conventional. The road to above average performance runs through unconventional, uncomfortable investing. Here’s how I put it in 2006:

> ***Non-consensus ideas have to be lonely. By definition, non-consensus ideas that are popular, widely held or intuitively obvious are an oxymoron. Thus such ideas are uncomfortable; non-conformists don’t enjoy the warmth that comes with being at the center of the herd. Further, unconventional ideas often appear imprudent. The popular definition of “prudent”—especially in the investment world– is often twisted into “what everyone does”.***

Most great investments begin in discomfort.

The Risks of Being Wrong… When Everything Seems Right

If the Fed is accurate and deflation is still the major concern, then their current loose monetary policies will stay in place, providing a backstop against any meaningful correction and the fuel the equity markets need to continue to make new all-time highs. The risk to our current portfolios is that our relative returns will suffer, albeit while still providing solid absolute returns. However, if the Fed is wrong (and they have been a lot over the last 20 years) and the real fight today is against inflation, a problem they are potentially making worse by not ending their loose monetary policy, then they will need to change course and begin to raise interest rates. To wit, the very astute fund manager John Hussman writes in his Weekly Market Comment from July 7th:

> *“The benefits of unusually easy monetary policies may appear quite tangible, especially if judged by the response of financial markets; the costs, unfortunately, will become apparent only over time and with hindsight.” This has happened often enough in the past and regardless of central banks’ communication efforts, the exit is unlikely to be smooth. Seeking to prepare markets by being clear about intentions may inadvertently result in the participants taking more assurance than the central bank wishes to convey. This can encourage further-risk taking, sowing the seeds of even sharper reaction. Moreover, even if the central bank becomes aware of the forces at work, it may be boxed in, for the fear of precipitating exactly the share adjustment it is seeking to avoid. A vicious circle can develop. In the end, it may be markets that react first, if participants start to see central banks as being behind the curve. This, too, suggests that special attention needs to be paid to the risks of delaying the exit. Market jitters should be no reason to slow down the process.”*

So if we look at the risk/reward of our current portfolio positioning, we feel the primary risk is that we underperform during this period of transition. If we are right, then our hedges should help provide excellent relative returns while the absolute return environment will be challenging. Suffice it to say, we are prepared to be right, but would rather be wrong.

Objectivity² Wealth Management's Top Themes for 2014:

- Continue to recognize that sometimes the **Best Defense is a Good Offense**
- The 30 year downward trend for Interest Rates is Over….What Next? **Fixed Income offers little to no Risk/Reward for most investors**
- Allocate to areas that can provide **non-correlated returns to equity markets** without taking on meaningful interest rate risk
- The Fed's exit from unprecedented monetary stimulus will not be smooth, thus **causing increased volatility across Capital Markets**. Our fundamental investment thesis is still unchanged**…Be Disciplined and Be Tactical.**
- **Path of least resistance** for the equity markets is higher. Our mantra is to take what is given but **don't add incremental risk in order to chase returns.**
- The **biggest surprise is likely to be on the upside** (i.e. coordinated global growth with equity market returns meaningfully above the consensus)

2014 Thoughts & Themes

Is Good News Good for the Markets?

The overwhelming consensus for 2014 is as follows:

- *The economic back drop is the best since the Credit Crisis ended in 2009 and GDP Growth accelerates to 3% with the possibility of 3.5-4% (surprise to the upside)*
- *Corporate Spending finally picks up as companies transition from expense reduction to investing for future growth, to sustain record high profitability levels*
- *Consensus earnings are 8-10% higher in 2014, placing the EPS at $117-120. If you take earnings of $117 and apply the historical P/E multiple of 16 you get a S&P target of 1872 (2% higher) and at the current P/E multiple of 17.25, you get a target of 2026 (10% higher).*
- *Negative headline events subside (EU monetary collapse, US fiscal cliff, China's hard landing, Obamacare etc.)*
- *Central banks continue to practice loose monetary policies (tapering is not tightening)*
- *Fund Flows become increasingly positive for equities as investors shift from fixed income and low yielding cash moves off the sidelines. We attribute this to an increase in investor confidence as the memories of 2008 are washed away by the strong equity market returns over the last 2 years.*
- *In a world where capital is looking for a home, US equity markets slightly above their long run historical P/E average of 16, seems a logical place for capital to flow. The path of least resistance for equities seems higher.*

Objectivity² Wealth Management's

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2014 Thoughts & Themes

Is Good News Good for the Markets?

So… Is it all Quiet on the Western Front? Given our contrarian ways we'd be remiss not to point out some additional food for thought:

- *Coordinated global growth leads to returns meaningfully above market consensus. The $64k question is can interest rates and equity markets go higher in unison?*
- *Whenever there is an overwhelming consensus that something is going to happen, usually the opposite happens. As evidence, look to the latest Institutional Investor Poll, which has hit an extreme with the Bull share up to 58.2%, while the Bear camp has remained at its lowly 14.3% level (see chart on next page). Even the correction camp has receded to 27.5%. As such we ended 2013 with the Bull/Bear Spread at it's widest level of 43.9%.*
- *The VIX index, a measure of market volatility, is trading at its lowest level since 2007, signaling an extremely high level of complacency*
- *The Fed is attempting to unwind from unprecedented monetary stimulus and to assume they pull that that off seamlessly, seems naively optimistic. A reminder that change happens at the margins.*

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Portfolio Manager & Strategist Interviews

Michael Shaoul (Marketfield)

❖ *Michael Shaoul, Chairman & CEO of Marketfield Asset Management discusses staying disciplined, thoughts on the future action of the Fed and the impact on inflation and interest rates, in the following two interviews:*

- http://video.foxbusiness.com/v/3666326518001/inflation-on-the-rise/?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+foxbusiness%2Fvideo+(Internal+-+Video+-+Video)#sp=show-clips *(click to view)*
- http://www.bnn.ca/Video/player.aspx?vid=377165*(click to view)*

David Rosenberg (Gluskin Sheff)

❖ *David Rosenberg discusses his thoughts on the Fed and makes a prediction that they will begin to increase policy rates in early 2015 to combat growing inflationary pressures*

- *http://video.cnbc.com/gallery/?video=3000288860* *(click to view)*

"The essence of investment management is the management of RISKS, not the management of RETURNS."

-Benjamin Graham, Legendary Value Investor

We manage risk within a global asset allocation framework (within min/max ranges across the various asset classes) and overlay tactical adjustments through the use of 50, 150 & 200 Day Moving Averages.

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Objectivity² Portfolios: Overview & Strategy

Low Volatility Allocation

Our goal with this portfolio is steady growth of capital with a primary focus on capital preservation and risk mitigation. We view this portfolio as an investment alternative to low yielding CDs and short term bonds, for our clients' most conservative pools of capital.

Target Allocation: 25% Equity, 20% Fixed, 45% Strategic, 15% Cash Alternatives

Current Allocation: 25% Equity, 20% Fixed, 30% Strategic, 25% Cash Alternatives

Benchmark Allocation: 15% Equity, 60% Fixed, 25% Cash (Dow Jones Conservative Index)

Target Net Return: CPI + 1%
(projected 3-5% annualized over 3 years)

2014 1st Half Update

In the first half of the year, the only change in the portfolio was the removal of our fund of funds manager (15% allocation) from our Strategic allocation. Given the state of the markets and our more conservative mindset with this portfolio, we have kept the capital we raised in cash. Our equity allocation reminded steady at 25% and we maintained our tactical overweight to our long/short equity manager over our dividend paying, global equity manager. This overweight hindered our performance over the short term but we continue to think this positioning will benefit the portfolio in the long term. The Fixed Income allocation, also remained constant at 20%. Despite our long term views that Fixed Income does not provide a very attractive risk/return profile, this sleeve has helped performance YTD, as longer dated yields have dropped.

"The essence of investment management is the management of *RISKS*, not the management of *RETURNS*."

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Objectivity² Portfolio Overview & Strategy

Moderate Allocation

This portfolio is built to balance our views on capital preservation and growth, and is an alternative to the traditional "60/40 Balanced" portfolio you will see on almost all investment platforms at other advisory firms.

Target Allocation:	**47.5% Equity, 15% Fixed, 36.5% Strategic, 1% Cash**
Current Allocation:	**47.5% Equity, 15% Fixed, 29% Strategic, 8.5% Cash**
Benchmark Allocation:	60% Equity, 35% Fixed, 5% Cash (Dow Jones Moderate Index)
Target Net Return:	**CPI + 3%** **(projected 5-7% annualized over 3 years)**

2014 1st Half Update

In the first half of the year, the only change in the portfolio was the removal of our fund of funds manager (7.5% allocation) from our Strategic allocation. Given the state of the markets and lack of excitement about a viable replacement, we decided to keep the capital we raised in cash. The equity allocation held steady at 47.5% and is a blend of 15% passive strategies, designed to track equity markets in a low cost vehicle, and 32.5% in Opportunistic Equity managers. This active sleeve is overweight a long/short manager to help lower some of the market risk and also has allocations to a global dividend fund and a tactical equity manager, that has a long track record of investing in levered companies. The overweight to our long/short manager hindered performance in the short term but we continue to think this positioning will benefit the portfolio in the longer term. Our Fixed Income allocation remains at 15%, which represents a significant underweight to the benchmark of 35%. While we continue to believe this represents a prudent long term strategy, the underweight has hurt relative performance thus far in 2014.

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Objectivity² Portfolio Overview & Strategy

Growth Allocation

This allocation is built to provide our client's with the most growth opportunities, while still adhering to our risk management philosophies.

Target Allocation: ***63.5% Equity, 0% Fixed, 36.5% Strategic***
Current Allocation: ***63.5% Equity, 0% Fixed, 28% Strategic, 8.5% Cash***
Benchmark Allocation: *80% Equity, 15% Fixed, 5% Cash (Dow Jones Moderately Aggressive)*

Target Net Return: ***CPI + 5%***

(projected 7-9% annualized over 3 years)

2014 1st Half Update

In the first half of the year, we made two adjustments in the portfolio. First was the addition of a dynamic equity manager who runs a fund with a strong bio-tech and pharma background. We sold ½ of our position in our Global dividend manager (7.5%) to fund this trade. Overall, the Equity allocation held steady at 63.5% and is now comprised of 15% passive strategies, designed to track equity markets in a low cost vehicle, and 48.5% in Opportunistic Equity managers. This active sleeve is now comprised of 4 managers, with a continued overweight to the long/short manager and tactical equity manager investing in levered companies. Our new manager addition was additive to portfolio performance in the first half of the year, outpacing the S&P 500. The overweight to our long/short manager hindered performance in the short term but we continue to think this positioning will benefit the portfolio in the longer term.

In addition, we removed of our fund of funds manager (5% allocation) from our Strategic allocation. Given the state of the markets and lack of excitement about a viable replacement, we decided to keep the capital we raised in cash. We continued to hold our Fixed Income allocation at zero, and despite our long term views that Fixed income provides a poor risk/return trade-off, the lack of an allocation has hurt our relative performance vs. the Growth Benchmark.

Disclaimers

The views in this commentary do not take into account the particular investment objectives, financial situations, or needs of every individual client.

Investments are subject to market risk, including possible loss of principal. International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risk are greater in emerging markets.

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Commodities are volatile investments and should only form a small part of a diversified portfolio. There may be sharp fluctuations even during periods when prices are rising overall. The price of gold has been subject to dramatic price movements over short periods of time and may be affected by elements such as currency devaluations or revaluations, economic conditions within an individual country, trade imbalances, or trade or currency restrictions between countries. As a result, the market prices of securities of companies mining or processing gold may also be affected.

The S&P 500 is an unmanaged index of 500 widely held stocks. It is not possible to invest directly in an index.

Dividends are not guaranteed and can fluctuate.

Past performance does not guarantee future results. There is no assurance that these trends will continue.

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Alternative investment strategies involve greater risks and are only appropriate for the most sophisticated, knowledgeable and wealthiest of investors.

Technical Analysis is a method of evaluating securities by analyzing statistics generated by market activity, such as past prices and volume.

Technical analysts do not attempt to measure a security's intrinsic value, but instead use charts and other tools to identify patterns that can suggest future activity.

Asset allocation and diversification do not ensure a profit or protect against a loss. Investments are subject to market risk, including possible loss of principal.

The Consumer Price Index (CPI) is a measure of the average change in consumer prices over time of goods and services purchased by households; it is determined monthly by the U.S. Bureau of Labor Statistics. Investors cannot invest directly in an index.

P/E is the price of the stock divided by its earnings per share.

VIX is the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. The VIX is a widely used measure of market risk. Gross Domestic Product (GDP) is the annual total market value of all final goods and services produced domestically by the U.S. The charts above are for illustrative purposes only.

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