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Nauset Market Commentary
Fourth Quarter 2013

Market Performance Recap: **Stocks Finish Strong**

With fresh evidence of increasing global growth in the final quarter of 2013, investors pushed stocks to new highs. The Russell 3000, a broad U.S. stock index, posted a Q4 gain of +10.1% and a total 2013 return of +33.6%. Bond prices continued their dismal year with a flat total return in Q4 to finish the year with a rare annual loss of -0.9% in the Barclays Intermediate Gov't/Credit Index.

Economic & Market Discussion: **Can Stocks Climb Higher?**

In our annual US stock outlook, we focus on three key factors: corporate profits, interest rates, and valuation levels. After a strong stock rally in 2013, particularly in riskier parts of the market, investors expect momentum to continue for stocks, despite concerns that a significant correction is long overdue.

- Corporate Profits – Earnings are likely to be the key area that determines stock returns this year. The consensus 2014 outlook is for earnings growth to hit its +10% historic average. Our opinion is that stocks will need a boost from higher domestic and global growth to reach that level, and any event shocks will present real risks to this profit scenario. If profit growth hits expectations, this factor rates a positive.
- Interest Rates – There is no doubt that Fed policy intervention has been a key driver in elevating stock prices by keeping interest rates low across the yield curve. The Fed plans to taper its large-scale bond buying starting this month, likely causing longer-term rates to creep higher. At the same time, the Fed intends to keep short-term rates low in 2014. If the longer-term rate raise is slow and controlled, we believe a steeper yield curve is only a slight negative for stocks.
- Market Valuation – Our view here is split between historical valuations and relative value. With record high corporate profit margins, one can make the case that stocks are overvalued at current earnings levels. On the other hand, the relative value of stocks remains attractive in comparison to bonds and cash. In net, we see stocks as fairly valued and thus, a slight positive.

Our conclusion is that stocks may deliver modest returns in 2014, but this scenario is predicated on more robust GDP growth than last year leading to solid corporate earnings growth despite increasing rates. While we are following this scenario now, we foresee a choppy ride and are flexible and ready to adjust to new data as the year unfolds.

Our current strategy emphasizes high quality, dividends and real growth factors in stock allocations. Our income allocations remain underweight and mostly defensive against the prospect of higher rates. Additionally, we continue to build and actively manage allocations to alternative and hedged investments to mitigate overall portfolio risk.

Market Performance **% Change for Periods Ended 12/31/2013**

Market Index	Fourth Quarter	2013	3-Year Annual.	5-Year Annual.
Russell 3000	10.10	33.55	16.24	18.71
MSCI EAFE – Non-US	5.36	19.43	4.93	9.13
MSCI Emerging Markets	1.83	-2.60	-2.07	14.79
DJ US Real Estate	-0.06	1.77	8.68	16.34
BarCap Intermediate Gov't/Credit Bond	-0.02	-0.86	2.90	3.96
IQ Hedge Multi-Strategy	2.88	6.05	3.81	4.78
3-Month T-Bill	0.01	0.05	0.07	0.10