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Nauset Market Commentary
Second Quarter 2014

Market Performance Recap: **Stocks Up as Growth Rebounds**

The US economy bounced back in Q2 from a weather-related sluggish first quarter to post improved economic, jobs and earnings reports. The result was a solid gain of +4.9% in the Russell 3000, a broad U.S. stock index led by tech, energy and health care stocks. Bonds posted another positive quarter despite interest rate fears with the Barclays Intermediate Gov't/Credit Index increasing +1.2%.

Economic & Market Discussion: **The "New Neutral"**

US stocks have posted above-average returns for the past five years during an environment of modest economic expansion aided by hyper monetary stimulation in recovery from the Great Recession. With the stock market hitting new highs, market analysts are decidedly mixed in predicting what happens next. The main investor fear is that both stock and credit markets hold more risk than return and could suffer a major correction given the potential for rate hikes, inflation spikes or a break in economic momentum.

Though potential for some downside volatility is certainly overdue, we believe that fears of a major meltdown are not supported by current economic or policy factors. To help understand how financial markets will respond to US and global conditions now and going forward, we have found a useful economic and market construct in the "New Neutral," developed by monolithic asset manager, PIMCO. The narrative says that global economies are moving at different speeds, but converging toward modest, but stable growth rates with low inflation based on central bank policy that will peg real rates (nominal rate less inflation) at 0% for several years into the future.

We agree with PIMCO that central bankers around the globe will keep short-term rates low and public debt high for the next few years. This action will keep a lid on growth while reducing downside market risk and minimizing asset bubbles. The investment implication is that returns will be muted along with below-average market risk. Therefore, recent above-market returns may not be repeated, but market downturns are likely to be moderate, and not reach painful bear market (-20%) levels. We agree with much of this thesis, though we are always monitoring the markets for new risk threats as well as return opportunities.

Our current strategy continues to focus on higher quality stocks and stock sectors as well as real asset allocations to energy infrastructure and real estate investments. Our income allocations remain underweight and slightly defensive against the prospect of rate volatility. And we are placing more emphasis on alternative and hedge investments that provide positive returns, while buffering risk.

Market Performance **% Change for Periods Ended 6/30/2014**

Market Index	Second Quarter	2014 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 3000	4.87	6.94	25.22	16.46	19.33
MSCI EAFE – Non-US	4.09	4.78	23.57	8.10	11.77
MSCI Emerging Markets	6.59	6.14	14.31	-0.39	9.24
DJ US Real Estate	7.06	16.42	13.02	10.72	22.38
BarCap Intermediate Gov't/Credit Bond	1.23	2.25	2.86	2.83	4.09
IQ Hedge Multi-Strategy	3.04	4.19	10.95	4.98	4.74
3-Month T-Bill	0.01	0.02	0.04	0.05	0.08

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