January 14, 2015
Volume 15, Number 4

Nauset Market Commentary
Fourth Quarter 2014

Market Performance Recap: **2014 US Returns Outpace Rest of World**

Strong Q4 returns boosted US stocks to another strong year with returns of +13.2% for the large cap Russell 1000 index. Small cap US stocks rallied in Q4, but posted more modest yearly returns of +4.9%. Sluggish global growth and geopolitical conflicts led to negative returns in both developed and emerging international market indices in 2014. For the year, fixed income defied bearish expectations and posted solid gains of +3.1% for 2014 as measured by the Barclays Intermediate Gov't/Credit Index.

Economic & Market Discussion: **2015 Outlook**

Looking over the next twelve months we are focused on three big themes: (1) normal returns return; (2) volatility – hello old friend; (3) diversifiers: taste like chicken.

- Return to normal returns – US large cap equities, as measured by the S&P 500 index, averaged +18.2% for the past three years versus +3.5% during the prior ten years. We do not expect a continuation of high teens returns. On the positive side, markets are supported by 2015 growth forecasts for GDP of +2.5% to +3% and corporate earnings of +6% to +9%. And we view stocks as attractive relative to other major asset classes. However, valuations have risen and the Fed is expected to raise short-term rates in 2015, a negative for stocks. Given this scenario, we expect US stock returns to be positive, but well below recent return levels.
- Volatility, hello old friend – Volatility, long absent in any meaningful way, is expected to return. Whether its geopolitics, oil dynamics or an unwanted blip in a macro-economic factor, skittish investors and traders are using any excuse to trim exposure only to jump back in when the news flow shifts to another topic. As long-term investors we view most volatility as noise, but we do analyze asset price drops for opportunities in favored sectors or subsectors.
- Diversifiers taste like chicken – Using alternative investments for diversification isn't as easy as it used to be. In our experience, many uncorrelated strategies do zig when markets zag for a while, but over time track closer to broad market behavior. So, we diligently review our non-traditional investments and seek replacements if they fail to provide returns with risk-buffering benefits.

As always, we will monitor all elements of the economy and markets while maintaining our flexibility to adjust to changing conditions.

Portfolio Strategy: **Balance Opportunity with Caution**

Our current strategy favors both growth and quality stocks with an emphasis on tech, health care and cyclical consumer sectors, as well as real assets in energy infrastructure and real estate. Our fixed income allocations are underweight with a mix of defensive holdings and higher-yielding, less rate-sensitive bonds. We also have a full allocation to alternative and hedged securities to provide diversification of returns and a risk buffer.

Market Performance **% Change for Periods Ended 12/31/2014**

Market Index	Fourth Quarter	2014	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	4.88	13.24	13.24	20.62	15.64
MSCI EAFE – Non-US	-3.57	-4.90	-4.90	11.06	5.33
Russell 2000	9.73	4.89	4.89	19.21	15.45
MSCI Emerging Markets Equity	-4.51	-2.19	-2.19	4.04	1.78
DJ US Real Estate	12.29	27.24	27.24	15.48	15.69
Bloomberg Commodity	-12.10	-17.01	-17.01	-9.43	-5.53
Barclays Gov't/Credit Interm. Bond	0.89	3.13	3.13	2.03	3.54
IQ Hedge Multi-Strategy	0.68	4.21	4.21	5.06	3.70
3-Month T-Bill	0.01	0.03	0.03	0.05	0.07

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