April 14, 2015
Volume 16, Number 1

Nauset Market Commentary
First Quarter 2015

Market Performance Recap: **First Quarter US Returns Positive, but Volatile**

An up and down opening quarter of the year finished on the positive side as the large cap Russell 1000 posted an increase of +1.6%. The winners for the quarter were small cap US stocks, up +4.3% in the Russell 2000, and international stocks with a gain of +4.9% in the MSCI EAFE. Commodities, energy MLPs and emerging markets were all lower for Q1. Fixed income posted modest gains of +1.4% for Q1 as measured by the Barclays Intermediate Gov't/Credit Index.

Economic & Market Discussion: **Take a Hike**

The Fed Reserve has signaled that it will likely increase the Fed funds rate this year, perhaps as early as June, depending on economic data. When it occurs, this will be the first Fed funds rate rise in nearly nine years, but we believe the Fed will move slowly from there and in small increments. Why? Let's review what a rate hike means for the economy and financial markets.

- Why hike rates now? – A Fed funds rate hike is usually the result of an overheated economy and/or surging inflation. However, this time the rate increase is the result of "normalization", a process in which the Fed is moving rates off zero toward a more normal level so it has room to lower rates again to jump start the economy if it slows down again.
- Can the economy take a punch? – Investors fear that the first hike rate will signal an end to easy money and that higher rates will eventually drive the US economy into recession. While that has happened in previous cycles, current rates are so low that small hikes are unlikely to negatively affect the economy. Despite higher borrowing costs for businesses and consumers, we believe the economy is strong enough to absorb nominally higher rates and continue to grow without risk of recession.
- Will markets wobble? – The first rate is likely to cause near term volatility in stocks. For bonds this may signal the beginning of a slow beating as rates finally get off the mat. However, as investors adjust to the real impact of slightly higher rates, fundamentals and relative value will come back into focus. Our view is that this will cause stocks to retrace any losses and set up the potential for further gains.

In summary: don't fear the hike. Stay focused on US economic strength and long-term value in stocks and remember that rates, even if slightly higher, remain at historic lows.

Portfolio Strategy: **Balance Opportunity with Caution**

Our current strategy remains largely in place: we favor growth and quality in equities with an emphasis on tech, health care and cyclical sectors, and have continued to increase our allocation to international developed market stocks. We continue to be underweight fixed income; preferring higher-yielding, less rate-sensitive bonds, MLPs, and income-producing real estate. And to diversify risk and returns, we have a full allocation to alternative and hedged securities.

Market Performance **% Change for Periods Ended 3/31/2015**

Market Index	First Quarter	2015 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	1.59	1.59	12.73	16.45	14.73
MSCI EAFE – Non-US	4.88	4.88	-0.92	9.02	6.16
Russell 2000	4.31	4.31	8.21	16.27	14.57
MSCI Emerging Markets Equity	2.24	2.24	0.43	0.31	1.75
DJ US Real Estate	4.27	4.27	22.00	13.17	14.57
Bloomberg Commodity	-5.94	-5.94	-27.04	-11.52	-5.71
Barclays Gov't/Credit Interm. Bond	1.45	1.45	3.58	2.31	3.52
IQ Hedge Multi-Strategy	2.06	2.06	5.18	4.87	4.05
3-Month T-Bill	0.01	0.01	0.03	0.05	0.07

NAUSET
WEALTH MANAGEMENT