DANN ASSET ADVISORS, LLC

Third Quarter 2014 Update

October 10, 2014

3Q14 Highlights

- U.S. economic growth continues, although with signs of consumer weakness
- Geopolitical events contribute to slowing growth in much of rest of world
- Large cap U.S. stocks rise modestly, small cap stocks decline
- After a stronger first half, international stocks again lag

The table below summarizes the performance of some key indices during the third quarter and year to date:

Market Performance		
Index	% Ch. 3Q14	% Ch. YTD
S&P 500	1.1	8.3
MSCI Developed Markets (excl US)	(5.9)	(1.5)
MSCI Emerging Markets	(3.7)	1.9
MSCI All Country World	(2.3)	4.1
US Aggregate Bond (1)	0.2	4.1
Liquid High Yield (1)	(2.5)	2.4
US Dollar Emerging Markets Bond (1)	(1.1)	7.4

(1) Barclays indices

Equities. Large cap U.S. stocks, as measured by the S&P 500 index, eked out a small gain during the third quarter, the seventh consecutive quarterly advance. Digging beneath the broad index indicated more volatility, however, with healthcare stocks advancing 5% but the energy sector declining 9%. In addition, small cap stocks (as measured by the Russell 2000 index) fell 7.4% during the quarter and early in October reached a 10% correction from July's all time high. So while the headline increase of 1.1% for the S&P 500 implied stability, certain sectors of the market exhibited greater weakness.

Relative to the U.S., international stocks had a poor quarter. After rising 8% into June, developed markets stocks excluding the U.S. began declining as the conflict in Ukraine and resulting economic sanctions contributed to economic slowing in the euro area. Emerging markets remained strong into late summer but then declined 7.5% in September over concerns of slowing growth in China and uncertainty around elections in Brazil. At the end of the quarter the S&P 500 was trading at a not inexpensive 16.7x projected 2014 earnings, a premium to emerging and other developed stock markets.

Fixed income. Yields on 10 year U.S. Treasury bonds ranged between 2.35% and 2.65% during the quarter with fluctuations stemming from changing market perceptions about U.S. growth and the timing of Federal Reserve rate increases. The Barclays U.S. Aggregate Bond index finished the quarter nearly unchanged but more speculative fixed income securities generated negative returns as indicated in the table. During the quarter, the U.S. dollar increased 7.7% against a basket of major currencies, its biggest gain since 2008. We believe the strong dollar may be enhancing foreign investors' attraction to U.S. Treasuries, helping to keep longer term rates low.

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General comments. For the past year we've expected U.S. GDP growth to strengthen and interest rates to rise. Combining the estimated 3% growth for the just-ended third quarter with the 4.6% reported for the second quarter (the second quarter being helped by a rebound from last winter's harsh weather) indicates reasonably good growth.

Still, during the third quarter, U.S. growth was uneven. The manufacturing/industrial side of the economy was very strong (industrial production and supply management numbers) but the consumer – as indicated by inconsistent housing and retail numbers – lagged. While auto sales have been running at the strongest pace since before the recession, we believe that these are being inflated by aggressive financing that may restrain future sales. We're concerned that without more consistent growth in consumer spending the manufacturing side of the economy potentially will end up with excess inventory, which could lead to a slowdown in production and the economy in upcoming quarters.

As a result of the foregoing, and combined with slower than expected international growth, we're becoming less confident about the potential for a sustained pick up in U.S. growth to above 3%.

Portfolio Positioning

The fixed income component of most diversified (fixed income and equity) portfolios remains largely in short duration (three years and under), investment grade corporate and municipal bond funds. To generate more income, for some clients we've layered in small positions in a short duration, more aggressive bond fund. While we don't expect rates to go down materially from current levels, we believe that if the economy doesn't continue strengthening interest rates most likely won't rise significantly over the near term. As a result, we may begin adding small positions in intermediate term investment grade funds to some client accounts.

With respect to equities, the best performing broad U.S. market sectors during the third quarter were healthcare, technology and consumer staples. Healthcare and consumer staples generally are considered more defensive, stable sectors of the market, and their strong performance may reflect the relatively better potential for these sectors if economic growth slows in coming quarters. The good performance of technology was not wholly consistent with that of other large multinational companies and was due in part to an 8% gain by Apple (a large weighting in the sector) in advance of new products announced late in the quarter.

The worst performing sectors were energy, utilities and real estate. Poor performance by energy likely reflected high inventories of oil and gas and the fact that the underlying commodities are priced in U.S. dollars (with a strong dollar negatively affecting the commodity prices). In addition, energy may have been impacted by the potential for a growth slowdown. Utilities and real estate typically decline when interest rates are rising; as interest rates were largely flat during the quarter the weakness in these sectors also may have stemmed from the possibility of slower growth ahead (slower growth having negative impacts on electricity usage and real estate rents).

For most equity-only clients, during the third quarter we sold two stocks – a diversified, global manufacturer and a management consulting and outsourcing company. In addition, we sold an emerging markets small cap, dividend focused exchange traded fund. Proceeds mostly were put into cash and existing holdings. Our only new position during the quarter was the stock of a fast casual restaurant chain that has the potential to improve results significantly if management successfully executes its profit improvement plan. Most equity-only accounts ended the quarter with roughly 8% in cash.

Economy

With 4.6% growth, second quarter GDP expanded at the strongest pace since the fourth quarter of 2011. Combining the second quarter with the weather-induced contraction of 2.1% in the first quarter and 3.5%+ growth in the second half of 2013, implies trend-line growth of 2.5%-3.0% over the past four quarters. Estimates for soon to be reported third quarter 2014 are in the 3% range.

As discussed on page two under General Comments, we're concerned by the relative strength of the industrial/manufacturing side of the economy relative to the much larger, more sluggish consumer side. In essence, we believe something has to change over the remainder of 2014 – either job, wage growth and consumer spending accelerates or manufacturing and production slows. As consumer balance sheets have improved materially since the recession, it may be that employment/wage improvement, should it occur, flows through strongly to spending and helps the economy maintain an improving trend. We believe this is the more likely outcome but are less optimistic about U.S. growth accelerating than we were three months ago.

Certainly, it will have to be the U.S. consumer that drives growth. The combination of sanctions stemming from the Ukrainian conflict and lack of labor market reforms in some of the eurozone's largest economies is causing Europe's tenuous recovery to stall. China, Japan and several Latin America countries also are experiencing slower than expected growth. Combining this weakness with the recently strengthening dollar is likely to put pressure on U.S. multinational company earnings in 2015 if current conditions don't change – and this is another potential negative for U.S. growth.

Potentially offsetting the foregoing is what we see as continued commitment to monetary stimulus from the central banks of most of the world's large economies. In the U.S., this month is likely to be the last for Federal Reserve bond purchases and, if the economy continues to improve, rates are likely to rise by summer 2015. Still, it seems clear (as emphasized with the most recently released minutes) that the Fed will continue to use monetary policy to support the economy if it believes the recovery is stalling (especially with inflation at current low levels).

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