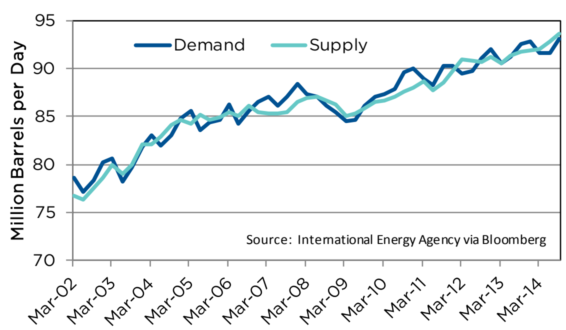
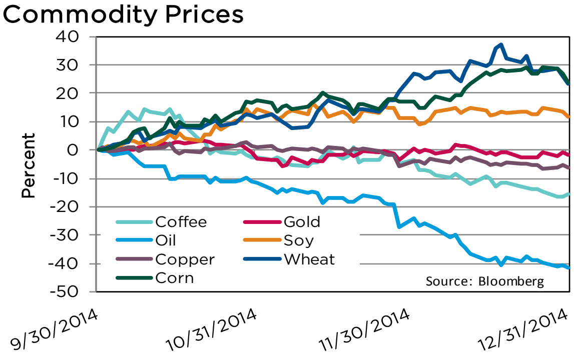
ECONOMIC REVIEW DECEMBER 2014

December closed 2014 with a resurgent U.S. economy and flagging growth in much of the world. The precipitous fall in oil prices can be attributed to recent events and long-term trends. Recently, quieting tensions in Israel and Palestine, Russia's weakened ability to threaten energy exports to Europe, OPEC's unwillingness to cut production and the culmination of the Fed's bond buying program weighed on oil prices. Oil production growth in North America did more to diminish supply fears than change the supply/demand balance, as world supply surpassed demand at greater than current levels several times during crude's run to $100+/barrel. Farm commodities benefitted from the surging U.S. dollar as they have more inelastic export demand and are not tied to global industrial needs, providing a higher revenue stream in the midst of rising prices. The flight to "safe" U.S. assets curtailed bond yields, even as the prospect of interest rate increases grows. Investors view foreign assets as less favorable, given economic conditions outside of the United States. Weak energy prices hurt Canadian stocks, the ECB and Bank of Japan continue to press for monetary easing and lower interest rates amid signals of economic trepidation, and China looks to lower interest rates. Just as the year closed, German Chancellor Merkel commented that a Greek exit from the Euro was "manageable", rehashing a fear that many investors felt had been quashed. Merkel's comments precede a Greek election in which anti-austerity candidates may win, forcing a potential new round of defaults if economic reforms are unwound.

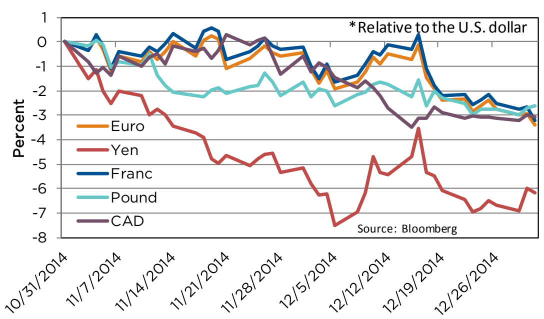
World Oil Supply and Demand



Commodity Prices



World Currencies Weaken



Market Returns

As of December 31, 2014

	December	3 Months	One Year
S&P 500	-0.3%	4.9%	13.7%
Russell 1000 Value	0.6%	5.0%	13.5%
Russell 1000 Growth	-1.0%	4.8%	13.1%
Russell 2000	2.9%	9.7%	4.9%
MSCI EAFE	-3.5%	-3.6%	-4.9%
Emerging Markets	-4.6%	-4.5%	-2.2%
Barclays Agg	0.1%	1.8%	6.0%
3-Month T-Bills	0.0%	0.0%	0.0%

Retailers hoping for a Christmas sales boost were largely appeased, though the boost was not as expansive as expected. Many retailers ordered special goods for the holiday season to entice shoppers with unique items anticipated to boost sales. However, many orders of goods from Asia were ensnared in a work slowdown at west coast ports. Shoppers noticed as items they expected to see in stores were absent, especially at clothing stores. In many cases, shipping containers with those items sat on cargo ships off the western U.S. coast. Port operators and the longshoremen and warehouse workers union were unable to meaningfully progress on contract negotiations, leading to the slowdown. The Institute of Supply Management cited the port delays as a contributing factor to the 3.2% drop from November's Purchasing Managers' Index.

In an effort to stem rapidly escalating prices, Russia's central bank raised its key interest rate to 17%, up from 10.5%. The move did little to stem the world's disdain for the ruble, which lost half of its value since the invasion of Ukraine. Russia urged European trading partners to lift sanctions imposed as a result of the invasion.

The Federal Reserve, while widely expected to raise interest rates in 2015, touted its patience to implement changes. With the fall in oil prices, a key component of inflation, the Fed has more breathing room to await newer economic data before taking action. While employment continues to strengthen in the U.S., the Fed will need to see wages grow before taking any action on interest rates. The housing market remains stable, and is not poised for a breakout.

With an abrupt policy change, the Obama administration announced the restoration of full diplomatic relations with Cuba. Some restrictions on travel and finance will be eased, and Cuban cigars will be legally available to U.S. consumers. Sanctions were first imposed by Eisenhower in 1960, in reaction to Castro's seizure of U.S. corporate assets and increased favoritism towards the U.S.S.R. Emotions over the change were mixed, as demands to end human-rights violations were not mentioned, yet many younger American citizens questioned continuing a conflict that pre-dates them. Russia recently cut aid to Cuba amidst its own economic turmoil stemming from the Ukraine invasion.

Investors looking ahead to 2015 must ascertain the effects of lower oil prices. In the U.S., the production boom has bolstered job creation, yet the price drop has already led to layoff announcements and delayed investment. Consumers will continue to reap benefits as the nearly $1.50/gallon drop in gasoline will free up money to purchase other goods. While the Fed is expected to raise interest rates, the timing is likely to be later than markets expect. Short of a global economic turnaround, the Fed recognizes that exports will be hurt by a strong dollar and may let the economy run a bit before applying the brakes. Being the singular large central bank raising interest rates is not a position the Fed will take lightly. The U.S. federal debt surpassed $18 trillion in December, and Congress surely will be on the Fed's case if borrowing costs escalate. Weakness in Europe and potential Greek rumblings should keep inflows to U.S. bonds from diminishing and provide support for low interest rates.