Dear Friends: October 2, 2014

3rd Quarter 2014 Recap

Issues in the Middle East, Ukraine, Scotland and Hong Kong continue to dominate headlines and affect the markets. These sustained negative headlines caused European markets to decline throughout the quarter as the MSCI EAFE Index lost 6% of its value during the quarter while the MSCI Emerging Market index declined almost 4% for the quarter and 8% just in the month of September. While problems in the Ukraine do not have a considerable direct impact on major worldwide corporations, Hong Kong does play a substantial role in the Chinese economy, and therefore the world. Disruptions in the region could cause significant decreases in corporate valuations, and thus drops in the equity markets.

Economic news out of the U.S. however was welcomingly positive as second quarter GDP was upwardly revised to 4.6% (from an already healthy number of 4.2%). While this GDP report was the strongest since pre-recession 1Q2006, part of the excess growth can be attributed to pent-up demand from 1st quarter weather related problems that depressed expansion. Data out of the Manufacturing industry was also positive as decreased costs for domestic energy and increased costs of labor abroad caused companies to shift manufacturing back home. This and other encouraging U.S. economic data allowed the S&P Index to hold the gains it produced during the 2nd quarter, end the 3rd quarter relatively flat, and reach a new all time high on September 18th.

Current market valuations remain in line with historical averages with a current trailing S&P 500 Price/Earnings ratio of 18.94. Projected corporate earnings growth is also favorable with expectations of 10% growth for the year ending 12/31/2014, indicating that corporations are maintaining healthy growth rates. Additionally, the unemployment rate has seen improvement with an August reading of 6.1%, which is down 0.6% from year end 2013!

Noise out of the Fed continues to weigh on markets and this trend will likely persist in the 4th quarter. With Quantitative Easing coming to an end in October and the Fed considering when and how it should raise interest rates, any information from Governor Yellen will be increasingly important. As the U.S. economy grows and the employment stabilizes it could create some tough decisions for the Fed later this fall as it decides how quickly it should rein back the accelerating economy with reduced stimulus. One data point of note is that there has been a recent 35% surge in the VIX volatility index, indicating that markets expect this current volatility to continue.

Moving abroad, the European Central Bank, who adopted an approach similar to that of U.S. by keeping interest rates low to stimulate growth, has decided to attack their problem of negative growth more aggressively by lowering interest rates into negative territory. The ECB hope this will force banks to increase lending to jump start economic growth. Emerging markets are not fairing any better than Europe and continue to be negatively affected by uncertainty as India deals with a new government, Brazil prepares for upcoming elections (and gets over its World Cup hangover), and China begins to show signs of a slowdown in their rampant growth.

Index	Index Close	Quarter Price Return (%)	12 Mo Price Return (%)
S&P 500	1,972.29	0.62%	17.29%
DJIA	17,042.90	1.29%	12.65%
NASDAQ	4,493.39	1.93%	19.14%
Barclays Aggregate Bond	109.11	-0.27%	1.78%
MSCI Europe-Australasia-Far East	64.12	-6.22%	0.50%
MSCI Emerging Markets	41.56	-3.86%	1.96%

The mutual fund industry had some big news this September as Bill Gross, the manager of the largest bond mutual fund in the world, PIMCO Total Return, resigned. In mid-August we informed clients of our intention to transfer out of the PIMCO Total Return fund in their Charles Schwab accounts due to concerns over fund performance and manager Bill Gross. After receiving strong support from our clients we proceeded with this recommendation in late August. This change was made after thoughtful and careful consideration by the Locust Capital Investment Committee.

Consistent with our ideals of constant improvement and top tier service we have made some changes to the Quarterly Performance Report. We believe that these changes make the report easier to understand while still containing the important information needed to review your portfolios. We are always open to feedback or new ideas and appreciate any questions you may have about the reports.

All the best,

Locust Capital Management, LLC