RDM CAPITAL ASSOCIATES

WEALTH MANAGEMENT

2014 THIRD QUARTER MARKET COMMENTARY
October 2014

Please visit our new and completely re-designed website, www.rdmcapital.com. In addition to background information about our firm and strategy, you will find links to financial calculators, daily market charts, a client login button for direct access to Pershing's NetxInvestor site and more.

We will also begin weekly blog posts on our wealth management blog, which will be posted every Friday. The first in the weekly blog posts was posted last Friday. Please take a minute to visit the blog at www.rdmcapital.com/blog every Friday for our latest notes on items of interest for our clients and the investment community in general.

EXECUTIVE SUMMARY

The markets in the third quarter were mixed for stock and fixed income investors, while commodities appear to be entering a bear market. Equities remained at or near all-time highs during the quarter despite minor gains in both the S&P 500 (up 0.6%) and the Dow Jones (up 1.28%). Year to date, the S&P and Dow are up 6.7% and 2.8%, respectively, thanks to continued economic progress and Federal Reserve assurances that interest rate hikes will not occur for some time. While RDM Capital's composite of equity accounts also was virtually flat (down less than 1%) in the quarter, the composite has returned 7.1% year to date, outperforming the S&P 500 and the Dow. Despite looming interest rate hikes down the road, fixed income continued to hold up well, as geopolitical tensions and poor economic data in Europe and China led investors to the perceived safety of less volatile fixed income investments. Finally, commodity-based investments (crude oil in particular) were under pressure due to the strengthening of the U.S. dollar and concerns about non-U.S. economies.

In this third quarter market commentary, we take an in depth look at each asset class and provide our take on the markets in the months to come.

EQUITY MARKETS

Equity Markets Edged Higher In The Third Quarter Amid Improved Economic Data

Despite increased market volatility in September, the S&P 500 gained 0.6% in the third quarter, marking the seventh quarterly gain in a row. Leading the markets performance was the technology sector with a 10.6% total return in the third quarter. Other strong sectors were the financial services sector, which gained 4.63% in the quarter, along with real estate stocks, which gained 7.46% and the basic materials sector, which saw a 4.19% gain. Healthcare and energy stocks, with an 11.27% and 11.83% return year to date, respectively, are two of the best performing sectors in 2014 and are also two of the most heavily weighted sectors in the RDM Capital composite of client equity accounts.

Equities have remained near record highs despite a string of negative geopolitical developments in recent months, which have hampered some overseas markets. Strengthening economic growth in the United States – second quarter GDP came in at 4.6% - and the Fed's low interest rate policies have supported domestic equities in particular. Low inflation in our economy means that, as communicated by the Fed, interest rates will remain low for a considerable amount of time even after the end of the Fed's quantitative easing program this year. The Fed's accommodation has supported asset prices in the economic recovery of the past five years and low interest rates will continue the trend for the foreseeable future.

Despite the positive returns of the past quarter, the equity markets saw an increase in volatility as geopolitical tensions worsened in Ukraine, Israel, Iraq and Syria. The string of military incursions added to investor concerns with the pace of economic growth in Europe, as well as the slowdown in growth in China, and the implications that such tensions may have on an already feeble economic situation abroad. Specifically, an escalation in economic sanctions by and against Russia could further dampen the economic situation in Europe through a reduction in international trade between Russia and western European nations and/or a decrease in oil and gas supplies from Russia.

While the economic situation in Europe is gloomy, indications that the European Central Bank may be willing to play a more direct role in stimulating the Eurozone economy through asset purchases of sovereign debt assured some investors in the quarter. However, Europe is much farther behind in supplying accommodation than the United States and the effectiveness of asset purchases in Europe is less certain, due to conflicting sovereign interests among member nations and a more complex, intertwined banking system in the Eurozone. A common concern with asset purchase programs, particularly among more conservative Eurozone nations like Germany, is the potential to stoke inflation. However, with inflation running at just 0.3% year over year in September, well below the 2% rate targeted by the ECB, the ECB should have room to begin quantitative easing in the Eurozone.

Our Take: We believe the U.S. equity markets are fairly priced at the moment. They are not as attractively under-valued as they were earlier in the economic recovery, but we do not believe that equities are on the whole over-priced. It is truly a stock-picker's market – a market that will see specific sectors or companies perform based on fundamentals rather than a market moving based on unique mass trading events or crises that affect all segments of the market at the same time.

The S&P 500's year-to-date performance of 6.7% is on pace to finish the year at the approximately 9% return that we forecasted at the beginning of the year. As expected, the U.S. economy continues to slowly grind higher, with corporate profits responding in suit. While some are concerned that the Fed has not set a precise timeframe for raising rates, we think the Fed is acting prudently by waiting for the data to signal that the economy can withstand higher rates.

As the risk subsides that the Fed will prematurely withdraw monetary support for the economy, and corporate profits continue to improve, we believe that U.S. equity markets will outperform other investments in the mid- to long-term.

FIXED INCOME

End of QE Arrives and Rate Rise Looms

We have outlined the impact that the end of the Federal Reserve's quantitative easing program ("QE") will have on the fixed income markets in several prior market commentaries. However, given the sluggish European economies and geopolitical tensions in recent months, as well as the Fed's forward guidance that interest rates will remain low for an extended period of time, U.S. treasuries have rallied in 2014 while interest rates have fallen (bond prices and yields move in opposite directions). The benchmark 10 year Treasury note saw a significant decline in yield during the third quarter before rebounding to finish the quarter at 2.49%, compared to approximately 3% at the beginning of the year.

While most bonds have held up fairly well in the face of an imminent rising interest rate environment, some cracks have appeared in segments of the fixed income market. Recently, high yield or "junk" bonds have come under pressure. Typically, the highest yielding and longest duration investments are the most sensitive to rising interest rates. Further, economic sluggishness will also impact high yield bonds, as these bonds are the most "equity-like" of the fixed income products. Because high yield issuers are usually of lower credit-quality and, therefore, more risky, junk bonds tend to be sensitive to the economy. An economic downturn would be more likely to cause a junk bond issuer to default on its debt than a AAA rated issuer, for example.

Our Take: We believe the fixed income markets will likely stabilize around their current levels for the next six to nine months, prior to the Fed hiking rates, depending on developments in geopolitical crises such as Ukraine-Russia, Iraq-Syria and Israel-Palestine. Returns in fixed income markets will also depend on upcoming economic data releases in Europe and China, which in 2014 has supported fixed income prices in the United States, due to weakness in those economies relative to the domestic economy. Improved economic growth in the U.S. has made American debt more attractive compared to many other nations.

Within the next twelve months, we expect to see the Fed begin to slowly raise rates. We currently seek to limit exposure to fixed income positions in client accounts, as future rate increases will depreciate the value of fixed income holdings, particularly those with longer durations and higher yields. After rates rise, however, we intend to re-evaluate client portfolios and consider high quality corporate bonds at higher yields than currently available, consistent with our clients' return objectives and risk tolerances.

Commodities Enter Bear Market Due to Europe, China

A strengthening U.S. dollar, increased commodity supplies, and fears about the pace of global economic growth combined to send commodity prices downward into bear market territory during the third quarter.

Since many commodities are traded in U.S. dollars, commodities and commodity sensitive equities will be very sensitive to currency fluctuations of the dollar relative to the rest of the world. Three main factors combined to cause an appreciation of the dollar vis-à-vis the euro and other foreign currencies: 1) the tightening of U.S. monetary policy through the end of the Federal Reserve's quantitative easing program, 2) the increased likelihood of more aggressive monetary stimulus measures by the European Central Bank and 3) improved domestic economic data. Due to these factors, the dollar has appreciated from 1.37 EUR/USD at the start of the third quarter to 1.26 EUR/USD at the close of the third quarter.

Further contributing to the commodity declines of the third quarter are increased supplies of many major commodities. The crude oil market has seen especially noteworthy declines. The technological breakthroughs in drilling for oil and natural gas experienced in this country are well documented. These breakthroughs have led to the United States catapulting to become the top producer of natural gas in the world and the third largest producer of oil. However, in recent months, increased Libyan oil production and decreased global demand for oil have led to increased oil supplies and significant declines in crude oil prices. For example, the 2014 peak for Brent crude oil occurred on June 19th at $115 per barrel and prices have since declined to under $95 per barrel at the end of the quarter, a nearly 20% decline after a prolonged period of low price volatility.

Our Take: We are mildly bearish on commodity prices in the near term, but bullish on the outlook for commodities over the medium to longer term. In the short term, a stronger dollar and sluggish economic growth in Europe (and to a lesser extent the United States) will continue to depress commodity prices. However, we believe commodities such as oil and other basic materials will rise as inflation eventually kicks in due to the enormous influx of liquidity injected into the financial system by central banks around the world. While the U.S. has wrapped up its quantitative easing stimulus efforts, the ECB is at the precipice of embarking on its own asset purchase program, which to this point has faced opposition from the more conservative Euro-zone nations like Germany. At RDM, we have shifted some client assets towards more commodity-sensitive investments as we remain vigilant about inflationary conditions down the road.