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CAPITAL MANAGEMENT

Q1

Quarterly Market Review

First Quarter 2014

Quarterly Market Review

First Quarter 2014

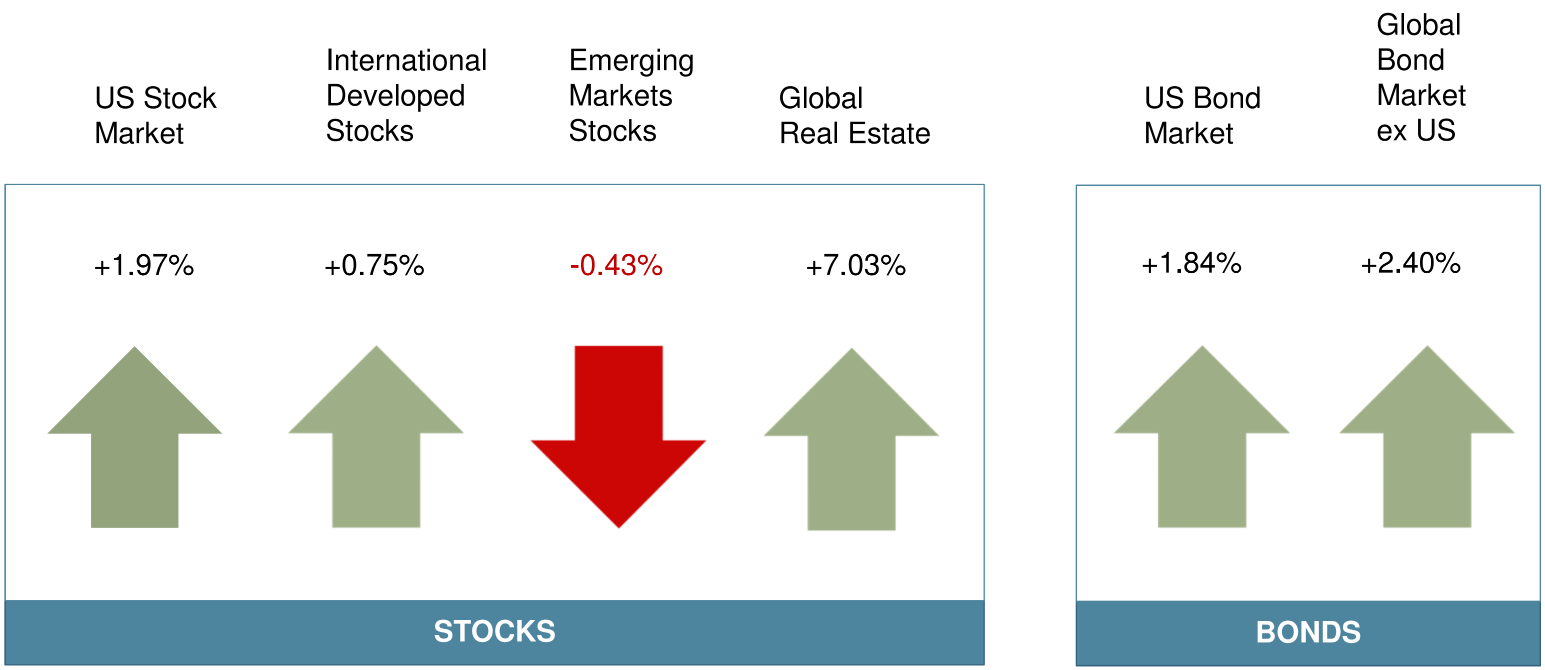
This report features world capital market performance and a timeline of events for the last quarter. It begins with a global overview, then features the returns of stock and bond asset classes in the US and international markets.

The report also illustrates the performance of globally diversified portfolios and features a topic of the quarter.

Overview:

Market Summary

First Quarter 2014 Index Returns



Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index), US Bond Market (Barclays US Aggregate Bond Index), and Global Bond ex US Market (Citigroup WGBI ex USA 1−30 Years [Hedged to USD]). The S&P data are provided by Standard & Poor's Index Services Group. Russell data © Russell Investment Group 1995–2013, all rights reserved. MSCI data © MSCI 2013, all rights reserved. Barclays data provided by Barclays Bank PLC. Citigroup bond indices © 2013 by Citigroup. US long-term bonds, bills, and inflation data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

World Stock Market Performance

MSCI All Country World Index with selected headlines from Q1 2014

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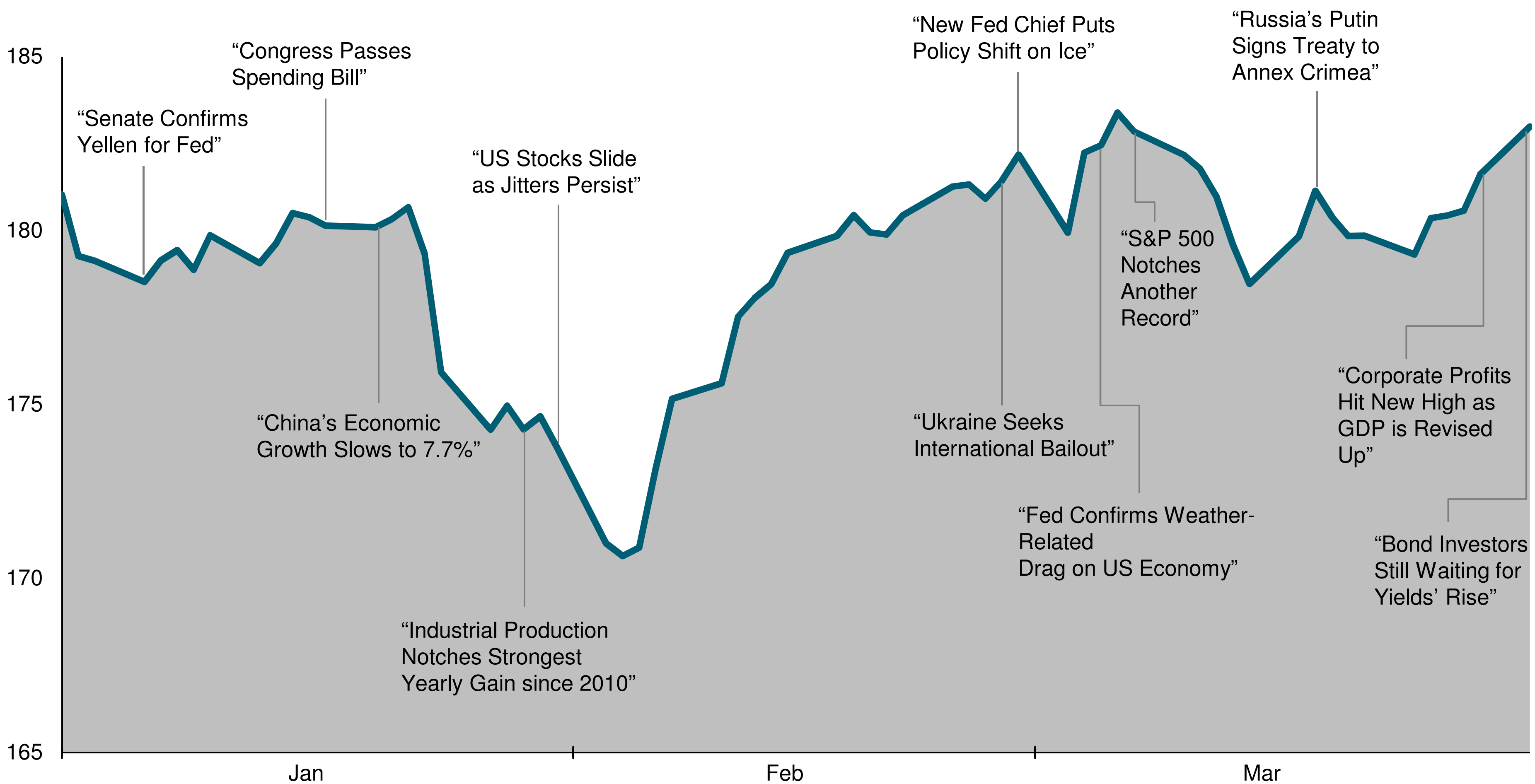


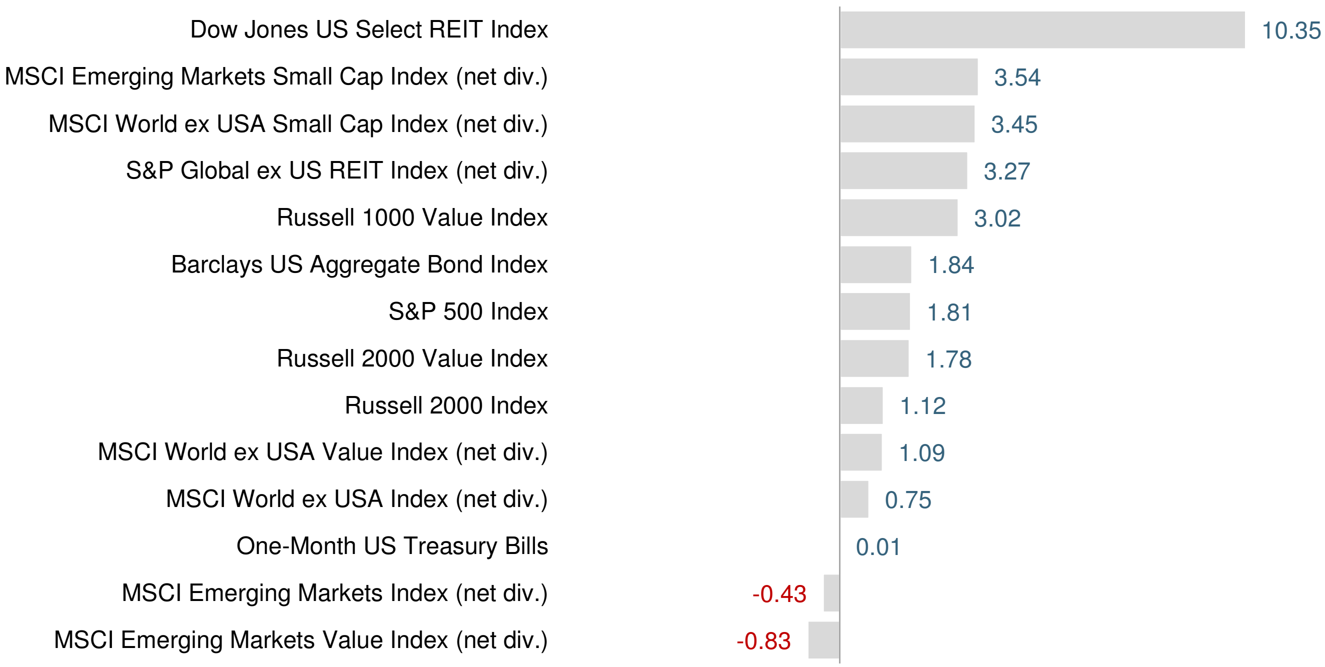
These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a longer-term perspective and avoid making investment decisions based solely on the news.

It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

World Asset Classes

First Quarter 2014 Index Returns

US REITs rebounded in the first quarter after declining in Q4 2013. Equity returns were mostly positive but lower than they were during much of 2013. While large caps in emerging markets lagged other equity asset classes, small caps in emerging markets were the top performers.



Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
Market segment (index representation) as follows: US Large Cap (S&P 500 Index); US Small Cap (Russell 2000 Index); US Small Cap Value (Russell 2000 Value Index); US Value (Russell 1000 Value Index); US Real Estate (Dow Jones US Select REIT Index); Global Real Estate (S&P Global ex US REIT Index); International Developed Large, Small, and Value (MSCI World ex USA, ex USA Small, and ex USA Value Indexes [net div.]); Emerging Markets Large, Small, and Value (MSCI Emerging Markets, Emerging Markets Small, and Emerging Markets Value Indexes); US Bond Market (Barclays US Aggregate Bond Index); and Treasury (One-Month US Treasury Bills). The S&P data are provided by Standard & Poor's Index Services Group. Russell data © Russell Investment Group 1995–2013, all rights reserved. MSCI data © MSCI 2013, all rights reserved. Dow Jones data (formerly Dow Jones Wilshire) provided by Dow Jones Indexes. Barclays data provided by Barclays Bank PLC. US long-term bonds, bills, and inflation data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

US Stocks

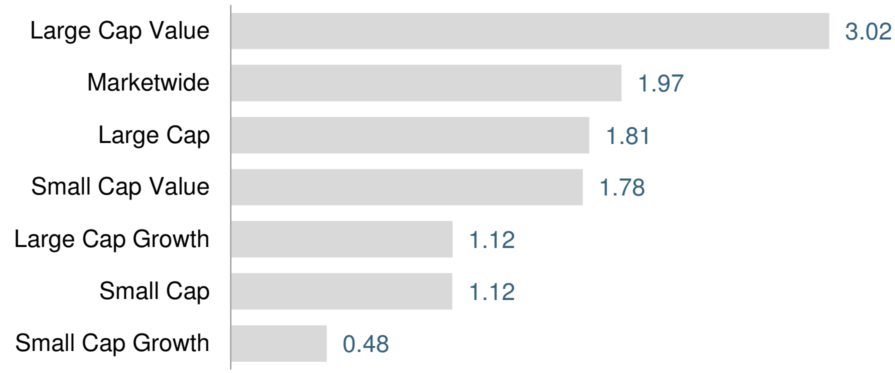
First Quarter 2014 Index Returns

Following strong performance during 2013, the US equity market delivered modest positive returns in the first quarter.

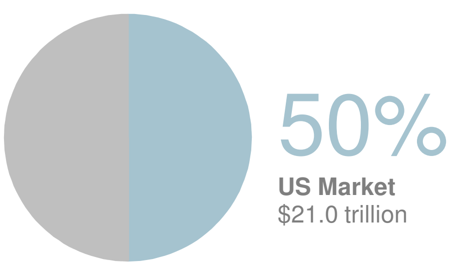
Value indices generally outperformed growth indices across all size categories.

Across the size dimension, large caps outperformed small caps.

Ranked Returns for the Quarter (%)



World Market Capitalization—US



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Marketwide	1.97	22.61	14.61	21.93	7.86
Large Cap	1.81	21.86	14.66	21.16	7.42
Large Cap Value	3.02	21.57	14.80	21.75	7.58
Large Cap Growth	1.12	23.22	14.62	21.68	7.86
Small Cap	1.12	24.90	13.18	24.31	8.53
Small Cap Value	1.78	22.65	12.74	23.33	8.07
Small Cap Growth	0.48	27.19	13.61	25.24	8.87

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Market segment (index representation) as follows: Marketwide (Russell 3000 Index), Large Cap (S&P 500 Index), Large Cap Value (Russell 1000 Value Index), Large Cap Growth (Russell 1000 Growth Index), Small Cap (Russell 2000 Index), Small Cap Value (Russell 2000 Value Index), and Small Cap Growth (Russell 2000 Growth Index). World Market Cap: Russell 3000 Index is used as the proxy for the US market. Russell data The S&P data are provided by Standard & Poor's Index Services Group.

International Developed Stocks

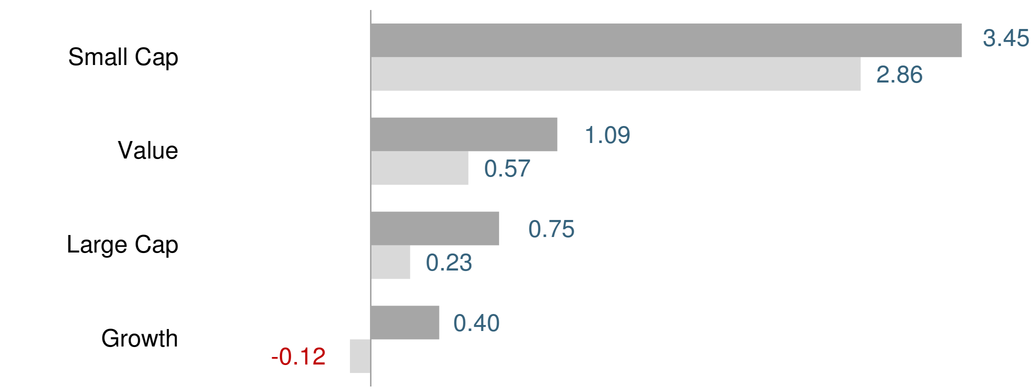
First Quarter 2014 Index Returns

During the first quarter, international developed markets continued to post positive performance. Small caps outperformed large caps.

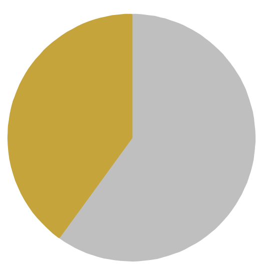
Value indices outperformed growth indices across all size segments.

The US dollar depreciated relative to many of the major international developed currencies.

Ranked Returns for the Quarter (%)



World Market Capitalization—International Developed



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	0.75	16.46	6.27	15.88	6.71
Small Cap	3.45	21.12	7.54	21.51	8.41
Value	1.09	19.08	6.57	16.39	6.71
Growth	0.40	13.88	5.94	15.33	6.63

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Market segment (index representation) as follows: Large Cap (MSCI World ex USA Index), Small Cap (MSCI World ex USA Small Cap Index), Value (MSCI World ex USA Value Index), and Growth (MSCI World ex USA Growth). All index returns are net of withholding tax on dividends. World Market Cap: Non-US developed market proxies are the respective developed country portions of the MSCI All Country World IMI ex USA Index. Proxies for the UK, Canada, and Australia are the relevant subsets of the developed market proxy.

Emerging Markets Stocks

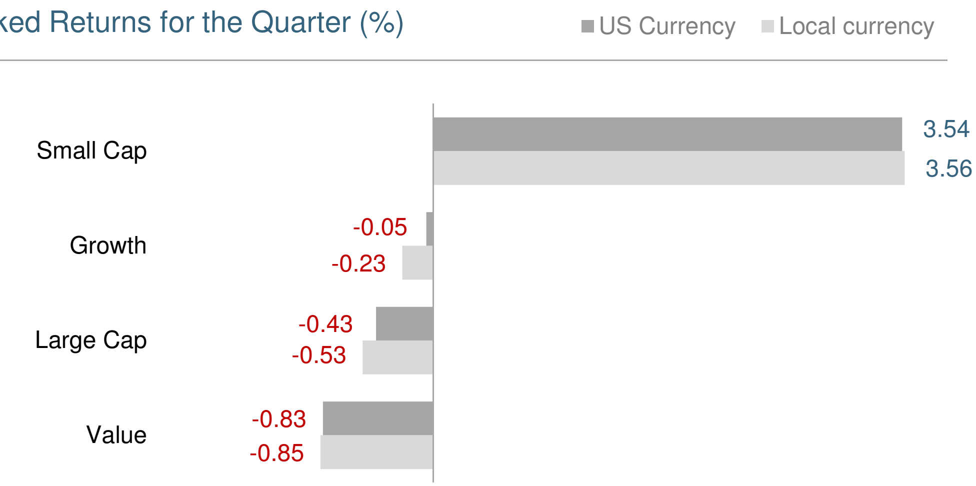
First Quarter 2014 Index Returns

Emerging markets generally lagged the US and non-US broad market indices during the first quarter.

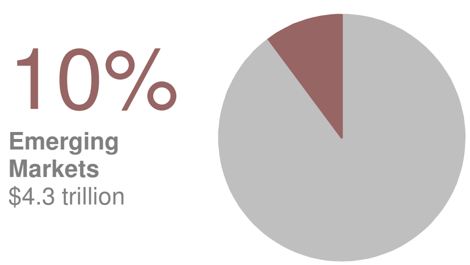
Small caps significantly outperformed large caps, and value underperformed growth across all size ranges.

Emerging markets currencies were mixed vs. the US dollar, with some of the major currencies seeing wide differences against the dollar.

Ranked Returns for the Quarter (%)



World Market Capitalization—Emerging Markets



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	-0.43	-1.43	-2.86	14.48	10.11
Small Cap	3.54	0.40	-1.45	19.70	11.50
Value	-0.83	-3.60	-4.51	13.76	10.82
Growth	-0.05	0.66	-1.26	15.15	9.35

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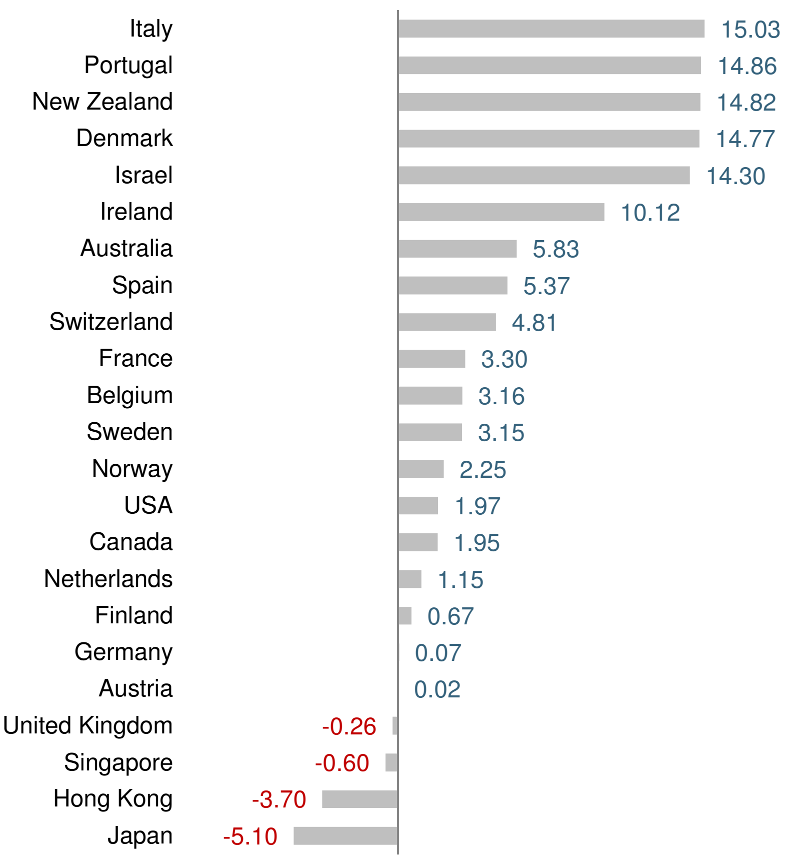
Market segment (index representation) as follows: Large Cap (MSCI Emerging Markets Index), Small Cap (MSCI Emerging Markets Small Cap Index), Value (MSCI Emerging Markets Value Index), and Growth (MSCI Emerging Markets Growth Index). All index returns are net of withholding tax on dividends. World Market Cap: Emerging markets proxies are the respective emerging country portions of the MSCI All Country World IMI ex USA Index.

Select Country Performance

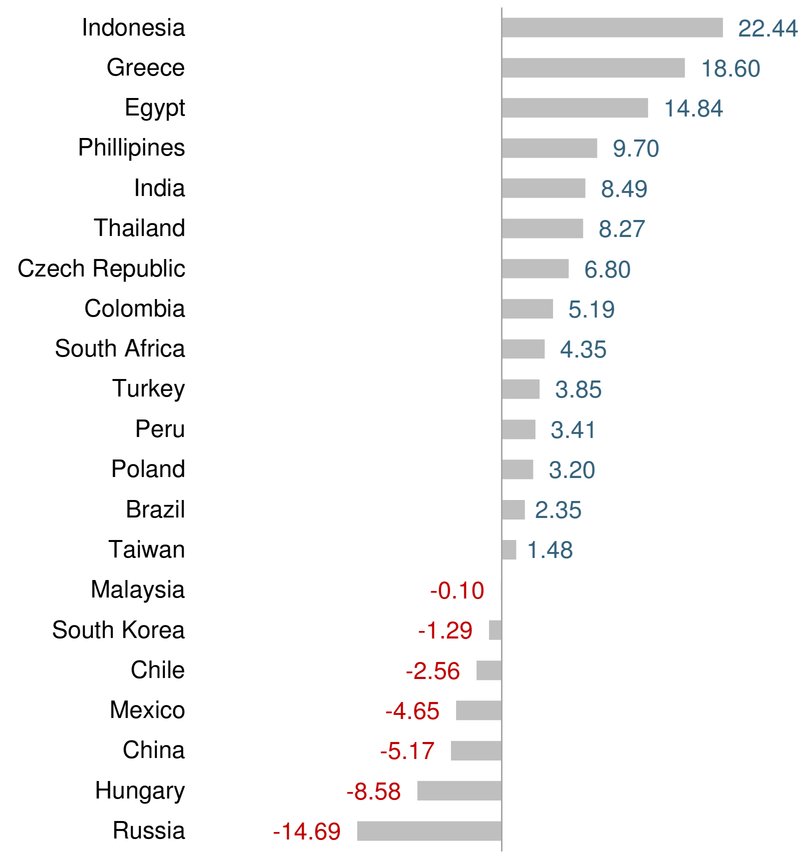
First Quarter 2014 Index Returns

Italy and Greece continued to record strong returns for the quarter; Italy was the best-performing developed market. Indonesia was the best- performing emerging market. With Russia's recent military action and political unrest dominating news headlines, the Russian equity market recorded the lowest return in US dollar terms.

Developed Markets (% Returns)



Emerging Markets (% Returns)



Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
Country performance based on respective indices in the MSCI World ex US IMI Index (for developed markets), Russell 3000 Index (for US), and MSCI Emerging Markets IMI Index. All returns in USD and net of withholding tax on dividends. Greece has recently been reclassified as an emerging markets country by MSCI, effective November 2013.

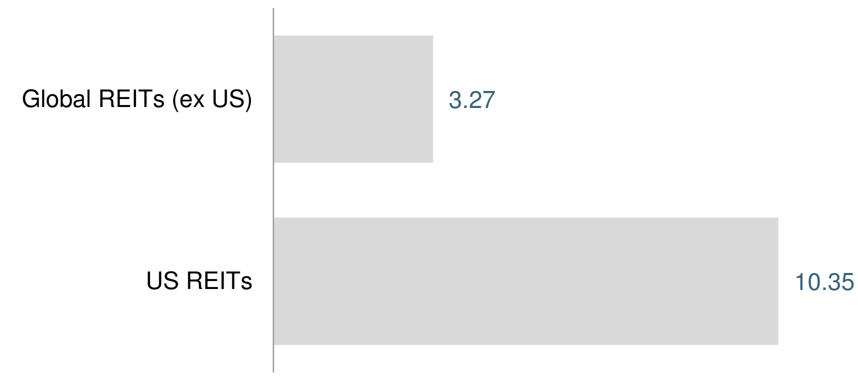
Real Estate Investment Trusts (REITs)

First Quarter 2014 Index Returns

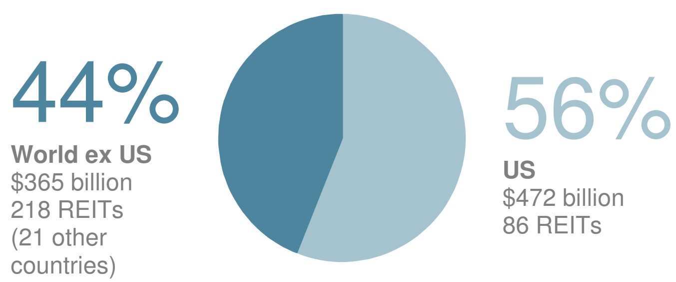
In a turnaround from 2013, REITs performed strongly during the quarter, particularly in the US.

Large cap REITs in the UK and Australia helped the performance of REIT securities outside the US.

Ranked Returns for the Quarter (%)



Total Value of REIT Stocks



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
US REITs	10.35	4.35	10.27	28.92	8.05
Global REITs (ex US)	3.27	-1.59	6.91	19.82	5.98

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Dow Jones US Select REIT Index data provided by Dow Jones ©. S&P Global ex US REIT Index data provided by Standard and Poor's © 2013.

Commodities

First Quarter 2014 Index Returns

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Commodities regained ground during the first quarter. The DJ-UBS Commodity Index rose approximately 7%.

Coffee, the biggest gainer in the index, returned just over 58%, which helped soft commodities generate significant positive returns as a group.

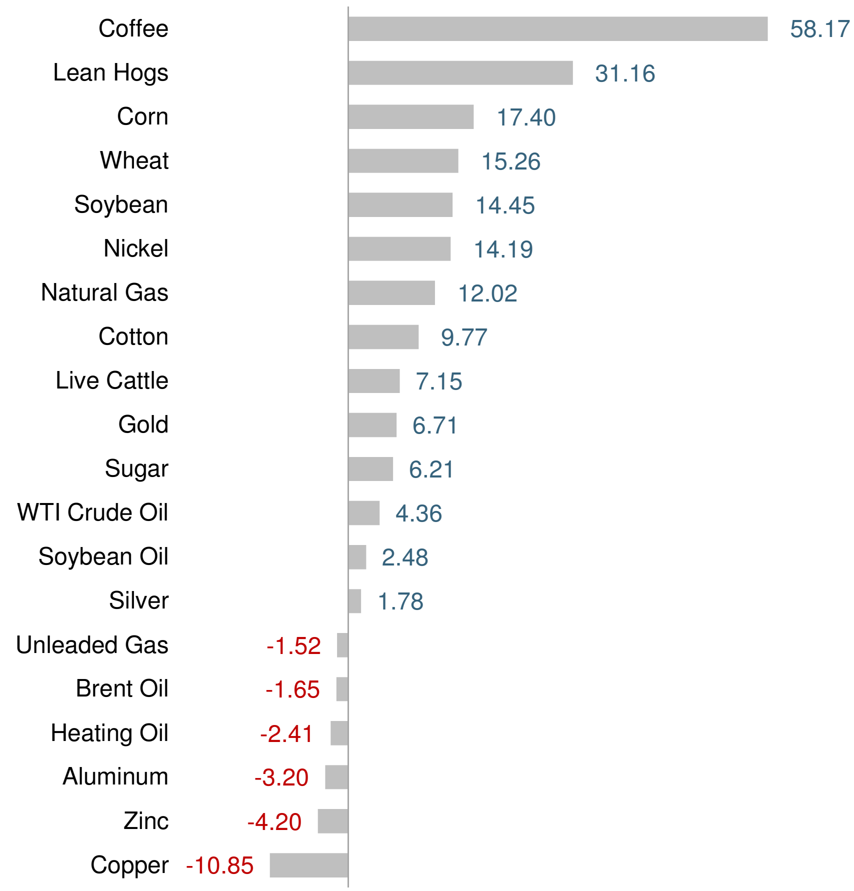
The energy complex produced mixed results. Gains in natural gas were somewhat offset by declines in gasoline and heating oil prices.

Period Returns (%)

** Annualized*

Asset Class	YTD	Q1	1 Year	3 Years*	5 Years*	10 Years*
Commodities	6.99	6.99	-2.10	-7.37	4.24	0.43

Individual Commodity (% Returns)



Past performance is not a guarantee of future results. Index is not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.
All index returns are net of withholding tax on dividends. Dow Jones-UBS Commodity Index Total Return data provided by Dow Jones ©.

Fixed Income

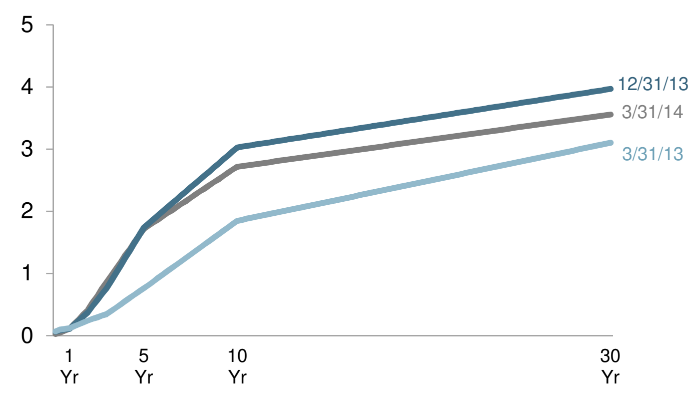
First Quarter 2014 Index Returns

In her first meeting as chair of the Federal Reserve, Janet Yellen announced that the Federal Open Market Committee (FOMC) will taper its monthly asset purchases from $65 billion to $55 billion. The Fed continued to maintain an accommodative stance through monetary policy, holding the federal funds target rate range at 0.00–0.25%. US interest rates generally fell during the quarter.

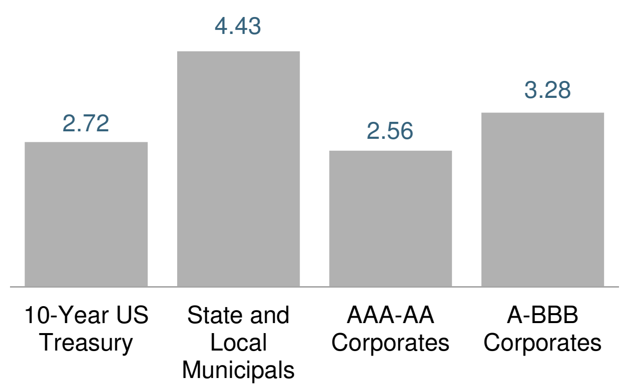
Broad US bond market returns were positive. The Barclays US Aggregate Bond Index advanced 1.8% during the quarter. Spread sectors, including corporate bonds, performed well, generating solid excess returns over Treasuries. Lower-quality bonds outperformed their higher-quality counterparts.

TIPS recovered somewhat from their 2013 decline. Municipal bonds generated solid returns.

US Treasury Yield Curve



Bond Yields across Different Issuers



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
BofA Merrill Lynch Three-Month US Treasury Bill Index	0.01	0.07	0.08	0.12	1.65
BofA Merrill Lynch 1-Year US Treasury Note Index	0.08	0.26	0.33	0.56	2.03
Citigroup WGBI 1–5 Years (hedged to USD)	0.55	0.93	1.94	1.82	3.12
Long-Term Government Bonds	5.30	-4.49	7.66	4.29	6.03
Barclays US Aggregate Bond Index	1.84	-0.10	3.75	4.80	4.46
Barclays US Corporate High Yield Index	2.98	7.54	9.00	18.25	8.68
Barclays Municipal Bond Index	3.32	0.39	5.79	5.71	4.45
Barclays US TIPS Index	1.95	-6.49	3.50	4.91	4.53

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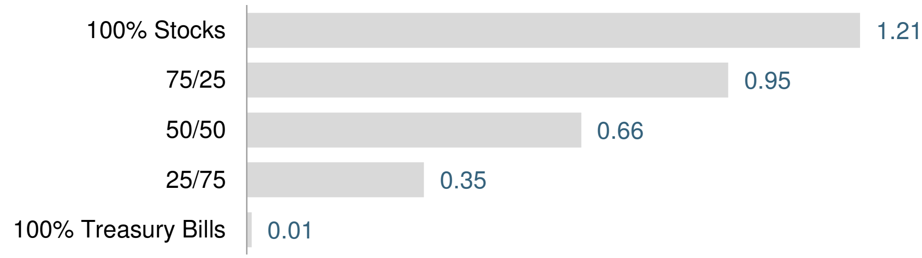
Global Diversification

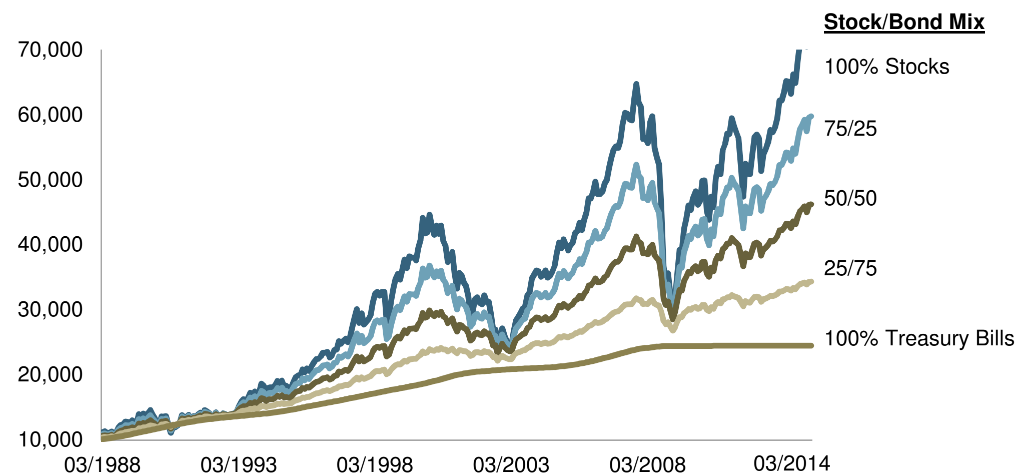
First Quarter 2014 Index Returns

These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but also have higher expected returns over time.

Ranked Returns for the Quarter (%)



Growth of Wealth: The Relationship between Risk and Return



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
100% Stocks	1.21	17.17	9.14	18.43	7.53
75/25	0.95	12.76	7.01	13.84	6.28
50/50	0.66	8.43	4.77	9.24	4.86
25/75	0.35	4.19	2.44	4.64	3.27
100% Treasury Bills	0.01	0.03	0.04	0.06	1.52

Diversification does not eliminate the risk of market loss. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management an actual portfolio. Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals.

Not Rocket Science

First Quarter 2014

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When the media raises the subject of beating the market through astute stock picking, the name Warren Buffett is usually cited. But what does this legendary investor actually say about the smart way to invest?

Buffett is considered to have such a track record of picking stock winners and avoiding losers that his annual letter to shareholders in his Berkshire Hathaway conglomerate is treated as a major event by the financial media.[1]

What does he think about the Federal Reserve taper? What could be the implications for emerging markets of a Russian military advance into Ukraine? What does an economic slowdown in China mean for developed markets?

Buffett has a neat way of parrying these questions from journalists and analysts. Instead of offering instant opinions about the crisis of the day, he recounts in his most recent annual letter a folksy story about a farm he has owned for nearly 30 years.[2]

Has he laid awake at night worrying about fluctuations in the farm's market price? No, says Buffett, he has focused on its long-term value. And he counsels investors to take the same sanguine, relaxed approach to liquid investments such as stocks as they do to the value of their family home.

"Those people who can sit quietly for decades when they own a farm or apartment house too often become frenetic when they are exposed to a stream of stock quotations," Buffett wrote. "For these investors, liquidity is transformed from the unqualified benefit it should be to a curse."

While many individuals seek to ape Buffett in analyzing individual companies in minute detail in the hope of finding a bargain, he advocates that the right approach for most people is to let the market do all the work and worrying for them.

"The goal of the non-professional should not be to pick winners," Buffett wrote. "The 'know-nothing' investor who both diversifies and keeps his costs minimal is virtually certain to get satisfactory results."

As to all the predictions out there about interest rates, emerging markets, or geopolitics, there will always be a range of opinions, he says. But we are under no obligation to listen to the media commentators, however distracting they may be.

"Owners of stocks . . . too often let the capricious and irrational behavior of their fellow owners cause them to behave irrationally," Buffett wrote. "Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits—and, worse yet, important to consider acting upon their comments."

The Buffett prescription isn't rocket science, as one might expect from an unassuming, plainspoken octogenarian from Nebraska. He rightly points out that an advanced intellect and success in long-term investment don't necessarily go together.

"You don't need to be a rocket scientist," he has said. "Investing is not a game where the guy with the 160 IQ beats the guy with 130 IQ."[3]

1. "Buffet Warns of Liquidity Curse," Bloomberg, Feb 25, 2014.
2. Berkshire Hathaway Inc. shareholder letter, 2013, www.berkshirehathaway.com/letters/2013ltr.pdf.
3. "The wit and wisdom of Warren Buffett," Fortune, November 19, 2012, management.fortune.cnn.com/2012/11/19/warren-buffett-wit-wisdom/.