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The Financial Counselors

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INVESTMENT LETTER – FOURTH QUARTER, 2014

Interest Rates, the Dollar, Oil, Deflation, Russia, Venezuela, China, Japan and Europe (Rebalancing Portfolios in an Unbalanced Financial Marketplace)

Financial Markets are always attempting to correct imbalances and establish new levels of price equilibrium. In the course of events, whether seeking a new level for oil and/or global equities, disorder disrupts equilibrium, and the re-pricing of risk (and opportunity) occurs. As market valuations increase, a classic investor error is to let risk levels rise, and allow unrealized gains to run. Often, the companion to this is panic selling during inevitable periods of decline. Responding to these short-term shifts in market direction, attempting to time market trends, inevitably is self-defeating. Roller coaster investor psychology often lures one to abandon sensible regimens earlier agreed to in more rational settings. At times like today, the temptation to abandon time-tested disciplines aimed at achieving market-comparable total returns seems hard to resist.

One time-tested palliative to moderate portfolio risk is asset class diversification--an investment tenet, as readers of these letters know, that is one of the primary ingredients in the firm's portfolio management approach. This modus operandi, coupled with periodic disciplined rebalancing, over the long-term has proven to be a technique which produces competitive risk-adjusted performance for individuals.

In the US, the equity bull market, which in retrospect began on March 9, 2009, topped 18,000 on the Dow Jones Industrial Index last week (2,122 days from the bottom). During the year just ended, Jack Ma, as a result of Alibaba's initial public offering last fall, became the world's wealthiest ($96 billion) individual. It must have amused him in no small measure that this was achieved in the much maligned *capitalist bounders'* equity markets. Year-end 2014 completed the eighth straight quarter of positive results for the S&P 500 US large company stock index. As most are aware, US large companies were the star performers (S&P 500 Index rose 14% throughout the year). But, due to the strengthening dollar (see Currency chart which follows), globally diversified equity portfolios generally underperformed US-only stocks. As illustrated, the US Dollar Index against all currencies appreciated roughly 14% during 2014. Versus the yen, the dollar gained 15% (+36% over the past two years), against the Euro it rose 14%.

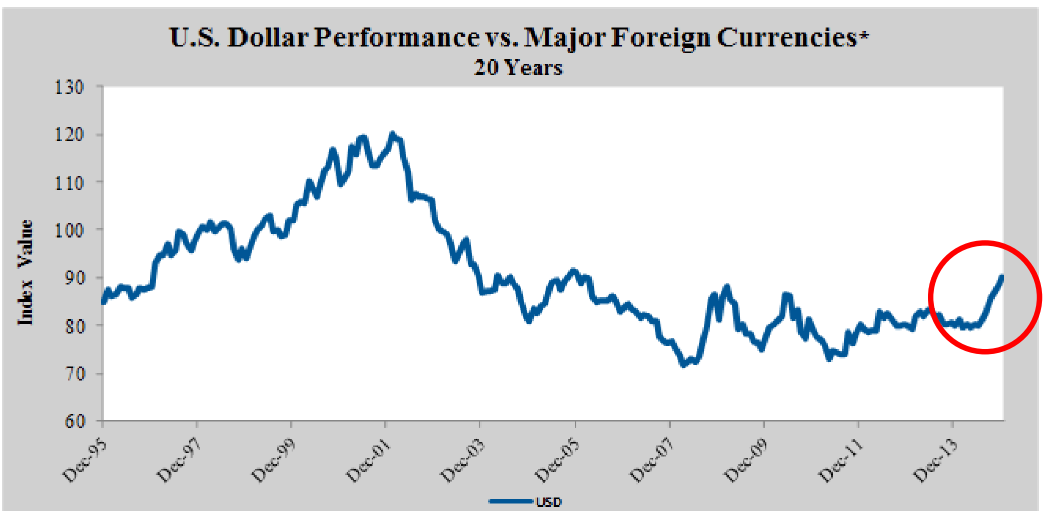
For globally diversified client portfolios, the impact of this dollar strength relative to foreign currency denominated international equities was a headwind of roughly 10.1% (i.e., the international equity proxy index was up 6.0% in local market currency terms, but declined 3.9% when translated into US dollars). Similar negative return spreads developed for Emerging Market against US equity positions.

In 2014, as a result of the US Dollar rally, generally lower returns from US small caps and international equities relative to US large cap stocks (one-third of total equities in our portfolio), our aggregate global equity portfolio returns were flat.

The Currency chart below illustrates the long term cyclical fluctuations of the US Dollar against a basket of major foreign currencies. In the past 5 years, the US Dollar has appreciated by 19.1% and by 11.6% in the past 10 years, reducing international investment returns to US investors. (When foreign investments and profits are converted back to US Dollars, weaker currencies buy fewer dollars.) However, during most (i.e., 2000-2008) of the previous decade the US Dollar devalued significantly which inversely boosted foreign investment returns.

Further, most notably, the US Dollar value is at the same relative level as 20 years ago! While the US Dollar may continue to appreciate in the near term, in our view it would be prudent to continue to hold non-dollar denominated securities for long-term currency, country and economic diversification.

Currency: U.S. Dollar Performance



Currrency	1 Year % Change	2 Year % Change	3 Year % Change	5 Year % Change	10 Year % Change	20 Year % Change
U.S. Dollar Index	**13.9**	**14.6**	**13.9**	**19.1**	**11.6**	**1.7**
USD vs. Euro	15.5	10.8	8.3	22.3	12.0	3.0
USD vs. British Pound Sterling	9.1	6.0	2.3	6.0	23.1	0.4
USD vs. Brazilian Real	10.8	29.8	44.5	53.5	0.1	214.1
USD vs. Russian Ruble	85.4	103.1	92.7	107.0	119.1	1610.9
USD vs. Japanese Yen	13.8	35.7	55.2	28.7	16.7	20.3
USD vs. Chinese Renminbi	2.5	-0.3	-1.7	-9.1	-25.0	-26.5

*Bloomberg data as of 12/31/2014

Big Brother's Concern: The IRS Is Set to Increase Its Share of Wallet and Federal Regulators Have Full Agenda for 2015

Unheralded at the beginning of 2014 (but which could become painfully evident to many clients sometime between now and April 15th) is that on January 1, 2014 the following tax increases occurred:

- Top Marginal Federal Income tax went from 35.0% to 39.6% (i.e., up 13%)
- Capital Gains tax rate went from 15% to 20% (up 33%) for top earners; including the Medicare surtax hike the rate went from 15% to 23.8% (up 59%)
- Dividend tax went from 15% to 20.0% (+33%)
- The top Medicare tax went from 1.45% to 2.35% (+62%)

So, for the Federal government at least, a tax revenue uptick is at hand. The fiscal deficit is moving in the right direction at the moment, but only for the moment. The real legislative battles over entitlement reforms are still to be mounted. On a positive note for Massachusetts residents, the personal income tax rate in 2015 drops to 5.15% from 5.20%.

As the US economy and equity markets continue to move into new high territory, regulators have many concerns to deal with. Trading volume and volatility will no doubt continue to escalate as speculation increases. Today, 95% of equity market volume is institutionally-generated, but 40% of this activity occurs in so-called "Black Pools" maintained by institutions to facilitate their own and other direct order matching outside of the exchanges. As such, this trading of large blocks is unregulated. Federal and state authorities need to unravel this behind-the-curtain activity, and at a minimum force public disclosure of these transactions in real time.

More directly affecting individual investors is the pending requirement (under the Dodd–Frank Wall Street Reform and Consumer Protection Act) that vendors of financial advice, investment products and transactions services reveal to their customers/clients whose interests are being served, and who benefits from, the arrangement the buyer is considering. Wall Street's "sell-side," in particular brokers (most now assuming the mantle of "financial consultant"), lobbying regulators charged with implementing the Dodd-Frank mandate, have succeeded in turning even Barney Frank on this one. The result is a watered-down proposed standard of ethical conduct so vague as to make the new fiduciary role rule almost meaningless. Interesting how effectively six-figure speaking fees at Florida winter conferences can alter one's point of view. If the Street's version of the proposed Dodd-Frank *fiduciary rule* prevails, buyer beware, more than ever, will have to be the investor's mantra.

Investor Behavior: A Key Variable in 2015 Financial Market Relative Valuations

In today's interconnected, instantaneous, networked, globally interactive financial markets, the perception of risk is re-priced almost continuously. The nature of the resulting transaction flows has changed considerably during the past ten to fifteen years. In the US, purchase and sale orders can be executed today through any of fifteen computerized exchanges, plus a variety of direct seller-buyer networks, or within "black box" facilitation nets, as well as directly through broker-dealer-owned positions and inventories. As most are aware, computerized high-frequency algorithmic trading models account for a majority of daily volume in both the stock and bond markets.

Investors (like military strategists drawing up plans to fight the next war with the last year's battle strategies and tactics in mind) are forever trying, and assume one can learn from recent experience. Many begin their investment decision-making process framed within a macroeconomic background; a reasonable starting point. But investment decisions are usually not linear in nature. And the dependent variables in the equation are always changing. Otto Eckstein, a professor of Economics in the writer's academic years and founder of Data Resources, as well as an early proponent of computerized econometric modeling, claimed to have identified 2,700 global micro-economic variables (many dependent) in his attempt to predict the future course of the US economy. But when he began his work in the early 1960s, he had to admit that consumer sentiment, investor behavior, geopolitical events, and policy shifts were not possible to program into even the most elaborate mainframe computerized financial market models of the era. It remains so today, despite the exponential increase in computing power.

In fact, one might argue that the more interconnected our financial markets become, the greater the potential resulting emotional swings in market momentum. Greed, fear, and impatience continue the non-quantifiable ingredients governing short-term investment market performance today. In the end, a consistent philosophy, attention to shifting relative asset class valuations, patience, and the willingness to stay focused on the longer view are the essentials of a successful investment approach.

As always, we welcome your comments and questions.

Sincerely,

Jim

Renée

James L. Joslin
Chairman, CEO & CCO

Renée Kwok
President

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Regional Performance (U.S. Dollar and Local Currencies)

As of 01/07/15

Name		2014	2013	2012	1 YR	3 YR	5 YR	10 YR*	F12 MO P/E
MSCI All Country World Index	USD	4.2	22.8	16.1	2.5	12.7	8.1	6.1	14.6
MSCI All Country World Index	Local	9.3	25.5	15.9	8.0	15.5	9.6	6.5	14.6
MSCI ACWI EX US	USD	-3.9	15.3	16.8	-6.1	7.5	3.2	5.1	13.0
MSCI ACWI EX US	Local	6.0	20.1	16.3	4.5	12.8	6.1	6.1	13.0
MSCI USA	USD	12.7	31.8	15.3	11.6	18.3	13.9	7.1	16.4
MSCI USA	Local	12.7	31.8	15.3	11.6	18.3	13.9	7.1	16.4
MSCI EAFE (Int'l Developed)	USD	-4.9	22.8	17.3	-8.1	9.5	4.0	4.4	13.6
MSCI EAFE (Int'l Developed)	Local	5.9	26.9	17.3	3.5	15.1	6.8	5.3	13.6
MSCI UK	USD	-5.4	20.7	15.3	-9.7	7.3	5.5	4.6	13.3
MSCI UK	Local	0.5	18.4	10.2	-1.7	8.1	6.7	6.8	13.3
MSCI Japan	USD	-4.0	27.2	8.2	-5.9	8.6	4.3	2.3	13.3
MSCI Japan	Local	9.5	54.6	21.6	7.4	25.6	9.6	3.9	13.3
MSCI EURO	USD	-8.3	28.3	21.6	-12.6	11.3	0.8	3.3	13.3
MSCI EURO	Local	4.4	22.7	19.7	0.7	14.1	4.8	4.5	13.3
MSCI Emerging Markets	USD	-2.2	-2.6	18.2	-0.6	3.1	1.0	8.4	11.0
MSCI Emerging Markets	Local	5.2	3.4	17.0	7.1	7.7	4.4	9.9	11.0
MSCI Far East	USD	2.8	2.7	20.2	5.5	7.7	4.6	9.2	10.8
MSCI Far East	Local	7.4	26.8	19.6	7.4	16.6	7.1	5.5	10.8
MSCI Latin America	USD	-12.0	-13.2	8.9	-12.4	-7.6	-6.3	9.6	12.4
MSCI Latin America	Local	-0.9	-4.6	12.2	-0.3	0.9	-0.1	10.4	12.4

Source: Bloomberg data

*As of 12/31/2014