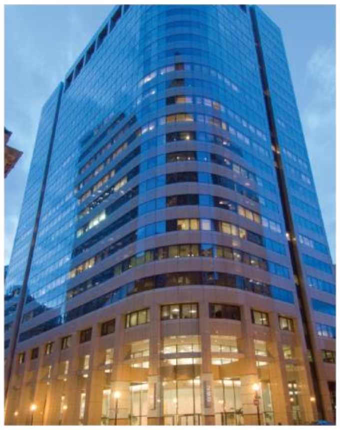
COMMENTARY | 1Q
APRIL 15, 2015

OUR VIEW



Prospective Portfolio Returns in a Diminished Economic Growth Environment

The financial media buzz of the moment focuses on why investors should lower their portfolio return expectations. For those following a globally diversified approach, this assertion tends to resonate with recent investment return results and much of the current punditry and cable network financial news (noise). For long-term investors, the sense of frustration is palpable as the sell-side trading crowd touts the need to find "alternative," more creative paths to enhanced potential returns. Confused by these conflicting views, investors can't be faulted for following a cautious, risk-averse approach.

The major global trading bloc economies (perhaps with the exception of China) remain burdened with debt incurred in 2008-2009 to bail out their financial sectors. Demographics (e.g., aging populations in Japan and declining fertility rates in the Western world), sagging labor productivity, increasingly ineffective central bank stimulative policies, and lack of constructive fiscal and tax reform programs all seem to conspire against improving secular circumstances. Compound the above with the acknowledged need to reduce 1st quarter 2015 US corporate earnings estimates because of a number of probably non-recurring headwinds, and investors can't be blamed for a less-than-sanguine attitude toward equities.

"Secular Stagnation" Ahead?

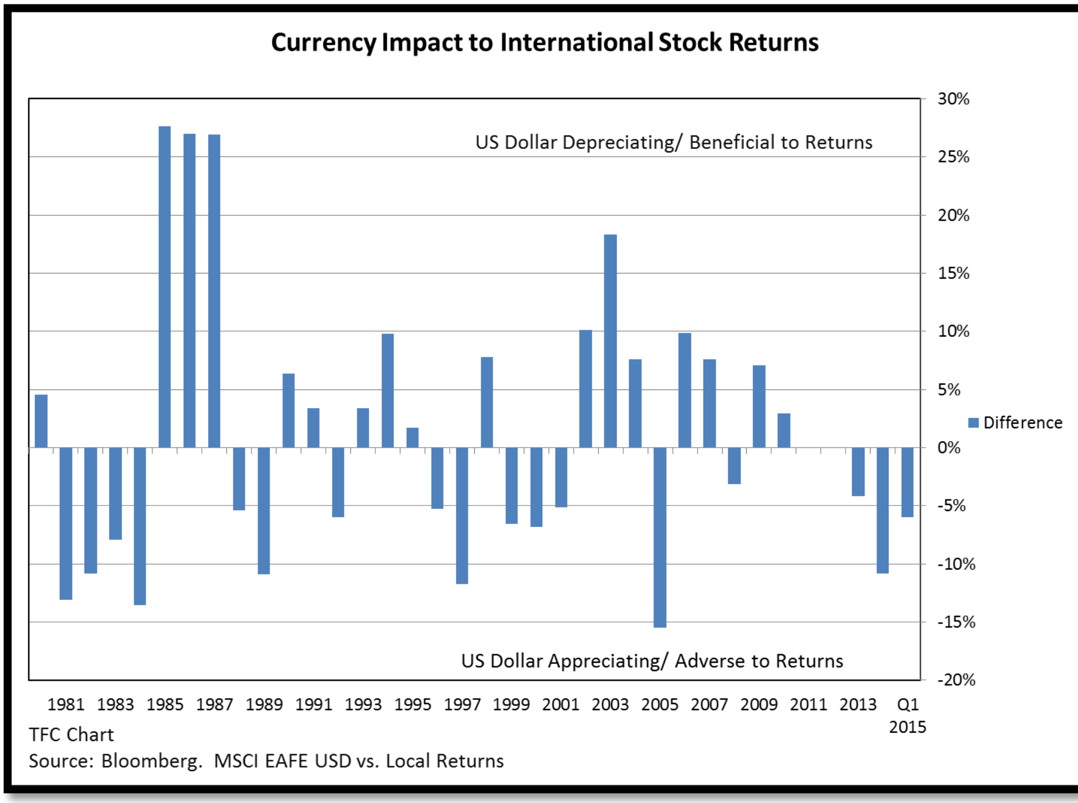
As always, it's hard not to run with the consensus, but at times like this taking a look at the other side of the coin, questioning why stock markets worldwide continue their 5-6 year upward trends into new record high territory, would appear timely.

Undeniably, the global economic and financial market recoveries, starting with the trough reached in March 9, 2009, are becoming a bit long in the tooth. But the slow, drawn-out economic turnaround, particularly in the US where escape velocity only now seems a possibility, has also been accompanied throughout by an uneasy improvement in investor sentiment which has tended to keep a lid on valuations. All this, of course, has been accomplished in an uncharacteristically low interest rate and inflationary setting. But, even though many equity markets around the globe reached new highs during the quarter ended March 31st, earnings multiples on prospective profits remain realistic by most historic measures.

Currency Does Matter

During the first three months of 2015, not unlike the second half of 2014, the US Dollar's rally continued (especially against the Euro), creating a 6% headwind for US investors in international stocks. Because of US Dollar strength relative to other foreign currencies, reduced earnings growth for larger US multinational corporations appears probable this year. Indeed such markdowns are already widely incorporated into most macro models and equity market valuation forecasts. Currency movements can have a dramatic impact on foreign stock returns for US investors. Going back 35 years, during some periods these swings have added over 25% to US investor returns, or have been as much as a 15% headwind to performance (see chart following).

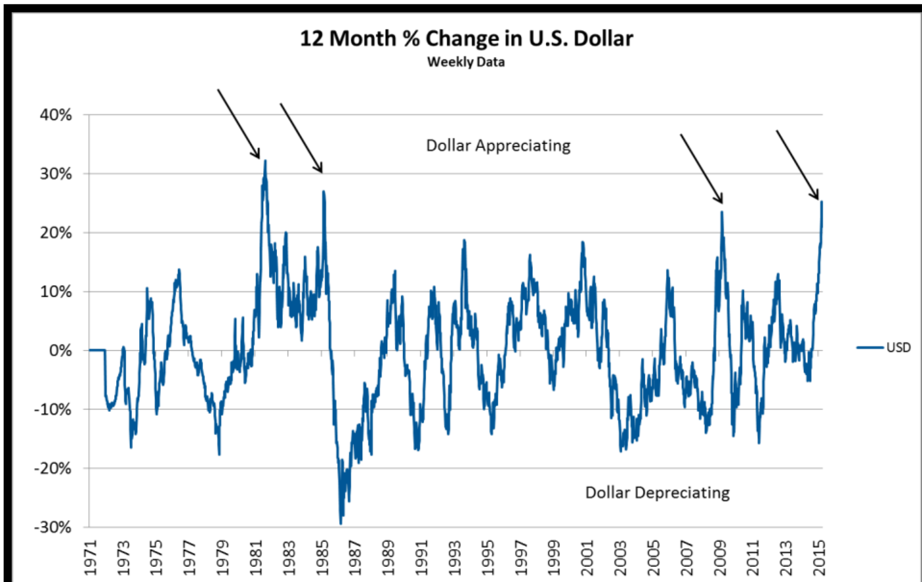
US Dollar Continues Its Rally



Even including its recent appreciation, the dollar has been in a long term downward trend starting in the early 1970's when the US left the gold standard. In fact, this declining relative dollar value has added roughly 1.0% per year to US investors' international equity returns over the entire period.

The dollar has appreciated approximately 20% over the last 12 months. While the size of the move is not unprecedented, *how quickly it occurred is unusual*. The following chart illustrates shifts of this magnitude took place only four times in the last 45 years. The IMF and NY Fed theorize that every 10% rise in the dollar reduces US GDP growth by 1-1.5 percentage points. Thus the recent 20% move could lower GDP growth by 2-3 percentage points during 2015-2016. Near term, this argues for the Fed to be more patient in raising short-term rates. Going forward, this could temper GDP growth which could, in turn, limit further US dollar appreciation.

US Dollar Appreciated More Than 20% in Past 12 Months

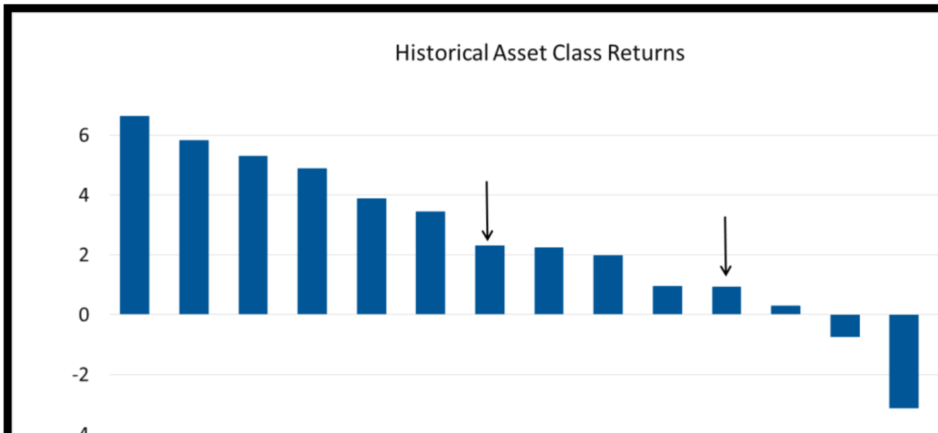


TFC Chart
Source: Bloomberg Data

Shifting Asset Class Returns

Asset class mix continues to be the dominant portfolio return driver.

International Equities Outperformed During the First Quarter



	US Small Growth	Intl. Small Growth	Intl. Small Value	Intl. Large Core	Intl. Value	Europe Stocks	Global Stocks	Emerging Markets	US Small Value	S&P 500	Short Term Bonds	Short Term Muni Bonds	US Large Value	Frontier Markets
QTD	6.6	5.8	5.3	4.9	3.9	3.5	2.3	2.2	2.0	1.0	0.9	0.3	(0.7)	(3.1)
2014	5.6	(4.6)	(5.3)	(4.9)	(5.4)	(6.2)	4.2	(2.2)	4.2	13.7	1.4	1.0	13.4	6.8
Full Cycle*	8.2	1.3	1.8	(0.6)	(1.4)	(1.0)	2.1	(1.9)	6.2	6.3	3.1	-	5.1	(3.6)

TFC Chart
Source: Bloomberg Data
* Full Cycle is the annualized return from October 2007 peak to present.

During the first quarter of 2015, most asset classes experienced positive returns. For US investors, global stocks, as measured by the MSCI ACWI Index were up 2.3% and short-term bonds 0.9%. Interestingly, over a complete market cycle from the peak in October 2007 to present, short-term bond returns have been 3.1% per year versus 2.1% for global stocks.

International developed country stocks returned 4.9% in the quarter. This contrasts with a US Dollar-adjusted international stock relative underperformance for 2014 of -4.9% versus 13.7% for US large company stocks. Emerging market performance was in-line with global stocks for the 3/31/15 quarter returning 2.2%, however, frontier markets exposure was a drag declining -3.1%. In addition, the Templeton Frontier Market fund underperformed its benchmark.

In terms of investment style, small company stocks in the US, developed country and emerging markets all performed well and added to portfolio performance during the quarter. Returns for small company stocks ranged from 2.0% to 6.6% depending on the market (US, developed or emerging) and style (growth vs. value).

Value stocks lagged both core and growth stocks for the quarter. This continues the trend of underperformance from 2014 and over the full market cycle. Since October 2007, US small company growth stocks were the best performing asset class returning 8.2% per year versus global stocks and S&P 500 stocks returning 2.1% and 6.3% respectively.

Recent Portfolio Activity

Investment Portfolio Changes

Late in 2010, we initiated a strategic investment allocation into Frontier Market (FM) countries. Frontier Markets are countries not included in the developed or emerging market indices. MSCI includes 24 countries in its Frontier Markets Index, representing 0.5% of the total global stock market. The largest members include Argentina, Kenya, Kuwait, Kazakhstan, Morocco, Nigeria, Oman, Pakistan, and Vietnam.

Generally these countries tend to: exhibit higher economic growth rates than developed and emerging market countries, have favorable demographics for continued growth, high domestic demand growth and have become the source for global low-cost manufacturing. Currently, these economies make up 6% of global GDP, but are projected to grow at twice the pace of developed markets and close to 40% above emerging markets for the foreseeable future.

From a valuation standpoint, a FM price/earnings ratio of 11.0 represents over 30% discount to the US (17.9x) and other developed markets (16.3x). As a group, FM shares currently trade at a 10% discount to the 12.3x emerging market P/E as well. The following table summarizes valuations relative to trailing 12-month earnings.

	Price to Earnings (x)*	Price to Book Value (x)	Dividend Yield (%)
U.S.	17.9	2.8	1.9
EAFE	16.3	1.6	3.0
Emerging Markets	12.3	1.5	2.7
Frontier Markets	11.0	1.6	4.0

*Trailing 12 months earnings per share

Source: Franklin Templeton

The MSCI Frontier Markets Index is highly concentrated both as to industries and individual countries. Financials currently make up 50% of the Index while 23% of the Index is invested in Kuwait and 16% in Nigeria. Furthermore, in 2014, Qatar and United Arab Emirates "graduated" out of the Frontier Markets index into the Emerging Markets index. Together these countries accounted for 30% of the index prior to the change. Given the high concentration and potential for large rebalancing swings, passive or indexed investment management approaches are not appropriate in Frontier Markets. We continue to believe a strategic allocation is warranted due to the compelling valuation differentials and potential increased macroeconomic growth. However, we will be switching fund managers for a number of reasons.

We have selected the Harding Loevner Frontier Emerging Markets Fund as a replacement for the Templeton Frontier Markets Fund. The firm was founded over 25 years ago and focuses on international and emerging market equities. Its portfolio is comprised of high-quality growth companies selected through fundamental research. The in-depth nature of the Harding Loevner due diligence and investment process, coupled with a low portfolio turnover style has combined to produce strong relative past results. The Fund's current holdings and composition reduces both energy and Middle East exposure; and the move will shift the portfolio towards Asia, a region which should benefit from the recent decline in energy and commodity prices.

Annually, at this time of year, Registered Investment Advisors (RIAs) like TFC are required to update our SEC disclosure reports. You will find attached a notice of our recent filing, as well as information about how to access this material. The firm takes these compliance requirements and our fiduciary responsibilities seriously. If you have any questions about these reports, please don't hesitate to contact us directly.

As always, we welcome your comments and questions.

Sincerely,

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Notice of Fixed Income Benchmark Change

Effective for this quarter, we are changing our fixed income benchmark from the Barclays Capital Aggregate Bond Index to the Barclays U.S. 1-5 Year Government/Credit Bond Index. The composition and duration of the Barclays U.S. 1-5 Year Government/Credit Bond index is a more accurate representation of our current fixed income portfolio strategy. Please refer to the charts below.