<u>Fourth Quarter 2014 Commentary</u>

Happy new year! We hope that your 2015 is off to a healthy and prosperous start.

Stocks closed the year with yet another quarterly gain, with the S&P 500 increasing 4.9% in the fourth quarter. This marks the 8th straight quarter of gains for the index. For its part, the Dow Jones Industrial Average gained 5.2%.

For the year, the S&P 500 gained 13.7%, while the Dow Jones advanced by exactly 10.0%. Most mutual fund managers trailed the indexes: according to Morningstar, only about 13% of actively managed, large-company stock funds posted returns above that of the S&P 500.

A Year of Surprises

"The only function of economic forecasting is to make astrology look respectable."
−John Kenneth Galbraith

The year 2014 reminded us yet again of John Kenneth Galbraith's famous quote, as almost all economists were wrong in their forecasts. Most economists predicted a rise in interest rates last year. In fact, a Wall Street Journal economic forecasting survey in January 2014 found 98% of participating economists (48 out of 49) were predicting that the yield on the ten-year Treasury note, about 2.9% at the time, would exceed 3% by the end of the year, with an average forecast of 3.52%. Other than three days in January, the ten-year yield spent the entire year below 3%, and as of this writing it is below 2%.

Those same economists expected oil to end 2014 at about $95 a barrel, up from around $92 at the time of the survey. After peaking around $107 a barrel in June, oil prices started a precipitous descent, with oil currently fetching less than $50 a barrel. For consumers, gasoline prices have fallen for more than 100 straight days, with the current average below $2.20 per gallon, compared with a peak of $3.70 in April.

In early fall, news of Ebola scared investors, sending stocks down close to 10%. Traders and analysts quickly saw that as the beginning of a large decline to come. Again, forecasts turned out to be wrong, as stocks started ascending again into record territory, with the Dow Jones recently crossing the 18,000 milestone for the first time.

What's Next?

A year like 2014 confirms our belief that the best thing for an investor to do is to turn off CNBC and pay no attention to market pundits. You might remember that when you opened an account with us, we gave you a memo titled "A Word About Expectations." In that piece, we said,

> *If you ever get the urge to call us up and ask us, "What do you think the market will do in the next quarter or two?", let us save you the time by giving you our answer now: "We don't know." We really don't. The stock market is driven in the short term by human emotions such as fear, greed, and envy. Instead of attempting to forecast the general market, we focus our attention on individual stocks and finding undervalued securities.*

We can think of no better time to reiterate that thought. The only thing that we know for sure is that the stock market will continue to fluctuate. Our job is to remain vigilantly observant of those fluctuations--not to react to them, but to take advantage of them. We continue our quest of finding good business to buy at attractive prices, and we welcome the volatility that creates the bargains that we are always searching for.

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