AMB

Economic and Portfolio Outlook 4th Quarter 2014

(Released October 2014)

Our economic outlook for the fourth quarter of 2014 for the U.S. is continued slow growth. We stated in our 3rd quarter Economic and Portfolio Outlook that we anticipated corrective activity in the equity markets during the second half of the year citing such facts as 1) most major bull markets have historically run for a 64-65 month cycle; 2) the S&P 500 Index had been in an extended period without experiencing a 10% correction (1,000 days at that time); and 3) the global escalation in Initial Public Offerings (IPOs). Added to this list of facts now are the ongoing geopolitical tensions in the Middle East as well as heightened fear over the recent transmissions of Ebola in the U.S. The Ebola reality or perception will have a negative impact on the economy. The travel industry will not be the only segment of the economy impacted. We expect to see 4th quarter GDP estimates cut in the first quarter of 2015 with partial blame accredited to the Ebola breakout.

As the major market indexes have continued to climb higher in 2014, so has the willingness of investors to take on more risk. You know investors are becoming aggressive when they are willing to use borrowed money—margin debt—to make their bets. August margin debt reached $463 billion, only $3 billion from the all-time high in February. The most recent times that margin loan debt as a percentage of GDP exceeded 2.5% were in 2000 and 2007. Today, it is back above this threshold.

Real GDP for the 2nd quarter was 4.6%, a volatile move up from 1st quarter GDP of -2.3% We believe this big bounce back in the 2nd quarter was due to a buildup in inventory, which points us in the direction that growth will continue to be slow the remainder of the year. While we do not yet have 3rd quarter GDP, the Fed has cut its real GDP forecasts for this year, next year and the longer term. The Fed cited the reason for their cut in 2014 GDP estimates as a "somewhat weaker near-term outlook for consumer spending." Their reason for cutting 2015 GDP estimates was to reflect "a higher projected path for the foreign exchange value of the dollar along with slightly smaller projected gains for home prices."

In harmony with slowing growth in the U.S., most global GDP estimates are being cut as well. The International Monetary Fund (IMF) drastically cut the GDP forecast for Germany from 1.8% to 1.2% this year and from 2.0% to 1.3% next year. Current Consensus for Europe 3rd quarter growth is 0.35%; however, we believe this is optimistic as incoming data is notably weaker than expected. We believe Europe will enter a triple dip recession.

The October 7, 2014 Job Openings and Labor Survey from the Bureau of Labor Statistics (BLS) reported that total job openings were over 4.8 million, the highest number of job openings since January 2001 and just shy of the record high of 5.2 million in December 2000. However, while the BLS survey reported that employers have almost never had more open positions, businesses have also decided to put an abrupt stop to hiring, which points to a major disconnect in the U.S. labor market.

The Fed's Quantitative Easing (QE) is projected to end after the Fed meeting on October 29th. The impact of the anticipated end of QE is already becoming evident. Fed Central Bank Reserves recently reached their lowest level in three years, and bank borrowing from the Fed has started to decline. However, in light of recent market volatility, there is the possibility the Fed will not proceed with the discontinuance of QE. Although not a voting member, James Bullard, Chairman of the Federal Reserve Bank of St. Louis, recently mentioned the possibility that the Fed will introduce QE4.

The great unknown is when the Fed will start to raise short-term interest rates. The challenge for the Fed is how to raise short-term rates without causing trouble for a still recovering economy. Strength in the U.S. dollar over the past three months has already sparked concern from some Fed members that a strong dollar could become a big problem for the U.S. economic recovery. Appreciation of the dollar could slow the gradual increase in inflation toward the FOMC's 2% goal. Raising short-term interest rates would create an even stronger headwind for U.S. growth.

S&P 500 Index was up 1.13% for the 3rd quarter and the Dow Jones Industrial Average was up 1.87%. U.S. small cap stocks as defined by the Russell 2000 Index continued their very poor performance for the year with a 3rd quarter decline of approximately 7%, registering a negative performance of over 3% for the Index on the year.

Interest rates moved lower over the first half of the year from 3% on the 10 year treasury to under 2.3%. Slowing growth, lower than expected inflation and the supply/demand equation are some of the key drivers that have led to this rate decline. We also believe there is a lot of demand for municipal, corporate and government issues and any uptick in rates will lead to a lot of buying, which should hold rates down.

Taking a broader perspective, we see that global rates around the world have also continued to decline. Germany and Japan 10 year rates are under 1% and .5% respectively. Relative to other developed countries, the U.S. rate of 2.3% does not look that bad. Taking all these factors into consideration, as long as economic growth continues at the current pace and inflation does not spike, we believe interest rates will remain lower for longer.

As we stated in our 3rd quarter Economic and Portfolio Outlook, municipal bonds were a bright spot to start the year and we are slightly overweight in this asset class. Due to a significant tightening in corporate debt spreads, we plan to reduce our corporate debt exposure during the 4th quarter and move into treasury securities as we believe they currently have a better risk profile. We believe the real risk at present is having total equity volatility exposure—being invested in equities and other instruments that move with equities (i.e. High Yield). That is why our focus will remain on high quality issues that give proper compensation for the underlying risk and a well-diversified portfolio.

CAPITAL MARKETS SNAPSHOT

EQUITY	As of 9/30/2014	3Q2014	YTD	12-Month Return
DJIA	17,042.53	1.87%	4.60%	15.29%
S&P 500	1,972.29	1.13%	8.34%	19.73%
NASDAQ	4,493.39	2.25%	8.57%	20.62%
MSCI EAFE	1,846.08	-5.88%	-1.38%	4.25%

RATES	As of 9/30/2014	As of 6/30/2014	As of 9/30/2013
Fed Funds Target Rate	0.25	0.25	0.25
3-Month Libor	0.23	0.23	0.25
6-Month CD	0.35	0.35	0.30
2-Year Treasury	0.56	0.46	0.31
10-Year Treasury	2.48	2.53	2.61
30-Year Mortgage	4.20	4.34	4.32
Prime Rate	3.25	3.25	3.25
COMMODITIES	**As of 6/30/2014**	**2Q2014**	**12-Month Return**
Gold	$1,216.50	-7.49%	-8.29%
Crude Oil	$91.16	-13.19%	-10.92%

Foreign Markets

The European Central Bank (ECB) has diverged away from other major central banks—notably the Federal Reserve and Bank of England—since June through interest-rate cuts, lending programs and private-debt purchase facilities. It will continue this divergence during the 4th quarter when the ECB begins adding four-year loans to banks as well as asset-backed securities and covered bonds to its balance sheet. This recent activity on the part of the ECB has resulted in a sharp depreciation in the euro's exchange rate, which should boost exports and annual inflation, which was at 0.3% through September—far below the ECB's 2% target. It remains to be seen whether the ECB has done enough.

Russia's economy is starting to hurt as a result of U.S. and European Union sanctions over the Ukraine crisis—sanctions that include limiting access to foreign financial markets for Russian companies. The impact of these sanctions is anticipated to have a prolonged effect. Russia has said it will create a multibillion-dollar emergency fund for companies hurt by the sanctions, a sign the country is preparing for a long period of economic isolation. The central bank warned that growth is expected to continue slowing this year amid sanctions and continued uncertainty, falling to near-recession levels.

Japans' economy had a difficult summer, giving rise to skepticism about the effectiveness of the central bank's stimulus program and prompting calls for more action. The yen dropped suddenly in mid-September to a six-month low against the dollar, fueling a new stock market rally and offering renewed hope to his campaign to boost inflation by lifting import prices. In December, Prime Minister Shinzo Abe must decide whether to approve a second tax increase scheduled for 2015. Bank of Japan Governor Haruhiko Kuroda is in favor of the tax increase stating it is necessary to curb the government's swollen debt. As Mr. Kuroda approaches his second anniversary next April, he will have to offer his views on the success, or not, of his 2-year campaign to end deflation and whether it should be extended, or how to exit it.

The Bank of England (BOE) remains on track to be the first of the world's major central banks to finally begin raising rates from record lows. BOE officials are expected to increase the U.K central bank's benchmark interest rate to 0.75% from 0.5% during the first quarter of 2015. A quarter-point rate increase next year would be the first in almost seven years. BOE Governor Mark Carney said that raising interest rates in the spring could enable the BOE to keep inflation close to its 2% annual target and enable the economy to create another 1.2 million jobs. The fly in the ointment, however, is annual inflation has been below the central bank's 2% target through 2014. BOE officials are also concerned that feeble growth in neighboring the Eurozone and conflict in Ukraine and the Middle East could push the U.K. off course. They want to see convincing evidence that Britons' real wages are poised to rise.

China's industrial production growth slowed to 6.9% year-over-year versus (concensus: 8.8%), the slowest pace since the global financial crisis period of late 2008/early 2009, suggesting the economy has lost momentum again following the 2nd quarter. Both fixed income and retail sales came in weaker than expected. Fixed income investment growth decelerated notably to 16.5% YTD in August, the slowest pace since 2001, while retail sales increased 11.9% year-over-year. August merchandise exports still showed a solid growth pace at 9.4% year-over-year, while imports disappointed, falling 2.4% year-over-year. There was pronounced weakness in the biggest China's biggest asset, far more important to their local economy than stocks: the housing market. Home sales fell 13.4% year-over-year in August compared to the fall of 17.9% year-over-year in July. Perhaps the most disturbing for China was the slowdown in cement and steel production, which is by far the best economic indicator of what is going on in the middle kingdom. Chinese electrical output saw its first year-over-year decline since Lehman, dropping by a shocking 2.2%.