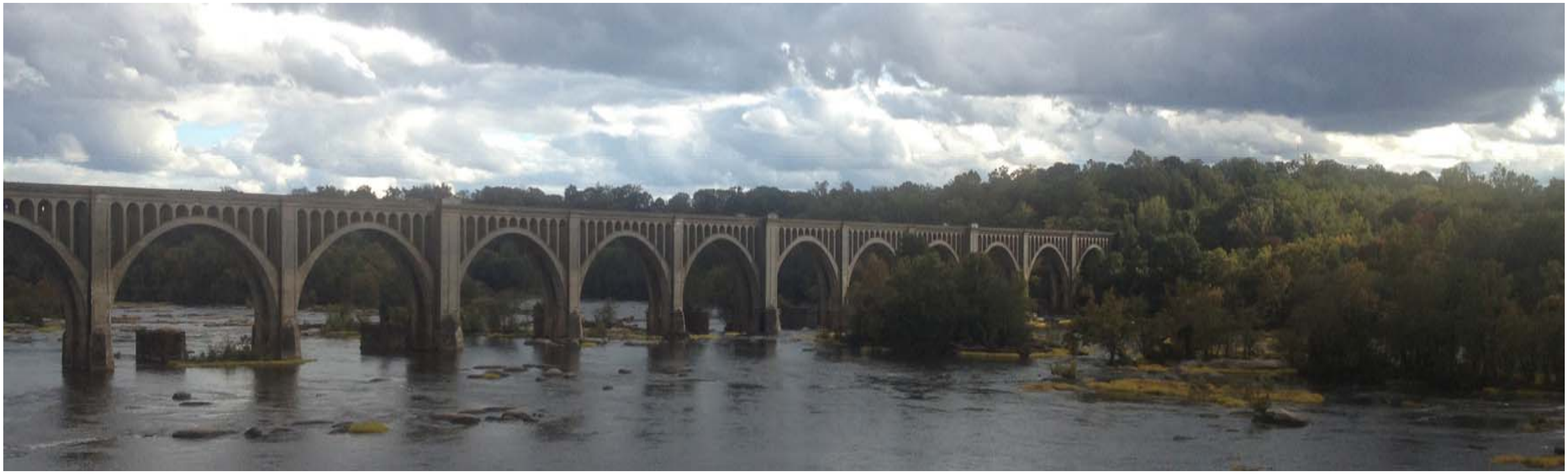

Quarterly Update & Economic Commentary—September 30, 2014

Quarter in Review

The third quarter saw an increase in volatility and wide dispersion in returns among different asset class categories. For instance, the most popular large cap proxy, the S&P 500, returned 1.13 percent for the quarter, while the small cap proxy, the S&P SmallCap 600, lost 6.73 percent, a difference of almost eight percent. The S&P 500's third quarter positive return represents the seventh straight quarter of positive returns, while the small cap index's negative return broke its eight consecutive-quarter "win" streak. Equity markets outside the U.S. also struggled during the third quarter. The MSCI EAFE NR, a proxy for international, developed markets, lost 5.88 percent during the quarter. MSCI Emerging Markets NR index, a proxy for emerging markets, lost 3.49 percent during the quarter, which included a 7.41 percent drop in the month of September.

The S&P 500's gains for the year remain strong at 8.34 percent, but year-to-date gains in the U.S. small cap index and international developed markets were wiped out by the poor third quarter performance; the S&P SmallCap 600 is down 3.72 percent for the year, and the MSCI EAFE is down 1.38 percent. The MSCI Emerging Markets index remains in positive territory by 2.43 percent.

Interest rates stayed relatively flat during the quarter; however, credit spreads widened quite a bit which hurt the performance of the more credit- sensitive fixed-income investments, like high yield bonds. The Barclays U.S. Aggregate bond index rose 0.17 percent during the quarter. The lower quality bond index, the Barclays U.S. Corporate High Yield, fell 1.87 percent during the third quarter. Both indices remain positive year-to-date (the Aggregate bond index is positive by 4.10 percent, while the high yield index is positive by 3.49 percent).

The majority of commodity spot prices fell through the quarter, some by a significant amount. Probably the most significant and beneficial drop was in oil and energy prices. The S&P GSCI Brent Crude spot price fell 14.95 percent and the S&P GSCI Energy spot price index fell by 13.88 percent. Energy prices were impacted by lower global demand and a strengthening dollar. Other large price declines were seen in the lean hog (-29 percent), corn (-23 percent) and soybeans (-21 percent) markets. Precious metals saw declines, led by silver's 19 percent decline. Additionally, gold, a favorite of bear market investors, lost 8.35 percent.

The Euro-region is continuing to show signs that deflation is a real risk; the probability of a recession is increasing. Recent economic readings hint toward a slowdown in Germany, which is a shift from previous quarters when the periphery countries were the concern and Germany was strong enough to hold up the entire region. A slowdown in Germany could be detrimental to the entire region. The European Central Bank (ECB) has continuously failed at adopting policies that will promote growth.

The third quarter saw a continuation - and in some cases an escalation - of some global risks. The war on terror has escalated, as members of the Islamic State of Iraq and Syria, known in the media as ISIS or ISIL, posted disgusting videos on YouTube of the beheading of two U.S. journalists and a British aid worker. In addition to the beheadings, it has been reported that these groups are known for killing dozens of people at a time, and carrying out public executions and other unthinkable acts. This group appears to be strong, well-financed, and does not particularly like the U.S. and other developed countries such as France and Great Britain. As a result of their growing power, concerns have been raised around a potential attack on U.S. soil as well as around other parts of the world.

Rumors surfaced during the end of the quarter that Russia's central bank would be initiating capital controls to reduce the flow of money out of the country. The concerns over the outflows support the thesis that the U.S. and European sanctions are continuing to take their toll on the Russian economy. The capital controls were denied, but it can be assumed that Russia is preparing to restrict outflows if they become overwhelming. The sanctions have been the U.S.'s and Europe's retaliation to Russian President Putin's defiance and attempt to take back control of Ukraine. Fortunately, much of the fighting has been suspended as a result of the September 5 ceasefire.

The Ebola virus outbreak appears to be worsening. Americans infected with the disease in Africa, were flown back to America for treatment, increasing the risk that Ebola can spread in America. In a separate case, the first American on U.S. soil had been diagnosed with the virus and as of the end of the quarter, he remained in critical condition. It is still unlikely that we will see an outbreak in developed countries like the U.S., but if something is not done to address the outbreak in Africa, we could see a much greater issue than many are projecting.

The U.S. economic news through the quarter remained generally positive. The employment picture continued to show signs of improvement. The closely-watched unemployment rate dropped to 6.1 percent, and the weekly jobless claims continued to fall throughout the quarter. The four-week moving average for jobless claims dropped to the low 290,000s, a level not seen since 2006. As expected, economic growth accelerated during the second quarter. Gross Domestic Product (GDP) grew at an annualized rate of 4.6 percent, which is likely an outlier on the upside, since the first quarter reading was a downside outlier and showed a negative growth rate.

The U.S. Federal Reserve continued on its expected path of tapering bond purchases. Assuming everything continues to move as expected, the Fed will end the bond purchase program during the October meeting. The Fed reaffirmed its previous guidance that the current interest rate policy will remain appropriate for a "considerable time" after asset purchases end. The "considerable time" phrase is the most watched language of the report. Once the phrase is removed, it is expected that the Fed will begin raising rates about six-to-ten months later. We are hopeful that rate increases will be as a result of supporting data and not a set timeline.

Initial Public Offerings (IPOs) can be an indicator of market participants' confidence. According to Renaissance Capital, the U.S. IPO market raised $37 billion in the third quarter, more than any quarter since Q4 1999. A significant amount of the funds raised came from China's e-commerce company, Alibaba, which raised a record $22 billion in assets. Although proceeds from IPOs were high, number of issuers fell to 59, down from 83 last quarter and 60 during the third quarter of 2013. When the IPO market is hot, the lines get blurred as to whether it is becoming frothy (like right before the dot-com bubble), or simply showing signs of a healthy market with high demand for new issues.

A Look at the Numbers

Name	3rd Quarter 2014 (%)	Year to Date (%)
DJ Industrial Average TR USD	1.87	4.60
S&P 500 TR USD	1.13	8.34
S&P MidCap 400 TR	-3.98	3.22
S&P SmallCap 600 TR USD	-6.73	-3.72
NASDAQ Composite TR USD	2.24	8.56
MSCI EAFE NR USD	-5.88	-1.38
Barclays US Agg Bond TR USD	0.17	4.10
Wilshire US REIT TR USD	-3.07	14.46
IA SBBI US 30 Day TBill TR USD	0.00	0.01

Forecast in Brief

There are plenty of reasons to be bearish — like the risk of an Ebola outbreak; the strengthening of a dangerous terrorist group, ISIS; the potential for violence to escalate in Russia and Ukraine; a potential recession in Europe; and a Fed rate hike in the coming months. Despite this growing list of concerns, we remain bullish on the equity markets.

We remain especially constructive on the U.S. economy and stock market. An improving employment picture, falling oil prices, low interest rates, and a stable housing market have consumers feeling more confident as we move into the holiday shopping season. We expect to see retailers benefit from a better positioned consumer.

The Fed is expected to announce an end to its bond purchases in October, but a rate hike is not expected until middle to end of 2015, or potentially even later. The Fed does not want to raise rates so quickly that it deters the recovery; however, they would like to raise rates soon, so they can have a tool to help the economy in the future when needed. Investors fear that the Fed actions will push interest rates higher, even though interest rates have declined during 2014 as the Fed tapered its bond purchases. Rates falling so significantly during 2014 were a surprise to many. One thesis for the drop in rates is because of a lower supply of Treasury issues. The government's deficit has fallen as revenues increased from a better economy. Another potential reason is the strength of the U.S. economy relative to other economies. Investors may feel more comfortable having money in U.S. dollars as opposed to other currencies, which results in capital flows into the United States. The trend of a strengthening dollar should continue over the short-term, especially if the ECB announces any meaningful actions in the coming months.

In addition to the upcoming holiday season and Fed announcements, investors will also be focusing on the mid-term elections in the U.S. and earnings announcements. Many strategists believe that if the Republicans take control of the Senate - which is not far-fetched - it could be a catalyst for pushing equity markets higher into year-end. According to S&P Capital IQ consensus data, earnings for the third quarter are expected to grow at just under seven percent, from the year ago quarter, similar to the expectations going into last quarter. Estimates last quarter were conservative, as actual earnings reported grew at an over 10 percent rate. Another surprise to the upside could provide a boost to market sentiment. We will also be looking at corporate management's comments regarding the future impact that a rising dollar can have on both sales and the balance sheet. The coupling of a market decline and an increase in earnings could result in the current "fairly-valued market" being slightly undervalued from a valuation perspective.

Our expectations over the short-to-intermediate term for the U.S. economy are generally positive; however, the same cannot be said about the prospects in other parts of the world. A main area of concern is the weakening European economy, especially signs of a slowing German economy. Even though economies in Europe do not look great right now, things can improve with the assistance from the ECB. ECB President Mario Draghi has initiated some stimulus from the central bank, but not nearly enough to fight the rising fears of deflation and deteriorating economic growth. Draghi has floated the idea of a U.S.-like asset purchase program, but as expected, he has been slow to implement. The lack of implementation could be a result of a lack of support which might be changing as struggles in Germany continue. Draghi has said that he will do anything necessary; we believe it is time for action instead of words.

A sales tax increase that went into effect in April is hurting Japan's economy. Since August, the dollar has strengthened by about eight percent versus the Yen. This currency move will benefit Japanese exporters but will negatively impact corporate earnings of companies buying materials abroad. Although somewhat weaker than expected, the Japanese economy is doing fairly well. Future action by the Bank of Japan is possible but the timing is uncertain. The Chinese economy continues to remain in question; however, its government has taken action in an attempt to stabilize the economy. Expect to see stable to slightly lower growth in the coming quarters. We continue to believe there remains long-term value in selective areas of other emerging market countries. We believe some of the larger emerging markets, like Brazil and Russia, will continue to see higher levels of volatility. Brazil is currently going through a Presidential election and Russia will continue to be led by an unpredictable Vladimir Putin. In addition to political uncertainties, both countries rely on selling commodities for revenue which will be impacted if prices continue to fall.

We believe the greatest immediate risk is the slowdown in global economic growth and the potential actions that will be necessary by the undependable European Central Bank. With that being said, we continue to see strength and opportunities in U.S. stocks. We believe there is a reasonable chance to see a correction in the U.S. equity markets over the near term. This is not to say that new money or cash balances should not be invested prior to the inevitable pullback. Investors who have waited for the last correction potentially missed a 30 percent gain in equity markets. On the other side, investors who are fully invested should look to rebalance their portfolios if they have significantly strayed from their initial allocation. Corrections are common, and can happen relatively quick. Trying to time the top and bottom is nearly impossible, and may result in earning a lower return than if one would just stay invested.

If anything in your financial situation has changed, please let us know so we can determine whether a change in your portfolio is necessary.

— Robert Moyer, CFA, CFP®

Director of Research

The views and opinions expressed are for informational purposes only and should not be construed as investment advice. The data provided is as of the writing and is subject to change without notice. All material presented is compiled from sources believed to be reliable and current, but the accuracy of third party sources cannon be guaranteed. The material is not intended to be relied upon as investment advice or recommendations, does not constitute a solicitation to buy or sell securities, and is not specific legal, investment or tax advice. The information provided does not take into account the specific objectives, financial situation, or particular needs of any specific person or entity and should not be relied upon as the sole factor in an investment making decision. Past performance is no guarantee of future results. Investing involves risk and could result in loss of principal.

ACG Advisory Services is a registered investment adviser.

1640 Huguenot Place
Midlothian, Virginia 23113
Phone: 804.323.1886
Fax: 804.323.1889
www.acgworldwide.com