



## First Quarter 2014

### Review and Outlook

Each year, it seems that publication of our first quarter newsletter is delayed. The new year always seems to bring unusual activity in the business, and this year has been no exception.

After the stellar 32.4% return for the Standard & Poor's 500 last year, it is not surprising that the market is taking a breather and seems to be stalling. As of mid-April, the market has declined slightly, although going practically nowhere included some sharp daily gains and losses. We had anticipated a pullback in stock prices at some point during the year, and this earnings season may yet provide an excuse for profit-taking.

Pundits expect that this will be the first quarter in a couple of years when year-over-year quarterly earnings growth will be negative. The brutal winter will probably be reflected in lower reported quarterly earnings for some companies. Indeed, there have been several companies that have reported earnings results below expectations, including Coca-Cola, Bank of America and J. P. Morgan. Disappointing earnings reported by a large company occasionally cause a one-day decline in the broader market on the day of the announcement.

We are reaching the high point of earnings releases for this quarter. Stay tuned for further developments.

- The Standard & Poor's 500 P/E multiple stands at over 15, above the long term average of 12, so the chances of an increase in stock prices in the face of relatively flat earnings are somewhat limited.
- The relative underperformance of higher-yielding stocks seems to have run its course. For example, higher-yielding stocks, such as Utilities, experienced a resurgence during the first quarter.
- Economic sectors of the market performed as follows, from high to low, during the first quarter: Utilities (+9.02%), Health Care (+5.40%), Consumer Discretionary (+3.16%),

Materials (+2.30%), Financials (+2.15%), Information Technology (+1.86%), Energy (+0.19%), Consumer Staples (-0.16%), Industrials (-0.39%), and Telecommunications Services (-0.73). There is no clear pattern to the relative performance of the various economic sectors. Utilities and Health Care offer good dividends and are relatively defensive, but then, so are Consumer Staples stocks, which lagged as a group. Telecommunications stocks pay good dividends, but their underperformance may be due to pressure on earnings.

- It's hard to know how Russia's bellicose activities will affect multinational companies' profits and their property in Russia. Confiscation or "freezing" of U. S.-owned assets in Russia would not be out of the question.
- The interest rate of the 2-year U. S. Treasury note rose slightly, and its price declined. The 2-year U. S. Treasury Note is the bond that is normally most influenced by the Federal Reserve Board's actions to raise or lower short-term interest rates.
- Ten-year and 30-year U. S. Treasury Notes rose in price, while their yields declined. The Fed's bond buying program is focusing in on longer-term maturities, creating an artificial demand for those bonds. This drives up bond prices and drives down bond yields.
- Corporate bonds outperformed U. S. Treasury securities last quarter. As of mid-April, Treasuries are in the red, while corporate bonds have produced positive returns. Long-term U. S. Treasury bonds, as of April 14, declined 8.80% in price over the past twelve months (or 5.54% after taking into account the interest income). Long-term corporate bonds produced relatively flat returns over that same period. In contrast, lower-quality bonds (CCC-rated) rose 9.19%. But year-to-date, long-term U. S. Treasury bonds rose 6.62% (or 8.12% including interest income), while long-term corporate bonds returned 7.78% and CCC-rated bonds rose 3.17%. The Federal Reserve Board has kept investors fairly well informed about their intentions, even as Mr. Putin's aggression in the Ukraine has kept bond investors on their toes.
- Commodity prices have risen. Gold rose by 7.2%, which probably relates to investors' flight-to-quality as a result of the crisis in Ukraine and concerns about what Vladimir Putin's next move will be. Oil prices rose 3.0% and natural gas prices rose 6.4%. The cold winter caused natural gas prices to rise due to higher usage. Gasoline prices also move up during a cold spell, since refiners shift production to home heating oil and away from manufacturing gasoline and diesel fuel.
- The economy seems to be on a slow path to recovery. Industrial production (a measure of factory output), has been on a steady rise since its nadir in 2009. Eight of the 12 regions that the Federal Reserve Board's beige book studies are strengthening. (The beige book is periodically released by the Fed, and is a research report that summarizes the strengths and weaknesses of each Federal Reserve region on a number of different metrics.)
- Labor market conditions are tightening, and some employers are reporting difficulty in recruiting employees for skilled positions.

- There do not seem to be major upcoming disputes about the Federal budget that might destabilize capital markets. Politicians in Washington, D. C. wisely put off major decisions until after the November 2014 mid-term elections.
- The congressional mid-terms, to be held in November, will be something to keep an eye on. And contenders for the Presidential race in 2016 are already gearing up for that marathon. The 2014 congressional mid-terms may have some impact on how capital market prices change as the campaign unfolds.
- The United Kingdom's stock market declined slightly as of the end of March, while the German market rose slightly, and the Japanese declined 9.2%. Returns adjusted back into U. S. dollars were not much different.
- The U. S. and other nations are still pondering how to effectively deal with Iran's nuclear ambitions, China's flexing of its muscles beyond its shores, and Vladimir Putin's dalliances in the Ukraine. Any of the above may cause a hiccup in prices of publicly-traded securities and commodities.

## **Investment Strategy**

- We are watching for a reasonable entry point into the fixed-income market, and for now, prefer to buy short term bonds to avoid big declines in bond values as interest rates continue to rise. In fact, for many of our clients, we are keeping cash in money market funds, rather than in short term U.S. Treasury Notes, to preserve investment flexibility. We are also keeping some cash on the sidelines as well as selling stocks that we no longer want to hold, while searching for purchase candidates.
- We will emphasize high-quality bonds (A-rated or better) when buying bonds for clients is appropriate. We have in the past purchased preferred stocks and lower-quality bonds for income on a limited basis, but only when the risks associated with these types of securities appears reasonable.
- While we may buy bonds from time to time, our emphasis will be on finding quality stocks that will provide a steady, or even rising, stream of dividends for our income-oriented investors. We will be on the lookout for companies with strong financial strength and the ability to raise their dividends.
- Occasionally, there may be interesting stocks that are either undervalued or have huge long-term growth potential that we purchase to boost clients' investment returns. Such stocks may pay little or nothing in dividends.
- Going forward, until there is a significant market pullback, we will be satisfied with taking advantage of changes in relative valuations of stocks that we already hold. We will occasionally add a stock when an interesting story presents itself.
- We are looking for stocks that may be less vulnerable to changes in bond yields.
- We believe that a long-term strategic position in Materials and Energy stocks is appropriate. We are keeping an eye on China and emerging markets as signs of economic weakness (in China) become increasingly evident, as well as commodity prices.

- We believe that a rise in stock prices will generally be tied to improvements in corporate earnings; and there will be bumps in the road in a generally, though modestly, rising stock market.
- We believe that this is a stock-picker's market that favors active management of sector weights and is unfavorable to index funds.
- We will sell stocks when (1.) they appear to be overvalued, (2.) substitution of a stock in one industry sector for another makes sense in order to de-emphasize industry sectors in which there may be fundamental weakness and (3) when it makes sense to increase cash or bonds in a client's portfolio and to de-emphasize stocks.
- Recent tax law changes have reduced the attractiveness of dividends versus capital gains. Investors with high income requirements should expect that we will experience periods of underperformance in stocks paying above-average dividends. Still, investors should consider their goals, first and foremost, and not try to chase market returns, which are notoriously volatile.

## Disclosure of Current Individual Stock Holdings

Individual stock holdings in accounts in which I have a direct beneficial interest are noted below. Stocks in *italics* are held in the accounts of a family member. The activity is current as of April 17, 2014.

### Holdings:

*A T & T Inc.*

*Altria Group, Inc.*

*Annaly Capital Mgmt.*

*Apache Corporation*

*Bank of America*

*Baxter International, Inc.*

*Berkshire Hathaway Cl. B.*

*CVS Corporation*

*Canadian Natural Resources*

*Canadian Pacific Railway Ltd.*

*Chevron Corporation.*

*Cisco Systems, Inc.*

*Conagra*

*Costco*

*Cullen Frost Bankshares*

*Cummins, Inc.*

*Dominion Resources Inc.*

*Duke Energy Corp.*

*eBay, Inc.*

*Enbridge, Inc.*

Flowers Foods Inc.  
*Ford Motor Company*  
*General Electric*  
*Gilead Sciences*  
Immersion Corp.  
Intuitive Surgical  
*Kansas City Southern*  
*Kimberly-Clark Corp.*  
*Lincoln National Corp.*  
*Mac-Cali Realty Corp.*  
McDonald's  
*Merck & Co. Inc.*  
*MetLife, Inc.*  
MTS Corporation  
*Newmont Mining Corp.*  
*Norfolk Southern Corp.*  
*Patriot Coal Corp.*  
PepsiCo Incorporated  
*PetSmart*  
*Pfizer Incorporated.*  
Philip Morris International, Inc.  
*Potash Corp.*  
*Qualcomm, Inc.*  
*Range Resources*  
*Realty Holdings Corp.*  
*Rio Tinto PLC Spon. ADR*  
*Schlumberger Ltd.*  
*Spectra Energy (Added)*  
*Target Corporation*  
*The TJX Companies, Inc.*  
*Verizon Communications*  
Vertex Pharmaceuticals  
*W. W. Grainger*  
*Wells Fargo & Co., Inc.*  
*Whiting Petroleum Corp.*

Purchases included General Electric, Gilead Sciences and Realty Holdings Corp. Sales included reductions in the position sizes of MetLife, Inc. and Whiting Petroleum to fund the purchases.  
**Note that this list may change due to an inheritance that will eventually be distributable.**

**Offer of Form ADV:** As always, clients are welcome to request our form ADV, Parts 2A and 2B.

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April 17, 2014

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**Labrador Investments, LLC**  
**Financial Market Trends**  
**March 31, 2014**

<b>U.S. Treasury Yields</b>	<b>12/31/13</b>	<b>3/31/14</b>	<b>4th Qtr. Change</b>	<b>12/31/2013</b>	<b>2014 Change</b>
90 day T-Bill	0.07%	0.05%	-0.03%	0.07%	-0.03%
2 Year T-Note	0.39%	0.42%	0.03%	0.39%	0.03%
10 Year T-Note	3.04%	2.74%	-0.29%	3.04%	-0.29%
30 Year T-Bond	3.98%	3.59%	-0.39%	3.98%	-0.39%

<b>Stock Market Indices</b>	<b>12/31/13</b>	<b>3/31/14</b>	<b>4th Qtr. Change</b>	<b>12/31/2013</b>	<b>2014 Change</b>
Dow Jones Industrial Average	16576.66	16457.66	-0.7%	16576.66	-0.7%
Standard & Poor's 500	1848.36	1872.34	1.3%	1848.36	1.3%
Nasdaq Composite	4176.59	4198.99	0.5%	4176.59	0.5%
Dow Jones Utility Index	490.57	532.13	8.5%	490.57	8.5%

<b>Bonds Market Indices (52 wks. as of 1/2/14)</b>	<b>First Qtr. 2014 Change</b>
Barclays Corporate Intermediate	1.57%
Barclays Corporate Long Term	5.85%
Barclays Aggregate	1.80%

<b>Foreign Stock Markets</b>	<b>12/31/13</b>	<b>3/31/14</b>	<b>4th Qtr. Change</b>	<b>4th Qtr. Currency Adjusted</b>	<b>1st Qtr. 2014</b>
FTSE100 (United Kingdom)	6749.09	6639.4	-1.6%	-1.2%	-1.6%
DAX (Germany)	9552.16	9614.6	0.7%	1.1%	0.7%
Nikkei Dow (Japan)	16291.31	14791.99	-9.2%	-7.4%	-9.2%

<b>Foreign Currencies</b>	<b>12/31/13</b>	<b>3/31/14</b>	<b>4th Qtr. Dollar's Perf.</b>	<b>12/31/2013</b>	<b>2014</b>
British Pound (\$/Pound)	1.6563	1.6631	-0.4%	1.6563	-0.4%
Euro (\$/Euro)	1.3759	1.3811	-0.4%	1.3759	-0.4%
Japanese Yen (Yen/\$)	105.28	103.22	-2.0%	105.28	-2.0%

<b>Commodities</b>	<b>12/31/13</b>	<b>3/31/14</b>	<b>4th Qtr. % Change</b>	<b>12/31/2013</b>	<b>2014</b>
Gold Spot Price/Oz.	\$ 1,204.80	\$ 1,291.75	7.2%	\$ 1,204.80	7.2%
West Texas Int. Crude Oil/bbl	\$ 98.61	\$ 101.57	3.0%	\$ 98.61	3.0%
Natural Gas	\$ 4.21	\$ 4.48	6.4%	\$ 4.21	6.4%

**Labrador Investments, LLC**  
**Focus and Holdings List**  
**March 31, 2014**

<b>NAME</b>	<b>12/31/13</b>	<b>03/31/14</b>	<b>% CHANGE</b>	<b>YIELD</b>
CF Industries Holdings, Inc.	\$ 233.04	\$ 260.64	11.8%	1.1%
E. I. du Pont de Nemours and Company	\$ 64.97	\$ 67.10	3.3%	0.7%
Freeport-McMoRan Copper & Gold Inc.	\$ 37.74	\$ 33.07	-12.4%	0.6%
Nucor Corporation	\$ 53.38	\$ 50.54	-5.3%	1.0%
Praxair Inc.	\$ 130.03	\$ 130.97	0.7%	1.3%
Rio Tinto plc	\$ 56.43	\$ 55.83	-1.1%	2.0%
Weyerhaeuser Co.	\$ 31.57	\$ 29.35	-7.0%	0.6%
CSX Corp.	\$ 28.77	\$ 28.97	0.7%	1.4%
Eaton Corporation plc	\$ 76.12	\$ 75.12	-1.3%	1.2%
Fluor Corporation	\$ 80.29	\$ 77.73	-3.2%	1.1%
General Electric Company	\$ 28.03	\$ 25.89	-7.6%	0.0%
Honeywell International Inc.	\$ 91.37	\$ 92.76	1.5%	2.1%
Illinois Tool Works Inc.	\$ 84.08	\$ 81.33	-3.3%	0.7%
Kansas City Southern	\$ 123.83	\$ 102.06	-17.6%	2.5%
The Manitowoc Company, Inc.	\$ 23.32	\$ 31.45	34.9%	1.8%
Norfolk Southern Corporation	\$ 92.83	\$ 97.17	4.7%	0.9%
Union Pacific Corporation	\$ 168.00	\$ 187.66	11.7%	1.9%
AT&T, Inc.	\$ 35.16	\$ 35.07	-0.3%	0.0%
Frontier Communications Corporation	\$ 4.65	\$ 5.71	22.7%	1.5%
Verizon Communications Inc.	\$ 49.14	\$ 47.57	-3.2%	0.3%
Coach, Inc.		\$ 49.66		0.0%
Darden Restaurants, Inc.	\$ 54.37	\$ 50.76	-6.6%	0.3%
Ford Motor Co.	\$ 15.43	\$ 15.60	1.1%	3.2%
Frisch's Restaurants, Inc.	\$ 25.63	\$ 23.67	-7.6%	1.1%
The Home Depot, Inc.	\$ 82.34	\$ 79.13	-3.9%	0.5%
Leggett & Platt, Incorporated	\$ 30.94	\$ 32.64	5.5%	1.3%
Lowe's Companies Inc.	\$ 49.55	\$ 48.90	-1.3%	0.0%
McDonald's Corp.	\$ 97.03	\$ 98.03	1.0%	0.8%
Target Corp.	\$ 63.27	\$ 60.51	-4.4%	0.9%
Tractor Supply Company	\$ 77.58	\$ 70.63	-9.0%	-0.2%
V.F. Corporation	\$ 62.34	\$ 61.88	-0.7%	1.7%
Wal-Mart Stores Inc.	\$ 78.69	\$ 76.43	-2.9%	0.6%
Walgreen Co.	\$ 57.44	\$ 66.03	15.0%	1.0%
Altria Group Inc.	\$ 38.39	\$ 37.43	-2.5%	0.8%
Anheuser-Busch InBev SA/NV	\$ 106.46	\$ 105.30	-1.1%	-0.5%
The Coca-Cola Company	\$ 41.31	\$ 38.66	-6.4%	-0.7%
ConAgra Foods, Inc.	\$ 33.70	\$ 31.03	-7.9%	1.1%
Flowers Foods, Inc.	\$ 21.47	\$ 21.45	-0.1%	2.1%
Kellogg Company	\$ 61.07	\$ 62.71	2.7%	0.9%
Kimberly-Clark Corporation	\$ 104.46	\$ 110.25	5.5%	0.4%
Kroger		\$ 43.65		-0.7%
Pepsico, Inc.	\$ 82.94	\$ 83.50	0.7%	0.7%
Philip Morris International, Inc.	\$ 87.13	\$ 81.87	-6.0%	1.1%
The Procter & Gamble Company	\$ 81.41	\$ 80.60	-1.0%	1.1%
Reynolds American Inc.	\$ 49.99	\$ 53.42	6.9%	0.8%
The J. M. Smucker Company	\$ 103.62	\$ 97.24	-6.2%	0.8%
BP plc	\$ 48.61	\$ 48.10	-1.0%	-0.6%
Canadian Natural Resources Limited	\$ 33.84	\$ 38.37	13.4%	0.8%
Cenovus Energy Inc.	\$ 28.65	\$ 28.96	1.1%	1.5%
Chevron Corporation	\$ 124.91	\$ 118.91	-4.8%	0.4%



Encana Corporation	\$ 18.05	\$ 21.38	18.4%	-0.2%
EnSCO International		\$ 52.78		-0.2%
Exxon Mobil Corporation	\$ 101.20	\$ 97.68	-3.5%	0.0%
National Oilwell Varco, Inc.	\$ 79.53	\$ 77.87	-2.1%	0.3%
Range Resources Corporation	\$ 84.31	\$ 82.97	-1.6%	-2.7%
Stone Energy Corp.	\$ 34.59	\$ 41.97	21.3%	-0.9%
American Express Company	\$ 90.73	\$ 90.03	-0.8%	-0.5%
Annaly Capital Management, Inc.	\$ 9.97	\$ 10.97	10.0%	0.4%
Cullen/Frost Bankers, Inc.	\$ 74.43	\$ 77.53	4.2%	1.6%
Equity Residential	\$ 51.87	\$ 57.99	11.8%	1.1%
Fifth Third Bancorp	\$ 21.03	\$ 22.95	9.1%	1.0%
Liberty Property Trust	\$ 33.87	\$ 36.96	9.1%	5.1%
Mack-Cali Realty Corp.	\$ 21.48	\$ 20.49	-4.6%	-1.2%
Realty Income Trust		\$ 40.86		5.4%
Sun Life Financial Inc.	\$ 35.33	\$ 34.63	-2.0%	0.1%
The Toronto-Dominion Bank	\$ 47.12	\$ 46.52	-1.3%	0.9%
U.S. Bancorp	\$ 40.40	\$ 42.86	6.1%	1.3%
Vornado Realty Trust	\$ 88.79	\$ 98.56	11.0%	0.5%
Wells Fargo & Company	\$ 45.40	\$ 49.74	9.6%	0.9%
Abbott Laboratories	\$ 38.33	\$ 38.51	0.5%	0.5%
AbbVie Inc.	\$ 52.81	\$ 51.40	-2.7%	0.8%
Amgen Inc.	\$ 114.08	\$ 123.34	8.1%	2.3%
Baxter International Inc.	\$ 69.55	\$ 73.58	5.8%	1.0%
Bristol-Myers Squibb Company	\$ 53.15	\$ 51.95	-2.3%	2.8%
Intuitive Surgical, Inc.	\$ 384.08	\$ 437.99	14.0%	0.7%
Johnson & Johnson	\$ 91.59	\$ 98.23	7.2%	0.8%
Eli Lilly and Company	\$ 51.00	\$ 58.86	15.4%	2.2%
Medtronic, Inc.	\$ 57.39	\$ 61.54	7.2%	1.9%
Merck & Co. Inc.	\$ 50.05	\$ 56.77	13.4%	1.4%
Meridian Bioscience, Inc.	\$ 26.52	\$ 21.79	-17.8%	2.0%
Pfizer Inc.	\$ 30.63	\$ 32.12	4.9%	0.8%
St. Jude Medical Inc.	\$ 61.95	\$ 65.39	5.6%	0.9%
Teva Pharmaceutical Industries Limited	\$ 40.08	\$ 52.84	31.8%	2.2%
Vertex Pharmaceuticals Incorporated	\$ 74.30	\$ 70.72	-4.8%	4.3%
Zimmer Holdings, Inc.	\$ 93.19	\$ 94.58	1.5%	0.9%
Immersion Corporation	\$ 10.38	\$ 10.55	1.6%	0.0%
Intel Corporation	\$ 25.96	\$ 25.81	-0.5%	0.8%
Microsoft Corporation	\$ 37.41	\$ 40.99	9.6%	1.7%
MTS Systems Corporation	\$ 71.07	\$ 68.49	-3.6%	1.0%
Texas Instruments Inc.	\$ 43.91	\$ 47.16	7.4%	1.1%
American Electric Power Co., Inc.	\$ 46.74	\$ 50.66	8.4%	3.9%
Dominion Resources, Inc.	\$ 64.69	\$ 70.99	9.7%	-0.1%
Duke Energy Corporation	\$ 69.01	\$ 71.22	3.2%	1.1%
Entergy Corporation	\$ 63.27	\$ 66.85	5.7%	5.0%
Exelon Corporation	\$ 27.39	\$ 33.56	22.5%	0.8%
NextEra Energy, Inc.	\$ 85.62	\$ 95.62	11.7%	1.0%
Spectra Energy Corp.	\$ 35.62	\$ 36.94	3.7%	0.3%

**Notes:**

Added: EnSCO International, Realty Income Trust

Deleted: Hospira

Stock Splits: VF Corporation, 2-for-1

Excludes certain speculative names purchased by one client.