



Fourth Quarter 2014

Review and Outlook

The past year will go down in the books as one in which it seemed as though the stock market was going nowhere, yet ended up almost 11% (Standard & Poor's 500). The more closely-watched Dow Jones Industrial Average rose 7.5%, while the NASDAQ Composite rose 13.4%. Utility stocks were on fire, up 26%, as investors craving yield bid up the prices of those dividend-rich stocks. Real Estate Investment Trusts (REITs), which also sport high dividends, were also big winners: the Dow Jones Select REIT Index rose 27.4%.

The lack of volatility was striking, as stocks never declined as much as 10% (which is customarily defined as a correction) for the entire year. This was the sixth straight up year for the Dow Jones Industrial Average, and the third straight year of increases for the Standard & Poor's 500.

Bonds got in on the positive action, too, as Intermediate Corporate bonds gained 7.6% (adding price increases and yield), while the big winners were Long Term Corporate bonds, which gained 15.72% (price increases plus yield).

All eyes have been on the Federal Reserve Board, as it continues to take the economy off of life support by ending its unprecedented bond purchase program that began during the financial crisis in 2008. Interest rates must rise eventually. When interest rates begin to rise, bond prices will suffer, more than negating any interest income from coupon payments.

Some investors (such as life insurers), purchase bonds as a way to lock in an income stream and cash flows to offset life insurance policies that they have sold. (This is known as matching assets (bonds) with liabilities (life insurance policies that will eventually be paid out).) So there will always be buyers of bonds, however irrational it might seem during periods of rising interest rates.

International investors have poured money into the U.S. due to its economy's strength relative to the world. These money flows have caused the dollar to strengthen vs. other major

currencies. The dollar's rise vs. other currencies has been dramatic, and caught many investors by surprise. The dollar rose 6.3% vs. the pound, 13.7% vs. the euro, and 13.7% vs. the yen in 2014.

The U. S. economy has been a star among the major economies. Europe is still struggling. There are rumblings that Greece is in jeopardy of being kicked out of the Eurozone. Europe's central bank has been on a bond buying binge, similar to the quantitative easing program that the U. S. Federal Reserve just exited in October. Japan's central bank is cutting interest rates in a bid to revive its economy.

China's slowdown is evident, and there are continuing concerns about the strength of its banking system (which has funded China's infrastructure improvements for many years). China must move away from infrastructure development and move toward a more normalized economy with greater consumption and less savings. As the transition occurs, there will be surprises along the way that may rattle international markets. A major reason that commodities prices are weak is that China's demand for basic materials has diminished as its infrastructure development program has abated.

Stocks of companies producing commodities were the big losers. The PHLX Gold/Silver Index declined 18.3%, while the PHLX Oil Service Index declined 25%. Commodities prices were the culprit. The price of gold declined slightly, off 2.2% during the fourth quarter, and off 1.5% for the year. Of course, gold prices had previously declined from the \$2000/oz. level, so in a sense, gold prices led the decline in commodities prices. The price of a barrel of West Texas Intermediate oil (the domestic standard) plummeted 46%, while natural gas prices suffered a 28.7% decline.

Looking forward, it is possible that the stock market will be weak early on this year, as investors cash in on their winnings in 2014. Starting in February, we may see tax refunds helping out the economy, either through spending or investments in financial assets.

The stock market's current valuation is somewhat elevated, but that condition can continue for a long time – months and even years – before another correction or bear market manifests itself. And given that the U.S. economy seems to be the strongest globally, investors will be drawn to this market despite reservations about how expensive stocks appear.

Too, the structure of the stock market has changed substantially over the years. Hedge funds, robots and index funds have come to dominate trading. And, in recent years, large pension funds (e.g. CALPERS) and endowment fund managers (e.g. Harvard College's investment portfolio) tried to improve their returns by investing in so-called alternative investments. Alternative investments include such assets as raw commodities and hedge funds.

My sense is that the hedge funds were "on the wrong side of the trade" on energy when prices started to decline. Hedge funds tend to move together like lemmings, and they also tend to use debt – essentially they borrow against their assets – in order to fund purchases of additional

assets. This improves (or “juices”) returns when the trade is going in their favor. But it can also damage hedge funds when the trade goes against them. When trades go against hedge funds in a big way, the banks that lend them money start to call in the loans. And when the loans are called in, the hedge funds end up accelerating the damage because they are selling into an already-declining market in order to raise capital to repay the bank loans. It is possible that recent weakness in energy prices may, in part, be due to sales of energy assets by hedge funds.

OPEC has also taken a stand on energy. The cartel is trying to maintain its share of the energy market by squeezing out the producers of oil and natural gas that have higher costs (e.g. the fracking companies in the U. S.). OPEC is going to be patient while the high cost producers shut in production and reduce supply. Until then, the U. S. economy (and global economies) will enjoy a windfall as energy prices stay low.

As the Federal Reserve Board begins to raise interest rates, stock market returns will of necessity begin to be choppy. When bond yields begin to look attractive as substitutes for stock dividends, money will flow out of stocks and into bonds. We have not really seen any activity of this nature in years, and it could be quite a shock to some investors who do not remember our financial history.

Investment Strategy

- *Cash and bond positions will remain short. We are buying a couple of ultra short-term bond funds as bond substitutes for clients who prefer not to maintain above-average exposure to the stock market. These bond funds yield about 1%, and they are not substitutes for cash. The unit values do fluctuate, and capital losses are possible. Another downside of these mutual funds is that there is a short-term redemption fee. The upshot: unless a client is willing to retain these mutual funds for an extended period, they are not really good substitutes for cash.*
- 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 appear reasonable. *Since preferred stocks and lower-quality bonds are currently expensive when compared to high quality bonds, we would prefer to avoid these types of investments at present.*
- 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.
- *We have identified a couple of mutual funds that are devoted to the basic materials and energy sectors. Given how beaten down energy stocks have become, now is a good time to place a strategic bet that energy stock prices will normalize. And since these stocks sport decent dividends, we will be paid to wait on improving stock prices.*

- *Given moderately elevated stock values, we prefer to maintain a relatively defensive posture, which may include holding some cash on the sidelines (particularly for retirees).*

Note: Changes appear in italics.

Disclosure of Current Individual Stock Holdings

Individual stock holdings in accounts in which I have a direct beneficial interest is noted below. Stocks in *italics* are held in the accounts of a family member. The activity is current as of January 5, 2015.

Holdings:

A T & T Inc.

A, T & T, Inc. (Inh.)

Alexandria Real Estate Equities

Altria Group, Inc.

Altria Group, Inc. (Inh.)

American Electric Power (Inh.)

Apache Corporation

Banco Santander

Bank of America

Baxter International, Inc.

Berkshire Hathaway Cl. B.

Bristol Myers (Inh.)

CVX Corporation

Canadian Natural Resources

Chevron Corporation.

Cisco Systems, Inc.

Coca-Cola (Inh.)

Conagra (Inh.)

Costco

Cullen Frost Bankshares

Cummins, Inc.

Dominion Resources Inc.

Duke Energy Corp.

DuPont(E.I.) (Inh.)

eBay, Inc.

Enbridge, Inc.

Excelon (Inh.)

Flowers Foods Inc.

General Electric

Gilead Sciences

Intuitive Surgical
Johnson & Johnson (Inh.)
Kansas City Southern
Kimberly-Clark Corp.
Liberty Property Trust (Inh.)
Lincoln National Corp.
Mac-Cali Realty Corp.
McDonald's
Merck & Co. Inc.
MetLife, Inc.
MicroSoft (Inh.)
MTS Corporation
National Grid, Plc. (Inh.)
Norfolk Southern Corp.
PepsiCo Incorporated (Added, Inh.)
PetSmart
Pfizer Incorporated.
Philip Morris International, Inc.
Range Resources
Realogy Holdings Corp.
Reynolds American, Inc. (Inh.)
Schlumberger Ltd.
Spectra Energy
The TJX Companies, Inc.
Tractor Supply
VF Corp. (Inh.)
Verizon Communications
Vertex Pharmaceuticals
W. W. Grainger
Walgreen Boots Alliance (Inh.)
Wells Fargo & Co., Inc.
Whiting Petroleum Corp.

Purchases included additions to Apache Corp., Cullen Frost, General Electric, International Flavors and Fragrances, L-3 Communications, Spectra Energy and Whiting Petroleum. Sales included Annaly Capital Mgt. (from one account), Canadian Pacific Railway, Frontier Communications, Kilroy Realty Trust, Lincoln National (Reduced) and Rio Tinto.. Walgreens is now Walgreen Boots Alliance (corporate merger). **Note that some assets are new due to an inheritance (noted as Inh. after the stock name) which was partially distributed from an**

estate, and this list may change due to additional stocks from that 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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January 5, 2014

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Labrador Investments, LLC
Financial Market Trends
12/31/2014

U.S. Treasury Yields	9/30/14	12/31/14	4th Qtr. Change	12/31/13	YTD Change
90 day T-Bill	0.005%	0.046%	0.04%	0.07%	-0.03%
2 Year T-Note	0.575%	0.668%	0.09%	0.39%	0.28%
10 Year T-Note	2.502%	2.173%	-0.33%	3.04%	-0.86%
30 Year T-Bond	3.208%	2.753%	-0.46%	3.98%	-1.22%

Stock Market Indices	9/30/14	12/31/14	4th Qtr. Change	12/31/13	YTD Change
Dow Jones Industrial Average	17042.9	17823.07	4.6%	16576.66	7.5%
Standard & Poor's 500	1972.29	2058.9	4.4%	1848.36	11.4%
Nasdaq Composite	4493.39	4736.05	5.4%	4176.59	13.4%
Dow Jones Utility Index	551.29	618.08	12.1%	490.57	26.0%

Bonds Market Indices (52 wks. as of 1/2/14)	YTD Change
Barclays Corporate Intermediate	7.46%
Barclays Corporate Long Term	15.72%
Barclays Aggregate	5.96%

Foreign Stock Markets	9/30/14	12/31/14	4th Qtr. Change	4th Qtr. Currency Adjusted	YTD Change
FTSE100 (United Kingdom)	6622.72	6566.09	-0.9%	-4.8%	-2.7%
DAX (Germany)	9474.30	9805.55	3.5%	-0.9%	2.7%
Nikkei Dow (Japan)	16173.52	17450.77	7.9%	-1.2%	7.1%

Foreign Currencies	9/30/14	12/31/14	4th Qtr. Dollar's Perf.	12/31/13	YTD Change
British Pound (\$/Pound)	1.6213	1.5579	4.1%	1.6563	6.3%
Euro (\$/Euro)	1.2631	1.2099	4.4%	1.3759	13.7%
Japanese Yen (Yen/\$)	109.6477	119.69	9.2%	105.28	13.7%

Commodities	9/30/14	12/31/14	4th Qtr. % Change	12/31/13	YTD Change
Gold Spot Price/Oz. (London AM Fixing)	\$ 1,210.00	\$ 1,183.90	-2.2%	\$ 1,201.50	-1.5%
West Texas Int. Crude Oil/bbl	\$ 91.19	\$ 53.27	-41.6%	\$ 98.61	-46.0%
Natural Gas	\$ 4.14	\$ 3.00	-27.5%	\$ 4.21	-28.7%

Labrador Investments, LLC
Focus and Holdings List
December 31, 2014

NAME	09/30/14	12/31/14	% CHANGE	YIELD
CF Industries Holdings, Inc.	\$ 279.22	\$ 272.54	-2.4%	1.6%
E. I. du Pont de Nemours and Company	\$ 71.76	\$ 73.94	3.0%	2.8%
Freeport-McMoRan Inc.	\$ 32.65	\$ 23.36	-28.5%	3.4%
Nucor Corporation	\$ 54.28	\$ 49.05	-9.6%	2.9%
Praxair Inc.	\$ 129.00	\$ 129.56	0.4%	2.0%
Rio Tinto plc	\$ 49.18	\$ 46.06	-6.3%	3.8%
Weyerhaeuser Co.	\$ 31.86	\$ 35.89	12.6%	2.8%
CSX Corp.	\$ 32.06	\$ 36.23	13.0%	2.2%
Eaton Corporation plc	\$ 63.37	\$ 67.96	7.2%	2.9%
Fluor Corporation	\$ 66.79	\$ 60.63	-9.2%	1.2%
General Electric Company	\$ 25.62	\$ 25.27	-1.4%	3.5%
Honeywell International Inc.	\$ 93.12	\$ 99.92	7.3%	2.0%
Illinois Tool Works Inc.	\$ 84.42	\$ 94.70	12.2%	2.0%
Kansas City Southern	\$ 121.20	\$ 122.03	0.7%	1.0%
The Manitowoc Company, Inc.	\$ 23.45	\$ 22.10	-5.8%	0.3%
Norfolk Southern Corporation	\$ 111.60	\$ 109.61	-1.8%	2.2%
Union Pacific Corporation	\$ 108.42	\$ 119.13	9.9%	2.0%
AT&T, Inc.	\$ 35.24	\$ 33.59	-4.7%	5.2%
Frontier Communications Corporation	\$ 6.51	\$ 6.67	2.5%	6.1%
Verizon Communications Inc.	\$ 49.99	\$ 46.78	-6.4%	4.2%
Darden Restaurants, Inc.	\$ 51.46	\$ 58.63	13.9%	4.6%
Ford Motor Co.	\$ 14.79	\$ 15.50	4.8%	2.9%
Frisch's Restaurants, Inc.	\$ 28.30	\$ 26.26	-7.2%	3.1%
The Home Depot, Inc.	\$ 91.74	\$ 104.97	14.4%	2.3%
Leggett & Platt, Incorporated	\$ 34.92	\$ 42.61	22.0%	3.6%
Lowe's Companies Inc.	\$ 52.92	\$ 68.80	30.0%	1.9%
McDonald's Corp.	\$ 94.81	\$ 93.70	-1.2%	3.4%
Starbucks	\$ 75.46	\$ 82.05	8.7%	0.0%
Target Corp.	\$ 62.68	\$ 75.91	21.1%	3.4%
Tractor Supply Company	\$ 61.51	\$ 78.82	28.1%	1.0%
V.F. Corporation	\$ 66.03	\$ 74.90	13.4%	1.7%
Wal-Mart Stores Inc.	\$ 76.47	\$ 85.88	12.3%	2.6%
Wallgreen Boots Alliance	\$ 59.27	\$ 76.20	28.6%	1.7%
Altria Group Inc.	\$ 45.94	\$ 49.27	7.2%	4.7%
Anheuser-Busch InBev SA/NV	\$ 110.85	\$ 112.32	1.3%	3.7%
The Coca-Cola Company	\$ 42.66	\$ 42.22	-1.0%	3.1%
ConAgra Foods, Inc.	\$ 33.04	\$ 36.28	9.8%	3.3%
Flowers Foods, Inc.	\$ 18.36	\$ 19.19	4.5%	2.5%
The J. M. Smucker Company	\$ 98.99	\$ 100.98	2.0%	2.5%
Kellogg Company	\$ 61.60	\$ 65.44	6.2%	3.2%
Kimberly-Clark Corporation	\$ 107.57	\$ 115.54	7.4%	3.2%
Kroger	\$ 52.00	\$ 64.21	23.5%	1.3%
Pepsico, Inc.	\$ 93.09	\$ 94.56	1.6%	2.9%
Philip Morris International, Inc.	\$ 83.40	\$ 81.45	-2.3%	4.6%
The Procter & Gamble Company	\$ 83.74	\$ 91.09	8.8%	3.2%
Reynolds American Inc.	\$ 59.00	\$ 64.27	8.9%	4.8%
BP p.l.c.	\$ 43.95	\$ 38.12	-13.3%	4.7%
Canadian Natural Resources Limited	\$ 38.84	\$ 30.88	-20.5%	1.9%
Cenovus Energy Inc.	\$ 26.88	\$ 20.62	-23.3%	3.1%
Chevron Corporation	\$ 119.32	\$ 112.18	-6.0%	3.3%
Encana Corporation	\$ 21.21	\$ 13.87	-34.6%	1.3%

Enesco International	\$ 41.31	\$ 29.95	-27.5%	5.9%
Exxon Mobil Corporation	\$ 94.05	\$ 92.45	-1.7%	2.8%
National Oilwell Varco, Inc.	\$ 76.10	\$ 65.53	-13.9%	2.2%
Range Resources Corporation	\$ 67.81	\$ 53.45	-21.2%	0.2%
Stone Energy Corp.	\$ 31.36	\$ 16.88	-46.2%	
American Express Company	\$ 87.54	\$ 93.04	6.3%	1.2%
Annaly Capital Management, Inc.	\$ 10.68	\$ 10.81	1.2%	10.7%
Cullen/Frost Bankers, Inc.	\$ 76.51	\$ 70.64	-7.7%	2.7%
Equity Residential	\$ 61.58	\$ 71.84	16.7%	3.1%
Fifth Third Bancorp	\$ 20.02	\$ 20.38	1.8%	2.6%
Liberty Property Trust	\$ 37.00	\$ 37.00	0.0%	5.1%
Mack-Cali Realty Corp.	\$ 19.11	\$ 19.06	-0.3%	2.9%
Realty Income Trust	\$ 40.79	\$ 47.71	17.0%	0.0%
Sun Life Financial	\$ 36.27	\$ 36.06	-0.6%	3.5%
The Toronto-Dominion Bank	\$ 49.39	\$ 47.78	-3.3%	3.4%
U.S. Bancorp	\$ 41.83	\$ 44.95	7.5%	2.4%
Vornado Realty Trust	\$ 99.96	\$ 117.71	17.8%	2.8%
Wells Fargo & Company	\$ 51.87	\$ 54.82	5.7%	2.7%
Abbott Laboratories	\$ 41.59	\$ 45.02	8.2%	2.1%
AbbVie Inc.	\$ 57.76	\$ 65.44	13.3%	3.2%
Amgen Inc.	\$ 140.46	\$ 159.29	13.4%	1.9%
Baxter International Inc.	\$ 71.77	\$ 73.29	2.1%	2.8%
Bristol-Myers Squibb Company	\$ 51.18	\$ 59.03	15.3%	2.9%
Intuitive Surgical, Inc.	\$ 461.82	\$ 528.94	14.5%	
Johnson & Johnson	\$ 106.59	\$ 104.57	-1.9%	2.8%
Eli Lilly and Company	\$ 64.85	\$ 68.99	6.4%	3.2%
Medtronic, Inc.	\$ 61.95	\$ 72.20	16.5%	2.0%
Merck & Co. Inc.	\$ 59.28	\$ 56.79	-4.2%	3.1%
Meridian Bioscience, Inc.	\$ 17.69	\$ 16.46	-7.0%	4.0%
Pfizer Inc.	\$ 29.57	\$ 31.15	5.3%	3.6%
St. Jude Medical Inc.	\$ 60.13	\$ 65.03	8.1%	1.6%
Teva Pharmaceutical Industries Limited	\$ 53.75	\$ 57.51	7.0%	2.3%
Vertex Pharmaceuticals Incorporated	\$ 112.31	\$ 118.80	5.8%	
Zimmer Holdings, Inc.	\$ 100.55	\$ 113.42	12.8%	0.9%
Immersion Corporation	\$ 8.58	\$ 9.47	10.4%	
Intel Corporation	\$ 34.82	\$ 36.29	4.2%	2.6%
MTS Systems Corporation	\$ 68.26	\$ 75.03	9.9%	1.8%
Microsoft Corporation	\$ 46.36	\$ 46.45	0.2%	2.6%
Texas Instruments Inc.	\$ 47.69	\$ 53.47	12.1%	2.6%
American Electric Power Co., Inc.	\$ 52.21	\$ 60.72	16.3%	3.9%
Dominion Resources, Inc.	\$ 69.09	\$ 76.90	11.3%	3.6%
Duke Energy Corporation	\$ 74.77	\$ 83.54	11.7%	4.4%
Entergy Corporation	\$ 77.33	\$ 87.48	13.1%	4.6%
Exelon Corporation	\$ 34.09	\$ 37.08	8.8%	4.0%
NextEra Energy, Inc.	\$ 93.88	\$ 106.29	13.2%	3.1%
Spectra Energy Corp.	\$ 39.26	\$ 36.30	-7.5%	3.3%

Notes:

Added: Halyard Health (Spinoff of Kimberly-Clark), Walgreen Boots Alliance (Name Chg.)

Deleted: Walgreen (Name Chg. to Walgreen Boots Alliance)

Excludes certain speculative names purchased by one client.