Labrador INVESTMENTS™

Second Quarter 2014

Review and Outlook

The stock market has been rising slowly and steadily in 2014. Investors are being lulled into a coma from the lack of excitement. The low volatility that we are now experiencing can be quantified: fewer than 10 days out of the entire second quarter saw a daily market change in excess of 2%, either up or down. It is times like these when investors can be suddenly snapped out of their reverie, as eventually, profit-taking will occur. Sometimes, there is a catalyst (an event that causes fear to grip market participants). In other cases, there is no discernable reason for a hefty decline.

According to Standard & Poor's, earnings estimates for large companies have declined 1.6% since the start of the year. As we pass the midway point of 2014, investors are starting to look towards 2015 earnings as a basis for valuing stocks. Using 2015 estimates, the Standard & Poor's 500 is trading at a 14.3X price-to-earnings (P/E) multiple. That makes the stock market about fairly valued vs. long term trends. Overall, earnings are expected to grow 15.1% for the full years from 2014 to 2015. In my view, this is overly-optimistic. This may lead to reduced earnings estimates as the year progresses, and as a result, downward pressure on stock prices.

- Interest rates have risen for bonds maturing in about 2 years. This is the area of the bond market that is most sensitive to changes in the Fed's policies. Short term bond prices continue to hover near zero, while bonds maturing in the 10-year and 30-year range have declined. The decline is probably associated with reductions in international tensions related to Russia's aggression towards the Ukraine.
- The total return for the S&P 500 is 7.14% through June 30. Only taking growth (and not dividends) into account, the S&P 500 is up 6.2% vs. a much more modest 2.3% total for the Dow Jones Industrial Average. The DJIA average contains stocks with higher dividend yields as a group than the S&P 500. However, stocks sporting reasonable dividend yields seem to be back in vogue, or at least have been recently.

- Economic sectors of the market performed as follows, from high to low for the 13 weeks ending July 3: Energy (+10.7%), Information Technology (+9.4%), Health Care (+7.4%), Materials (+6.0%), Consumer Discretionary and Consumer Staples (+5.4%), Industrials (+4.2%), Financials (+4.0%), Telecommunications Services (+2.6%) and Utilities (+2.5).
- Longer term bonds in the corporate area have outpaced intermediate-term bonds so far in 2014(+11.22% vs. +3.61%). My sense is that investors' risk aversion is somewhat muted due to some stabilization geopolitically. Whether investors are being lulled into a false sense of security remains to be seen.
- Commodity price changes have been modest. Gold rose 2.8%, but is up 10.2% year-to-date, while oil rose 4.4% (7.6% year-to-date) and natural gas declined 1.1% (rising 5.2% year-to-date).
- Economic growth plummeted 2.9% in the first quarter of 2014, probably due in large part to bad weather.
- The official unemployment rate in the U.S. has dropped to 6.1% from 6.7% in December 2013.
- Congressional legislation has ground to a halt. Since 2014 is an election year, no one in Congress wants to vote for anything that might be associated with a whiff of controversy.
- International tensions seem to have diminished (or at least have not gotten worse), although there has not been a real resolution to any of them.
- In the second quarter, the United Kingdom's stock market rose a modest 1.6%, while the German market rose 2.3% and the Japanese market rose 2.5%. However, after adjusting for currency changes, the UK's market rose 4.7%, the German market rose 1.3% and Japan's market rose 4.2%. Clearly, none of the major stock markets is offering a bonanza to investors.

The search for stocks with reasonable valuations and upside potential that also pay a nice dividend continues to be frustrating. The truth is that with interest rates so low, investors have been forced into buying stocks with decent dividend yields for income. Investors who would otherwise put some of their cash into the bond market are propping up valuations. Until such time as the bond market offers a reasonable yield, investors will continue to prefer dividend-oriented stocks over bonds.

Our outlook for the bond market is that the low interest rates are here to stay for quite a while. So what is a bond investor to do? Until interest rates rise to at least reflect a positive return after inflation, we are satisfied with either holding cash or investing in stocks (or mutual funds) that provide at least a small dividend yield and growth as a bonus. Preferred stocks may also be an option for some investors. We would prefer a positive return after inflation and taxes, but the bond market is nowhere near offering a return of that magnitude.

There are so many odd happenings, both domestically as well as internationally, putting different pressures on capital markets, that trends in asset prices are hard to predict.

Accordingly, we prefer to take a conservative approach (as much as one can, with stocks dominating investment portfolios).

It will be hard for investors to justify purchasing bonds with longer maturities until interest rates rise to normal levels, then remain somewhat steady. Until then, expect a greater demand for bonds with shorter maturities and less demand for bonds with longer maturities.

Governments, households and corporations, in turn, will be looking for ways to lock in lower interest rates. This mismatch in the motives of buyers (investors) and sellers (issuers of debt instruments) will cause short term interest rates to remain low and longer term bond yields to rise.

Taking a longer view, the Federal government's annual deficit is trending down. This is a function of a slightly improving economy (despite the first quarter debacle of -2.9%) due to:

- Rising tax receipts – with business profits rising and higher employment
- A tax rate increase that was pushed through a couple of years ago
- Rising tax receipts as previously unemployed workers to back to work
- Lower unemployment benefits: expiration of the extended unemployment benefits nudges people who would otherwise not seek employment to look for work

The Fed's strategy of gradually unwinding its stimulus program will eventually put pressure on interest rates. This, in turn, will put pressure on stock prices, as investors slowly move "income-oriented" money out of dividend-oriented stocks and into bonds.

Meanwhile, overseas, the situation in the Ukraine has stabilized somewhat (if you can call it that), as the Ukrainian military fights back against Russia's invasion. We have not heard much lately about China flexing its muscles in the South China Sea. The European economy seems to have stabilized. On the other hand, unrest in the Middle East remains unabated.

Clients who own mutual funds are finding that the returns of stocks of smaller companies are lagging those of larger companies. While we have not rebalanced (i.e. sold mutual funds that invest in smaller companies, and purchased mutual funds that invest in larger companies), we have been focusing new money purchases in larger companies, with a bias towards value-oriented stocks and away from growth stocks. The reasons are twofold:

- With market valuations high, there is heightened risk of a stock market correction, so there is a defensive component to our recent purchases
- Value stocks tend to sport higher dividend yields than growth stocks

Investment Strategy

- We 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 have identified a couple of short term bond funds with relatively stable prices that might be suitable for money that should be invested in the bond market, that pay about a 1% dividend yield. The 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 pastm 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.
- 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 but may pay no dividends, or almost no dividends.
- 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 for signs of economic weakness that can put pressure downward on commodity prices.
- We believe that a rise in stock prices will generally be tied to improvements in corporate earnings *(although low bond yields have played a big role in stock valuations)*; 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.
- *Beginning In 2012, we saw a trend away from high-yielding stocks and towards lower-quality issues with little or no dividend. In the last couple of months, it appears that dividend-oriented stocks are back in vogue. Weakness in dividend-oriented stocks due to tax law changes may have run its course. Investors with high*

income requirements should come to expect that the investment performance of stocks paying above-average dividends will diverge from the major market averages. Investors should consider their goals, first and foremost, and not try to chase notoriously volatile market returns.

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 July 8, 2014.

Holdings:
A T & T Inc.
A, T & T, Inc. (Inh.)
Altria Group, Inc.
Altria Group, Inc. (Inh.)
Annaly Capital Mgmt.
Annaly Capital Mgmt. (Inh.)
Apache Corporation
Bank of America
Baxter International, Inc.
Berkshire Hathaway Cl. B.
CVX Corporation
Canadian Natural Resources
Canadian Pacific Railway Ltd.
Chevron Corporation.
Cisco Systems, Inc.
Conagra (Inh/Added)
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.
Ford Motor Company
Frontier Corp. (Inh.)
General Electric
Gilead Sciences
Immersion Corp.

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.)
Newmont Mining Corp.
Norfolk Southern Corp.
Patriot Coal Corp.
PepsiCo Incorporated (Added, Inh.)
PetSmart
Pfizer Incorporated.
Philip Morris International, Inc.
Potash Corp.
Qualcomm, Inc.
Range Resources
Realogy Holdings Corp.
Reynolds American, Inc. (Inh.)
Rio Tito PLC Spon. ADR
Schlmberger Ltd.
Spectra Energy
Target Corporation
The TJX Companies, Inc.
Tractor Supply
VF Corp. (Inh.)
Verizon Communications
Vertex Pharmaceuticals
W. W. Grainger
Walgreen (Inh.)
Wells Fargo & Co., Inc.
Whiting Petroleum Corp.

Purchases included General Electric, Gilead Sciences, International Flavors and Fragrances, Realogy Holdings Corp., Starbucks and The TJX Companies, inc. Sales included ABB, Ltd., PepsiCo (Reduced) and Potash Corp.. **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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Labrador Investments, LLC
Financial Market Trends
6/30/2014

U.S. Treasury Yields	3/31/14	6/30/14	4th Qtr. Change	12/31/13	YTD Change
90 day T-Bill	0.05%	0.02%	-0.03%	0.07%	-0.05%
2 Year T-Note	0.42%	0.45%	0.03%	0.39%	0.06%
10 Year T-Note	2.74%	2.51%	-0.23%	3.04%	-0.53%
30 Year T-Bond	3.59%	3.34%	-0.25%	3.98%	-0.64%

Stock Market Indices	3/31/14	6/30/14	4th Qtr. Change	12/31/13	YTD Change
Dow Jones Industrial Average	16457.66	16954.27	3.0%	16576.66	2.3%
Standard & Poor's 500	1872.34	1962.61	4.8%	1848.36	6.2%
Nasdaq Composite	4198.99	4368.68	4.0%	4176.59	4.6%
Dow Jones Utility Index	532.13	565.44	6.3%	490.57	15.3%

Bonds Market Indices (52 wks. as of 1/2/14)	YTD Change
Barclays Corporate Intermediate	3.61%
Barclays Corporate Long Term	11.22%
Barclays Aggregate	3.93%

Foreign Stock Markets	3/31/14	6/30/14	4th Qtr. Change	4th Qtr. Currency Adjusted	YTD Change
FTSE100 (United Kingdom)	6639.4	6743.94	1.6%	4.7%	0.0%
DAX (Germany)	9614.6	9833.07	2.3%	1.3%	2.9%
Nikkei Dow (Japan)	14791.99	15162.1	2.5%	4.2%	10.1%

Foreign Currencies	3/31/14	6/30/14	4th Qtr. Dollar's Perf.	12/31/13	YTD Change
British Pound ($/Pound)	1.6631	1.7151	-3.0%	1.6563	-3.4%
Euro ($/Euro)	1.3811	1.3679	1.0%	1.3759	0.6%
Japanese Yen (Yen/$)	103.22	101.5258	-1.6%	105.28	-3.6%

Commodities	3/31/14	6/30/14	4th Qtr. % Change	12/31/13	YTD Change
Gold Spot Price/Oz.	$ 1,291.75	$ 1,327.50	2.8%	$ 1,204.80	10.2%
West Texas Int. Crude Oil/bbl	$ 101.57	$ 106.07	4.4%	$ 98.61	7.6%
Natural Gas	$ 4.48	$ 4.43	-1.1%	$ 4.21	5.2%

Labrador Investments, LLC
Focus and Holdings List
June 30, 2014

NAME	03/31/14	06/30/14	% CHANGE	YIELD
CF Industries Holdings, Inc.	$ 260.64	$ 240.53	-7.7%	4.0%
E. I. du Pont de Nemours and Company	$ 67.10	$ 65.44	-2.5%	1.8%
Freeport-McMoRan Copper & Gold Inc.	$ 33.07	$ 36.50	10.4%	1.3%
Nucor Corporation	$ 50.54	$ 49.25	-2.6%	1.5%
Praxair Inc.	$ 130.97	$ 132.84	1.4%	2.6%
Rio Tinto plc	$ 55.83	$ 54.28	-2.8%	2.2%
Weyerhaeuser Co.	$ 29.35	$ 33.09	12.7%	0.9%
CSX Corp.	$ 28.97	$ 30.81	6.4%	0.6%
Eaton Corporation plc	$ 75.12	$ 77.18	2.7%	2.0%
Fluor Corporation	$ 77.73	$ 76.90	-1.1%	0.8%
General Electric Company	$ 25.89	$ 26.28	1.5%	0.9%
Honeywell International Inc.	$ 92.76	$ 92.95	0.2%	1.8%
Illinois Tool Works Inc.	$ 81.33	$ 87.56	7.7%	1.7%
Kansas City Southern	$ 102.06	$ 107.51	5.3%	1.1%
The Manitowoc Company, Inc.	$ 31.45	$ 32.86	4.5%	0.1%
Norfolk Southern Corporation	$ 97.17	$ 103.03	6.0%	2.2%
Union Pacific Corporation	$ 93.83	$ 99.75	6.3%	1.8%
AT&T, Inc.	$ 35.07	$ 35.36	0.8%	1.8%
Frontier Communications Corporation	$ 5.71	$ 5.84	2.4%	0.4%
Verizon Communications Inc.	$ 47.57	$ 48.93	2.9%	2.1%
Coach, Inc.	$ 49.66	$ 34.19	-31.2%	1.4%
Darden Restaurants, Inc.	$ 50.76	$ 46.27	-8.8%	2.2%
Ford Motor Co.	$ 15.60	$ 17.24	10.5%	0.5%
Frisch's Restaurants, Inc.	$ 23.67	$ 23.60	-0.3%	0.7%
The Home Depot, Inc.	$ 79.13	$ 80.96	2.3%	1.9%
Leggett & Platt, Incorporated	$ 32.64	$ 34.28	5.0%	1.2%
Lowe's Companies Inc.	$ 48.90	$ 47.99	-1.9%	0.9%
McDonald's Corp.	$ 98.03	$ 100.74	2.8%	3.2%
Starbucks		$ 77.55		1.0%
Target Corp.	$ 60.51	$ 57.95	-4.2%	2.1%
Tractor Supply Company	$ 70.63	$ 60.40	-14.5%	0.6%
V.F. Corporation	$ 61.88	$ 63.00	1.8%	1.1%
Wal-Mart Stores Inc.	$ 76.43	$ 75.07	-1.8%	1.9%
Walgreen Co.	$ 66.03	$ 74.13	12.3%	1.3%
Altria Group Inc.	$ 37.43	$ 41.94	12.0%	1.9%
Anheuser-Busch InBev SA/NV	$ 105.30	$ 114.94	9.2%	4.0%
The Coca-Cola Company	$ 38.66	$ 42.36	9.6%	1.2%
ConAgra Foods, Inc.	$ 31.03	$ 29.68	-4.4%	1.0%
Flowers Foods, Inc.	$ 21.45	$ 21.08	-1.7%	0.5%
The J. M. Smucker Company	$ 97.24	$ 106.57	9.6%	2.3%
Kellogg Company	$ 62.71	$ 65.70	4.8%	1.8%
Kimberly-Clark Corporation	$ 110.25	$ 111.22	0.9%	3.4%
Kroger	$ 43.65	$ 49.43	13.2%	0.7%
Pepsico, Inc.	$ 83.50	$ 89.34	7.0%	2.6%
Philip Morris International, Inc.	$ 81.87	$ 84.31	3.0%	3.8%
The Procter & Gamble Company	$ 80.60	$ 78.59	-2.5%	2.6%
Reynolds American Inc.	$ 53.42	$ 60.35	13.0%	2.7%
BP plc	$ 48.10	$ 52.75	9.7%	2.3%
Canadian Natural Resources Limited	$ 38.37	$ 45.91	19.7%	0.8%
Cenovus Energy Inc.	$ 28.96	$ 32.37	11.8%	1.0%
Chevron Corporation	$ 118.91	$ 130.55	9.8%	4.3%

Encana Corporation	$ 21.38	$ 23.71	10.9%	0.3%
Ensco International	$ 52.78	$ 55.57		3.0%
Exxon Mobil Corporation	$ 97.68	$ 100.68	3.1%	2.8%
National Oilwell Varco, Inc.	$ 77.87	$ 82.35	5.8%	1.8%
Now, Inc.		$ 36.21		
Range Resources Corporation	$ 82.97	$ 86.95	4.8%	0.2%
Stone Energy Corp.	$ 41.97	$ 46.79	11.5%	
American Express Company	$ 90.03	$ 94.87	5.4%	1.0%
Annaly Capital Management, Inc.	$ 10.97	$ 11.43	4.2%	1.2%
Cullen/Frost Bankers, Inc.	$ 77.53	$ 79.42	2.4%	2.0%
Equity Residential	$ 57.99	$ 63.00	8.6%	2.0%
Fifth Third Bancorp	$ 22.95	$ 21.35	-7.0%	0.5%
Liberty Property Trust	$ 36.96	$ 37.93	2.6%	1.9%
Mack-Cali Realty Corp.	$ 20.49	$ 21.48	4.8%	0.6%
Realty Income Trust		$ 44.42		5.4%
Sun Life Financial	$ 35.33	$ 36.71	3.9%	1.3%
The Toronto-Dominion Bank	$ 46.52	$ 51.41	10.5%	1.7%
U.S. Bancorp	$ 42.86	$ 43.32	1.1%	1.0%
Vornado Realty Trust	$ 98.56	$ 106.73	8.3%	2.9%
Wells Fargo & Company	$ 49.74	$ 52.56	5.7%	1.4%
Abbott Laboratories	$ 38.51	$ 40.90	6.2%	0.9%
AbbVie Inc.	$ 51.40	$ 56.44	9.8%	1.7%
Amgen Inc.	$ 123.34	$ 118.37	-4.0%	2.4%
Baxter International Inc.	$ 73.58	$ 72.30	-1.7%	2.1%
Bristol-Myers Squibb Company	$ 51.95	$ 48.51	-6.6%	1.4%
Intuitive Surgical, Inc.	$ 437.99	$ 411.80	-6.0%	
Johnson & Johnson	$ 98.23	$ 104.62	6.5%	2.8%
Eli Lilly and Company	$ 58.86	$ 62.17	5.6%	2.0%
Medtronic, Inc.	$ 61.54	$ 63.76	3.6%	1.2%
Merck & Co. Inc.	$ 56.77	$ 57.85	1.9%	1.8%
Meridian Bioscience, Inc.	$ 21.79	$ 20.64	-5.3%	0.8%
Pfizer Inc.	$ 32.12	$ 29.68	-7.6%	1.0%
St. Jude Medical Inc.	$ 65.39	$ 69.25	5.9%	1.1%
Teva Pharmaceutical Industries Limited	$ 52.84	$ 52.42	-0.8%	1.2%
Vertex Pharmaceuticals Incorporated	$ 70.72	$ 94.68	33.9%	
Zimmer Holdings, Inc.	$ 94.58	$ 103.86	9.8%	0.9%
Immersion Corporation	$ 10.55	$ 12.72	20.6%	
Intel Corporation	$ 25.81	$ 30.90	19.7%	0.9%
MTS Systems Corporation	$ 68.49	$ 67.76	-1.1%	1.2%
Microsoft Corporation	$ 40.99	$ 41.70	1.7%	1.1%
Texas Instruments Inc.	$ 47.16	$ 47.79	1.3%	1.2%
American Electric Power Co., Inc.	$ 50.66	55.77	10.1%	2.0%
Dominion Resources, Inc.	$ 70.99	71.52	0.7%	2.4%
Duke Energy Corporation	$ 71.22	74.19	4.2%	3.1%
Entergy Corporation	$ 66.85	82.09	22.8%	3.3%
Exelon Corporation	$ 33.56	36.48	8.7%	1.2%
NextEra Energy, Inc.	$ 95.62	102.48	7.2%	2.9%
Spectra Energy Corp.	$ 36.94	42.48	15.0%	1.3%

Notes:

Added: NOW, Inc. (Spinoff of National Oilwell Varco), Realty Income Trust, Starbucks Corp.

Deleted: None

Stock Splits: Union Pacific, 2-for-1

Excludes certain speculative names purchased by one client.