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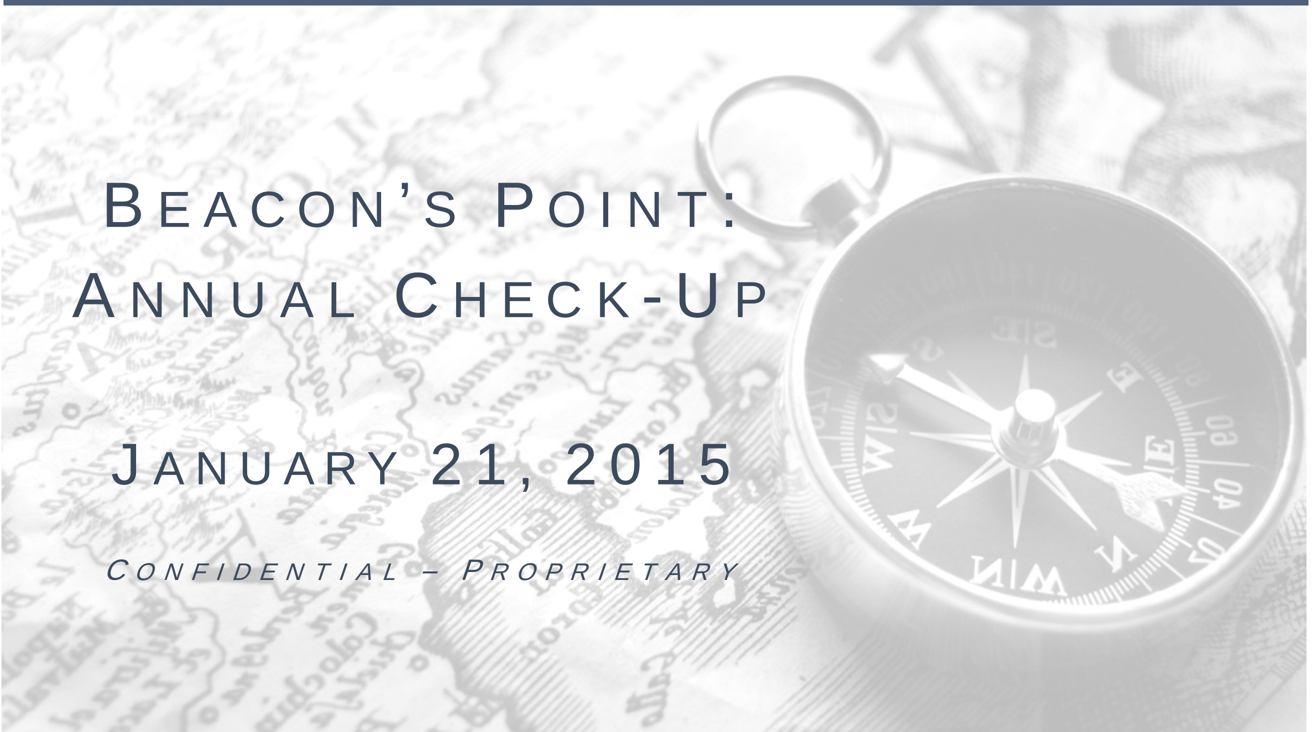

BEACON'S POINT: ANNUAL CHECK-UP

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CONFIDENTIAL – PROPRIETARY

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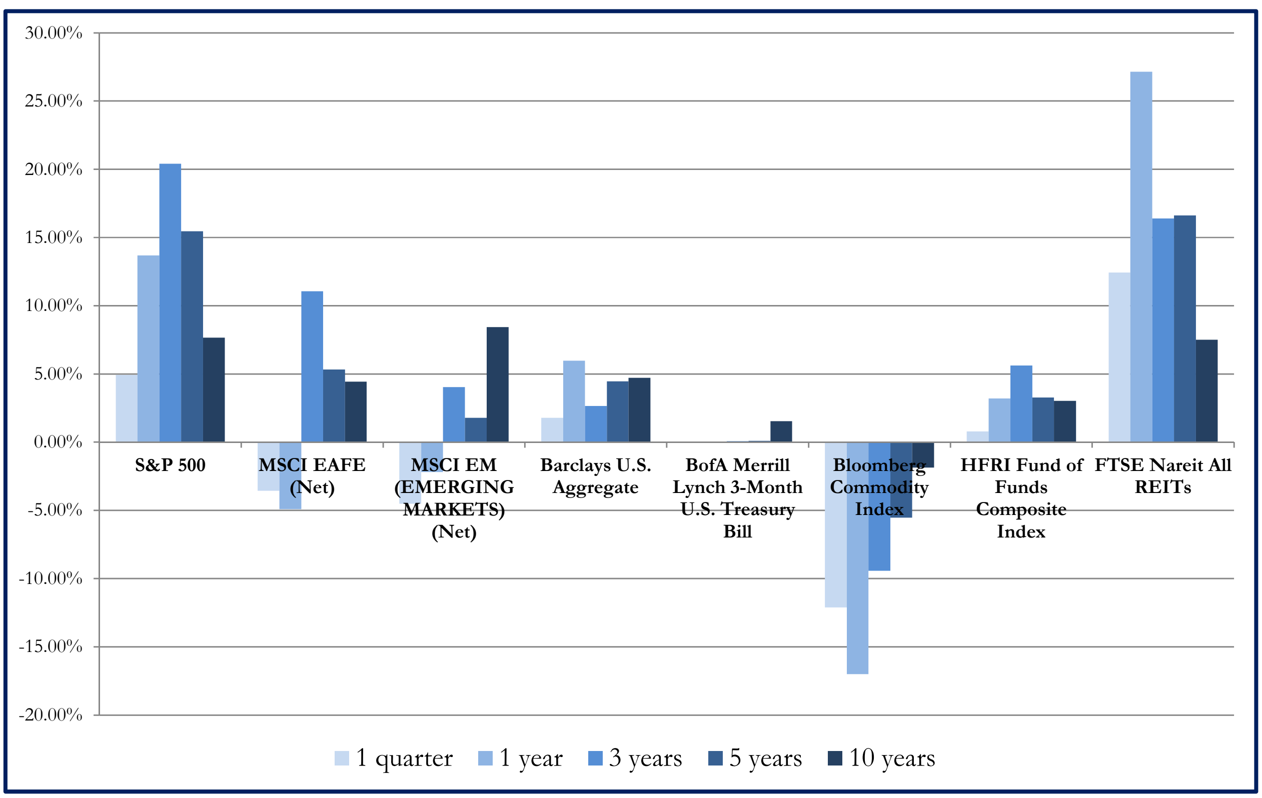
Annual Check-Up

So long 2014, hello 2015! At the start of another New Year, we pause to reflect on the previous 12 months, discuss why markets are seemingly starting to change their tune, and acknowledge that the coming year may pose some new challenges for the global economy and financial assets. Capital market volatility has bounced off its recent record low levels and may very well take center stage in 2015. While multiple factors have contributed to this volatility spike, it appears that the major drivers are concerns over a global growth slowdown and central bank policy decisions. Before we look forward, let's briefly look back at 2014.

Our annual check-up reveals that investors with U.S.-centric portfolios recorded another strong year. The S&P 500 Index gained just under 14%, including dividends, and the Barclays Capital U.S. Aggregated Bond Index advanced almost 6%. This bond performance defied expectations at the start of the year – contrary to the consensus view, Treasury yields fell in 2014, pushing bond prices higher, a move that was most pronounced at the long end of the yield curve.

Outside of the U.S., asset class returns last year were far less impressive. Both developed international and emerging market equities lost ground, foreign currencies were weak (paced by the Russian ruble's 50% depreciation relative to the U.S. dollar), and non-U.S. fixed income ended the year in negative territory. The worst segment of the market was the commodity complex, while global real estate securities (REITs) outperformed all other assets. The following chart compares returns for several key indices over the short-term and long-term periods ending December 31, 2014.

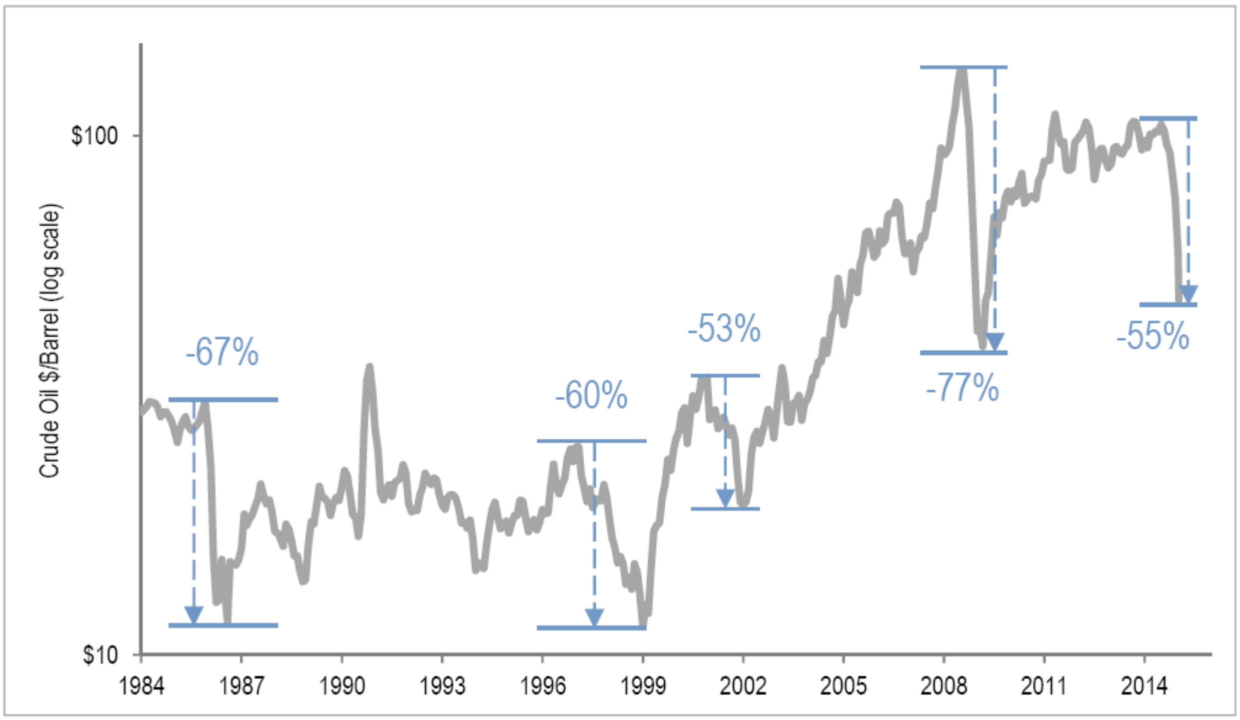


Source: Zephyr Style Advisor, Beacon Pointe

This divergence in financial markets performance is a reflection of the differences in the underlying economies. On one hand, the U.S. economy posted back-to-back strong growth quarters (2Q14 and 3Q14, the latest available data). Corporate America's profits reached a new all time high. Inflation remains tame, while the labor market shows encouraging signs of strength. On the other hand, the Eurozone is struggling with weak growth and deflation, geopolitical tensions remain elevated, Japan is back in recession, and China growth continues to trend down. As these developments do not occur in a vacuum, U.S. investors have been – and should be – paying attention. Additionally, the current environment is even more challenging due to the following top-of-mind issues:

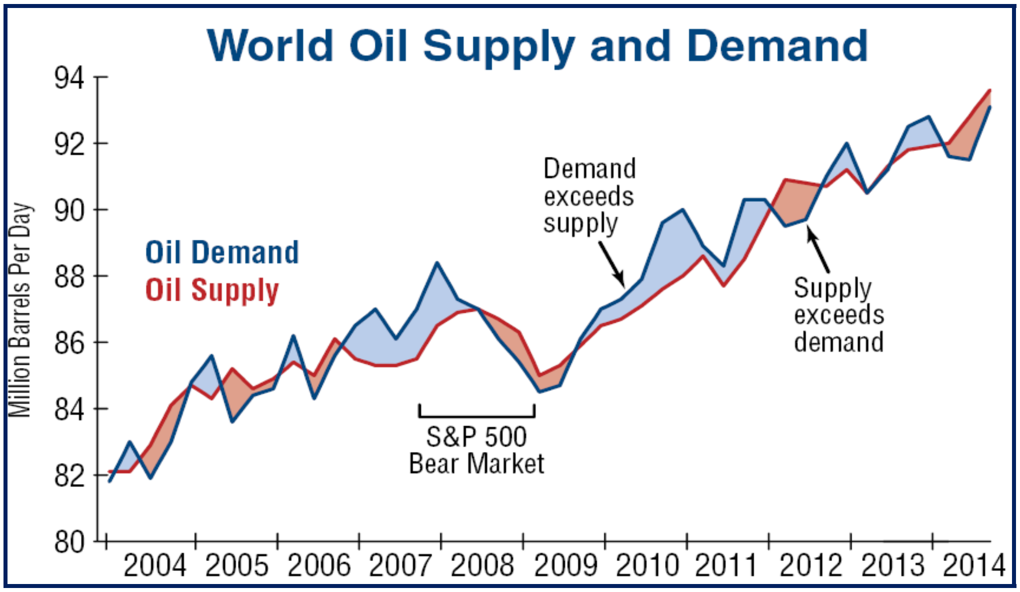
Oil price on our minds...

The spectacular collapse in the price of oil is perhaps the most compelling investment theme of the day. Since June 2014, when it traded at a high of around $107, crude has lost over 55% of its value and now trades in the mid to high $40s (as shown in the chart below).



Source: Goldman Sachs

Oil in the $40s is painfully reminiscent of 2008. However, most analysts believe that the current bear market in oil is primarily supply-driven. Generally, supply-driven oil bear markets are followed by increased productivity and growth. (In contrast, demand-driven oil bear markets reflect stress in the real economy, as during the 2008 financial crisis and Great Recession.) Game-changing advances in extraction technology and the remarkable growth in North American shale production have been big factors on the supply side of the oil equation. And OPEC's surprising recent decision to maintain – as opposed to cut – its own production levels accelerated the rate of decline for oil prices. The basic law of economics dictates that when supply exceeds demand (as is the case at present, shown in the graph on the following page), prices fall, leading to adjustments in production and capacity.



Source: InvesTech Research, International Energy Agency

The implications of lower oil are numerous and far reaching. Starting with the positive news – low oil prices are as good as a tax cut for consumers, boosting confidence and increasing disposable income. Many sectors can and will benefit from reduced input costs, especially those companies that can maintain pricing and expand their margins. Retail and consumer companies should fare particularly well. Finally, the major oil importers, such as China, Europe, and Japan, will benefit from the cheaper commodity. Potential negatives, domestically, include weakness in the energy sector (with pressure on cash flows, margins, and profits), interruptions in the labor market recovery (to the extent that job creation is tied to the U.S. energy renaissance), and spread widening contagion beyond energy high yield issuers. Outside of the U.S., lower oil will certainly be a headwind for OPEC members as well as Mexico, Brazil, Russia, and Norway. The extent of the squeeze will depend on each oil exporter's cost of production/breakeven level. How they react to persistently low oil prices, or to any further declines, bears watching.

Swiss Franc on our minds...

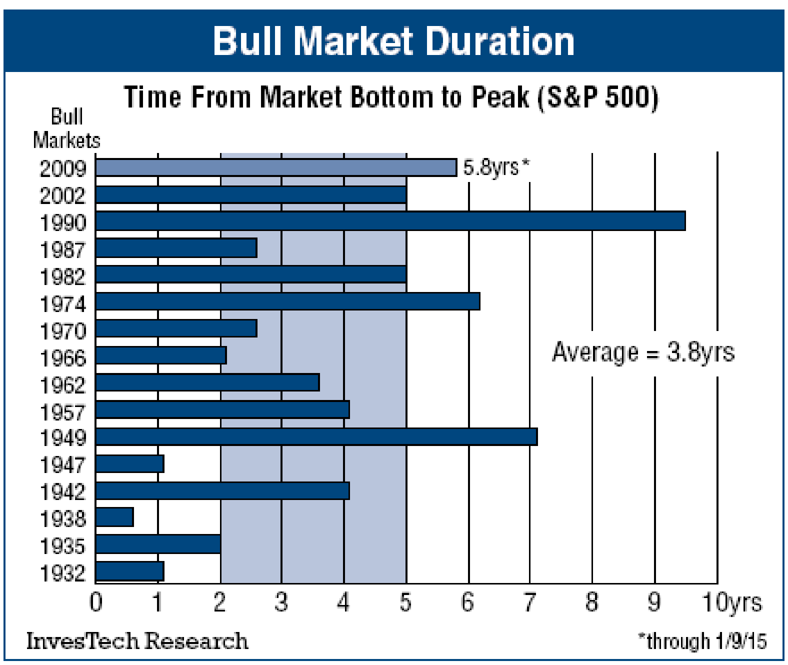
In mid-January, Switzerland's central bank unexpectedly removed the cap on the Swiss franc's exchange rate against the euro, which had been in place for over three years. This resulted in a sharp decline in the euro/franc rate (a 30% move) and pressured the Swiss stock market down (-8% on the day.) A stronger currency hurts Switzerland's export-oriented companies, as their goods and services become more expensive to businesses and consumers beyond its borders. Globally, the abandonment of the cap, and the accompanying rate cuts by the Swiss National Bank, provided additional fuel to the volatility fire, especially in currency and debt markets. In the age of continuous information and relative transparency, investors are especially sensitive to unexpected shifts in central bank policy. Will there be more of this to come in 2015?

Interest rates on our minds...

As was widely anticipated, the ECB (European Central Bank) is finalizing a new asset purchasing program this week in an effort to restart economic growth in the Eurozone and fight deflationary pressures. European bond yields continue to fall and are, in fact, negative for Germany's and Switzerland's five year government bonds. In Japan, various policy measures have yet to stem the fall in inflation as Japan's economy seems stuck in neutral. Last week, India announced interest rate cuts amid slowing growth and low inflation. Meanwhile in the U.S., the last round of the Fed's Quantitative Easing program ended in the fall of 2014. Federal Reserve policy is now focused on the optimal timing and pace of interest rate increases. Among other factors, the Fed will have to consider the impact of a stronger dollar, global capital flows, and deteriorating economic conditions outside of the U.S.

Until late 2014, capital markets were quick to overcome one potential source of risk after another. Voya Investment Management argues that "resilience has been a defining characteristic of markets for some time now, as we have seen them shake off such potentially destabilizing events as Europe's chronic economic malaise, China's growth slowdown and Japan's sharp and surprising return to recession. And that's not to mention the various geopolitical hotspots – Ukraine, the Middle East and elsewhere – that flared up from time to time." We could add the Ebola scare, terrorist attacks, and natural disasters to the list. Resilience, however, seems to have been replaced by nervous jitters over the last couple of months.

Presently, markets react to bad news with intra-day volatility and lower closes, rather than shrugging the news off, as had been the case previously. This renewed appreciation of risk should not come as a surprise, given the age of the current bull market and the lack of meaningful corrections over the past few years. Data from InvesTech Research (summarized in the graph below) shows that "most bull markets last between two and five years, and the average life span since 1930 is just 3.8 years." InvesTech Research points out that "today's bull market –at 5.8 years of age– is already two years longer than the average, and may soon become the third longest bull market of the past 85 years." As we wrap up this annual check-up, the prescription for the New Year reads much like this Dutch proverb: "In prosperity, caution; in adversity, patience." If volatility persists throughout 2015, as we expect, both caution and patience will serve investors and their portfolios well.



Source: InvesTech Research

Please feel free to call Beacon Pointe at 949-718-1600 should you need additional information or have any questions.