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Dear Client,

It appears that 2014 is going to be the kind of year that requires (and let's hope rewards) a great deal of patience on the part of investors. In our March letter we observed that the equity markets were likely to advance in a "two-steps-forward and one-step-backward" fashion, and that has definitely been the case. That goes for fixed income as well. In spite of all the difficulties we have faced in the first four months of the year we still expect reasonable economic growth, high single-digit earnings growth, and an S&P 500 return near 10%.

There have been two corrections so far this year in the S&P 500: late January down 5.8% and early April down 4.0%. In 2013 there were a few more, but the range was similar. There was a correction of down 2.8% on the low side and down 5.8% on the high side. Although it may not have felt like it, through April 30th the S&P 500 (including dividends) was up 2.4%, and our three main strategies were up, as well. Net of fees, our Equity Select Portfolio was up 1.6%, the Dividend Portfolio was up 8.0%, and the Mutual Fund Mix Portfolio was up 2.6%. Regardless of the Fed's tapering policy fixed income has performed better than many had expected to date. The UST 10-year has returned about 3%.

There have been a number of things that have caused the investors to have doubts. However, the markets have been able to slog through the bad news and the worries. The cold weather almost literally froze the economy, and as a result we have seen a real mixed bag in the performance of the economy. Last week began with a weaker-than-expected Q1 GDP gain of 0.1%. Days later strong retail sales and personal income were reported, followed on Friday by the largest non-farm payroll number (+288k) in over two years. Russia's annexation of Crimea and the threats to Ukraine continue to sow a great deal of uncertainty. We also believe a good deal of the weakness in equity markets in late March and early July was driven by selling related to larger-than-expected tax bills due on April 15th. If it didn't actually happen to you, we are pretty sure you know any number of friends or neighbors who expressed surprise (that's putting it nicely) at the tax bill they faced as a result of changes in the tax code this year. There has also been a rotation from some of the more expensive (based on P/E) growth stocks back into defensive and value stocks, which has caused a steep correction in some of the more visible biotech and social media names. We believe much of the weather-related activity will recover, that the tax selling is over, the Federal Reserve remains committed to near-zero short-term rates, and we don't expect the Ukrainian situation to escalate to a point where our military is involved, or our economy suffers significantly.

In the meantime large, global businesses have been busy taking advantage of opportunities. Apple and many other firms continue to buy back their own stock and increase dividend payments. Facebook, IBM, Comcast, Pfizer, and General Electric are just a handful of the companies that have either completed or are actively pursuing mergers and acquisitions. These deals have been made with long-term results in mind. There may be temporary economic and political headwinds, but these companies see opportunities, value, and synergies. We should behave the same way with our investments – look at the longer-term.

We'd like to make a comment about Michael Lewis' recent book, "Flash Boys", which describes his view of high-frequency trading (HFT) and his suggestion that the market is "rigged." We don't think the market is rigged and we fear that notion may, unfortunately, just serve to keep certain investors from putting their money to work investing in good, solidly-profitable, well-managed companies. From our vantage point, clients now execute equity trades with historically narrow bid/offer spreads and historically low transaction costs. Electronic trading and a proliferation of competitive exchanges are responsible for this very favorable development.

If 2014 continues to zig and zag as the market gradually heads higher knowing what's in your portfolio and why it's there will give you confidence about your investments, so please contact us with any questions. As always, thank you for letting us manage your portfolios.

Michael A. Camp
Principal

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