



## First Quarter 2014 Report

Dear Valued Client:

The picture we have painted of the United States economy over the last several years, of an economy steadily growing but at a subdued rate, remained much the same in the first quarter of 2014. Despite a bitterly cold winter, most important economic indicators remained positive – the Conference Board's Consumer Confidence Index increased from 78.3 to 82.3 in March and the Conference Board's Leading Economic Indicators also increased in January and February. Recent reports from the Institute of Supply Management ("ISM") indicate the U.S. economy grew for the 58<sup>th</sup> consecutive month in March.

Employment growth in March was relatively strong with 192,000 net new jobs created, slightly higher than the 12-month average of 183,000 jobs. The rate of unemployment remained unchanged at 6.7%. Housing prices continued to increase with the Case Shiller Home Price Index up 13.8% on a year to year basis, although it posted its third straight monthly decline. Single family home sales decreased in the quarter, probably reflecting the increase in mortgage lending rates. Looking back a quarter, the Bureau of Economic Analysis announced that U.S. GDP grew at 2.6% in real terms in the fourth quarter of 2013, slower than the rate of growth of 4.1% in the third quarter. For all of 2013, real GDP growth was 1.9%, compared to 2.6% in 2012.

Index	Qtr	YTD
S&P 500	1.81	21.86
Russell 2000	1.12	24.90
MSCI EAFE	0.77	18.06
MSCI Emerging Mkt	-0.37	-1.07
Barclays Treas Intern	0.65	-0.84
Barclays Agg Bond	1.84	-0.10
DJ Commodity	6.99	-2.10
HFRI Global Hedge	1.11	4.63
10 Yr Treasury Yield	2.72	1.85

In the first quarter, the actions of the Federal Reserve were under particular scrutiny with the transition from Ben Bernanke to Janet Yellen. The FOMC continued to reduce its bond buying by \$10.0 billion per month during the first quarter. Chairman Yellen's first attempt to articulate the Fed's position on increasing interest rates temporarily spooked the market, causing rates to spike sharply upward in February before settling down again.



2013 ended on a splendid note with the S&P 500 up 32.4% for the year. When we wrote last quarter, we suggested that we thought that equity valuations had gotten extended and that there was potential for a correction. While some high

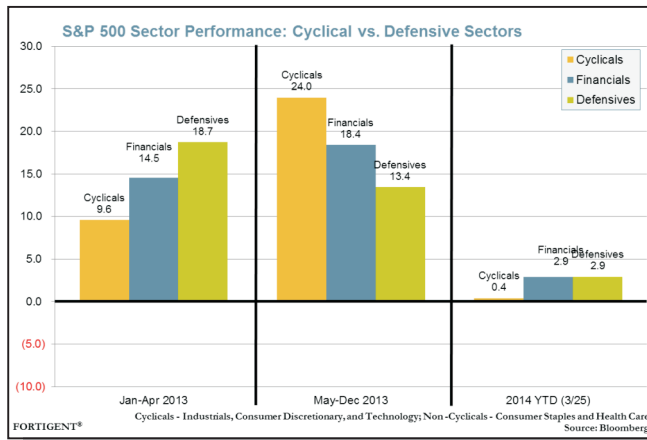
valuation growth companies are in the midst of a pull back, the broad equity markets bumped along in the first quarter, but were still positive. For the quarter, the S&P 500 rose 1.8%, with U.S. large cap stocks favored over higher valuation small cap stocks and defensive

*continues on page 2*

# First Quarter 2014 Report (continued)

stocks outperforming more cyclical stocks - similar to 2013. International stocks had mixed returns in the first quarter, with the MSCI World Index up 1.4%. Emerging market indices were down for the quarter. Russian equities, reflecting the geo-political adventures of President Putin, were down 14.5%. Overall, equity markets were much more volatile in the first quarter. The Vix Index spiked to more than 18 in February and nearly reached that level again in March.

The bond market had a better quarter. After being down 2% in 2013, the broad-based Barclay's Aggregate Index was up 1.8% in Q1 and the yield on the U.S. Treasury 10-Year Bond decreased from 3.03% on December 31 to 2.72% on March 31. Corporate bonds returned 2.9% for the quarter, with spreads tightening as well as rates falling, and municipal bonds performed well with the Barcap Muni AAA Index up 2.2%. The fixed income market also benefited from net inflows of \$34.3 billion to bond mutual funds after seeing net outflows of \$83.6 billion in 2013.



The S&P 500 began the year at 1,831.98. It dipped to 1,741.89 on February 3 and recovered to 1,872.34 on March 31. As of the writing of this letter, the S&P stood at 1,828. Consensus 2014 earnings for the S&P 500 are \$118.78. Consensus 2015 earnings are \$132.47. At today's valuation that means the price/earnings ratio on 2014 earnings is 15.4 and on 2015

earnings is 13.8. The average price/earnings ratio of the S&P 500 over the last 10 years is 13.8. This suggests that the market at this time is relatively fairly valued.

Our expectation is that the U.S. economy will continue to grow at the slow pace of the last three years. We expect equity markets to continue in the range they have followed so far this year. As we get closer to the Fed raising short term rates, interest rates will increase, pushing bond prices down and probably weighing on the equity markets as well.

Copyright © 2014 Hemenway Trust Company LLC

Important Information: Information regarding investments is for information purposes only. The views expressed are subject to change based on market or other conditions without notice. The information should not be construed as investment advice or a recommendation to buy or sell any security or investment product. It does not take into account an investor's particular objectives, risk tolerance, tax status, investment horizon, or other potential limitations. All material has been obtained from sources believed to be reliable, but the accuracy cannot be guaranteed. Past performance is not a guide to or guarantee of future performance. An HTC portfolio could suffer losses as well as achieve gains. Where reference is made to returns of specific indexes, returns of the indexes also do not typically reflect the deduction of investment management fees, trading costs or other expenses. It is not possible to invest directly in an index. Indexes are the property of their respective owners, all rights reserved.