July 1, 2014

Dear Client,

The themes in the investment markets during the just completed second quarter were virtually unchanged from recent periods. The Federal Reserve persists in keeping short-term interest rates at zero while reducing the purchases of government backed bonds and mortgages; the economy continues its muddle through recovery; slow employment advancements endure; after a brief spike at the end of last year, longer-term interest rates dropped back into a trading range established over the last few years; and the stock markets are trending higher on low volume, likely due to few attractive investment alternatives and no major event derailing the progress.

Focusing on the Federal Reserve for a second, their every six weeks meetings include discussions on the normalization (increase) of interest rates. However, the time horizon is distant enough to have little more than a temporary impact on investment decisions. At this point expectations are for tentative action sometime in 2015 but not if the board members have concerns regarding the economic recovery, so the onset of rate increases is very uncertain.

The reference to no major events in the first paragraph ignores the new problems in Ukraine and what appears to be a significant meltdown in numerous Middle Eastern countries. As both of these regions are important energy centers, as recently as 2005, when the U.S. imported over 60% of oil consumed, these instabilities would likely have affected global markets and might have involved military intervention. But with less than 40% of U.S. consumed oil now being imported, and the percentage trending lower, there is less concern on a policy or economic level.

Regarding the investment climate, I continue to be very selective in adding to new or existing positions as the market improvements over the last five plus years are getting extended related to both time and percentage. When I find an attractive investment I have no problem taking action, there are just not that many clear winners in today's environment and I have sold some holdings to take profit. This leaves my portfolios with cash balances that are higher than normal.

I have included a chart prepared by GMO LLC, a very well regarded money management firm that focuses on asset valuations and allocations. The chart provides a visualization of the forecasted 7-year returns on a number of asset classes adjusted for inflation (real return forecast). Needless to say, the projected returns are muted at best, and in the case of some asset classes, expected to be negative. Also remember, that while an investment in say emerging markets has an expected positive return, in my opinion, the projected return is not high enough to compensate for the investment risk. As I have stated before, these types of projections and forecasts are of no use in predicting investment returns over the next year or so but do have a good longer-term record.

New West Investment's portfolios are benefiting from superior risk adjusted returns this year due to stock selection. The average managed portfolio is enjoying over three quarters of the broad stock market returns with only half the exposure to the stock market. Enclosed please find your investment portfolio report through the second quarter and invoice, if applicable. Please call with questions, concerns or to discuss your thoughts. Have a great summer.

Best regards,

Peter V. Hedberg