Pinnacle Capital Management, LLC

January, 2015

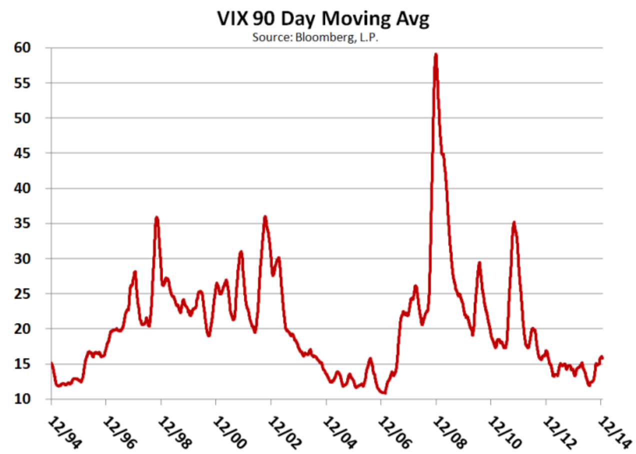
COMMENTARY

ECONOMIC STATISTICS					
	4th Qtr (12/31/14)	3rd Qtr (9/30/14)	*% Change*	1 Yr Ago (12/31/13)	*% Change*
S&P 500 Index	2,058.90	1,972.22	*4.4%*	1,848.36	*11.4%*
10 Year Treasury Yield	2.17%	2.49%%		3.03%	
Gold Spot ($ / oz)	$1,184.86	$1,208.16	*-1.9%*	$1,205.65	*-1.7%*
WTI Crude Oil (next future)	$53.27	$91.16	*-41.6%*	$98.42	*-45.9%*
GDP Qtr / Qtr	N/A	5.0%		3.5%	
CPI Y / Y	0.8%	1.7%		1.5%	
Unemployment Rate	5.6%	5.9%		6.7%	

2014 can safely be referred to as the year of volatility. Swings in the stock and bond markets occurred at magnitudes not seen since the market crashes of 2008 and early 2000s! Actually, we were only kidding; the opposite is true. While market volatility increased somewhat in 2014 from the prior year – especially in the latter half – by historical standards volatility was still quite low. The chart on the reverse side shows the 90 day moving average of the CBOE SPX Volatility Index, better known as VIX, for the past 20 years. We can provide other indicators of volatility, but the point is 2014 was a below average year for volatility.

So the question is, why did the year seem so gut wrenching? First, to many of you it might not have seemed that way. We know, however, from the volume of calls we received that for others 2014 felt like a sickening roller coaster ride. We think the answer stems from a few factors. First, with interest rates so low, many more individuals were relying on stock market returns to meet their personal objectives. With income from fixed investments not what it used to be, many individuals were paying attention as they hadn't before. In search of returns, many may have had higher exposure to stocks as well. To them, volatility was something quite new. Second, many had gotten used to relatively smooth markets. 2013 was especially calm as both stock and bond prices advanced. At the same time, the memory of past meltdowns still lingered. Any hint of a downturn spooked investors. Third, the pervasiveness of the various media – radio, television, the internet – has made many hypersensitive to any and (perhaps) all price movements. We ask this rhetorical question: Why are you not as tuned into, and perhaps not as stressed about, the daily and even intraday movements in the market value of your residence?

Perhaps the answer has something to do with the lack of real time, intraday information. The key point to remember is that while volatility is a risk, for most investors the biggest risk is not achieving long term goals. Don't allow your focus on the short term to blind you to long term necessities!



Turning to the economy, 2014 represented a continuation of the moderate growth we have experienced since 2009. Through September, real GDP was up 2.7% year over year including acceleration to a 5.0% annual rate in the 3rd quarter. Meanwhile, unemployment fell from 6.7% to 5.6% during the course of the year, while the ongoing decline in labor force participation abated for the year.

The real problems are overseas. Europe remains stagnant, and it is likely that they will begin a quantitative easing program similar to that in the U.S. We think that will be a mistake, but we are only policy observers – not influencers. Japan also remains in zero growth mode, while Russia is close to, if not in, recession. Latin American growth has also slowed, with Brazil trying to get itself back on track. We're actually optimistic about that possibility. And the recent fall in commodity prices, particularly that of oil, threatens the growth of all commodity based economies from Australia to the Middle East to Canada.

Even the GDP of China, that great engine of worldwide growth, is slowing. Many focus on this as the great negative going forward, but we still view it as a positive. This "slowdown" is to the rate of about 7% GDP growth. Even if it comes in slower, such a high growth rate for the world's second largest economy will continue to add significantly to global final demand.

One impact from these economic divergences is the strength of the U.S. dollar. At this point it is nothing to fear. Imports become cheaper. And while exports become more expensive, potentially impacting U.S. exporters and profitability, this has the overall impact of strengthening consumers' wallets. We'd point to the 1980s as a period when this nation was emerging from economic malaise and found itself with a strong currency. That period was also a strong period of corporate profit growth and stock market gains.

The most notable other economic event in 2014 was the fall in oil prices. While we've commented before that there were very few areas of over investment, the oil patch might be one of the few exceptions. And the real issue isn't that there was so much investment – it was that the investment yielded so much success. The great success of fracking led to dramatic increases in oil production in the U.S. Increased supply invariably leads to falling prices, and in 2014 the price broke. Overall, the decline in prices is a positive for the economy. Still, we'll watch for any signs of debt problems among oil companies.

So, turning to 2015, our optimism remains. Corporate profits should continue to do well, especially among U.S. companies. Interest rates remain way too low. This will discourage bank lending. The biggest beneficiaries of this are large publicly traded corporations that can afford to borrow without banks. Meanwhile, stock valuations are generally within reason. But as prices aren't compellingly undervalued, we expect volatility to tick upward as nervous investors react to every piece of world news. Opportunities within the bond markets will remain difficult to find. As we have for some time, we prefer to keep maturities short and take on moderate credit risk – i.e., exposure to economic growth – as opposed to the risk of long maturities. Time will only tell what 2015 will bring. In the meantime, we'll continue to focus on the fundamentals and long term results.

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