LORI L. LIFFRING, CFA ♦ MICHAEL L. BRIDGMAN, ChFC ♦ GAYLAN C. ABOOD
JUSTIN S. ANDERSON, MBA AAMS ♦ KAREN K. BENEFIEL, CPA AAMS

MARKET COMMENTARY

After a relatively flat first quarter, stocks picked up momentum in the second quarter. Large cap stocks in the S&P 500 gained 5.2% in the quarter and are now up 7.1% on a year to date basis. Although also comprised of large cap stocks, the DJIA is only up 2.7% for the year. Small cap stocks in the Russell 2000 were up 3.2% year to date. International stocks in the MSCI EAFE have gained 4.8% for the year. Emerging market stock returns were about the same as their developed market counterparts. Bonds had been reporting similar returns to stocks in the first part of the year, but second quarter showed divergence. The aggregate bond index was up 2.04% for the quarter and 3.93% for the year.

Initial estimates for first quarter GDP were for 1% growth. By the time all revisions had been made, the final figure showed a -2.9% contraction. That decline was the largest since early 2009 when we were in the throws of the Great Recession. It could be somewhat surprising, then, that investors' appetites for stocks appeared so strong. Some attribute the continued rise in stock prices to a lack of selling by current stock investors rather than strong buying patterns. Subdued volatility in the markets seems to support that theory.

Most economists are blaming an especially harsh winter for terrible GDP growth in the first quarter and expect second quarter to rebound strongly. Analysts are projecting GDP growth of 3% for the quarter and the full year. Many believe the economy can grow at this pace for the next year or two because the consumer is in better financial shape with less debt servicing costs and stronger personal balance sheets. Housing has been picking up again as has manufacturing. The Federal Reserve estimates agree with GDP growth near 3% for 2014 through 2016 but also show that this pace is not expected to continue. Their view is for 2.3% long-term GDP growth and David Kelly, economist with JPMorgan, concurs that growth will be slower after the next couple of years.

Slower economic growth is expected to result in slower growth in corporate earnings as well. Therefore, stock returns are expected to be less than 10% (what many people consider the long term average return of stocks). Many analysts, including David Kelly, expect stock returns of only 4% to 6% over the next five years. Kelly says that Quantitative Easing has pushed up asset prices but has not spurred any real investment spending in growing productive capacity. Until we have greater productivity growth from increased capital spending and a growing labor force, earnings growth, and therefore stock returns, are likely to remain in the mid single digits.

It is difficult for stock prices to grow more than underlying earnings growth because price-earnings ratios and other valuation measures have already expanded and are near long-term 15-year averages. These higher absolute valuations also may increase the risk of a correction. Pullbacks in stock prices may provide purchasing opportunities for investors that could increase their personal rates of return more than the 4% to 6% projected for the overall market.

Foreign markets may also provide more opportunity for higher returns. Europe is coming out of a double-dip recession, and earnings in many of the Euro countries are depressed. BCA Research notes that "corporate profit growth almost always rebounds much more strongly than other segments of an economy during the early stage of a business cycle recovery". In addition, the Euro currency has been weaker which can also help profit growth. The European Central Bank is also more likely to keep monetary policy easy. Stocks of European companies are also sporting lower valuations than US companies which can give them an added boost.

Yields on the 10-year Treasury retracted again this quarter moving from 2.7% to 2.5%. The decline is not expected

2014 BENCHMARK RATES OF RETURN

INDEX	SECOND QUARTER	YTD
S&P 500	5.2%	7.1%
DJIA	2.8%	2.7%
NASDAQ	5.0%	5.5%
Russell 2000	2.1%	3.2%
International	4.1%	4.8%
Fixed Income	2.0%	3.9%

We value our relationship with you, and we are always available to meet with you in person or by phone. Please do not hesitate to call or email us with any questions that you may have.

17330 WRIGHT ST, STE 205 | OMAHA, NE 68130 | P: (402) 697-1166 | F: (402) 697-9271
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MARKET COMMENTARY

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to continue. JPMorgan projects the 10-year yield will rise back above 3% by year-end but not as high as the 4% previously projected. Continued demand for US Treasuries by central banks is cited as the reason yields won't climb as high. Short-term yields are expected to remain at current levels until 2015. Slower economic growth will stop the Federal Reserve from raising rates earlier than planned.

In an environment where stock valuations are near highs and bond yields are expected to rise, a well diversified portfolio can help reduce risk and smooth out total returns over the long term. Patience and discipline are important to help keep emotions from overly influencing investment decisions which could lead to unintended negative results. If you have questions about the strategies used in the management of your account, please do not hesitate to talk with your portfolio manager.

FINANCIAL PLANNING

Credit Pitfalls

It used to be that you saved your money in order to buy things like furniture, TVs, vacations, and home improvements. The evolution of credit has changed all that. Now, the credit world has conditioned us to believe that we can have what we want without waiting. Sometimes, it even tricks us into believing that we are saving money even though we are spending money that we don't have.

Credit can be good when used responsibly - paying off credit card balances each month. You may also have a legitimate need, like your car broke down and you need to get it repaired, but don't have the money in hand to do so yet.

However, it can also be abused - when credit card balances continue to grow and don't get paid off in a timely manner. Continuing to live above your means through the use of credit can create real problems. Once you are living a lifestyle that is supported by credit, drastic measures are usually needed to get back on the right track. For one couple who had racked up a six figure debt, that meant no cable, no eating out, no movies, and a second job for the husband for over four years.

They got into financial trouble when they started a family and the wife stopped working outside the home. The size of their family doubled and they didn't make the financial adjustments necessary to reflect their reduced income. They only added a little each month to their credit card balance, but with no plan of how to pay it down, it mushroomed into a bigger problem.

It's difficult when faced with the temptation - the world is sending the message that you "deserve" it because you work hard or because your friend or family member just bought one and they love it or because the one you want is so much better than the one you have. You don't have to get stuck in the trap. Your portfolio manager can help you determine how much is prudent to spend or how to save to reach your goal. Making smart choices on debt and spending can improve your lifestyle through less stress and peace of mind.

The couple above now has a credit score in the high 700's and they won the National Foundation for Credit Counseling's PACE Award for Professional Achievement and Counseling Excellence. Now, frugal living has become part of their lifestyle. They've been able to buy a house, give to their church, and help other family members - and they've learned what was truly valuable to them.

QUESTION: *How can I help my adult children?*

ANSWER: Often we hear from clients who want to help out their adult children but not have their children become financially dependent on them. One of the best ways to do this is to avoid giving them money for daily living expenses but to help them out with one-time expenses. For example, rather than helping them with their house payment each month, help them with the down payment to get their monthly house payment to a level they can afford on their own. This strategy keeps them accountable to their own monthly budget so that they have to live within their means, but you were also able to give them something that gave them a better life. College education is another example whether it be their own education or that of their children. Some parents like to take the children and grandchildren on a family vacation which is also a good example of giving your kids things they may not afford on their own but without making them dependent on you on an ongoing basis. Of course, you need to make sure that what you are giving your children is not at the expense of your own financial well-being. Otherwise, when the money runs out, you could be dependent on them.

CAMBRIDGE ADVISORS NEWS

Thank you for choosing Cambridge Advisors as your investment advisor. We are serious about helping you reach the goals you've set for your future, and we appreciate the trust and confidence you have placed in us. We are always available to help the people who are important to you, too. If you have family or friends who have questions about their financial situation, we would be happy to talk with them to see if our services would benefit them.