PATRIOT
INVESTMENT
MANAGEMENT

Dear Clients & Friends of Patriot Investment Management

After much of the US suffered through a particularly harsh winter, spring has arrived, bringing with it much milder temperatures. In the first quarter of 2014, domestic markets seemed to mirror the weather. Following a volatile January, the markets settled down into a rather calm first quarter, with the S&P 500 hovering around 1%. In the last five years, negative headlines and volatile markets have become so commonplace, that a benign quarter is a nice change of pace as we put the Great Recession in the rear-view mirror and the U.S. economy returns to a more normal business cycle.

U.S. Economy: The harsh winter had a dampening effect on the first quarter, due to a buildup of auto inventories, and increased utility costs. Inflation remains low as the Fed continues to taper their bond-buying program by another $10 billion; Fed purchases are now at $55 billion per month, down from $85 billion when tapering first began. Janet Yellen, Ben Bernanke's successor as Federal Reserve Chair, has indicated that the Fed will continue tapering as long as conditions warrant, possibly wrapping up the bond-buying program by fall of 2014. The Fed does not plan to raise the Federal funds rate until the economy achieves maximum employment and inflation reaches 2%.

Since the end of World War II, the broad equity market has experienced thirteen bear markets, or about one every six years. However, the main driver in the business cycle that leads to a recession is inflationary pressure. In our current low inflation environment, it is likely that the overall effect will be to extend the recovery phase of this business cycle past the six-year average.

Leading economic indicators are strengthening as consumer spending increased slightly, and housing continues to stabilize. Dividends saw a record increase in the first quarter, 22.9% above first quarter 2013. 421 of the S&P 500 companies (84.2%) now pay a dividend, the most since 1998. In addition, all 30 members of the Dow pay a dividend as well. Commodities and Treasury bills rebounded in the first quarter of 2014, and muni bonds have become more stable as many states' revenue and reserves have grown.

Global Markets: The global economy overall is on firm footing, with continued growth expected in developed markets. Developed Europe, particularly Germany and the U.K., show signs of economic recovery, with increased consumer spending, stabilization in housing, and both hiring and construction poised for increases in 2014. While still weak, Portugal, Italy, Greece and Spain are also showing signs of improvement.

Geopolitical uncertainties are creating some notable exceptions, mainly in China and Japan, which in turn, are contributing to a slowdown in emerging markets. China is struggling to maintain a high level of growth while avoiding excessive credit expansion. Foreign investment in China has become more short-term, increasing volatility and risk going forward. Japan's recent consumer spending tax hike will likely lead to a drop in consumer demand for goods, and will, in turn, increase market volatility. Brazil faces challenges with inflation and slower growth, but also opportunities, as they will host both the upcoming World Cup and the 2016 Summer Olympics.

The Russian aggression in the Ukraine will not have as far reaching effects economically in the long-term as Russia accounts for less than one percent of the global economy. While 50% of Russia's exports are derived from energy, their trading partners have other energy sources to turn to, and strong U.S. and European sanctions would deliver a hard hit to their economy.

As 2014 progresses, we anticipate continued growth, but at a more subdued pace than 2013. In this moderate growth, low inflation, low interest rate environment, it makes economic sense to stay focused on equities in the near term, keep bond maturities short, and costs low. Regardless of what the market does in the short run, staying focused on your long-term objectives is the key to investing success.

<u>2014 First Quarter Returns</u>

S&P 500 + dividends	1.81%
Dow	- 0.01%
Russell 2000	1.12%
Emerging Markets	-0.80%
Barclays Aggregate Bond Index	1.87%

Returns are price-only unless otherwise noted

10 year Bond yield as of 03/31/14	2.72%

Inflation	1.7% thru March 2014
Unemployment	6.7% in March 2014

Thank You!

We value the confidence and trust you have placed with us, and we welcome your questions and comments. Our goal is to be our clients' trusted resource for all things financial.

Do you know someone who could benefit from our expertise? We appreciate your introductions and the opportunity to help your friends and colleagues meet their financial goals.