Dear Clients & Friends of Patriot Investment Management

Markets continued to climb in the second quarter of 2014, with the Dow Jones Industrial and S&P 500 setting new records, spurred on by increased manufacturing after the slowdown at the beginning of the year due to an abnormally harsh winter. We expect to see steady, modest growth in the economy through the second half of 2014, as inflation and interest rates remain low. Going forward, the main concern for volatility in the markets is geopolitical instability.

U. S. Economy:

The labor market continues to be the main area of weakness in the economy, dampening wage growth. This situation is a mixed blessing – slower wage growth is a drag on consumer spending, but it will also help to keep inflation in check in the near future. There is also positive news coming from this sector; during the second quarter, approximately 800,000 jobs were added to the economy. With this latest increase, the labor market has finally regained all 8.7 million jobs it had lost during the 2008 crisis, with June's unemployment rate hitting a low of 6.1%.

The housing market rebounded from the first quarter with sales of single-family homes growing 18.6% in May, boosted by an increase in VA loans for returning vets, many of them first-time home buyers. Additionally, home resales grew 4.9%, which was the largest jump in nearly three years according to the National Association of Realtors®.

In June, inflation rose 0.3%, with gas prices increasing and a slight decrease in food prices, easing somewhat from its fastest monthly pace in more than a year set in May. However, the Fed is unlikely to raise the Federal Funds rate from its record low of .25% until 2015. This anticipated increase has been priced into the markets, and bond rates will likely begin to inch up in the second half of the year. The bond market will continue to be a challenging area, and will likely experience short-term volatility when the Fed does increase rates. While the stock market would no longer be considered undervalued, there is still room for growth, and more attractive than cash or bonds as a hedge against inflation.

Federal Reserve Chair Janet Yellen is optimistic about the economy, with steady growth of GDP expected to reach 3% in the second half of the year, and overall inflation to remain relatively low. This environment has allowed the Fed to maintain its reduction of bond-buying by $10 billion per month, and Yellen expects the program to end in October of 2014.

Global Markets:

Globally, stocks have increased 40% in the last two years, and are 150% above their 2009 lows. As Europe continues its economic recovery, the sector is still largely undervalued. The European Central Bank has cut interest rates to -0.1% in an effort to stimulate lending, and discourage banks from holding excess deposits – a market friendly move.

Emerging markets throughout the globe advanced along with the U. S. markets and European stimulus. Japan is the most undervalued of the developed foreign markets, and the sweeping financial reforms known as 'Abenomics' have the potential to begin pulling Japan out of its twenty-plus year malaise. The Chinese economy, on the other hand, showed signs of slowing in the second quarter of 2014, with GDP falling just short of its target to 7.4%. Housing in China continues to slow, with sales prices dropping in approximately half of seventy major Chinese cities.

The instability in the Ukraine, and the increased sanctions on Russia will continue to harshly impact the Russian economy, and overall geopolitical instability will likely add to market volatility in the second half of the year, although the effect has been largely muted thus far.

<u>2014 Second Quarter Returns</u>

S&P 500 + dividends	5.23%
Dow Jones Industrial	2.24%
Russell 2000	2.05%
Emerging Markets	5.64%
Barclays Aggregate Bond Index	2.07%

Returns are price-only unless otherwise noted

10 year Bond yield as of 06/30/14	2.52%

Inflation	2.1% thru June 2014
Unemployment	6.1% in June 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.