PATRIOT
INVESTMENT
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Dear Clients & Friends of Patriot Investment Management

U. S. markets continued their climb in the third quarter of 2014, with the Dow Jones Industrial Average and the S&P 500 again setting new records. Concerns over geopolitical instability, slowing global growth and a likely Fed rate increase in 2015 will drive market volatility, as investors nervous of the new highs react to headlines. However, a global recession remains unlikely, and we expect the steady, modest growth we have seen in the economy this year to continue through the fourth quarter of 2014.

The stock market is now considered fairly valued, and we can expect slower, modest growth going forward. Despite this fact, equities are still far more attractive than cash or bonds as a hedge against inflation. The current low rates on cash and bonds coupled with the fact that life expectancies are getting longer make the risk of outliving one's money very real. Therefore, it is more important than ever to take a thoughtful approach to investing for the long-term, avoiding both excessive risk-taking and being too conservative out of fear of short-term volatility spurred by current events.

U. S. Economy:

U. S. fundamentals are strong, as real GDP increased 4.6% in the second quarter, higher than expected estimates. The U.S. dollar has strengthened relative to other currencies due to geopolitical concerns, dampening commodities prices. Slower wage growth is still posing a drag on consumer spending, but is also helping to keep inflation in check, which currently stands at 1.7%. The unemployment rate reached 5.9% in September, nearly a full percentage point lower and a year earlier than the Fed's target, and is very close to economists' estimates for full employment.

September sales of new homes reached their highest level since July of 2008 – a six-year high – while sales of previously owned homes reached a one-year high. As the 30-year mortgage rate falls, both sales numbers may increase moving forward. An unexpected contributor to the sluggish housing market recovery has been the increase in student loans. Since 2005, the 20-29 year-old demographic have decreased their mortgage expenditures by 20% as their debt service to student loans has increased.

Due to the slow recovery since the financial crisis, new commercial property construction is running below its historical average; the restricted supply will likely drive demand higher as the economy expands. Despite the recent pullback in real estate investments, low interest rates provide inexpensive financing, and historically low leverage rates have reduced overall risk. Going forward, these factors combine to create a favorable environment for growth in commercial real estate.

Federal Reserve Chair Janet Yellen is expected to announce the end of the Fed's bond-buying program, QE3, this month. The Fed is now the largest holder of U.S. government securities, with a $4.5 trillion balance sheet, and may plan to keep its holdings above historic levels until the end of the decade. By simply holding these securities, the Fed will continue to keep prices up and yields down, which will further support the U. S. economy. Yields have also been kept down as investors have favored the relatively higher yields on Treasuries compared to the ultra-low yields on European and Japanese fixed income securities. The bond market will continue to be a challenging area, and investors can expect short-term volatility when the Fed does begin to increase rates in 2015.

Global Markets:

Investors are seeing mixed growth in Europe and Asia. The European energy sector declined as drillers may lose access to some Artic locations due to the international sanctions against Russia, and luxury car exports have dropped due to decreased growth in Asia. However, the healthcare, technology, financials and utilities sectors did well in the third quarter. Europe is experiencing slower growth, concerns over deflation, and a depreciating euro. The European Central Bank has cut interest rates again in an effort to stimulate lending, and will begin a bond-buying program similar to the U.S.

Overall, Asian markets have done well in the third quarter. Japan continues its monetary easing program as last spring's tax increase has weighed heavily on GDP, and inflation is still below 2%. While the depreciating euro has hurt Europe, the depreciating yen has helped increase Japanese exports, and the healthcare and technology sectors also enjoyed increased profits.

Most emerging market currencies have depreciated against the dollar, and expectations of the Fed rate increase in 2015 have dampened both equities and bonds. Chinese markets showed signs of improvement as increased stimulus and new reforms in corporate governance helps to counteract concerns over slowing growth. Thailand, Indonesia, Mexico and India have faired better as hopes run high for political reform, while Brazil, Russia and Turkey struggle in the face of political unrest.

Ebola fears are subsiding as stricter infection control guidelines are implemented, and Nigeria has been declared Ebola-free. The instability in the Ukraine and the Middle East may continue to add to market volatility in the fourth quarter.

2014 Third Quarter Returns

S&P 500 + dividends	8.34%
Dow Jones Industrial	1.29%
Russell 2000	-4.41%
Emerging Markets	-4.33%
Barclays Aggregate Bond Index	4.10%

Returns are price-only unless otherwise noted

10 year Bond yield as of 09/30/14	2.52%

Inflation	1.7% thru September 2014
Unemployment	5.9% in September 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.