APPLETON PARTNERS, INC.

# QUARTERLY MARKET OVERVIEW
# QI 2014

Coming into the year, the S&P 500 was at an all-time nominal high, and the 10-year Treasury yield had risen to the key 3% level. Stocks sold off towards the end of January on emerging markets concerns with the S&P 500 dipping nearly 6% before rallying to end the quarter up 1.81%. The bond market also headed higher as the same anxiety overseas caused a flight to safety, causing yields to drop with the 10-year finishing the quarter at 2.72%. Municipal fixed income as measured by the Barclays Managed Money Municipal Short/Intermediate Index finished the quarter up 1.38%, and Taxable bonds as measured by the Merrill Lynch US Corp/Gov't 1-10Year A or Better Index returned 0.88% over the same period.

One unescapable dynamic that faced the U.S. economy for much of the first quarter was the weather. Record cold temperatures and a record amount of snowfall over much of the country dampened construction activity, homebuilding, retail sales, and caused an estimated $5 billion loss in productivity, according to Barron's. For individual companies, management was given a textbook excuse for fourth quarter sales and earnings that missed expectations, and many used it to justify any weakness. One would presume a pickup in economic indicators following a period of externally depressed numbers, and that is what we expect heading into the early part of the second quarter. With the polar vortex behind us, we look to the upcoming earnings season, specifically companies' forward guidance, for hints of any underlying economic strength.

Stocks started the year relatively unchanged, with many investors weighing the potential of further upside versus the anxiety of being near all-time highs and facing higher valuations. At the end of January, an impetus to sell stocks presented itself in the form of an emerging market sell-off. Fears of an economic slowdown in China, political uncertainty in Turkey and Argentina, and the Fed's tapering program all contributed to the downturn. Adding to the volatility, several of the top performing stocks of 2013 underperformed due to profit taking. The VIX, a widely used measure of volatility, registered the 14th largest move in its history in late January as the stock market experienced one of its worst weeks since late 2011. Although this pause in the market was larger than any experienced in 2013, the S&P 500 once again found support at the 100-day moving average as investors moved in to buy the dip. The S&P was able to rally back and roughly stay at the level it began the year, but under the surface, sector performance varied greatly. Utilities, a small percentage of the S&P 500, rallied over 9% on the quarter as the drop in bond yields made their lofty dividend yields more attractive. On the other end of the spectrum, the bad weather hampered retailers, dragging down the Consumer Discretionary sector, which finished the quarter down nearly 3%. The difference in sector performance speaks to the falling correlations among stocks, which are at their lowest levels since the financial crisis.

With benchmark yields retreating from the dreaded 3% level, the fixed income markets have had a strong start to the year. Technicals have also been contributing to performance, with the bleeding from municipal mutual funds abated and first quarter inflows into taxable bond funds already topping the inflows throughout all of 2013. Going forward, we expect a constructive environment for both municipal and taxable bonds given what we expect to be modest, but not stellar economic growth this year. We see a reasonable probability that economic growth in 2014 comes in below the Fed's expectations, necessitating an aggressively dovish tone towards forward rate policy as the Fed continues to taper its quantitative easing program. Our risk focus is biased towards credit risk versus interest rate risk as the proverbial "robbing Peter to pay Paul" scenario plays out between shareholders and bondholders. Last quarter, share repurchases totaled $126 billion, representing close to 30% annual growth and marking the 17th consecutive quarter that share repurchases increased as a percentage of corporate free cash flow. Looking ahead into the remainder of 2014, we will continue to target the best risk/reward situations with an eye towards high quality credit profiles.

Despite the taper, we anticipate that monetary and fiscal policy across all central banks will remain accommodative, aiding the global economy in its gradual recovery. For equities, we look for cyclical stocks to outperform their defensive counterparts as company managements utilize their cash hoards for M&A activity, return of capital to shareholders, and growing sales. This won't be without an increase in volatility however, as investors digest likely lower growth estimates in the near term. For fixed income, focus will remain on Fed language. The Fed will likely continue to shift investor focus away from their previously given quantitative targets towards qualitative language surrounding future interest rate policy, specifically their pledge to keep rates low for an extended period of time. Furthermore, it is hard to picture a scenario in which U.S. rates rise substantially while other sovereign yields continue to fall.

***As always, we welcome your comments and questions. Please contact us if there are any changes to your financial situation or investment objectives.***

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