Volatility returned to the markets in the third quarter of 2014, as both stocks and bonds experienced choppy trading before finishing relatively unchanged for the period. The S&P 500 finished the quarter with a total return of 1.13%, bringing the year-to-date return up to 8.34%. Municipal fixed income as measured by the Barclays Managed Money Municipal Short/Intermediate Index finished the quarter up 0.82%, bringing the year to date total return up to 3.78%. Taxable bonds as measured by the Merrill Lynch US Corp/Gov't 1-10 Year A or Better Index went unchanged over the quarter, returning 0.00%, leaving the year-to-date return at 2.03%.

In our last letter, we identified the pillars of the current rally in equities, and many of those remain in place: accommodative monetary policy, better than expected corporate earnings, improving economic data, increased merger and acquisition activity, and the return of cash to shareholders through buybacks and dividends. We feel that those elements can continue to support stocks heading into the fourth quarter, but we are monitoring a few items closely. Through the end of the second quarter, the trailing twelve-month buyback total was $539.2 billion, the highest level since Q1 2008. While the absolute dollar amount of share repurchases has been staggering, the pace of the buybacks has been declining. According to FactSet, quarterly buybacks declined on a year-over-year basis for the first time since the third quarter of 2012, and experienced a quarter-over-quarter decline of -22.9%. It would be constructive if the decrease in buybacks stemmed from an increase in capital expenditures, as some reports have suggested, and not the result of management teams feeling as though their stock has become too expensive to continue buying. We are also closely monitoring the upcoming earnings season. Analyst estimates for third quarter earnings growth, as compiled by FactSet Research, have been nearly halved from 9% down to 4.6% over the past three months. Although counterintuitive, lowered expectations allow companies to more easily beat Wall Street expectations and potentially fuel further gains.

The U.S economy continued to show signs of an ongoing recovery and, in the process, further diverged from the rest of the world. With the European economy struggling to find its footing, anticipation of an accommodative policy response from Mario Draghi and the ECB built throughout the quarter. This not only acted as an anchor for global interest rates, but also weakened the Euro currency and sent the U.S. dollar soaring to fresh highs. Heading into the end of the quarter, the U.S. Dollar Index, which measures the U.S. dollar against six other currencies, rose twelve straight weeks- the longest such streak in the history of the index. A stronger dollar brings about mixed consequences, and it can be difficult to tell which outcome will prevail. On the positive side, a strong currency increases purchasing power, while also reducing inflationary pressures. Lower inflation not only aides in keeping costs down for consumers and businesses, but it also keeps pressure on central banks to continue their accommodative policies.

On the other side of the ledger, a strong dollar can hurt U.S. exporters, as their contracts in foreign currencies yield fewer dollars and strengthen sales of their foreign competitors. We will be watchful heading into the coming earnings season to see how much of an impact the strengthening dollar has on U.S. multinationals.

Despite edging closer to the end of quantitative easing and an increase in short-term interest rates, benchmark yields in the U.S. have remained subdued. In fact, the bond market seems to be calling a bluff on the Fed's willingness to bring rates up. The Fed's latest projections suggest a Fed fund rate of 1.75% by the end of 2015, whereas the futures market sees just a 0.75% level in the same time frame. We continue to believe that a combination of extremely low inflation, lower relative rates globally and the specter of geopolitical flare ups will keep yields in a range similar to those seen in the first nine months of 2014. The accommodative Fed still remains a positive driver for both the equity and fixed income markets. Demand for fixed income has remained strong. Through September, there has been more than $100 billion of cash that has funneled into taxable and municipal mutual funds. Despite steady demand, we did see some spread widening, particularly in the taxable market, as supply was equally impressive and geological concerns weighed.

Geopolitical tensions dominated headlines for most of the quarter, apparently fading as we approached the end of September. Ceasefires in Ukraine and Gaza have held, and investors seem more comfortable with the idea that sanctions against Russia will not result in extensive damage to the European economy. Recently, however, the spread of the Ebola virus to the U.S, and to a lesser extent the large protests in Hong Kong, have rattled investors. We will be closely monitoring how much of an impact the Ebola scare has on economic activity, particularly travel and tourism, as we head into the fourth quarter.

Looking ahead to the final months of 2014, stocks have

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historically been seasonally strong in the fourth quarter, particularly following mid-term elections. According to a report from FBN Technical Research, since 1950, the S&P 500 has been positive 6 months after mid-terms 100% of the time with an average gain of 15%. For fixed income, we look for the bond markets to remain range-bound, with credit spreads on higher quality assets remaining narrow. As the change in Fed policy approaches in 2015 and volatility returns, these assets should outperform their higher risk fixed income counterparts.

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