Many felt that we'd see higher interest rates and a slowdown in the four and a half year old rally in stocks during 2014. Neither came to fruition, as accommodative monetary policy from global central banks kept rates anchored and provided a tailwind for equities. The S&P 500 rose 4.93% over the final quarter to finish the year with a 13.69% gain. While the S&P 500 produced another year of robust returns, active managers struggled to keep pace this past year. According to Morningstar, only 13% of U.S. large cap equity managers beat their benchmarks in 2014. With the 10-Year U.S. Treasury yield dropping from 2.97% down to 2.19%, fixed income benchmarks enjoyed a year of positive returns. Municipal fixed income, as measured by the Barclays Managed Money Municipal Short/Intermediate Index, finished the quarter up 0.43%, bringing the year to date total return up to 4.23%. Taxable bonds, as measured by the Merrill Lynch US Corp/Gov't 1-10 Year A or Better Index, rallied 1.01% during the final quarter, leaving the year-to-date return at 3.06%.

Looking ahead to 2015, we would offer the following thoughts. We continue to be constructive on stocks for many of the same reasons we have discussed in prior letters: sustained accommodative monetary policy from global central banks, a low interest rate environment, increased merger and acquisition activity as companies look to bolster growth using their ample balance sheets, and a healthy corporate profit outlook as earnings continue to rise and beat analyst expectations. According to data from FactSet, analysts' earnings estimates for the fourth quarter (+1.1%) and 2015 (+7.7%) have both been cut dramatically, almost entirely due to the drop in energy producers' profit projections. As we have witnessed over several quarters, reduced earnings expectations have been advantageous for the stock market, with more room for upside surprises once the bar has been lowered. With the equity rally standing just months shy of its sixth birthday, stock valuations have garnered more attention. Nevertheless, earnings are expected to continue to grow at a mid-to-high single digit rate, allowing the market to appreciate without P/E multiple expansion.

Financial markets will not be without volatility in the coming year, however. The Fed faces the unenviable task of weaning the U.S. economy off of an unprecedented amount of monetary stimulus at the same time the rest of the world contemplates easing. This divergence of monetary policy will undoubtedly lead to investor angst as markets attempt to forecast the path of global interest rates. Inflation has shown no signs of increasing and the drop in oil should only exacerbate the matter. More importantly, wage growth has been anemic, with annualized hourly wage growth dropping to 1.65% in the latest jobs report. We believe that the Fed will exercise self-proclaimed "patience" in raising rates domestically, and easy monetary policy abroad will keep foreign rates low, further anchoring U.S. rates. The guessing game, of when and by how much the Fed moves, will lead to choppy trade in both equity and fixed income markets.

Declining interest rates bolstered fixed income returns in 2014, but that tailwind has likely run its course as we head into 2015. The macroeconomic environment and fundamental credit quality should be supportive of credit risk in the near term, but we will be closely monitoring the spillover effect from the energy sector on the rest of the credit markets. Aside from the reverberation from the energy sector, our biggest credit concern continues to be "event risk" driven by unforeseen corporate actions like spin-offs and M&A.

As an example, we know of at least 30 spin-offs that are scheduled to be completed in 2015. While there was record issuance of corporate bonds in 2014, there has also been ample demand to balance such supply. In 2014, there was more than $75 billion of inflows into taxable fixed income mutual funds and ETFs. Given the global rate environment, we anticipate demand for fixed income products will remain robust, which will also support the fixed income markets in 2015.

The sharp decline in the price of oil, and subsequent debate over the ultimate winners and losers, will continue to influence the direction of trade as we enter 2015. As 2014 came to a close, the price of WTI crude oil had dropped roughly 50% from its June high. Multiple explanations have been given for the decline, with a global economic slowdown and excess supply being the most common two. We tend to side with the latter. OPEC has decided not to cut production regardless of some member nations' precarious financial positions. U.S. shale producers have continued to ramp up production, despite the drop in the price of oil as producers have gained efficiencies, dropping their marginal costs. We cannot ignore the fact that we are likely entering an age of energy surplus, with the days of $100/barrel oil behind us for the time being. The impacts of this shift will vary. There is the immediate impact, seen in the decline in stock prices of energy producers; the implicit positive impact to consumers of cheaper gasoline to fuel their cars, and cheaper heating oil to warm their homes; and the ancillary impacts on geopolitics. The thawing of the relationship between the U.S. and Cuba can no doubt be partially tied to Venezuela no longer being able to prop up the Cuban economy due to the impact of the oil price drop on the Venezuela's balance sheet. We will be closely monitoring the changing landscape as we look for investable opportunities in the coming year.

We expect that both the equity and fixed income markets are poised to continue their course of positive performance heading into 2015. Risks in the form of economic contagion from overseas, ambiguous monetary policy, and unforeseen geopolitical tensions are present. For equities, we would anticipate volatile trading similar to the second half of 2014 as opposed to the first half. For bonds, in addition to the supply/demand dynamics mentioned above, Treasury yields should remain anchored by foreign sovereign debt yields that continue to grind lower in the face of the promise of stimulus.

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

APPLETON PARTNERS, INC. ONE POST OFFICE SQ. BOSTON, MA 02109 TEL. 617.338.0700 WWW.APPLETONPARTNERS.COM