In our last letter, we anticipated volatile trading during the first quarter of 2015, and financial markets did not disappoint. Questions surrounding when and by how much the Fed will raise interest rates led to choppy trade during the quarter. Sandwiched between two negative months, February was the S&P 500's best month (+5.75%) since October 2011. Despite a robust February, the index finished the quarter with a modest total return of 0.95%. Fixed income markets also saw an uptick in volatility as the U.S. 10-Year Treasury yield, which started 2015 at 2.19%, ranged from 1.65% to 2.24% before closing the quarter at 1.92%. Municipal fixed income as measured by the Barclays Managed Money Municipal Short/Intermediate Index finished the quarter up 0.94%. Taxable bonds, as measured by the Merrill Lynch US Corp/Gov't 1-10 Year A or Better Index, rallied 1.41% to start the year.

Financial markets continue to benefit from easy monetary policies from central bankers around the world, most notably in Europe and Japan. The source of volatility in the U.S. is the Fed's anticipated move in the opposite direction from their brethren. Discussions regarding when and how the Fed will hike interest rates have dominated the landscape. Coming into the year, some pundits were calling for a rate hike in the spring, with consensus falling into the June camp. Even the FOMC is split on the difficult decision. Following a recent FOMC meeting, the word "patient" was removed from the policy statement, but the committee members' own economic projections, or "dots", were lowered. While the U.S. is certainly on stronger economic footing than most other developed nations, we believe the Fed should exercise caution in contemplating any potential rate hikes, as it may stymie economic expansion. Recent economic data points have been weaker than anticipated, and the continuing strength in the U.S. dollar has hurt domestic businesses that compete abroad. Inflation remains stubbornly low, and the weakness in commodities, highlighted by the 50% drop in the price of oil over the past 6 months, will continue to anchor expectations. Despite recent wage hikes from large employers such as Wal-Mart, Target, and McDonalds, national hourly earnings have not followed suit. This is most likely due to the loss of higher paying jobs in the energy sector, as oil exploration and production companies have curtailed spending. As stated in prior letters, until inflation meaningfully accelerates, the Fed is more likely to err on the side of keeping rates lower for longer. For appearances' sake, the FOMC could make a minor move later this year, but we put a higher probability on the Fed changing policy in 2016.

With the Fed "liftoff" debate ongoing, investors will be eager to get a look at companies' results and outlooks during the coming earnings season. According to FactSet, as of 12/31/14, year-over-year first quarter earnings were anticipated to rise by 4.3%. At the end of March, estimates for the same period anticipate a decline of 4.6%, the drop largely stemming from reductions to energy sector profit expectations. Excluding the energy sector, the estimated earnings growth rate for the S&P 500 would jump to +3.4% from -4.6%. Apart from energy, one of the more closely watched themes will be the impact of the U.S. dollar. As of the end of March, the trade-weighted U.S. dollar index had risen roughly 12% over the past year, and is at its highest point in over a decade. With nearly one third of the aggregate revenue of S&P 500 companies coming from abroad, the rising dollar is sure to take a toll on companies that did not hedge their exposure. Lowered earnings expectations, as mentioned in earlier commentaries, have frequently led to positive surprises, and we look for that trend to continue this quarter.

The storyline in fixed income continues to be dominated by quantitative easing and its effect on global asset flows. Just as the Fed looks poised to remove monetary accommodation from the U.S. market, the EU and Asia have been launching their own easing strategies intended to fight economic weakness and disinflation. In the current state of the global markets, all debt tends to trade on a relative basis so, with European and Japanese benchmark yields trading below 1% or even negative in some cases, it will continue to be difficult for higher quality intermediate U.S. Treasuries to break out of the 1%-2% range. Another "technical" factor contributing to strength in both taxable and municipal bonds has been inflows into mutual funds and ETFs. Through April 1st, municipal and taxable funds/ETFs had inflows of $10.4 billion and $21.2 billion, respectively. For municipals, this represents 84% growth from the inflows in the last quarter of 2014, while taxable funds/ETFs actually saw an outflow of close to $20 billion in the fourth quarter of 2014. From a credit perspective, we will be watching to see if the ravenous share buybacks over the last several years come back to haunt corporate balance sheets, given S&P 500 earnings are expected to decline in the first quarter of 2015 for the first time since September 30, 2012.

Over the past few years, the steady climb of the stock market has allowed passive investments to perform well, as a rising tide lifted all boats. Looking ahead, investors increasingly have become wary of valuation as metrics, such as the forward-P/E, have climbed above recent averages. This, combined with the anticipated increase in volatility, should provide a favorable backdrop for active stock picking. We have been able to find opportunities in the healthcare and technology sectors in particular, that offer promising growth at reasonable valuations. For fixed income, we will continue to seek value in our sector and security selection with focus on capitalizing on supply and demand imbalances, should they present themselves.

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