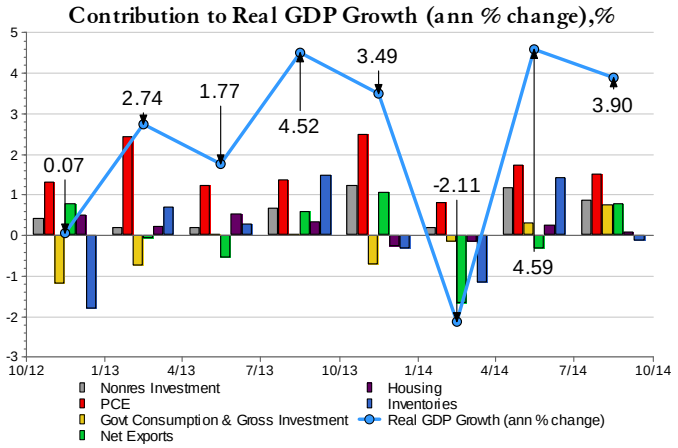
VANTAGE CONSULTING GROUP
3500 PACIFIC AVENUE VIRGINIA BEACH, VA 23451 (757) 491-1200 FAX (757) 422-5378

Market Review

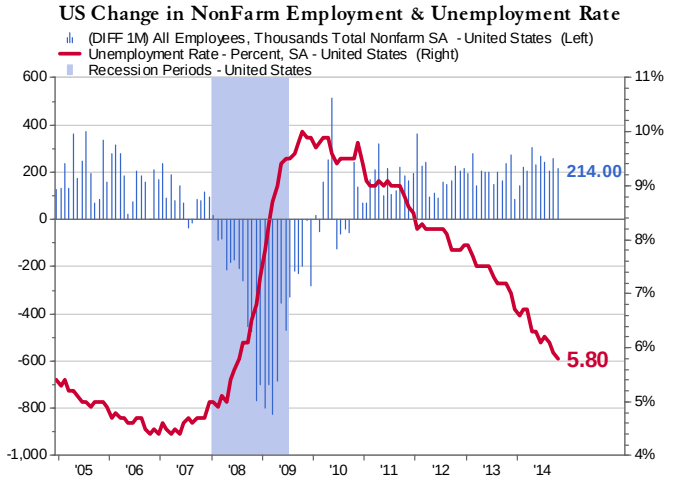
November 2014

Economic Review

U.S. third quarter real GDP growth was revised upward to a 3.9% annual rate (a.r.) according to the second estimate by the Bureau of Economic Analysis. The uptick in third quarter GDP reflected positive contributions from Personal Consumption Expenditures (PCE), residential/nonresidential fixed investment, federal government spending, exports, and state/local government spending which were partly offset by a negative contribution from private inventory investment. Imports, which are a subtraction in the calculation of GDP, decreased. The economy grew at 4.6% during the second quarter and contracted -2.1% during the first quarter.



The unemployment rate edged down to 5.8% according to the Bureau of Labor Statistics. The unemployment rate has declined 0.8% since January. The civilian labor force participation rate was 62.8% and remains close to the lowest levels since 1978. Total nonfarm payroll employment increased by 214,000 in



October, in line with the average monthly gain of 222,000 over the past 12 months. Average hourly earnings for all employees on private nonfarm payrolls rose by 3 cents to $24.57 in October. Over the year, average hourly earnings have risen by a modest 2.0%.

The headline Consumer Price Index (CPI) remained unchanged in October and increased 1.7% over the last twelve months as declining energy prices continue to put downward pressure on headline inflation. Core CPI rose 0.2% Month over Month (m/m) and +1.8% Year over Year (y/y). Breakeven measures of inflation declined for the second consecutive month. The 5 year/5year forward breakeven inflation rate declined 13 bps to 1.98%. The Producer Price Index, for final demand, rose 0.2% in October. This increase followed a -0.1% decline in September and no change in August.

U.S. home prices, as measured by the S&P Case Shiller 20-City Composite Index, rose 0.3% during September. The Index is now up 4.9% y/y. Housing starts declined -2.8% in October as the multi-family component dipped to its lowest level since January. Building permits rose 4.8% month over month m/m during October. New home sales increased 0.7% m/m to 458K a.r. based on stronger sales in the Northeast and Midwest.

The minutes from the Federal Open Market Committee's (FOMC) October meeting were released in December and were viewed as more dovish than the statement. The committee members supported the decision to maintain the current interest rate environment while reiterating the importance of continuously evaluating employment and inflation measures. The FOMC next meets on December 16 and 17.

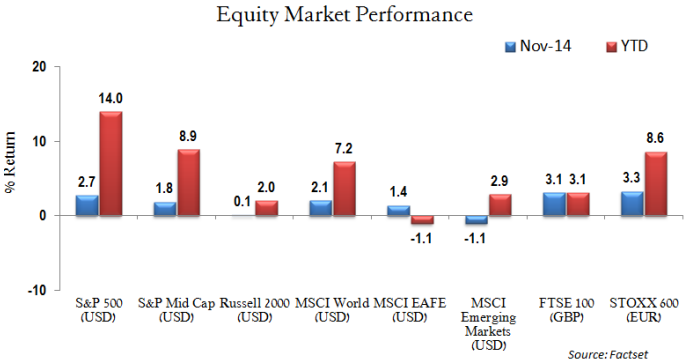
In Europe, third quarter GDP growth for the 18-country Eurozone was just 0.2% over the previous quarter. This estimate, while weak, was higher than the Reuters forecast of 0.1% growth. Growth was bolstered by stronger readings out of France, which grew 0.3%. Greece has finally showed positive signs after a nearly six-year recession, posting 0.7% growth in the third quarter. Germany, which has been among the global economic leaders over the past several years, narrowly avoided a recession by posting a 0.1% growth rate. Italy, however, remains in a recession, contracting by -0.1%. Inflation data in Europe were also mixed; headline inflation matched estimates at 0.4%, while core inflation was below estimates at 0.7%. In response to low inflation and tepid growth rates, the European Central Bank (ECB) is preparing to launch a broad easing program in early 2015. Vitor Constancio, a Vice President of the ECB, signaled the bank's willingness to buy government bonds if it determines more aggressive stimulus is required to boost growth and curb disinflation.

In the UK, the Office for National Statistics second estimate of GDP growth for the third quarter was 0.7% Quarter over Quarter. This growth rate is lower than the previous quarter's 0.9% rate, but remains unchanged from the previous estimate released in October. Coupled with below-expected inflation, the moderate growth has added to speculation that the Bank of England will delay raising benchmark interest rates. The labor market in the UK continues to show signs of strength; the UK currently has 1.96 million people unemployed, which is the lowest figure so far in 2014.

In Asia, third quarter Japanese GDP contracted by -1.6% y/y, and second quarter GDP was revised to a -7.3% growth rate. This second consecutive quarter of contraction has unexpectedly pushed Japan into a recession, causing concern that the government may further delay an expected increase in the national sales tax. Chinese economic data was also weak; the Purchasing Managers Index (PMI) fell to 50.3 from 50.8 in the previous month, while Chinese factory output shrank for the first time in six months. In India, the economy slowed slightly in the first full quarter of new Prime Minister Narendra Modi's regime. The estimate for the July-September quarter GDP growth was 5.3%, lower than the 5.7% rate in the previous quarter. Capital formation growth, an indicator of investment activity, remained low at 28.3%, while government investment also declined to 11.7% from 13.4%.

Equity Markets

Global equities ended November mostly positive, as the MSCI World Index gained 2.1% and is up 7.2% in 2014. Domestic large cap stocks, as measured by the S&P 500, rose 2.7% in November and are up 14% year-to-date (YTD). Domestic mid-cap stocks, as measured by the S&P 400 returned 1.8%, while the Russell 2000 small-cap index gained 0.1%. The headline indices for Europe (STOXX 600) and the UK (FTSE 100) gained 3.3% and 3.1%, respectively. The MSCI Europe, Australasia, and Far East Index (EAFE) added 1.4% in November and is down -1.1% in 2014. Emerging Markets, as measured by the MSCI Emerging Markets Index, was the only major equity class to post losses in November, losing -1.1% for the month.

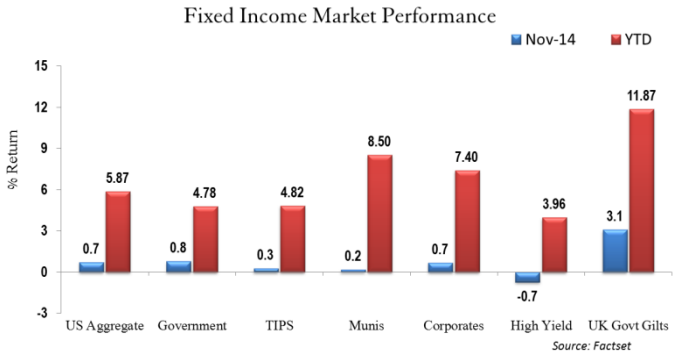


The S&P 500 traded nearly straight up in November, posting a negative return on only 6 days, the most severe of which was -0.26%. Market volatility, as measured by the CBOE Market Volatility Index (VIX), finished the month modestly lower, closing at 13.33, down from 14.03 at the end of October. The VIX spiked over 10% on the last trading day of the month, as it had reached a low of 12.07 on November 26th. The 13.33 monthly close is well below the long-run average of 20. Volatility of European stocks, measured by the Euro Stoxx 50 VIX Index, trended lower throughout November, closing at 18.03 after closing October with a 20.32 reading.

Bond Markets

The month of November saw global investors buying U.S. Treasuries and the US Dollar driven by a dovish posture of the European Central Bank, unexpected negative GDP in Japan and a rate cut in China. The U.S. bond market, as measured by Barclays U.S. Aggregate Index, increased 0.45% to bring the YTD gains to 5.9%. Investment Grade Credit spreads continued to expand, widening 6 bps during November, as measured by Barclays Option Adjusted Spread, on record supply of new issues.

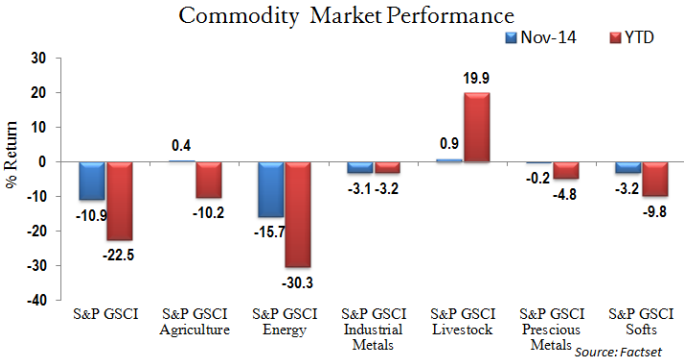
The 30-year U.S. Treasury bond yields fell 15 basis points to close at 2.91%. The 10-year U.S. Treasury bond yield closed at 2.20% last month, 13 bps lower than October's closing yield of 2.33%. The UK 10-year benchmark gilt yield declined 31 bps to close at 1.93%. The yield on German 10-year benchmark bonds fell 14 bps to close at 0.66% in November.



Commodities

The S&P GSCI Total Return Index, a headline index of 24 commodities, fell -10.9% in November and is now down -22.5% in 2014. Only the Agricultural and Livestock sub-indices finished the month in positive territory, as global deflation and slowing growth concerns pushed commodity prices lower. The Livestock sub-index, which is constructed using Cattle and Hog future price data, has returned 19.9% in 2014. A number of events this year have affected the livestock markets: spreading of the PED virus (in hogs) to North America, increased global demand for meat, rising production costs, and future cattle supply concerns.

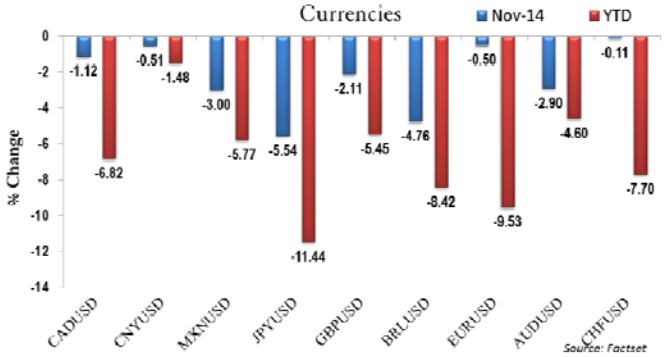
The Energy sub-index continued to decline, posting a -15.7% return for the month adding to significant year-to-date losses. The sub-index is now down more than 30% in 2014, pushed lower by a stronger US Dollar, oversupply concerns, and a forecast shortfall in demand as global growth wavers. The Organization of the Petroleum Exporting Countries (OPEC) surprised investors at the end of November by agreeing to keep oil production at current levels; the downtrend in oil prices had led to speculation about a constriction of the oil supply by the exporting cartel. Saudi Arabia, with its strong fiscal position and declining government debt, is widely believed to be the leader of the "status quo" coalition within OPEC.



West-Texas Crude Oil ended October at $80.70/bbl and traded down most of the month, closing November at $65.99/bbl. The S&P Crude Oil sub-index declined -17.8%, and is down -28.5% in 2014. Refined products fell sharply in November, led lower by Gasoline [-14.2%], Gasoil [-11.3%], and Heating Oil [-13.4%]. After contracting sharply in October, refining margins stayed relatively constant or rose slightly in November.

Currency

The US Dollar rallied for the fifth straight month against a basket of peers in November, as it saw great demand from global investors on diverging economic growth paths for the U.S. and the rest of the world. The US Dollar Index appreciated 1.5% in November.



The Euro declined for the fifth month against the US Dollar on expectations of further monetary easing by the ECB due to weak growth and low inflation prospects in the Euro area. The Euro declined -0.50% against the US Dollar to close at 1.246 USD/EUR. The British Pound depreciated -2.1% against the US Dollar in November to close at 1.566.