January 2, 2015

Dear Clients and Friends,

Much has happened over the past quarter; Japan slipped into recession, Europe continues to struggle with deflationary pressures and growth in China continues to slow.

In the wake of this less than rosy global economic picture, things 'back home' continue to improve. US GDP growth was twice revised higher for the third quarter, initially to 3.9% from the original 3.5%, with the most recent revision coming in at a jaw dropping 5% - right as the Santa Claus rally was in full swing. These improving GDP growth rates are slowly being reflected in the employment figures as well. According to the Bureau of Labor Statistics; nonfarm payrolls expanded an average 240,000 per month for the first 11 months of 2014, totaling just over 2.6MM jobs.[i] While US equity markets continue to appear fully valued at 16 times 2015 estimates, investors are willing to pay full price for steady growth in a *slow and low* global recovery.

One of the biggest stories of the quarter has been the dramatic and *accelerating* decline in the price of oil. On June 20th, oil peaked at $107/barrel – by late September it had dropped to just over $91/barrel. As of this writing, a barrel of crude fetches less than $54. AAA recently estimated that this amounts to a *daily* savings of $500MM to consumers, which is real money that can and will be spent elsewhere in the economy. One's belief in the derivation of the oil price 'gift' determines their perception of the risk attached to the gift. If the driver of lower prices is an oversupply issue, then this likely is truly a gift with very few strings attached to the consumer. However, if this price correction is the result of shrinking global demand, the benefit of the short-term gift could well be outweighed by much harsher ramifications to the global economy and financial markets. For now we are in the oversupply camp and view the correction as a net benefit to consumers and the US economy.

As dramatic as the fall in the price of oil, the steep rise of the US dollar is of equal significance both domestically and abroad. Since July, when the Fed announced its intentions to end their bond purchasing program and stronger employment figures began to appear, the US dollar index, a trade weighted basket of currencies, has strengthened by 12.5%. Just as US companies have benefited with low interest rates making debt service highly affordable, the opposite can be said for companies and governments that have issued dollar denominated debt as the strengthening dollar effectively increases their cost of capital. The strong dollar's impact on multinational profits and emerging market economies remains a point of question and a situation we continue to monitor.

As we approach Janet Yellen's first anniversary as Chairman of the Federal Reserve, it is worth noting how the transition has gone. By all accounts Yellen has successfully overseen the execution of the "taper" – that is the slowing of the Fed's bond purchasing program, through its finale in October. She has also been a calming, reassuring and consistent voice to market participants about the timing of eventual rate increases. We think it important to remember that, while we are in a less accommodative state than we were at the beginning of the year (or the beginning of the quarter for that matter) short term rates have been at the 0 – 0.25% target for six full years. Thus, the Fed remains in an accommodative posture. If short term rate increases, when they do come, are of the quarter point variety as Yellen's predecessors' were, then even while tightening the rate policy should still be considered accommodative by historical standards.

T I 301.657.8870 F I 301.657.0566 I www.FBBcapitalpartners.com I 4520 East-West Highway I Suite 450 I Bethesda, MD 20814

This condition tees up our most likely scenario for rates in 2015 which is a continued flattening of the yield curve. We see an environment where short term rates rise and longer term rates may rise a bit, but not dramatically and not in lockstep with short term rates. Our belief is that longer term rates will have a lid on their upper bound as the supply of treasuries continues to decline due to shrinking (yes that's right shrinking) budget deficits, and strong global demand (even without the Fed participating as a buyer) outpacing supply. It's a simple question really, which would you rather own, a 10-year Spanish government bond paying you 1.59% or a good old 10-year US Treasury paying 2.20%? We believe the global yield hunt will continue well into 2015 and as such keep longer term rates low while short term rates begin to rise.

Low long term interest rates compounded by economic growth and rising employment could be the trifecta needed to kick start household formation, which we believe would be a significant shot in the arm for the housing recovery. As such, we continue to expect strong corporate balance sheets and solid cash flow growth to fuel additional share repurchases, increases to dividend payouts and additional capital spending which feeds right back into lower unemployment and higher relative GDP growth in 2015.

While the last few weeks of December have seen markets move steadily higher we would expect volatility to return after the New Year as companies report earnings for the fourth quarter and announce expectations for the coming year.

As we enter 2015 we believe stocks continue to be a more compelling value relative to bonds, however, risks abroad remain and we believe it prudent to be disciplined in our allocation and our corresponding over and underweights. Our mantra of diversified portfolios and asset allocation persists and we expect some rebalancing in the first quarter as we realign portfolios where we have allowed equity positions to run.

With Best Wishes for the New Year,

FBB Capital Partners

P.S. As a reminder, your form 1099's should carry all relevant tax information that you need for your 2014 tax preparation (with the exception of K1's). As in years past, we expect the initial delivery by Charles Schwab and TD Ameritrade to occur by mid-February but with a high likelihood of revisions to follow well into March. Due to these potential revisions, we would suggest avoiding filing early.

---

[i] http://data.bls.gov/timeseries/CES0000000001?output_view=net_1mth