FRANCIS FINANCIAL INVESTMENT LETTER

FIRST QUARTER 2014 KEY TAKEAWAYS

Global markets experienced an up and down quarter but ended mostly positive despite developments such as Russia's annexation of Crimea, further evidence that China's growth is slowing amidst government efforts to manage a potential credit bubble, the changeover in Federal Reserve leadership, and a general continuation of the slow economic recovery in the United States and Europe.

In terms of U.S. economic growth, the quarter's progress was complicated by severe winter weather that likely depressed some of the short-term indicators of the economy's health. Overall, though, the picture remains one of modest but steady economic growth with a noteworthy rebound in housing alongside persistently slow-to-recover employment. U.S. stocks cooled from last year's pace but posted gains for the quarter.

Developed international stocks were flat, largely due to a sizeable decline in Japan, where a new sales tax is the latest uncertainty as the country tries to achieve sustainable growth and healthy inflation. Amidst slow growth but still-high unemployment and very low inflation (and deflation fears), many European markets rose.

Emerging markets have been beset by ongoing concerns about economic growth alongside macroeconomic instability in countries such as Ukraine (most recently) and Turkey. These issues have been a headwind over the past year and led to a small first quarter loss for emerging-markets stocks (though our actively managed emerging-markets funds were positive).

Core bonds were among the quarter's stronger performers, reinforcing the important role they play in a diversified portfolio. Municipal bonds were another bright spot in the quarter amidst improving economic health for states and municipalities.

It is important to note distinction between the short-term news and information that seems to drive markets day to day (and over any given quarter) and the longer-term analysis that underlies our five-year scenarios and asset-class-return models. While we pay attention to the shorter-term information and its effect on markets, we aren't apt to make adjustments to our longer-term views solely as a result of these developments. This quarter's investment commentary discusses the longer-term analysis that informs our view of the economic environment and the asset classes we own.

Our analysis indicates that the household debt deleveraging process has progressed at a slightly faster pace than we expected. This is good news for the economy and has led us to increase the underlying assumptions used in our equity return models. More broadly, we have also recalibrated our broad economic scenarios to reflect a more positive view of the macro landscape. The net result is that we are slightly increasing our equity risk exposure in our balanced (stock/bond) portfolios.

Even after this adjustment, we remain mindful that we have not yet achieved "normal" economic status; specifically, we remain skeptical as to how the Fed will unwind its huge balance sheet and normalize interest rates without major market disruptions and how China manages its credit and infrastructure bubble.

Turmoil in the emerging markets over the past year has led us to revisit our investment thesis there as well. While we maintain a favorable long-term view of emerging-markets asset classes, we are unwinding our emerging-markets local-currency bond positions based on both asset-class specific issues and portfolio risk-management considerations.

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