INVESTMENT COMMENTARY

1st Quarter 2015

Bragg Building
1031 South Caldwell Street, Charlotte

"The Stone Age did not end for lack of stone, and the Oil Age will end long before the world runs out of oil."

-Sheikh Zaki Yamani, former OPEC oil minister

MAN-BOY

There was a boy on my 1980 Quail Hollow Middle School football team named "Man-Boy." Actually that was his nickname. His real name was Darryl Redfern. When I first met him, I wondered about the origins of his nickname. Man-Boy? While he was pretty stocky, he was probably three or four inches shorter than I was and he was a pretty quiet guy. It wasn't until we started practicing in full pads and helmets that it became clear how he got the nickname. Simply stated, Man-Boy was a beast. He was a man in a boy's body. I learned this firsthand on the first full-contact tackling drill we did. My coach, long-time Quail Hollow veteran Ken Waldron, had two players lie on the ground on their backs, about ten feet apart. He then dropped the football into the hands of one player and simultaneously blew his whistle. At the sound of the whistle, both players were to jump up and charge toward each other. The ball carrier tried to run over the defender who of course tried to tackle the ball carrier. Man-Boy and I got to go first. What happened next remains a blur to this day. I remember hearing the sound of the whistle as the football landed in my hands. I remember scrambling to my feet and starting to turn around. Then the world went dark. I never even *saw* Man-Boy before he hit me. After some time on the ground I heard the distant voices of my teammates, "You okay, man? Can you get up? Catch your breath... you'll be all right." I was stammering, "Unnhhh...never saw him...I never saw him...so fast...hit me so hard...hit me like a freight train...unnhhh!" Thank goodness we didn't have concussions back in 1980 because I certainly would have had one! Instead Coach just gave me a good shake and sent me to the back of the line. I'm convinced that Man-Boy is the reason I talk so slowly to this day.

Practice wasn't fun when you had to face Man-Boy but the games were another story. Man-Boy was a terror on defense. We played McClintock Middle in our first game. They won the toss and we lined up on defense. As soon as the ball was snapped, Man-Boy was in the backfield slamming the quarterback to the ground. The defensive line never touched him and the quarterback had an experience similar to mine in the tackling drill; he never saw Man-Boy before getting absolutely clobbered. The same thing happened on second down. On third

(Continued on page 4)

MARKET REPORT

Global stock markets were mixed in the first quarter. Investors in US large caps endured a fair amount of volatility with little to show for it. The S&P 500 finished the period with a total return of just under 1% after a series of price swings as follows: down 3%, up 4%, down 3%, up 6%, down 4%, up 3%, down 2%. We can take some consolation from the fact that mid cap, small cap and foreign equities delivered more gains with returns of between 4% and 5%. See the table on the next page for more detail on benchmark returns for various periods. Bonds fared well during the quarter considering the persistently prolonged low-yield environment. Municipals were up 1% and taxable bonds were up 1.6%.

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Market & Economic Update *(Continued from page 1)*

Market Index Returns for Periods ending March 31, 2015

Index	1st Quarter	1 Year	3 Years	5 Years	10 Years
S&P 500 (US Large Cap)	1.0	12.7	16.1	14.5	8.0
S&P 400 US (US Mid Cap)	5.3	12.2	17.0	15.7	10.3
Russell 2000 (US Small Cap)	4.3	8.2	16.3	14.6	8.8
MSCI EAFE (Foreign Equity)	4.9	-0.9	9.0	6.2	5.0
Barclays Aggregate Bond	1.6	5.7	3.1	4.4	4.9
Barclays Muni Bond	1.0	6.6	4.1	5.1	4.9

Three-, five- and ten-year returns are annualized. Past performance is not an indication of future performance.

WHY THE VOLATILITY?

I always enjoy hearing pundits tell us why the market went up or down on a given day. Who compiles the millions of "reasons" investors sell or buy? The only indisputable explanation for a "down day" is that there were more sellers than buyers and therefore the sellers were the price takers. On "up days" the buyers outnumber the sellers and therefore the buyers become the price takers. But that explanation would get old if repeated every day, wouldn't it? Having made this point, I certainly can't tell you what will move the market in the coming months. I *can* describe a few things we've been watching and I suspect that these might be on the radar for other investors too:

Weaker Economic Reports: The monthly jobs report issued by the Bureau of Labor Statistics showed that the economy only created 126,000 new jobs in March, barely half of the number that were expected. The report also revised downward the number of jobs created in January and February. The unemployment rate remained stable at 5.5% but the labor force participation rate fell to 62.7%, the lowest level since 1978 (see chart below). In the prior week the Bureau of Economic Analysis said gross domestic product (GDP) grew at an annual rate of 2.2% in the fourth quarter. This was a downward revision from the original estimate and a far cry from the 5% rate of the third quarter of 2014. Some have blamed the weaker reports on the harsh winter and labor disruption at west coast ports, and it should be noted that the economy is now in its 70th month of expansion and that reports for the first half of 2014 were also weak before turning up significantly in the second half.

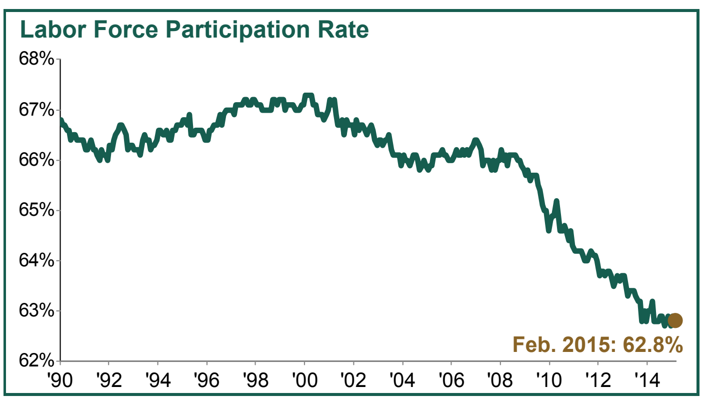

Chart compiled by JP Morgan. Source: BLS, FactSet.

Strength of the Dollar: Since mid-2014, the dollar has strengthened significantly relative to other world currencies (see chart below). In just the first quarter, for example, the dollar appreciated more than 13% against the Euro. While this is good for consumers buying imported goods, it squeezes US exporters by making their products more expensive abroad. The impact of this is showing up in corporate earnings reports which are expected to fall in the first quarter for the first time since 2009. (see chart on next page).

Oil: US crude prices are down 56% since last June. While the quantity of oil consumption has continued to grow, the rate of production has grown at a much higher pace. Inventory is piling up! Most economists expect lower

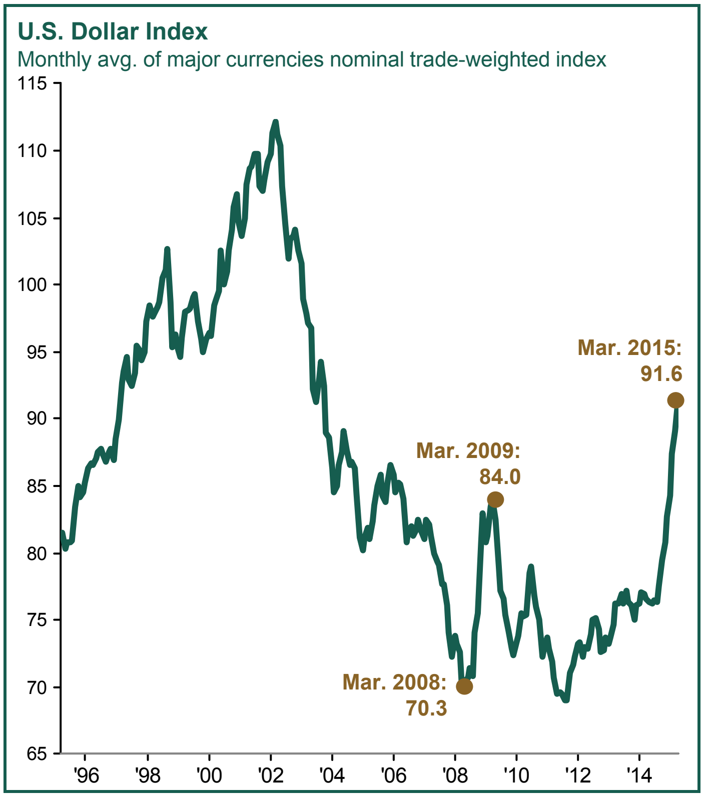

Chart compiled by JP Morgan. Source: BEA, Federal Reserve, FactSet. Currencies in the Trade Weighted US Dollar Major Currencies Index are: British Pound, Euro, Swedish Kroner, Australian Dollar, Canadian Dollar, and Swiss Franc. Data are as of March 31, 2015.

Market & Economic Update *(Continued from page 2)*

fuel costs to continue to benefit the consumer sector of the economy in the coming months. This is important as consumer spending makes up approximately 68% of GDP and many consumers spend a significant percentage of their income on energy. On the other hand, the energy sector accounted for a significant portion of the weakness in the recent jobs report as energy firms are still shedding workers. And earnings in the oil patch are really taking a hit as you would imagine.

Fed Policy in the US: The Fed has indicated that it hopes to begin increasing interest rates this year but Fed Chair Janet Yellen has been careful to signal that any move will be data-dependent. In other words, if economic data remains or becomes increasingly weak, the Fed may defer or move slowly. As we have discussed for many quarters now, the Fed has a $4.5 trillion balance sheet, primarily resulting from its unprecedented program of quantitative easing or QE (pumping cash into the economy by buying bonds in the open market). Past experiments with QE have eventually led to inflation and the Fed's goal is to extract the excess liquidity from the banking system before inflation takes hold. We've yet to see inflation; much of the excess liquidity is still sitting on bank balance sheets as banks have been slow to lend in the sluggish economy. If the Fed raises rates too much or too soon it could stifle the expansion and roil financial markets. This issue will be with us for many quarters to come.

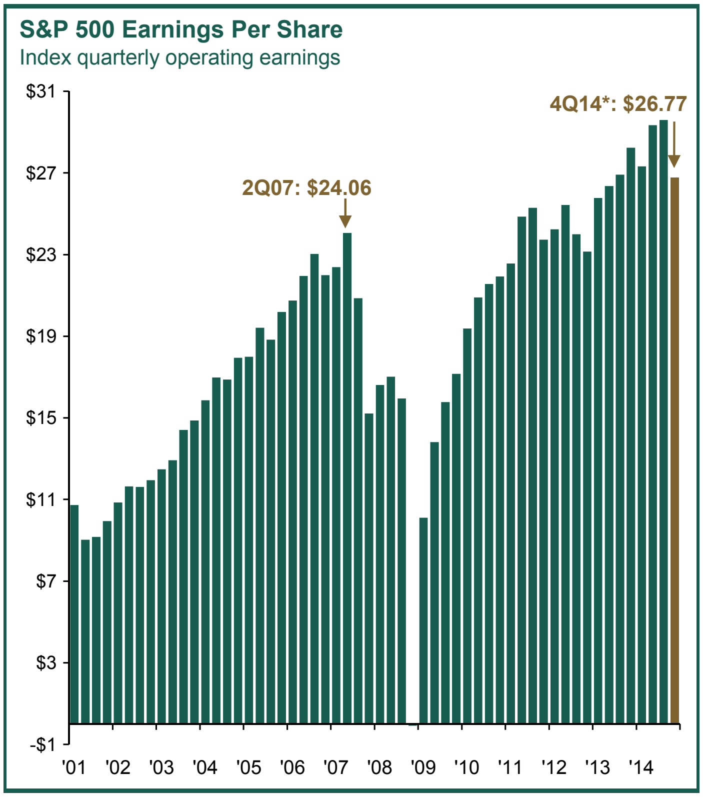

*Chart compiled by JP Morgan. Source: BEA, Standard & Poor's, Compustat, FactSet. EPS levels are based on operating earnings per share. *Most recently available data is 4Q14, which is a Standard & Poor's estimate. **S&P 500 Operating EPS % of Sales per Share fell to 0% in 4Q2008 and is adjusted on the chart. Data are as of March 31, 2015.*

Europe/Japan/China: Europe and Japan are both engaged in aggressive campaigns to stimulate their economies through monetary and fiscal policy and there are signs of life in both economies as a result of these measures. Weaker currencies in Europe and Japan are providing an additional boost to exports, and lower energy prices have helped manufacturers by lowering input costs. Overall economic growth continues to lag that of the US but signs point toward a pick-up in coming months, especially if the US expansion continues. China's economy continues to slow. Thus far we've witnessed a deceleration from 10% growth to 7.5% and it is projected that growth will slow to 7% and below in coming years as China attempts to transition from an investment-led economy to a more sustainable, consumer-driven economy. Social and political tensions and the challenges of running a centrally-planned economy in a country with two billion people will make this experiment one of great interest and consequence to the rest of the world. Stay tuned.

The Stock Market: Stock prices are driven by earnings. Several of the challenges I've discussed - the strong dollar, weaker US growth, plunging oil prices and challenges abroad will likely continue to negatively affect earnings in the coming quarters. Using various measures, the S&P currently is trading slightly above the average valuation of the last 25 years. While these higher valuations may simply be a consequence of the extremely low interest-rate environment, we may be due for some choppiness in the months ahead. We think it makes sense to be prepared for this. Please let us know if you would like to discuss your portfolio. ■

Change in Production and Consumption of Oil
Production, consumption and inventories, million barrels per day

Production	2013	2014	2015*	Growth since 2013
US	12.4	14.0	14.9	20.8%
OPEC	36.5	36.5	36.5	-0.1%
Other	42.0	42.6	42.7	1.5%
Global	90.9	93.0	94.1	3.5%
Consumption				
US	19.0	19.0	19.3	2.0%
Europe	14.3	14.2	14.1	-1.6%
Japan	4.5	4.3	4.2	-7.5%
China	10.3	10.7	11.0	6.8%
Other	43.2	44.0	44.5	3.2%
Global	91.2	92.2	93.1	2.1%
Inventory Change	-0.3	0.9	1.0	

*Source: EIA, FactSet, J.P. Morgan. *Forecasts are from the EIA Short-Term Energy Outlook and start in 2015.*

Man-Boy *(Continued from page 1)*

down Man-Boy changed tactics. Recognizing that the QB was small of stature, Man-Boy simply grabbed the little guy and picked him up off the ground. Squeezing him tight with one arm, he snatched the ball from him with his free hand and then ran the length of the field for a touchdown. He did the exact same thing on the next series. I'm not kidding! We seventh graders laughed and celebrated but alas, the fun didn't last. After only two games they moved Man-Boy up to varsity and if memory serves me right he then was moved up to the South Mecklenburg High School team where he continued to dominate the field.

We were bummed to lose Man-Boy but we still had a good season once our quarterback, Greg Wilcox, figured out that he should *always* throw the ball to Roman Phifer. Greg Wilcox would later be inducted into the Davidson College Sports Hall of Fame (baseball pitcher) and Roman Phifer went on to win three Super Bowl rings with the New England Patriots (linebacker). But that's another story. This story is about getting hit incredibly hard by something we don't see coming.

In just the last twelve months investors have been "hit" by significant events that we generally didn't see coming. The price of oil has declined by 50%, the US dollar has appreciated significantly against other currencies, the terrorist group ISIS seemingly came out of nowhere and corporate earnings have actually declined. Just since I graduated from college 25 years ago, the world has been "hit" by massive change–economic, political, medical, technological and natural, including: Gulf War I, the collapse of the Soviet Union, the Bosnian War, the launch of AOL, the web browser, the cloning of Dolly the sheep, the creation of the hybrid-drive car, the Hong Kong handover, the Kosovo War, the incorporation of Google, the advent of stem cell research, the launch of the iPod, the arrival of the new Millennium and Y2k, the Asian Crisis, the bursting of the tech bubble, the 2000 Presidential Election & Florida Recount, 9/11, the Afghanistan War, the completion of the Human Genome Project, the advent of Wi-Fi, Gulf War II, the Asian Tsunami, Hurricane Katrina, the unveiling of the iPhone, the first private space flight, the advent of Google maps, the launch of Facebook and the global rise of social media, the election of Barack Obama, the rise of China's economy, the passage of the Affordable Care Act, the reemergence of Putin's Russia, the global financial crisis, the Arab Spring and the phenomenon of massive central bank monetary stimulus. During this 25-year period of great progress, crisis and disaster, the S&P 500 advanced from 353 to 2058. Including dividends, the compound annual return was 9.6% (6.9% after inflation). Had you invested $100 at the beginning of 1990 and earned this return through 2014, you would have $989 today (assumes re-investment of dividends).

Change, especially technological change, is accelerating. Many of you have followed the story of Uber, the ride-sharing service that is disrupting the traditional taxi-cab business. But consider that within a decade, self-driving cars will potentially make both businesses obsolete. Is it conceivable that children born today will never own a car? My son Charlie (7) will be really disappointed if that is the case...he really wants a "monster truck" to drive in the mud. Imagine the disruption of this technology. Truck drivers, taxi drivers and bus drivers will be looking for other jobs. And because crash rates will plummet, car repair shops, insurance companies, chiropractors and emergency room workers will see far less business. Not to worry; history has shown time and again, new businesses will emerge to employ those who are displaced.

The driverless car is just one example of coming changes. Wearable medical devices and other technologies will dramatically change the diagnosis and treatment of disease and illness and even the delivery of healthcare. Last week Misao Okawa, the oldest living human, died at age 117. Futurists say the first person to reach age 150 has already been born and that because aging is a "disease to be cured," life expectancy will increase dramatically. Imagine being 120 years old but feeling like you're only 40! Solar power and other alternative energy sources will eventually replace fossil fuels, not because we'll run out of fossil fuels but because necessity, innovation and basic economics will drive the change. As a former Saudi oil minister famously said, the Stone Age didn't end because we ran out of stones.

But what about the dark side of technological change? What about the "hits" we don't see coming that will knock us on our backs and rough up our portfolios? Obviously they are part of our future as well. Witnessing the inconceivably brutal beheadings and massacres committed around the world in the name of religion reminds us that the freedoms and open society we enjoy are precious and indeed fragile. The juxtaposition of the rich-society technological innovations I've described with the barbarism, backwardness and depravity we're witnessing in other parts of the world is incredibly difficult. And in the nuclear age, the world's problems are our problems. A quote often attributed to Albert Einstein brings this home: "I do not know with what weapons World War III will be fought, but World War IV will be fought with sticks and stones." Gosh Benton, that's no way to end a newsletter! I know, I know. Let's all hope and pray we live to 150 instead! I truly think we will. Optimism is the word here! Bring it on, Man-Boy!

As always, thank you for trusting Bragg Financial with your planning and investing.

Sincerely,

Benton S. Bragg

Benton S. Bragg, CFP®, CFA®
President, Bragg Financial Advisors, Inc.