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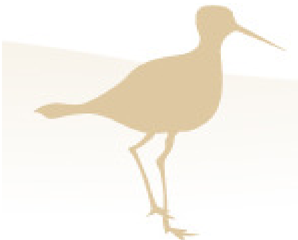
Sandpiper Capital



Gleanings

Better then Worse then…

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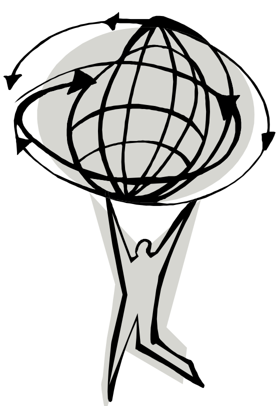
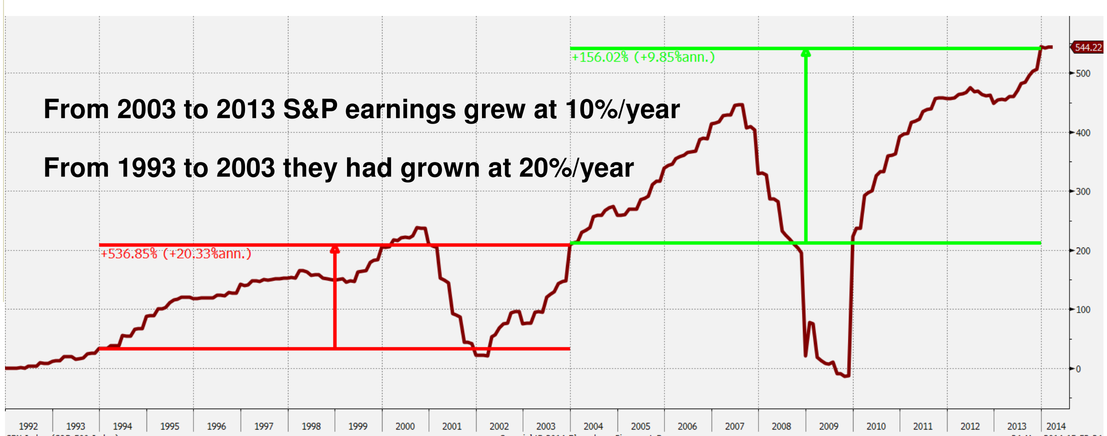
"The risk of change has been steadily growing. Complacency is not appropriate in these circumstances. Vigilance is required."



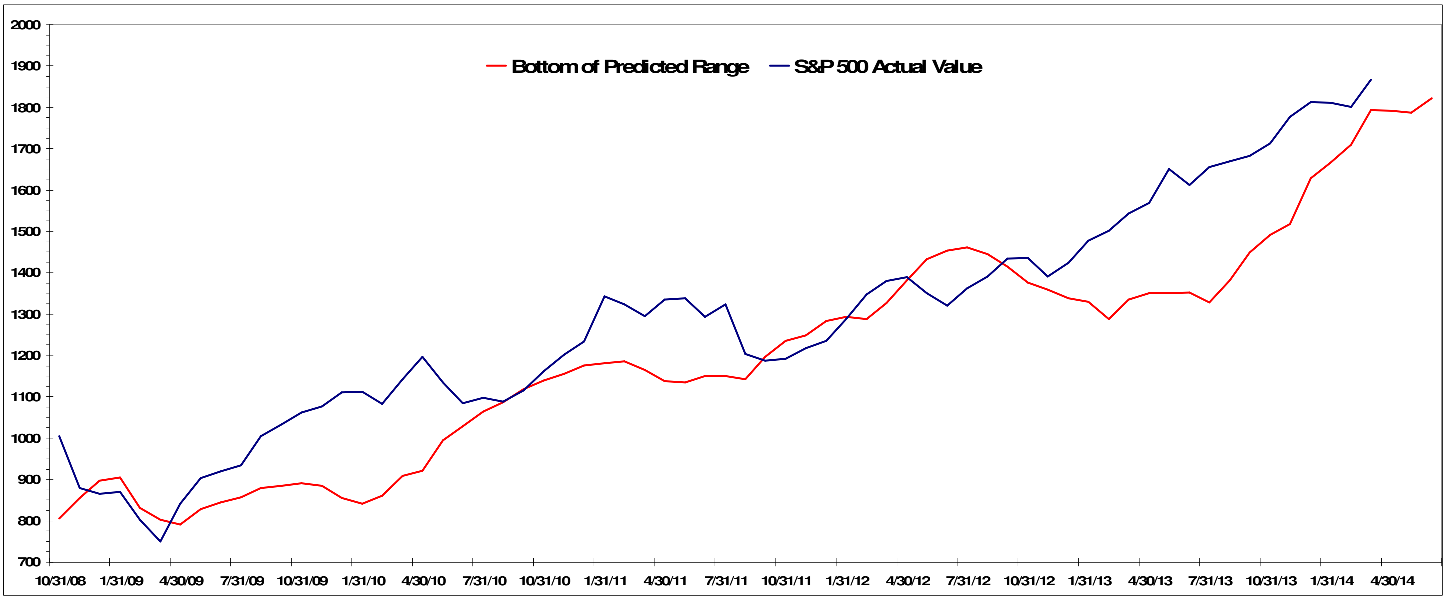
Market Returns Annually and for Year to Date and Ten Years Ending 03/31/2014

Index	2012	2013	YTD	10 Yrs
S&P 500	15.9	32.4	1.8	**7.4%**
ML 1-5 yr Gov't/Corp	2.5	.3	.4	**3.3%**
EAFE (Dev Fgn Mkts)	17.2	22.8	.7	**6.5%**
Emerging Markets	18.7	-2.5	-.5	**10.5%**

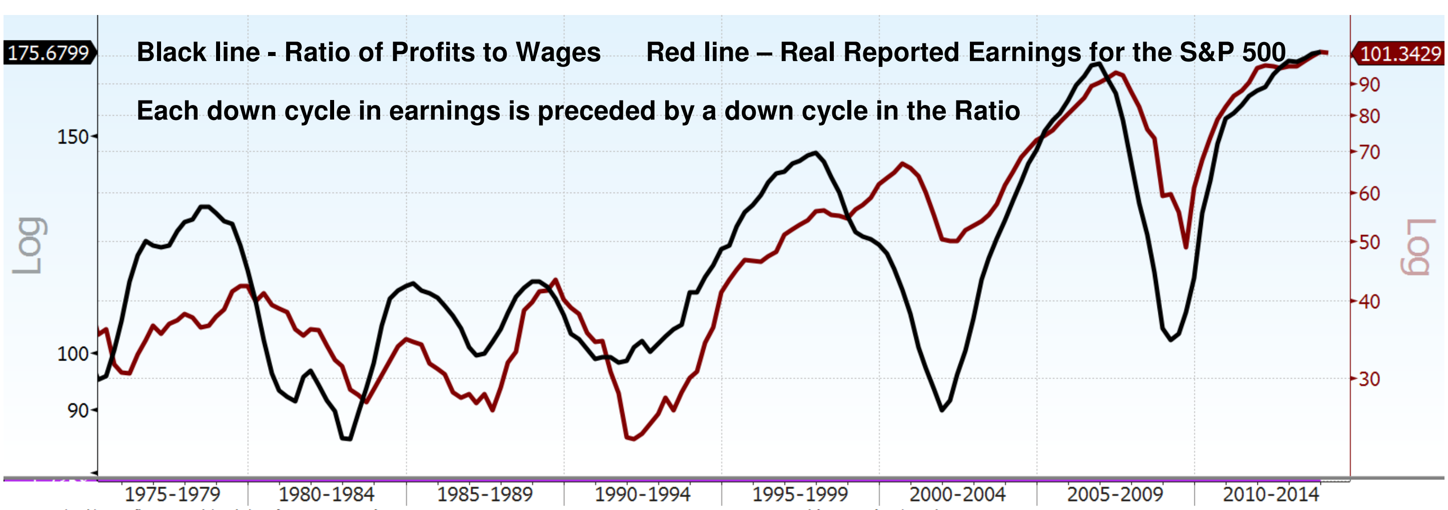
The current market reality is that changes to future prospects come more swiftly, more abruptly and more dramatically than we expect. Whether it's speculation brought on by government subsidization of risk (through low interest rates and too big to fail bailouts) or the prevalence of businesses geared toward a profitable exit plan for owners instead of growing long term profitability based on value for customers, the risk of change has been steadily growing. The first chart below illustrates one aspect of that volatility by tracking the three year rate of change in S&P profits over the last five decades. For domestic stock investors the growing volatility that is documented there comes in concert with the lower average returns shown in the second chart. As our high cost economy loses market share to the low cost economies of the world, the rate of growth in earnings has been halved. Complacency is not appropriate in these circumstances. Vigilance is required.



Our allocation model (first chart below) has two components that go into computing the "bottom". Reported S&P earnings and reported inflation. The rise in the calculated value over the last nine months is more to do with annual inflation dropping to 1.1% than to any strength in earnings. At that rate however, there is not much room for improvement. Any increase in future value of the S&P, that is, if the model still predicts that as well in the future as it has over the last fifteen years, will depend upon earnings increasing. That is a little worrisome given the graph on the previous page that shows the rate of growth in earnings dramatically dropping. Without trying to predict the future, however, the fact is that the S&P (in blue) is currently not far off from what we compute as the worst likely case price.



When profit growth contracts, does that mean another profit recession looms? We look to our cyclical profits model below to gain some insight. This is simply the ratio of corporate profits to wages. As economies improve, so does the demand (and cost) of labor, cutting into profits. These cyclical turns are illustrated by that ratio plotted by the black line in the chart below. The red line is reported real (inflation adjusted) earnings. Predicting each downturn in corporate profits well in advance, we have incorporated this information as a complement to our allocation model. While no longer increasing, the ratio of profits to wages has not started down. That reassures us that the next few quarters of reported earnings, and with that, the next nine months of market activity, should be fine. (Assuming no increase in inflation and the creek don't rise.) We will be watching this closely.



Tom Lukic