TOWNELEY CAPITAL MANAGEMENT, INC.

Fourth Quarter and Annual Review

January 30, 2015

The year 2014 ended with a bang—a smaller bang than we saw a year ago, but a bang nonetheless. In 2013, domestic equities posted tremendous returns while fixed income ended the year on losses or at best, very modest gains. This past year, both domestic equities and bonds closed the year on solid gains. Foreign equity markets posted gains in their local currencies, but the strengthening dollar transformed those gains into dollar-denominated losses. At first glance, 2015 appears to be full of promise. Unemployment is falling, gross domestic product (GDP) is rising, gas is cheap, inflation is practically nonexistent, and our currency is strong. A closer look, however, reveals that after a run of six years, the bulls may be growing weary.

The Economy

The economic outlook is complicated. A year ago, unemployment stood at 6.7%; by the close of 2014, it had fallen to 5.6%. However, 1.17 million more Americans are out of the labor force than were a year ago, and the number of people who currently want a job has grown by 280,000 since December of 2013. The Consumer Price Index rose 0.8% in 2014, marking the third consecutive year of increases smaller than 2%. However, the price of oil had a major impact on the CPI. Its energy index dropped 10.6% over the twelve months ending in November 2014, while its food index rose 3.4% during that time span. It appears that corporate profits have peaked. Companies have looked under every rock in the search to cut costs, so increased revenue is the most likely source of growth in net profits. Meanwhile, interest rates are so low that the Federal Reserve has little room to adjust monetary policy should another crisis develop. Of course, it could pull a new economic-stimulus rabbit from the hat.

Two aspects of the economic landscape are of particular interest: the strong U.S. dollar and the collapse of oil prices. It is helpful to remember that the strength of any currency is always relative; the dollar gained 11.6% over the euro in 2014. That means American companies are spending fewer dollars on imported goods and making a little more on exported goods. When the dollar is strong, it takes more of another currency to buy goods exported from the U.S., so we could see a decline in profits earned abroad. Further, loans have been issued in dollars while the proceeds were invested in non-dollar assets that are now depreciating, resulting in a short position on the dollar. As payments become due in more expensive dollars, the derivative market could experience unforeseen risks.

With respect to oil, a 2.9% increase in the global oil supply has led to a 40% to 50% reduction in oil prices. Currently production exceeds demand by about 1 million barrels a day. It would seem that cutting back production to better match demand would prop up prices, but it is likely that forces outside of market economics are at work. Some observers surmise that other oil-producing nations are waiting for the lower prices to mortally wound—or at least severely injure—the highly-leveraged U.S. oil industry. Other, more speculative theories are also in play. In any event, predicting the bottom is difficult, since the excess comes from the supply side of the equation. Further, if a recession were to constrict demand, the results could launch a staggering chain of events.

In short, uncertainty is the dominant theme as we survey the economy. We note an increase in volatility but cannot say with certainty when, or to what extent, prices may fall.

Domestic Equities

The final quarter of 2014 brought gains across the board. Value stocks bested growth stocks in the large-cap and medium-cap arenas and small-cap stocks were the biggest winner for the fourth quarter (but not for the year). At almost any other time, these annual returns would be great news. However, 2013 brought such stellar returns in this market that expectations may have been unreasonably high.

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Domestic Equities Returns for 4th Quarter 2014 and 12 Months Ended 12/31/14

Index	4th Quarter	2014
Large Cap Stocks (S&P 500 Index with Income)	4.9%	13.7%
Large Cap Growth Stocks (Russell 1000 Growth)	4.8%	13.0%
Large Cap Value Stocks (Russell 1000 Value)	5.0%	13.5%
Mid Cap Growth Stocks (Russell Mid Cap Growth)	5.8%	11.9%
Mid Cap Value Stocks (Russell Mid Cap Value)	6.1%	14.7%
Small Cap Stocks (Russell 2000)	9.7%	4.9%

International Equities

The table below illustrates that the poor performance of international equities stems from the strong dollar. In local currencies, each index ended 2014 in the black. It is only with the conversion into dollars that the indexes reflect losses for the year. Foreign investors will likely continue to seek United States investments as long as U.S. interest rates exceed their foreign counterparts, so the relative strength of the dollar may continue to increase.

The prospect of deflation in Europe has led the European Central Bank to announce a bond purchasing program intended to improve the economy. ECB President Mario Draghi stated that "they are intended to be carried out until end-September 2016 and will in any case be conducted until we see a sustained adjustment in the path of inflation." In Greece, one candidate in the nation's late-January election has indicated his willingness to revisit the possibility of exiting the euro bloc.

International Equities Returns for 4th Quarter 2014 and 12 Months Ended 12/31/14
(Annual Returns Provided in U.S. Dollars and Local Currencies)

Index	4th Quarter	2014: U.S. Dollars	2014: Local Currency
International Stocks (MSCI EAFE)	-3.6%	-4.9%	5.9%
European Stocks (MSCI Europe)	-4.3%	-5.7%	4.7%
Emerging Markets (MSCI Emerging Markets)	-4.4%	-1.8%	5.2%

Fixed Income

Strong fourth-quarter gains in nearly all classes of fixed income brought bonds into the black for the year, a welcome improvement over previous quarters' mixed returns. The big surprise in this market was the unexpected decline in interest rates through the year, boosting returns for bonds with longer terms. Long-term municipal bonds put in the strongest performances for the year, while short- and intermediate-term munis brought up the rear. As January draws to a close, interest rates continue to fall, nearing an all-time low.

Fixed Income Returns for 4th Quarter 2014 and 12 Months Ended 12/31/14

Index	4th Quarter	2014
Bond Market (Barclays Aggregate U.S. Bond)	1.8%	6.0%
Intermediate-Term Gov't/Corp (Barclays Int U.S. Gov/Credit)	0.9%	3.1%
Long-Term Gov't/Corp (Barclays Gov/Credit)	1.8%	6.0%
Treasury Intermediate-Term (BofA Merrill Lynch Treas Int)	0.9%	2.5%
Corporate Intermediate-Term (BofA Merrill Lynch Corp Int)	1.1%	4.0%
Short/Intermediate-Term Muni (Barclays Municipal Three-Year)	-0.1%	1.2%
Long-Term Municipals (Barclays Municipal Bond)	1.4%	9.1%

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Gold

Gold lost 2.3% in the fourth quarter, ending the year down 1.7%. This result compares quite favorably with 2013's loss of 28.7 %, particularly in light of the still-strengthening dollar, which is negatively correlated with gold. However, in 2014 it was the second-strongest major currency in the world (right behind the U.S. dollar). We enclose a special commentary on gold for your review.

Your Portfolio

Last week we strategically rebalanced all our client accounts to their target allocations, returning them to the objectives chosen based on each client's unique needs—and locking in the domestic equity gains of 2014. In recent months we have seen signs of market euphoria. Margin debt is at an all-time high, new issues are thriving, and stocks are no bargain. These indicators could suggest that we're approaching a correction. However, no one knows with certainty. With portfolios rebalanced to target allocations, we are prepared to weather further good times or a market decline.

Selling holdings that are posting gains calls for discipline. To understand why it is necessary, it helps to remember our strategy. We cannot control market performance. We *can* build portfolios that are designed to manage risk. Managing risk calls for diversification across several classes of assets and maintaining target allocations in client portfolios. We determine your allocation based on your specific circumstances, considering factors such as age, health, plans for retirement, children's educational needs, and your tolerance for risk. We do not trade your portfolio to chase performance; we trade your portfolio to keep you positioned as appropriate based on your specific situation. Should any of your circumstances change, please contact your portfolio manager so we can determine whether a change in your allocation is warranted. Also, if you have a friend who could benefit from our disciplined, experienced approach to investment management, we would love to talk with them. Please let us know.

News from Towneley

- We have several exciting initiatives in the works here at Towneley: A website redesign will improve its usefulness to you; podcasts are in production, featuring information on diverse topics of interest to our clients; simplified advisory contracts and supporting documents will reduce paperwork.

- On February 1, our President, Tracy Kuntz, marks 30 years with Towneley. Over the years she has accumulated a store of expertise and wisdom that benefits Towneley clients. Our stable team sets us apart in our industry; Tracy has set a fine example of the value of long tenure.

- Along with your quarterly reporting, we have enclosed the *Contributions, Withdrawals, and Expenses* report. It provides information that may be relevant for tax reporting. TD Ameritrade will furnish realized gains and losses and 1099s directly to you.

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Gold: A Commentary

Gold started off 2015 with a bang. As one can see from the table below, gold outperformed all other currencies during the early days of 2015. Significantly, gold was also the second best currency, after the U.S. dollar, during the year 2014. Since 1970, when gold started to trade more freely in U.S. dollar terms, gold and the dollar have tended to be inversely correlated. The U.S. dollar, clearly the dominant reserve currency in the world, has been the preferred medium of exchange in world trade. Nevertheless, looking at the table below, one can see that in the years 2006, 2007, 2010, 2011, 2012 and early 2015 gold was up in every major currency. What we observe here is a tendency for all currencies to be debased against gold as central banks everywhere try to devalue their currency in an attempt to improve their local economy and gain a trade advantage over their neighbors. In addition, many central banks are continuing to purchase gold and add it to their reserves.

With the European Central Bank's recent announcement that it will purchase huge amounts of bonds, even at negative interest rates, we can only conclude that the goal is a relative decline in the value of the euro. Because interest rates around the world are so low, or negative in some cases, the currency wars are on as every country tries to game its trading partners. The likely outcome? Increasing volatility in the financial markets and growing uncertainty about where to safely place your money. It soon may no longer be about return *on* your money but rather return *of* your money. We think gold's traditional role as a highly liquid asset without counterparty risk is causing a renewed interest in gold. Price inflation hedging, which has always been a long-term prospect, is secondary now.

We believe a 5% position in gold continues to be warranted. Individual investors may wish to purchase and hold an additional small cash reserve of bullion gold coins like U.S. Gold Eagles or Canadian Gold Maple Leafs. These coins are issued in one troy ounce denominations and smaller and are sold without a numismatic premium. Be sure to take physical delivery; a safety box can hold a lot of value and provides you with a portable store of value in the event of a calamity or catastrophe.

Institutional investors have a much more complex problem because of the necessary fiduciary requirements, multiple signatures and investment policy statements. The best place to hold large amounts of physical gold bullion is in allocated storage in your name within an experienced, insured non-bank depository. Never permit unallocated storage of your gold because it introduces counterparty risk. If you are concerned about government confiscation, diversification of large holdings around the world is appropriate. Non-bank depositories are available in London, Zurich, Hong Kong and Singapore along with other countries.

Gold Price % Annual Change — Monday, January 12, 2015

	USD	AUD	CAD	CHF	CNY	EUR	GBP	INR	JPY
2006	23.0%	12.6%	23.0%	14.2%	18.7%	10.6%	8.3%	20.8%	24.4%
2007	30.9%	18.3%	12.1%	21.7%	23.3%	18.4%	29.2%	16.5%	22.9%
2008	5.6%	31.3%	30.1%	-0.1%	-2.4%	10.5%	43.2%	28.8%	-14.4%
2009	23.4%	-3.0%	5.9%	20.1%	23.6%	20.7%	12.7%	19.3%	26.8%
2010	27.1%	13.3%	21.3%	15.4%	22.8%	37.1%	31.4%	22.3%	11.4%
2011	10.1%	10.2%	13.5%	11.2%	5.9%	14.2%	10.5%	31.1%	4.5%
2012	7.0%	5.4%	4.3%	4.2%	6.2%	4.9%	2.2%	10.3%	20.7%
2013	-28.3%	-16.2%	-23.0%	-30.1%	-30.2%	-31.2%	-29.4%	-18.7%	-12.8%
2014	-1.5%	7.7%	7.9%	9.9%	1.2%	12.1%	5.0%	0.8%	12.3%
2015	4.1%	4.3%	7.3%	6.3%	4.2%	6.5%	7.0%	2.4%	2.7%
Average	10.2%	8.4%	10.2%	7.3%	7.3%	10.4%	12.0%	13.3%	9.9%

goldprice.org

Global Exchange Traded Fund Strategies

Fourth Quarter 2014 Performance Review
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Global Balanced Strategy

Our Global Balanced Strategy, which allocates among bonds, stocks, and hard assets around the world, declined 0.4% during the fourth quarter, which lowered its 2014 year-to-date gain to 1.4%.

Global investors continued to favor U.S.-denominated assets during the fourth quarter, helping to continue the dollar rally and driving U.S. asset prices to record highs. Major U.S. stock indexes set new all-time highs, and 10-year U.S. Treasury note yields fell below 2.2%. The dollar became the strongest currency in the world, widening the return gap among major financial markets. During the third quarter, real U.S. GDP increased at a stunning annual rate of 5%, the highest real growth rate in 10 years. The strong growth was backed by a declining jobless rate, which dropped below 6%, and a shrinking current account deficit, which fell to a 15-year low of 2.2%.

Europe and Japan, in contrast, failed to climb out of their economic slumps. The slowdown in developed market countries spilled over to emerging market countries, such as China, where growth slowed to 7.4%, its weakest rate in 24 years.

While the International Monetary Fund is predicting slower global economic growth in 2015, the U.S. economy's 2015 outlook seems bright. Along with a low jobless rate, the steep decline in oil prices could further boost U.S. consumption. The latest Consumer Sentiment Index soared to an 11-year high. As a result of the strengthening U.S. economy, demand for U.S. dollars has increased. The Dollar Index, which tracks the dollar's value against U.S. major trading partners, surged 5% in the fourth quarter, bringing its gain for the year to nearly 13%.

Since the first quarter, commodities markets had been trading sluggishly due to weak global demand. The latest decline in crude oil prices slammed commodity price indexes, knocking the Thomson Reuters/Jefferies CRB Index down 17.4% for the quarter and securing another year of losses. Silver and copper also suffered heavy losses. After a steep third quarter drop, gold moved sideways during the fourth quarter, finishing 2.3% lower than a quarter ago.

Global bond yields also drifted lower due to muted economic growth. 10-year European bond yields fell throughout the year, closing near 0.6%. Japan's 10-year bond yields, after trading within a narrow range of 20 basis points most of the year, took a decisive turn in November and finished the year near 0.3%. U.S. bond yields were tempered by foreign demand for "safe" assets. At quarter's end, global bonds were down 1.0% for the quarter. The bond portion of the strategy lost 0.7% during the fourth quarter, which dropped its annual return to 0.9%. The bond portion's performance was tempered by foreign currency losses resulting from the strong dollar and lower inflation.

Global equities advanced 0.4% during the quarter, led by red-hot U.S. stocks. The S&P 500 Index rose 4.9%, while overseas stocks were hit by local currency weakness against the U.S. dollar. The MSCI EAFE Index dropped 3.6% and the MSCI Emerging Market Index declined 4.4% for the quarter. The equity portion of the strategy gained 0.4% during the quarter, contributing to an annual return of 4%.

At quarter's end, the equity and hard assets portion made up 54% of the strategy, and bonds accounted for the remaining 46%. Specifically, 22% of strategy assets were invested in U.S. equities, 23% in foreign equities, 28% in U.S. bonds, 22% in foreign bonds, and 9% in hard assets.

Global Exchange Traded Fund Strategies

Developed Markets Strategy

Our Developed Markets Strategy, which invests in equities and fixed income securities of industrialized countries, declined 4.3% during the fourth quarter, increasing its loss for the year 2014 to 5.4%.

Foreign developed markets underperformed their U.S. peers for yet another quarter due to the strong U.S. dollar. Since last summer, the dollar has been in demand, rapidly increasing its value against most foreign currencies. After suffering a sell-off in the fall, the decline in the euro and the yen accelerated against the dollar. At year's end, each currency's exchange rate per dollar was at least 10% lower than it had been a year earlier as countries attempted to boost their economies.

Since November 2012, the yen has lost 50% of its value against the U.S. dollar. The Yen/USD exchange rate fell from 80 to over 120 yen per dollar. The European Central Bank is currently under pressure to stave off stagnation risk in the Eurozone. Since the ECB revealed its plan to directly purchase European sovereign bonds, the U.S. dollar has tumbled from $1.40 to $1.21 per euro in the past eight months, a decline of nearly 14%.

Due to the strong dollar, U.S. dollar-based investors in developed market assets had a poor quarter, while local investors did well. In local terms, the MSCI EAFE Index rose 1.8% for the fourth quarter, increasing its 12-month gain to 5.9%. Similarly, bond markets in Europe and Japan delivered positive local returns for the fourth quarter. In particular, euro-denominated bonds had a spectacular year, advancing by over 10%.

The robust Japanese stock market helped boost developed market equities' fourth quarter result by advancing 6.7% in local terms. The equity rally was credited to Japan's quantitative easing, which motivated Japanese pension funds to reallocate their capital out of Japanese government bonds. Economically, Japan continued to miss its growth target as output has contracted in the last two quarters. In Europe, stock markets slipped less than 1% in euro terms for the quarter as investors anticipated the beginning of the ECB bond purchase program.

The equity portion of the strategy declined 5.4% during the quarter, widening the loss for the year to 6.3%. This result was due to our continued underweight in Japanese equities, compared with the benchmark. The bond portion of the strategy, which includes a mix of fixed income and inflation-protected securities, declined 3.3% for the quarter, ending 2014 down 4.8%.

At quarter's end, roughly 48% of the strategy was invested in equities, of which 12% was allocated in Asia, 27% in Europe, and 9% in the rest of the world, including Israel, the U.S. and Canada. The balance of the strategy was invested in bonds.

Emerging Markets Strategy

Our Emerging Markets Strategy, which invests in less developed economies, declined 4.4% in the fourth quarter, resulting in a 1.1% loss for the year.

A strong dollar, poor global economic growth and plunging crude oil prices put pressure on emerging market assets. Emerging market currencies devalued against the U.S. dollar and emerging country bonds and equities sank. Even dollar-denominated emerging market bonds did poorly.

Emerging market bonds were popular during the first half of 2014, then prices softened. The pace of the decline accelerated in the past three months as the dollar's value continued to soar. During the past five years, emerging countries have been on a global borrowing binge, doubling their dollar debt loads to about $9 trillion dollars. As emerging nations' currencies sharply weakened, investors worried that a situation like the 1998 emerging market crisis might be developing. Increasing uncertainty offset emerging market debt's gains earlier in the year, putting pressure on emerging market debt trading despite lower global bond yields. At the end of 2014, local currency bonds finished 5% lower than last year, while dollar-denominated bonds reported a twelve month gain of 6%.

Global Exchange Traded Fund Strategies

Emerging market equities also suffered a setback, losing 4.5% in the fourth quarter. Deep losses in Latin America and Eastern Europe canceled out gains in China and India. Global slowdown reduced commodity demand, and the imbalance in energy markets was further widened by the oversupply from U.S. shale oil production. The OPEC nations cut their prices to secure their market shares, causing crude prices to plunge by almost 50% and driving down stock prices in Eastern Europe and Latin America by over 10% in the fourth quarter. Russian stocks were the hardest hit, losing over 30% during the quarter.

2014 was a terrible year for Russian stock markets. A sell-off began last January when Putin embarked on the Crimean war. Continued lower oil prices will only worsen Russia's economy as 50% of its revenue comes from oil and gas exports. The Russian ruble fell by almost 50% against the U.S. dollar, significantly impacting Russian companies. Unfortunately, as a group, Russian companies borrowed as much as $600 billion in dollar-based debt over the past few years. Not only does a Russian financial crisis seem to be emerging, but Russia will likely receive no help from the west if such a crisis actually occurs.

The turmoil in the energy markets isn't all bad. Emerging Asian oil-importing countries are likely to reap rewards. The region's stock markets were surprisingly resilient amid the storm in the commodity world. Despite China's lower economic growth rate, Chinese stocks jumped 7% in the fourth quarter, due, in part, to China central bank's unexpected rate cut in November.

Overall, emerging market equities lost 2% for the year, underperforming U.S. equities by 16%. The equity portion of the strategy suffered a quarterly loss of 6.2%, resulting in a negative return of 2.3% for the year. The remaining portion, invested in blended fixed income securities, was down 2.4% for the quarter, dropping its twelve-month return to 1.2%.

Equities continued to constitute 48% of the strategy, of which 23% was invested in Asia, 10% in Latin America, 8% in Eastern Europe, and 7% in the Middle East and South Africa as of December 31, 2014. The balance of the strategy, 52%, was invested in fixed income securities.