PRIVATE ASSET MANAGEMENT, INC.
WEALTH STRATEGY ADVISORS
PARADIGM

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This month, we will review the first quarter, 2015, plus comment on themes that we have noticed in current investment articles. Our goal is to help you make better investment decisions, especially with regard to market volatility and not taking on undue risk.

First Quarter Review

Returns were reasonable for most major asset classes. However, most major asset classes ended the quarter expensive versus their long-term valuation averages.

Index	First Quarter Return
Barclays U.S. Aggregate Bond	1.6%
S&P 500	1.0%
Russell 2000	4.3%
MSCI EAFE Foreign Developed	4.9%

The Barclays U.S. Aggregate Index's total return for the quarter was 1.6%. Due to continued modest inflation and tempered growth, interest rates declined during the quarter. For example, the yield on the 10-year Treasury bond declined from 2.2% to 1.9%. The rate decline caused prices to rise. We estimate that nearly two-thirds of the 1.6% return for the quarter was due to rising prices with the remainder being interest income.

The S&P 500 posted a modest return that was evenly split between price appreciation and dividends. Due to the decline in oil prices, the rising dollar, and continued anemic economic growth, estimates for 2015's earnings have come down 3% since the beginning of the year. This means that the S&P 500 ended the quarter at 17.5 times estimated earnings for 2015, which is slightly above its long-term average.

Small cap stocks, as measured by the Russell 2000, had a good quarter. These companies derive a much greater portion of their earnings from the U.S. than larger companies do. Given that growth in the U.S. stacks up well versus other developed economies, investors are currently willing to pay higher price earnings ratios for these companies. However, this index now trades at 20 times estimated earnings for 2015, slightly above its long-term average.

Foreign stocks rebounded after a poor performance in 2014. Most of the increase appears to be related to cheaper valuations versus the U.S. stock market. Rising valuations may continue. Plus, towards the end of the year, investors may see signs that growth outside the U.S. is picking up, thus supporting earnings and higher valuations going into 2016.

Current Investment Environment Articles

We are going to break the articles into two groups: those that are mostly descriptive and those that include a potential course of action.

Major themes in the descriptive articles align with our thinking:

1. Valuations are above their historical averages, but are not at bubble levels.
2. Earnings will be impacted by falling oil prices and a rising dollar, but will grow in both 2015 and 2016.
3. Bull markets end with recessions and not with slow-growing earnings.
4. This year the Federal Reserve is likely to raise rates, although they will do it slowly.

These descriptive articles on stocks and bonds usually concede that a 5%-10% stock market correction could occur simply due to normal volatility and investor mood swings. This is important because we believe investors should focus on executing their long-term strategy and not focus on these inevitable short-term market swings.

Two major themes we found in the articles that include a potential course of action are:

1. How to earn more income.
2. How to earn higher stock returns.

Both themes raise the possibility for investors to take on undue risk. Therefore, we advise caution when reading and acting on these articles.

These articles acknowledge that you are taking on more risk to earn higher returns. However, we think some articles understate the risk-reward trade-off. One article talked about increasing income by engaging in peer-to-peer lending, either directly or through certain online platforms. Also, we've seen articles about investing in frontier markets in an attempt to earn higher returns. Frontier markets are riskier than emerging markets and include countries like Nigeria and Romania.

How well do you understand the risks of peer-to-peer lending or frontier markets? Not understanding these markets well can increase the likelihood of a poor long-term outcome.

First quarter returns were reasonable. In the coming months, accept market volatility while avoiding taking on undue risk to boost returns. This is not the time, in our opinion, to pursue higher risk, higher reward investments that you may not understand.

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