



First Quarter Investment Commentary

2014

Aloha Means both “Hello” and “Good Bye”

U.S. stock markets shrugged off the Russian re-annexation of Crimea to reach new highs during the first quarter of 2014. The U.S. stock market, as measured by the S&P 500 Index, finished the first quarter of 2014 with a return of 1.8%. Some likely catalysts for the market rise include a strengthening Labor Market, returning Consumer Confidence and a pick up in Industrial Production.

The first quarter of 2014 also marked the five year anniversary of the current Bull Run. The firming economy allowed the Federal Reserve to scale back its level of Quantitative Easing to \$55 billion a month of artificial stimulus. The Federal Reserve’s balance sheet as of April 9th stands at \$4.29 trillion, up from \$4.14 trillion as of January 22nd 2014. That’s an increase of over \$145 billion in three months. With improved conditions, it is expected that the Federal Reserve will continue to reduce the amount of artificial stimulus along the order of \$10 billion at each of their subsequent meetings throughout the rest of the year.

Despite one of the longest and coldest winters in decades, it was a strong quarter across the board for equity returns. Nine out of ten sectors of the S&P 500 posted positive gains. However, there was a significant spread between the best performing sector, Utilities (+10.1 %) and the worst performing sector, Consumer Discretionary (- 2.8 %). Colder weather resulted in increased demand for heat and utilities. Being housebound cut in to the ability of the consumer to go out and consume.

The stock portion of Old Point Trust Equity Model accounts had a return of 3.0 % for Q1 compared to the S&P 500’s return of 1.8 %. Following is a table of the S&P 500 returns by sector:

Q1 2014 Performance Summary by Sector

Sector	Return
Utilities	10.1 %
Health Care	5.8 %

Materials	2.9 %
Financials	2.6 %
Information Technology	2.3 %
Energy	0.8 %
Telecommunications	0.5 %
Consumer Staples	0.5 %
Industrials	0.1 %
Consumer Discretionary	- 2.8 %

In comparison, here are how some of our more widely held securities performed over the first quarter:

Amgen (AMGN)	8.7 %
Baker Hughes (BHI)	18.0 %
Devon Energy (DVN)	8.5 %
Dominion Resources (D)	10.7 %
Hewlett-Packard (HPQ)	16.2 %
Johnson & Johnson (JNJ)	8.0 %
Lockheed Martin (LMT)	10.7 %
Microsoft (MSFT)	10.4 %
Raytheon (RTN)	8.9 %
Teva Pharmaceutical (TEVA)	27.7 %
Walgreen (WAG)	15.5 %

The Labor Market

March saw a noticeable strengthening of the Labor Markets. Initial Jobless claims dropped by 32,000 to 300,000 in the week ended April 5th. That's the lowest rate since May of 2007, according to a report issued by the Labor Department on April 10th. The figure was lower than the most optimistic forecast in a Bloomberg survey of 52 economists. The median estimate was for 320,000 claims. Continuing Jobless claims also decreased by 62,000 to 2.78 million in the week that ended March 29th. That is the lowest for continuing claims since January of 2008.

Consumer Confidence

Consumer Confidence has gained on the back of a strengthening Labor Market. In March, Consumer Confidence climbed to its highest level since January of 2008. The Conference Board's Index reached a level of 82.3, which was higher than all estimates. The median forecast in a Bloomberg survey of 76 economists called for the

reading to rise to 78.5, up from February's reading of 78.1. Estimates for March had ranged from 75 to 80, so 82.3 was quite a welcomed surprise.

Industrial Production

Industrial production accelerated in March. The Institute for Supply Management's Index increased to 53.7 from 53.2 in February. A reading above 50 indicates expansion and last March the Index stood at 51.5. There was a big leap from February to March in Production. There was also a noticeable pick-up throughout the quarter in the backlog of orders to be filled. Here is a breakdown of the ISM numbers through the first quarter:

	<u>January</u>	<u>February</u>	<u>March</u>
Manufacturing Index	51.3	53.2	53.7
Prices paid	60.5	60.0	59.0
Production	54.8	48.2	55.9
New Orders	51.2	54.5	55.1
Backlog of Orders	48.0	52.0	57.5
Supplier Deliveries	54.3	58.5	54.0
Inventories	44.0	52.5	52.5
Customer Inventories	44.0	46.5	42.0

Producer Prices

Along with the trio of improving statistics in the Labor Markets, Consumer Confidence and Industrial Production, we have seen a concurrent increase in the level of Producer Prices. The Labor Department's Producer Price Index increased 0.5% in March. Within that number, Services costs rose the most in four years and there was also a noticeable acceleration in the costs of food and fuel. Core wholesale prices, which exclude the volatile food and energy categories, gained 0.6%. The estimate had been for a monthly gain of only 0.2% in the core Index.

Still, some evidence suggests that rising gasoline and food prices are beginning to put a strain on household budgets. The average price of a gallon of regular gas on April 10th was \$3.62, according to AAA. In 2013, gasoline costs averaged \$3.49 per gallon. That would be a 3.7% increase for the year to date. Further price increases can be expected as we head into the peak driving season and we are faced with continued geopolitical turmoil.

Wholesale food costs went up 1.1% in March, which was the largest monthly jump in nearly a year. Food costs were led higher by the increasing costs for meat, particularly for pork and sausage. The price of beef has risen noticeably too.

Ballooning Federal Debt

According to www.usdebtclock.org the total debt of the United States is \$17,579,691,132,612 and climbing rapidly, as I write this commentary on Sunday April 13th, 2014. That's over \$250,000,000,000 more than when I wrote my last commentary just three months ago. I encourage everyone to check out this website because it is loaded with everything you need to know about our escalating debt problem.

If \$17.58 trillion is a number that is just too big for you to comprehend, then let me break it down for you into something a little easier to handle: that much debt amounts to \$55,301 for every citizen. Since most of you who are reading this note also just paid your taxes, \$17.58 trillion represents \$151,997 of debt for each taxpaying citizen.

This website also shows rolling tallies of our largest budget items, including Medicare and Medicaid, Social Security and Defense. An even more staggering number shown on the site is the nation's unfunded liabilities. They are in excess of \$128.702 trillion, or a liability per taxpayer of \$1,112,747. Please check out this website and share it with everyone you know. Our collective attention must be on this problem or ultimately our debts will consume us.

Warren's Way

The Berkshire Hathaway annual letter came out in late March. Berkshire increased its book value by 19% in 2013, lagging the S&P 500's return of 32%. In the letter, Mr. Buffet explained, "We have under-performed (the S&P 500) in ten of our 49 years, with all but one of our shortfalls occurring when the S&P gain exceeded 15%." Still, historically, Berkshire Hathaway has been able to out-perform the S&P 500 handily over the past half of a century. How has Warren Buffet been able to post such impressive long-term returns? He sums it up this way: "Keep things simple and don't swing for the fences. When promised quick profits, respond with a quick 'No'."

On a separate note, Mr. Buffet teamed up with Quicken Loans recently during the men's NCAA basketball tournament to offer a Billion dollars to anyone who could correctly predict the outcome of every game in the basketball tournament. The odds of picking every winner correctly in a 64 team bracket are about 1 in 1 billion, according to Ezra Miller, a math professor at Duke University.

“I charged a premium that was a reasonable amount above what I thought the odds were” Mr. Buffet explained to ESPN before the tournament started. “I had another guy at Berkshire Hathaway make his own calculation, independent of me, and we were in the same ballpark. But it was a pretty big ballpark.” Entries in the competition were capped at 15 million.

For Berkshire’s guarantee to pay off this Billion dollar payout, should anyone correctly guess, Mr. Buffet made his company a quick premium estimated to be between ten and fifteen million dollars. Quicken Loans promised him quick profits on a billion to one bet. Perhaps Mr. Buffet is going soft on his own advice in his older age? Still, if I had a billion dollars of available cash to invest, I think I might have taken that bet too.

“Sell In May and Go Away”?

“Sell in May and Go Away” is a longstanding phrase in the collective wisdom of the markets. Here at Old Point Trust, we are not market timers in the purest sense. We are prudent investors. However, on occasion we do take notice of statistical trends. Marketwatch.com provides a timely reminder that March and April have been the market’s strongest months, on average, over the past twenty years, as seen in the following table:

S&P 500 Over the Last Twenty Years

<u>Month</u>	<u># of returns</u>	<u>Average Return</u>	<u>% Positive</u>	<u>Rank</u>
January	20	0.54 %	65 %	7 th
February	20	- 0.58 %	55 %	11 th
March	20	1.52 %	65 %	2 nd
April	20	2.19 %	75 %	1 st
May	20	0.41 %	60 %	8 th
June	20	- 0.31 %	55 %	10 th
July	20	0.55 %	50 %	6 th
August	20	- 0.89 %	55 %	12 th
September	20	- 0.06 %	60 %	9 th
October	20	1.51 %	65 %	3 rd
November	20	1.34 %	65 %	5 th
December	20	1.46 %	80 %	4 th

One interesting insight, besides the obvious summer lull, is that in each of these months, there is a positive return at least 50% of the time.

Fixed Income

With interest rates poised to rise and credit spreads at their tightest levels since the end of the 2008-2009 credit crisis, I expect that rising rates will completely offset the current yield that we are able to get from Investment Grade credits in the 3 to 7 year part of the yield curve. Historically the yield on a 10 year treasury bond has averaged 2 to 2 ½% over the inflation rate. Even with inflation running at about 1.5 % over the first quarter of this year, the yield on a 10 year treasury would have to rise to 3.5% or 3.75% just to approach historical norms. Although I expect higher rates, with the 10 year treasury at 2.625% as of April 11th, I do not expect to see rates run up to that historic norm over the remainder of this year.

Aloha, Hobie!

Hobart “Hobie” Alter, the inventor of foam surfboards and the “Hobie Cat” sailboat, recently died at the age of 80, according to a statement on the Hobie website, www.hobie.com

In discussing the future with friends as a young man, Hobie declared that he wanted to make a living “without having to wear hard-soled shoes or work east of California’s Pacific Coast Highway. By ‘Making people a toy and giving them a game to play with it’ he was able to realize that dream. And in the process, he introduced the world to an outdoor lifestyle and collection of products that made things just a bit more fun for all of us.”

His sister recently recalled that their father taught Hobie early on to always tell the truth, no matter the consequence, and that any deal worth doing could be done with a handshake. Truly a pioneer in the business of pleasure, that spirit of Hobie Alter will be greatly missed.

Aloha, Hobie.

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