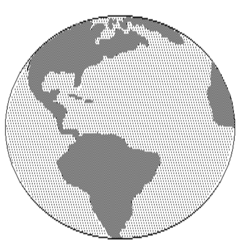
FINANCIAL PARTNERS, INC.

a Wealth Advisory firm

Market Watch
1st Quarter 2015

Summary

- The U.S. stock market reached another record high, and then struggled
- Unlike last year, international stocks outperformed US stocks this quarter
- ECB's own QE program started to boost Europe's economy
- Euro hit an 11-year low against the US dollar
- Fed signaled intent to raise interest rates
- Bonds, once again, produced positive returns, with rates declining
- For 2014, inflation remained low at 1.7% (excluding food and energy). If these categories are included, inflation was flat for the full year.



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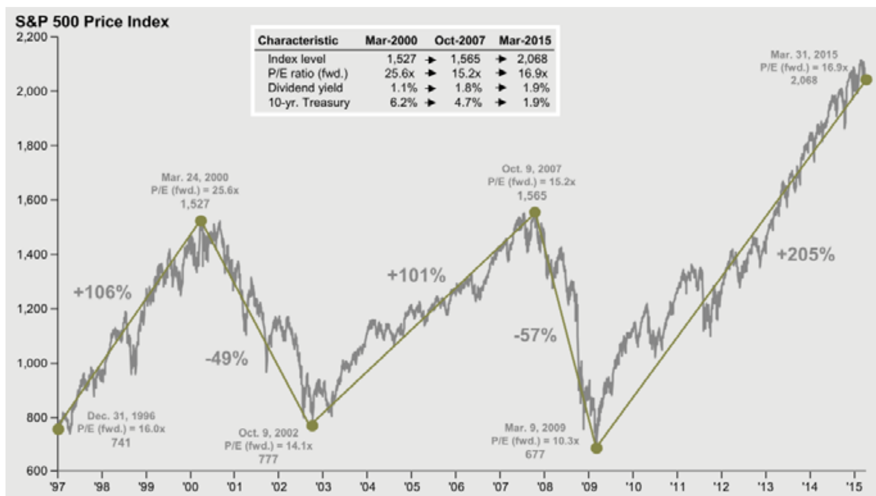
Despite volatility, a moderately positive quarter

Unlike 2014, this quarter saw small stocks outperforming large stocks and international beating U.S. markets. All broad equity markets were up for the quarter, with most gains coming in February.

After a strong 2014, large U.S. stocks hit another new all-time high this quarter while the NASDAQ pushed past 5000 (just 7 points away from its own all-time high, last seen just before the dot.com bust in March 2000). For the quarter, the S&P 500 posted a modest gain of 0.95%, while NASDAQ was up 3.79%.



After a disappointing 2014, the developed international markets showed positive signs, with both the Eurozone and Japanese markets posting solid gains. The MSCI Europe Australia Far East Index (EAFE) was up 5% in the first quarter of 2015. The Emerging Market economies also showed signs of growth with the MSCI Emerging Market Index rising 2.28% for the quarter.

The US bond sector continued to surprise investors with another strong performance in the first quarter. With oil and commodity prices falling and global economic growth struggling, bond prices rallied as the Treasury 10-year bond yield fell to 1.94% at quarter's end. The bond market benchmark, the Barclay's US Aggregate Bond Index, gained 1.61% during the quarter.

Fed and QE

The US Central Bank (the "Fed") has two mandates from Congress: 1) to stabilize monetary and credit conditions, and 2) to seek to maximize employment as well as promote stable prices. Since the

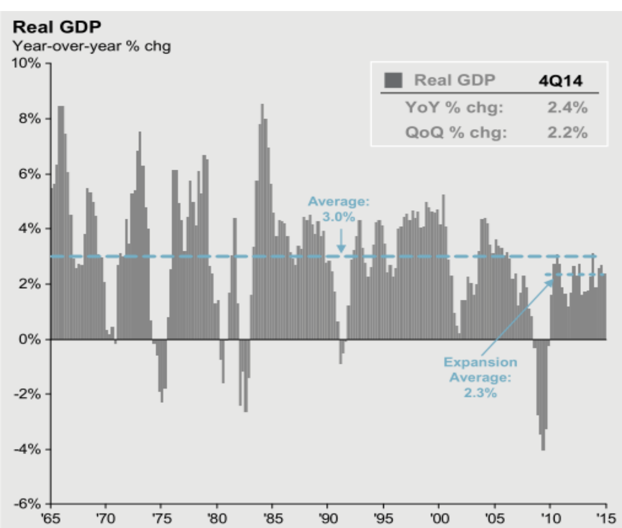
"Great Recession," the Fed has focused its efforts on its second mandate—seeking to promote a healthier economy and job growth by keeping interest rates low. In its last meeting, the Fed reaffirmed its view that rates should be kept low. Still, it has signaled its intent to begin raising rates (something it last did in 2006). The timing of any rate increases remains uncertain. The Fed remains cautious about the health of the economic recovery. Fed Chair Janet Yellen has said that borrowing costs would probably be raised gradually, without following a predictable pattern.

As often happens, following these initial announcements, the markets reacted temporarily before settling down and recovering. Historically, stock markets have generally done reasonably well in environments when interest rates are slowly rising, so we see the Fed's stance as no reason for concern.

The US Economy

Forecast on GDP

The economic picture was a mixed bag in 2014. Weather and other factors slowed the economy in the first quarter, while the 2nd and 3rd quarters saw recovery and nice growth rates—only to cool in the fourth quarter. GDP expanded at a 2.2% annual rate for the year. The dollar strengthened in 2014 gaining 7.8% against a basket of major currencies between June and December. This reduced corporate profits as weaker foreign currencies reduced revenues attributable to operations outside the United States. However, robust US consumer spending limited the harm. For all of 2014, after-tax corporate profits fell 8.3%, the largest annual drop since 2008.



So far in 2015, the sturdy dollar, lingering weakness in Europe and Asia, harsh winter weather in the United States and a now-settled labor dispute at busy U.S. West Coast ports dampened economic activity in the first two months of the year. There are some signs of a pick-up in activity, but the dollar will likely provide a challenge for domestic manufacturers since US products are now more expensive for most overseas buyers. First-quarter GDP growth estimates range between a 0.9% and 1.4%.

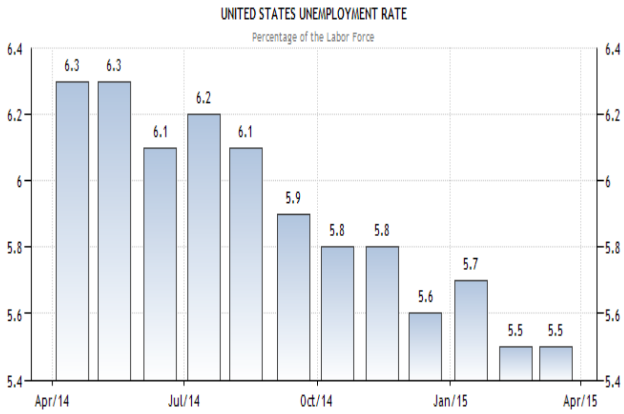
Dollar and Oil

The dollar has gained roughly 13% against the currencies of our main trading partners since last June. Economists say that the impact of that gain on the US economy is equivalent to a half-point interest rate hike. At the same time, the sharp oil price drop has curtailed U.S. drilling activity (energy producers have idled half of their rigs since October). This has caused associated payrolls to fall 11,000.

Employment

The economy continues to add jobs, but job growth did slow at the end of the first quarter. The latest March labor report indicated that US employers added the fewest number of jobs in more than a year (nonfarm payrolls rose just 126,000 last month). This weakness reflects the impact of both the strong dollar and lower crude oil prices (which has hurt the energy sector as noted previously).

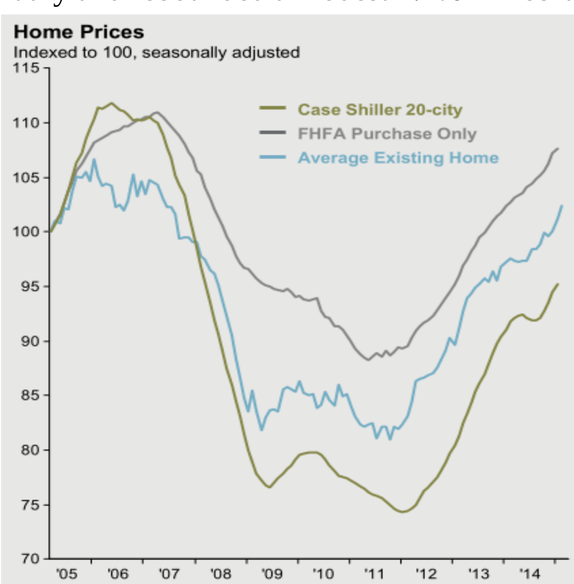
In the latest report, the jobless rate held at 5.5%, but the labor force participation rate (the percent of the American population that is working) fell to a 36-year low. The broadest measure of joblessness fell to 10.9%. This measures the unemployed, those who want to work but have given up searching, and those working part-time because they cannot find full-time employment. So, despite improvements in employment, more improvement is needed.



The Fed believes that a 2% inflation rate is the ideal level for a growing economy, and in fact, encourages the economy to grow. Consumer inflation has been below the 2% level since the recession and continues to remain low (1.7% over the 12 months through February if one excludes food and energy).

Housing

Sales of previously-owned homes in the United States have been slow. The rate of sales fell 4.9% in January and rebounded a modest 1.2% in February.



New home sales data, however, is showing a different picture. Figures from the Commerce Department Tuesday showed purchases of new homes unexpectedly rose 7.8% in February from the prior month (to a 539,000 annualized pace). This is the highest rate since February 2008. The S&P/Case-Shiller home price index increased 4.6% after rising 4.4% last year.

Consumer confidence

Consumer confidence among lower- and middle-income households fell at the end of the quarter. In part, this reflects the impact of rising utility bills and higher prices at the gas pump. The University of Michigan final March sentiment index registered at 93 (below February's 95.4 reading). The report also suggested that larger spending gains were likely to continue to be deferred until incomes increase.

The World Economy

Eurozone

Europe's economy is bouncing back. Data from the European Commission showed that Eurozone economic sentiment rose to 103.9 in March. This represents four straight months of improvement. The Eurozone GDP rose 0.3% during the first quarter. Preliminary estimates showed expansion in Germany and Spain accelerated while France barely grew and Italy stagnated. Deflation continues to be a concern in Europe. Consumer prices fell 0.1% in March and European unemployment remains high at 11.3%.

Following in the footsteps of the US, England and Japan, in January, the European Central Bank ("ECB") rolled out its own 19-month "quantitative easing" program. This will inject 1.1 trillion Euros ($1.2 trillion) into the Eurozone economy. It is expected that this will boost economic activity.

Japan

Japan is fighting a 25 year recession and an overhang of government debt. The government has initiated a number of measures in an attempt to boost growth. Still, Japan's emergence from recession has been weaker than hoped for or expected. It has not helped that Japanese companies have reduced investments and drawn down their inventories. Still, gross domestic product expanded 1.5% in 2014, overcoming an increase in the sales tax last April.

China

Despite two interest rate cuts since November 2014, the Chinese economy seems to have lost momentum. That said, China's economy still expanded by 7.4%

2014. Purchasing Managers surveys suggested even a slight contraction in March. Some analysts expect first-quarter economic growth to dip below the government's new full-year target of 7.0% – a number widely seen as the level needed to keep employment steady. Like the US economy, China's growth is key to what happens in the rest of the world.

Emerging Markets

The rate of growth in global emerging market countries also weakened in March, although there were both strong and weak areas. Data for the four largest emerging economies revealed a mixed picture. While growing more slowly than historically, China's economy still grew nicely. India's new government has begun making important changes which should help boost growth. In contrast, Brazil and Russia are each struggling with regional and internal issues and their economies are hurting.

Markets, though, don't always follow the economy. Despite their local problems, these same BRIC countries (Brazil, Russia, India and China) showed positive market returns during the quarter. Russia was up 18.6% in dollar terms as the tensions in Ukraine eased. China and India were up 8.1% and 5.4% for U.S. investors. But, given Brazil's weak currency, 1st quarter returns declined 14.6% in dollar terms (it was up 2.7% in local currency).

HSBC Emerging Markets Index

Investments

US Equities

Although the U.S. stock markets experienced a fair amount of volatility during the 1st quarter, both the Standard & Poor's 500 and Dow 30 Industrial indices hit all-time highs in January and finished the quarter up: +0.95% for the S&P 500 and +0.33% for the Dow 30. The best performing sectors were Health Care and Consumer Discretionary, while Energy, Financial and Utility sectors fell for the quarter. The S&P 500 index has now risen 205% from its March 2009 lows, and is 55% above its October 2007 peak.

From a market valuation perspective, using the forward P/E (current stock price divided by estimated future earnings over the next 12 months), the S&P 500 index is now priced at 16.9 times forecasted earnings. This is slightly above the 15-year average of 16. The current dividend yield for S&P 500 index remained unchanged at 1.9% at the end of the quarter.

International Equities

Despite having to battle the strength of the dollar, international markets posted mostly positive results for U.S. investors this quarter. Japan was up 10.4% in yen, which translated to 10.3% for American investors. Germany and France both posted solid gains of 8.4% and 4.8% respectively in dollar terms. The MSCI EAFE index, the most widely used international index, gained 11% in local currency, while dollar denominated returns were up 5%. On average over the last 10 years, the MSCI EAFE index has risen by 5.4% annually (compared to the S&P's rise of 8.0% per year).

2014	1Q15
REITs 28.0%	DM Equity 5.0%
Large Cap 13.7%	Small Cap 4.3%
Fixed Income 6.0%	REITs 4.0%
Asset Alloc. 5.2%	EM Equity 2.3%
Small Cap 4.9%	Asset Alloc. 1.9%
Cash 0.0%	Fixed Income 1.6%
High Yield 0.0%	Large Cap 1.0%
EM Equity -1.8%	High Yield 0.6%
DM Equity -4.5%	Cash 0.0%
Comdty. -17.0%	Comdty. -5.9%

For the first quarter of 2015, the MSCI Emerging Markets Index was up 4.9% for local investors and 2.3% for US investors. Over the last 10 years, the Emerging Markets asset class has been among the best performing equity sectors with a compound annual return of 8.8%.

Fixed Income

The bond market continued its strong performance into 2015. The strong dollar, low inflation and higher Treasury yields (compared to negative yields in Europe) made the U.S. bond market an attractive place to allocate fixed income assets. During the quarter, bond prices rose as the yield on 10-year Treasuries fell from 2.17 to 1.94%.The Barclays Capital US Bond market index posted a gain of 1.61% for the quarter and was up 5.72% over the last 12 months.

Short-term bonds rose 0.59% for the quarter, and 1.12% over the last 12 months. Intermediate bonds gained 1.4% while posting a solid gain of 3.58% for the twelve months ending March 31.

Treasury Inflation-Protected Securities (TIPS) typically reflect investors' expectations of future of inflation. TIPS experienced a solid gain of 1.42% during the 1st quarter and rose 3.11% over the last twelve months.

Emerging market debt posted a modest return as dollar-denominated emerging market bonds gained 1.87% during the quarter. Returns over the twelve months period were positive 4.53%.

Alternatives

Our alternative holdings again experienced mixed returns during the first quarter of 2015.

- The Alerian Master Limited Partnership Infrastructure Index, which tracks energy transportation and storage facilities, has been one of our better performing assets over the last several years. However, in response to falling oil prices, the index was down 5.14% during the quarter and is up only 0.47% for the last 12 months.
- Global real estate, represented by the NAREIT Real Global Index, rose 4% over the quarter and is up 14.8% over the last 12 months.
- Timber, as measured by the FTSE NAREIT Timber REIT, declined 3.85% during the quarter, but is up 9.08% over the last 12 months.
- Commodities (the basket of energy, precious metals, agriculture products and livestock) continued to decline thanks to the drop in oil prices and the broader world slowdown. It was down 5.94% for the quarter. Over the year, the Bloomberg Commodity Index declined 27.0%. Obviously this decline has been difficult to watch, but we believe it is nearly inevitable that energy prices will rise once again, we do not recommend eliminating this exposure.
- Managed Futures, represented by the S&P Diversified Trends Indicator Index was up 2% for the quarter and is up 9.44% over the last 12 months.

Summary

In March investors celebrated the six-year anniversary of the bull market in stocks. People who were brave enough to be invested in stocks back then have made a very attractive return on their investments. This is now the fourth-longest bull market in history, with the S&P 500 up 205% since its low in March 2009. While our economic recovery has sometimes been frustratingly slow, the market's rise has been assisted by record low interest rates. Now with higher interest rates in sight, the real questions are: "Where are stocks headed next?" and "Has this bull run its course?"

Looking forward over the next several years, our outlook suggests portfolios will struggle to attain historical returns. At some point, interest rates will begin to rise. This will likely hold back bond returns for some period of time. By most estimates, US stocks are fully valued today and so gains in the market will have to rely on profit growth. P/E expansion (how much you pay for a dollar of earnings) is unlikely to continue to boost market returns.

Japan and Europe will likely struggle as they try to regain their economic strength (while being held back by the need to reduce their debt burdens). It is quite possible that the best returns will come from emerging markets or some of the alternative sectors. If you want to control portfolio volatility, (which is likely to be a frequent companion of markets) we believe having a diversified portfolio will continue to be the best way to manage your money.

Although market results can never be assured, we at Mosaic Financial Partners stand by our belief that a solid financial plan along with a disciplined investment approach that includes a globally diversified portfolio is a prudent "insurance policy" against the financial uncertainty. Moreover, here at Mosaic, it is our promise and commitment to you that we will continue serve your financial needs with passion, energy and integrity. We thank you for your continued confidence in us.

Sources:

Morningstar, JP Morgan Asset Management, Reuters, Blooomberg.com, NYtimes.com, U.S. Bureau of Labor Statistics, HSBC Markit