

# Q2

Quarterly Market Review  
Second Quarter 2014

**TRANSITIONS**   
Wealth Management, LLC

# Quarterly Market Review

Second Quarter 2014

This report features world capital market performance and a timeline of events for the last quarter. It begins with a global overview, then features the returns of stock and bond asset classes in the US and international markets.

The report also illustrates the performance of globally diversified portfolios and features a topic of the quarter.

## Overview:

Market Summary

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US Stocks

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Select Country Performance

Real Estate Investment Trusts (REITs)

Commodities

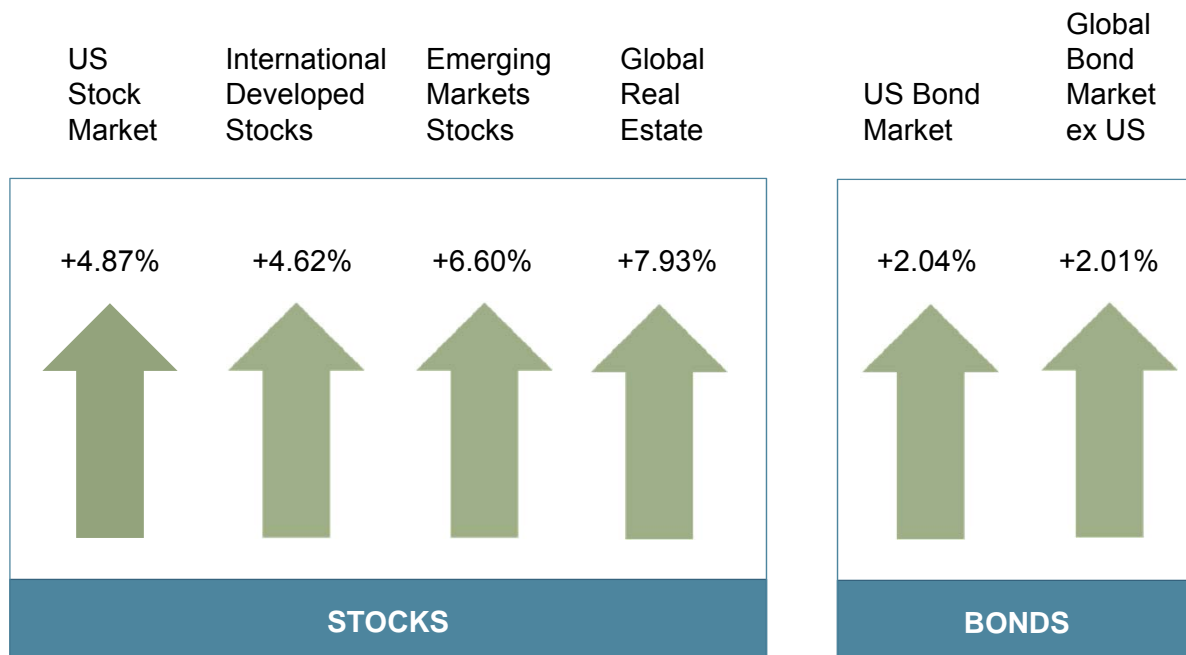
Fixed Income

Global Diversification

Quarterly Topic: Connecting the Dots

# Market Summary

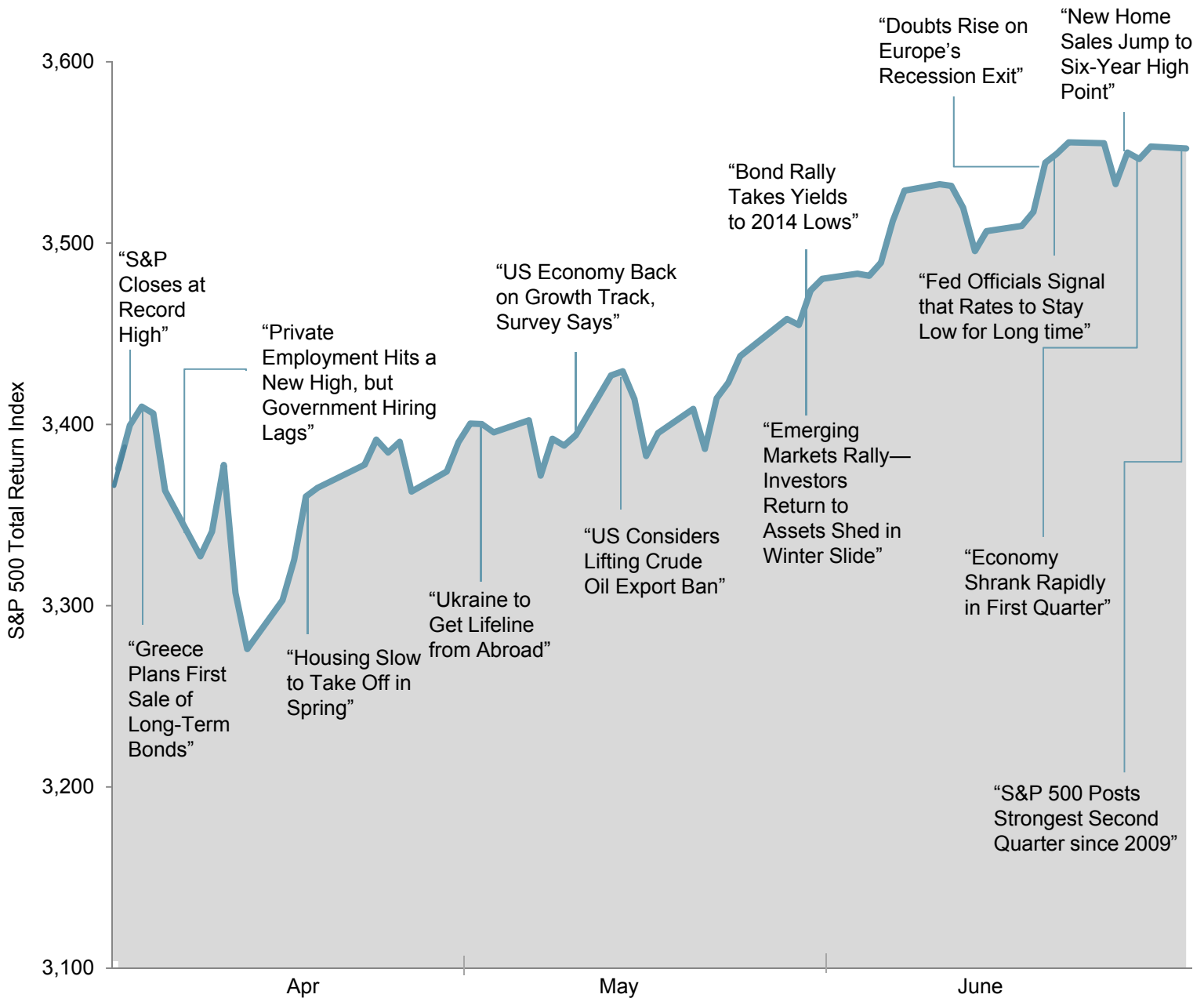
## Second Quarter 2014 Index Returns



Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index), US Bond Market (Barclays US Aggregate Bond Index), and Global Bond ex US Market (Citigroup WGBI ex USA 1-30 Years [Hedged to USD]). The S&P data are provided by Standard & Poor's Index Services Group. Russell data © Russell Investment Group 1995-2014, all rights reserved. MSCI data © MSCI 2014, all rights reserved. Barclays data provided by Barclays Bank PLC. Citigroup bond indices © 2014 by Citigroup.

# US Stock Market Performance

S&P 500 Index with Selected Headlines from Q2 2014



*These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a longer-term perspective and avoid making investment decisions based solely on the news.*

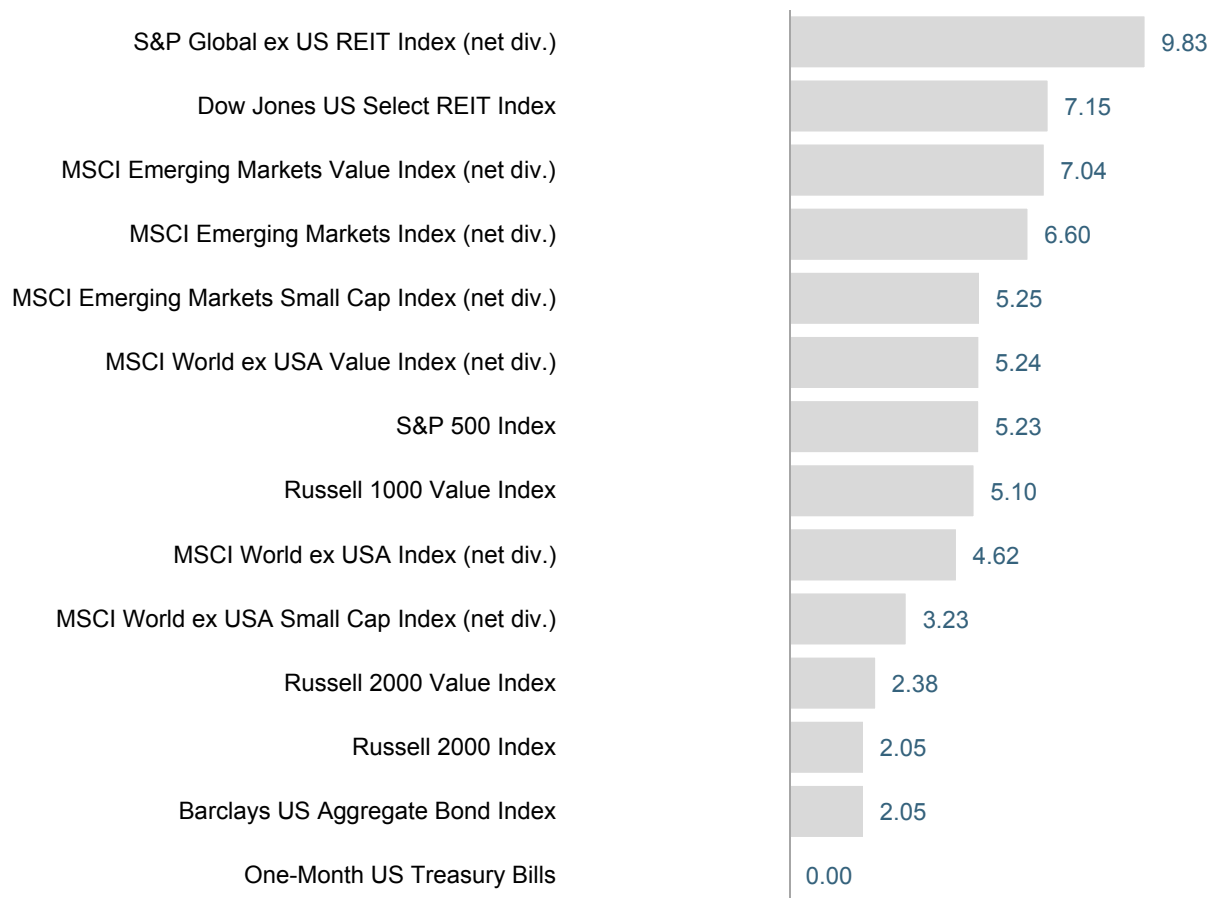
Returns in US dollars. Graph Source: The S&P data are provided by Standard & Poor's Index Services Group.

It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

# World Asset Classes

## Second Quarter 2014 Index Returns

Equity markets posted positive performance for the quarter, led by emerging markets. This was the first quarterly period in which emerging markets had outperformed developed markets since the third quarter of 2012. REITs both in the US and in developed non-US markets outperformed equities. Large cap indices outperformed small cap indices in the developed and emerging markets, including the US. In general, value outperformed growth indices, though performance was mixed within size ranges and regions.



# US Stocks

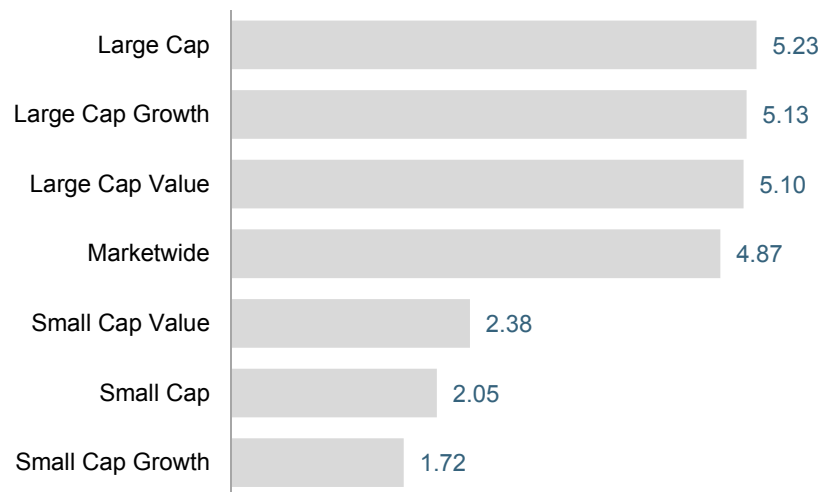
## Second Quarter 2014 Index Returns

The US equity market recorded positive performance, with large caps outperforming small caps for the quarter.

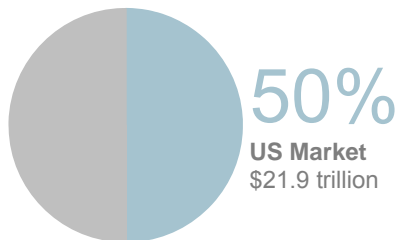
Value outperformed growth within small cap and mid cap indices.

Within large caps, value and growth indices recorded similar performance.

### Ranked Returns (%)



### World Market Capitalization—US



### Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Marketwide	6.94	25.22	16.46	19.33	8.23
Large Cap	7.14	24.61	16.58	18.83	7.78
Large Cap Value	8.28	23.81	16.92	19.23	8.02
Large Cap Growth	6.31	26.92	16.26	19.24	8.20
Small Cap	3.19	23.64	14.57	20.21	8.70
Small Cap Value	4.20	22.54	14.65	19.88	8.24
Small Cap Growth	2.22	24.73	14.49	20.50	9.04

\* Annualized

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: Marketwide (Russell 3000 Index), Large Cap (S&P 500 Index), Large Cap Value (Russell 1000 Value Index), Large Cap Growth (Russell 1000 Growth Index), Small Cap (Russell 2000 Index), Small Cap Value (Russell 2000 Value Index), and Small Cap Growth (Russell 2000 Growth Index). World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. Russell 3000 Index is used as the proxy for the US market. Russell data © Russell Investment Group 1995–2014, all rights reserved. The S&P data are provided by Standard & Poor's Index Services Group.

# International Developed Stocks

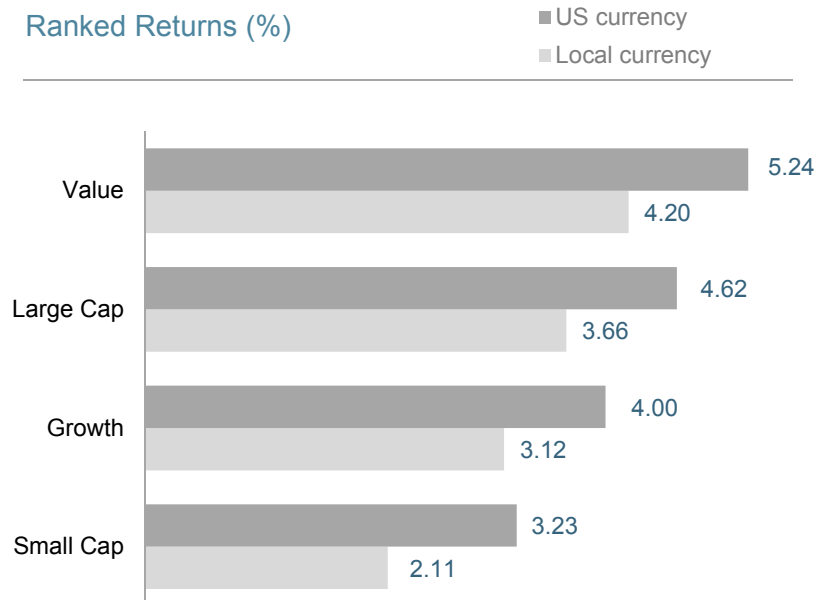
## Second Quarter 2014 Index Returns

International developed markets indices recorded similar performance to the US, with large caps outperforming small cap indices.

Value indices outperformed growth indices across all size segments.

The US dollar depreciated relative to many of the major international developed currencies.

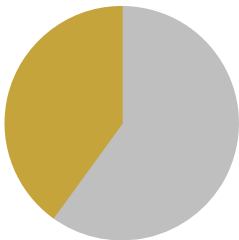
### Ranked Returns (%)



### World Market Capitalization— International Developed

**39%**

International  
Developed  
Markets  
\$17.4 trillion



### Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	5.40	23.83	7.58	11.67	7.18
Small Cap	6.79	29.55	8.75	15.32	8.73
Value	6.39	26.91	8.22	11.54	7.09
Growth	4.41	20.79	6.90	11.74	7.20

\* Annualized

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# Emerging Markets Stocks

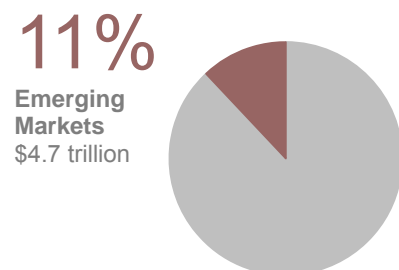
## Second Quarter 2014 Index Returns

In a reversal from the previous quarter, emerging markets led equity returns versus developed markets, including the US.

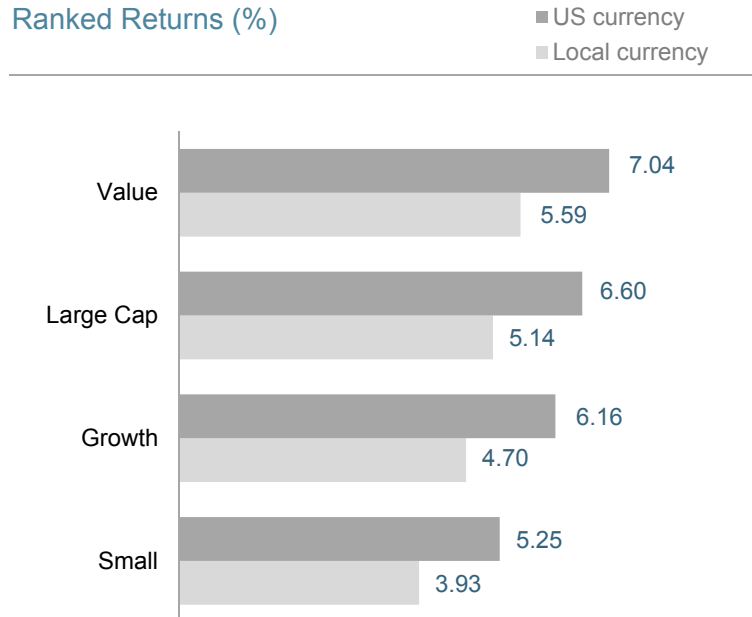
As with developed markets, large caps outperformed small cap indices for the quarter. Value indices outperformed growth indices across all size segments with the exception of mid caps.

The US dollar depreciated relative to many of the major emerging markets currencies.

### World Market Capitalization— Emerging Markets



### Ranked Returns (%)



### Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	6.14	14.31	-0.39	9.24	11.94
Small Cap	8.98	14.20	0.58	11.48	13.37
Value	6.16	14.43	-1.63	8.30	12.59
Growth	6.11	14.18	0.79	10.13	11.25

\* Annualized

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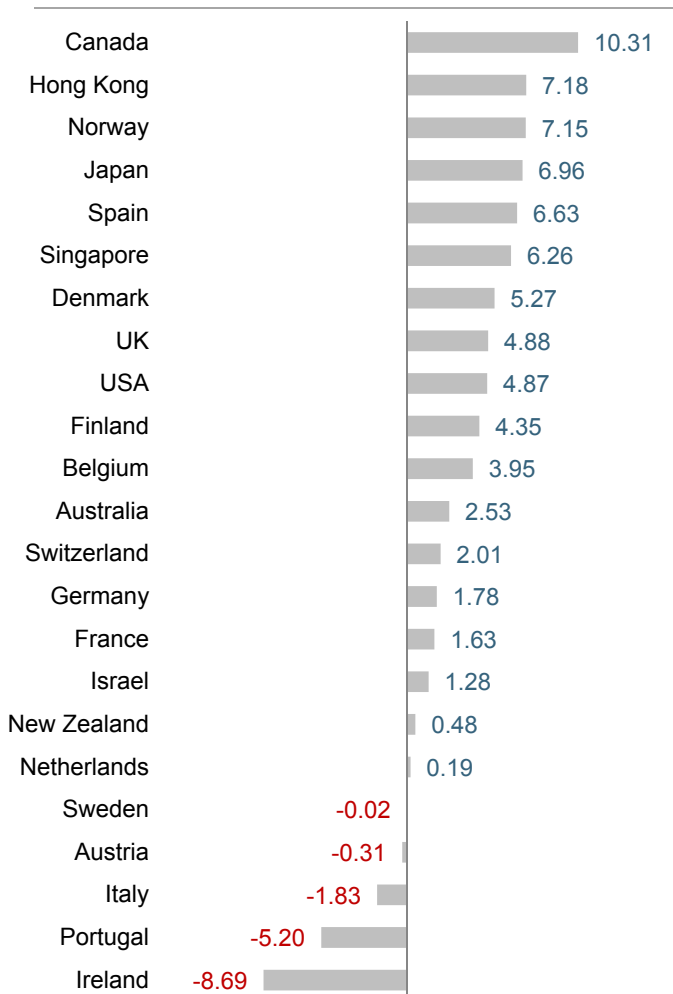


# Select Country Performance

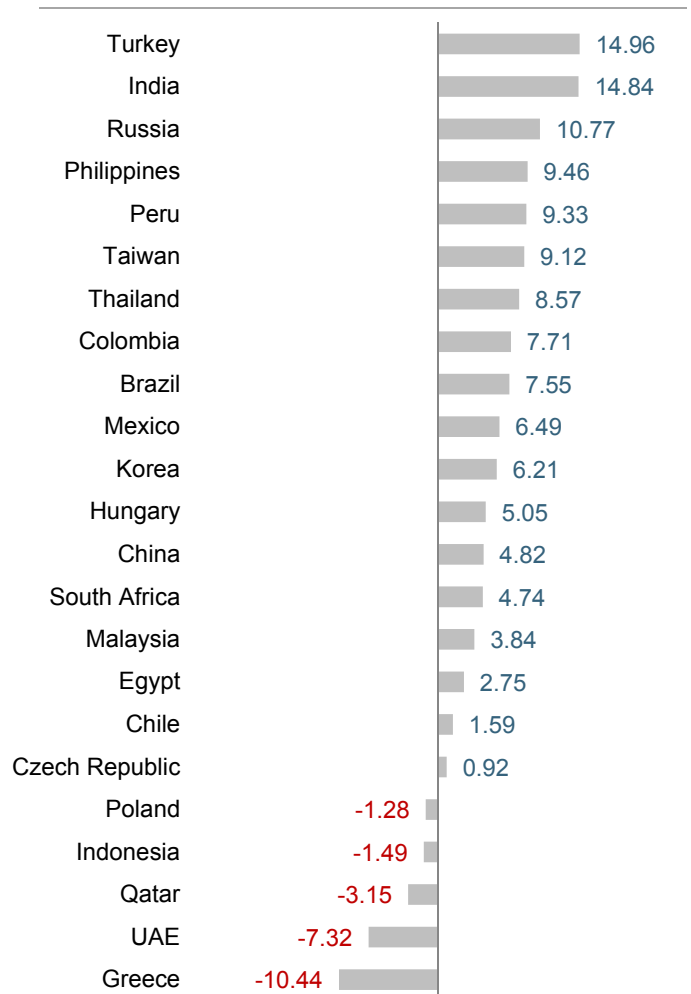
## Second Quarter 2014 Index Returns

Canada recorded the highest performance in developed markets, followed by Hong Kong. In a reversal from the previous quarter, Italy and Ireland recorded some of the lowest returns in developed markets. Turkey and India led performance in emerging markets. Qatar and the UAE, recently reclassified by MSCI to the Emerging Markets IMI Index, were among the lowest performing emerging markets.

### Ranked Developed Markets Returns (%)



### Ranked Emerging Markets Returns (%)



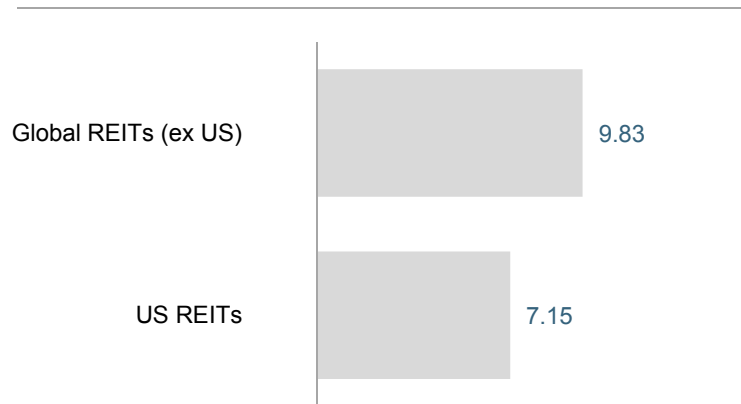
Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Country performance based on respective indices in the MSCI World ex US IMI Index (for developed markets), Russell 3000 Index (for US), and MSCI Emerging Markets IMI Index. All returns in USD and net of withholding tax on dividends. MSCI data © MSCI 2014, all rights reserved. Russell data © Russell Investment Group 1995–2014, all rights reserved. UAE and Qatar have been reclassified as emerging markets by MSCI, effective May 2014.

# Real Estate Investment Trusts (REITs)

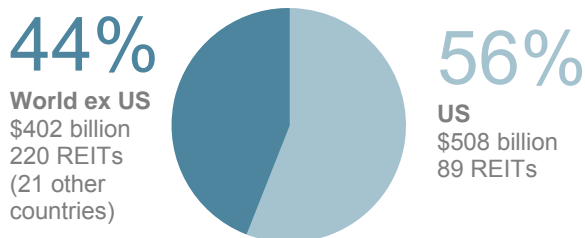
## Second Quarter 2014 Index Returns

REITs again returned positive performance, outperforming broad market equity indices in the US and developed non-US markets.

### Ranked Returns (%)



### Total Value of REIT Stocks



### Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
US REITs	18.24	13.27	11.38	23.76	9.41
Global REITs (ex US)	13.42	17.86	8.67	16.43	7.28

\* Annualized

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Total value of REIT stocks represented by Dow Jones US Select REIT Index and the S&P Global ex US REIT Index. Dow Jones US Select REIT Index used as proxy for the US market and S&P Global ex US REIT Index used as proxy for the World ex US market. Dow Jones US Select REIT Index data provided by Dow Jones ©. S&P Global ex US REIT Index data provided by Standard and Poor's © 2014.

# Commodities

## Second Quarter 2014 Index Returns

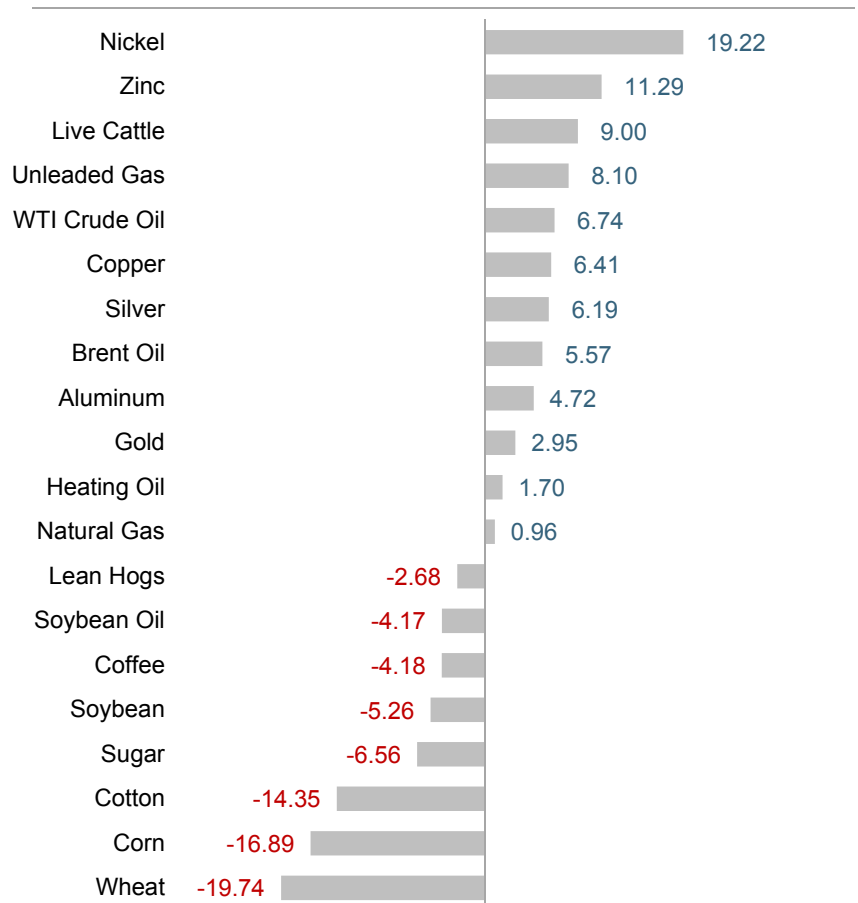
Commodities finished the quarter relatively flat. The Dow Jones-UBS Commodity Index (renamed the Bloomberg Commodity Index) returned 0.08%.

Nickel, the biggest gainer in the index, returned 19.22%. Its gain was most likely due to a supply constraint in the international markets.

Energy commodities were modestly up for the quarter, returning 4.36%.

Grain commodities had the worst quarter overall, returning -13.23%. Wheat led the decline with a -19.74% return.

### Ranked Returns for Individual Commodities (%)



### Period Returns (%)

Asset Class	YTD	Q2	1 Year	3 Years*	5 Years*	10 Years*
Commodities	7.08	0.08	8.21	-5.17	1.99	0.87

\* Annualized

# Fixed Income

## Second Quarter 2014 Index Returns

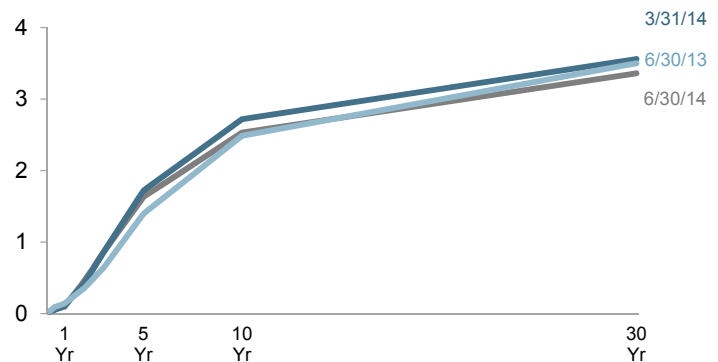
Interest rates across all US fixed income markets declined during the second quarter. The 10-year Treasury note ended the quarter at 2.53%, a decline of 20 basis points over the period. The 30-year Treasury bond finished with a yield of 3.34%, a decline of 22 basis points. The decline in intermediate- and long-term rates, coupled with relatively unchanged short-term rates, led to a flattening of the US Treasury yield curve.

The 30-year Treasury bond returned 5.20% and continued to outpace all fixed income markets with a 13.80% return for the year.

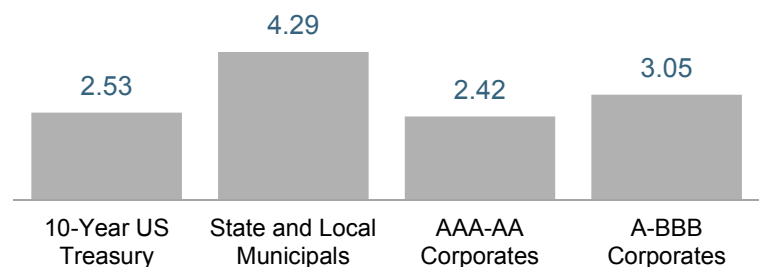
Long-term corporate bonds returned 4.40% for the quarter and 10.42% for the year, beating intermediate-term corporate bonds, which returned 1.77% and 3.49%, respectively.

Municipal revenue bonds slightly outpaced municipal GO bonds by 2.83% vs. 2.19% for the quarter. Long-term municipal bonds outperformed all other areas of the curve by returning 4.11% for the period and 10.05% for the year.

### US Treasury Yield Curve



### Bond Yields across Issuers



### Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
BofA Merrill Lynch Three-Month US Treasury Bill Index	0.02	0.06	0.07	0.11	1.63
BofA Merrill Lynch 1-Year US Treasury Note Index	0.15	0.29	0.29	0.50	2.07
Citigroup WGBI 1-5 Years (hedged to USD)	1.13	1.84	1.85	1.89	3.25
Long-Term Government Bonds	10.90	6.81	8.02	7.17	7.15
Barclays US Aggregate Bond Index	3.93	4.37	3.67	4.85	4.94
Barclays US Corporate High Yield Index	5.46	11.73	9.48	13.98	9.05
Barclays Municipal Bond Index	6.00	6.14	5.35	5.81	4.97
Barclays US TIPS Index	5.83	4.44	3.55	5.55	5.25

\* Annualized

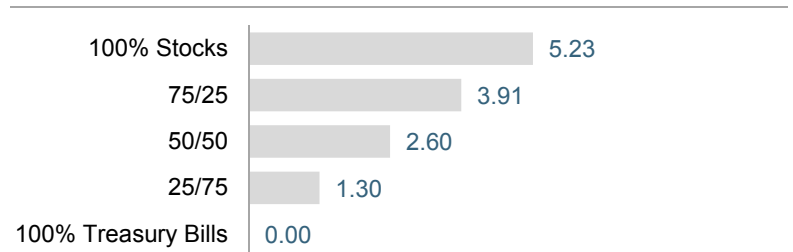
Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve. State and local bonds are from the Bond Buyer Index, general obligation, 20 years to maturity, mixed quality. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the Bank of America Merrill Lynch US Corporates, BBB-A rated. Barclays data provided by Barclays Bank PLC. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (S&B) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld). Citigroup bond indices © 2014 by Citigroup. The BofA Merrill Lynch Indices are used with permission; © 2014 Merrill Lynch, Pierce, Fenner & Smith Incorporated; all rights reserved. Merrill Lynch, Pierce, Fenner & Smith Incorporated is a wholly owned subsidiary of Bank of America Corporation.

# Global Diversification

## Second Quarter 2014 Index Returns

These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but also have higher expected returns over time.

### Ranked Returns (%)

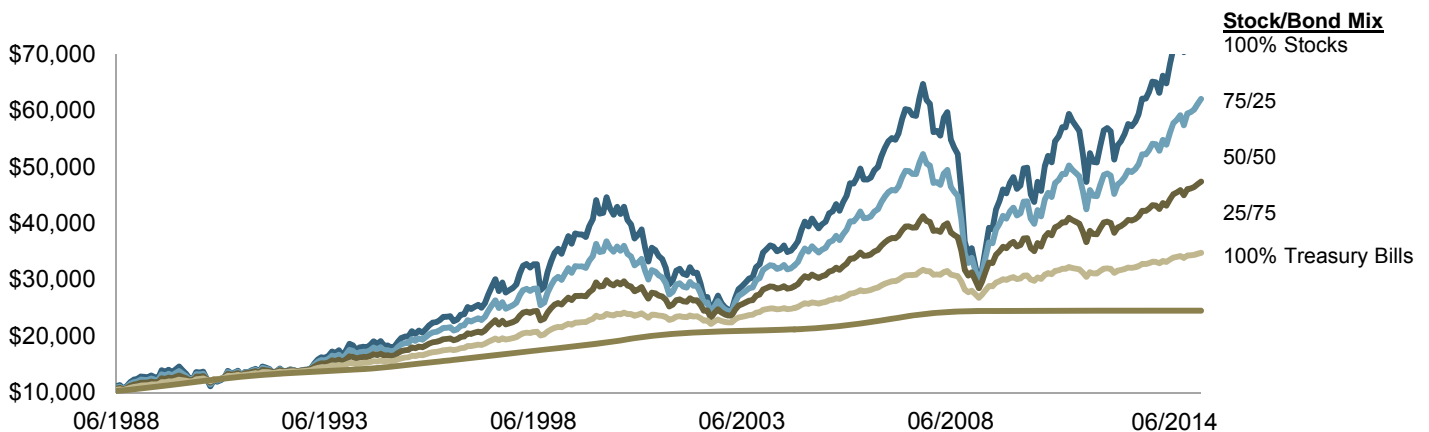


### Period Returns (%)

\* Annualized

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
100% Stocks	6.50	23.58	10.85	14.88	8.02
75/25	4.89	17.35	8.25	11.22	6.64
50/50	3.27	11.35	5.58	7.53	5.09
25/75	1.64	5.57	2.84	3.81	3.37
100% Treasury Bills	0.01	0.02	0.03	0.06	1.50

### Growth of Wealth: The Relationship between Risk and Return



Diversification does not eliminate the risk of market loss. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management an actual portfolio. Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals. Data © MSCI 2014, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld).

# Connecting the Dots

Second Quarter 2014

**Human beings love stories. But this innate tendency can lead us to imagine connections between events where none really exist. For financial journalists, this is a virtual job requirement. For investors, it can be a disaster.**

“The Australian dollar rose today after Westpac Bank dropped its forecast of further central bank interest rate cuts this year,” read a recent lead story on Bloomberg.

Needing to create order from chaos, journalists often stick the word “after” between two events to imply causation. In this case, the implication is the currency rose because a bank had changed its forecast for official interest rates.

Perhaps it did. Or perhaps the currency was boosted by a large order from an exporter converting US dollar receipts to Australia or by an adjustment from speculators covering short positions. Markets can move for many reasons.

For individual investors, financial news can be distracting. All this linking of news events to very short-term stock price movements can lead us to think that if we study the news closely enough we can work out which way the market will move.

But the jamming of often-unconnected events into a story can lead us to mix up causes and effects and focus on all the wrong things. The writer and academic Nassim Taleb came up with a name for this story-telling imperative: the narrative fallacy.<sup>1</sup>

The narrative fallacy, which is linked to another behavior called confirmation bias, refers to our tendency to seize on vaguely coherent explanations for complex events and then to interpret every development in that light.

These self-deceptions can make us construct flimsy, if superficially logical, stories around what has happened in the markets and project it into the future.

The financial media does this because it has to. Journalists are professionally inclined to extrapolate the incidental and specific to the systematic and general. They will often derive universal patterns from what are really just random events.

Building neat and tidy stories out of short-term price changes might be a good way to win ratings and readership, but it is not a good way to approach investment.

Of course, this is not to deny that markets can be noisy and imperfect. But trying to second-guess these changes by constructing stories around them is a haphazard affair and can incur significant cost. Essentially, you are counting on finding a mistake before anyone else. And in highly competitive markets with millions of participants, that’s a tall order.

There is a saner approach, one that doesn’t require you spending half your life watching CNBC and checking Bloomberg. This approach is methodical and research-based, a world away from the financial news circus.

The alternative consists of looking at data over long time periods and across different countries and multiple markets. The aim is to find factors that explain differences in returns. These return “dimensions” must be persistent and pervasive. Most of all, they must be cost-effective to capture in real-world portfolios.

Admittedly, this isn’t a story that’s going to grab headlines. Using the research-based method and imposing a very high burden of proof, this approach resists generalization, simplification, and using one-off events to jump to conclusions.

But for most investors, it’s the right story.

1. Nassim Nicholas Taleb, *The Black Swan: The Impact of the Highly Improbable*, Penguin, 2008.

Adapted from “Connecting the Dots” by Jim Parker, *Outside the Flags* column on Dimensional’s website, April 2014. Dimensional Fund Advisors LP (“Dimensional”) is an investment advisor registered with the Securities and Exchange Commission. All expressions of opinion are subject to change without notice in reaction to shifting market conditions. This content is provided for informational purposes, and it is not to be construed as an offer, solicitation, recommendation or endorsement of any particular security, products, or services.