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The Fed indicates it will end the "QE" bond buying program in October. Surprisingly, we believe rates may increase slightly but will remain low for at least a few more months even without the Fed buying pressure. We all knew the low-interest-rate party had to end; will it go quietly or will things get ugly? We do not expect interest rates to move sharply higher due to a sluggish global economy and heightened deflationary concerns.

The market ended the quarter with increased volatility exemplified by five days of triple-digit swings for the Dow. However, trading volume on major exchanges has dropped to the lowest levels since 2006. Most international markets were lower for the quarter and U.S. small companies fell almost 8%, even though large stocks in the U.S. edged up less than one percent.

The increasing volatility appears to be driven by geopolitical risk, and there is no shortage of worrisome events. Between Syria, ISIS and the airstrikes in Iraq, Russia and the Ukraine, Argentina's bond default, and the closely contested Scottish independence vote, it is no wonder that global investors became skittish. On the plus side, the Fed remains dovish and second-quarter GDP was revised upward to a robust 4.6%. All of these events play a part in markets and economies.

Historically, the fourth quarter proves profitable for investors. Since 1990, the S&P has gained an average annual return of 5% during the last three months of the year. December is historically the best month of the year for market performance. We are hopeful this trend to finish strong will be repeated for 2014.

For many clients we sold a position in European markets during the quarter; exiting days before the Russian escalation against Ukraine. Europe appears now to be in a deflationary trend exacerbated by average GDP growth of less than one percent.

Clients who take a distribution from their account, particularly in excess of 4% (the generally recommended distribution rate), may exceed their return rate and draw down the value of their account. We endeavor to do our best to exceed each client's withdrawal rate and thereby continue to grow account values, but with market fluctuations, no assurance of return can be made.

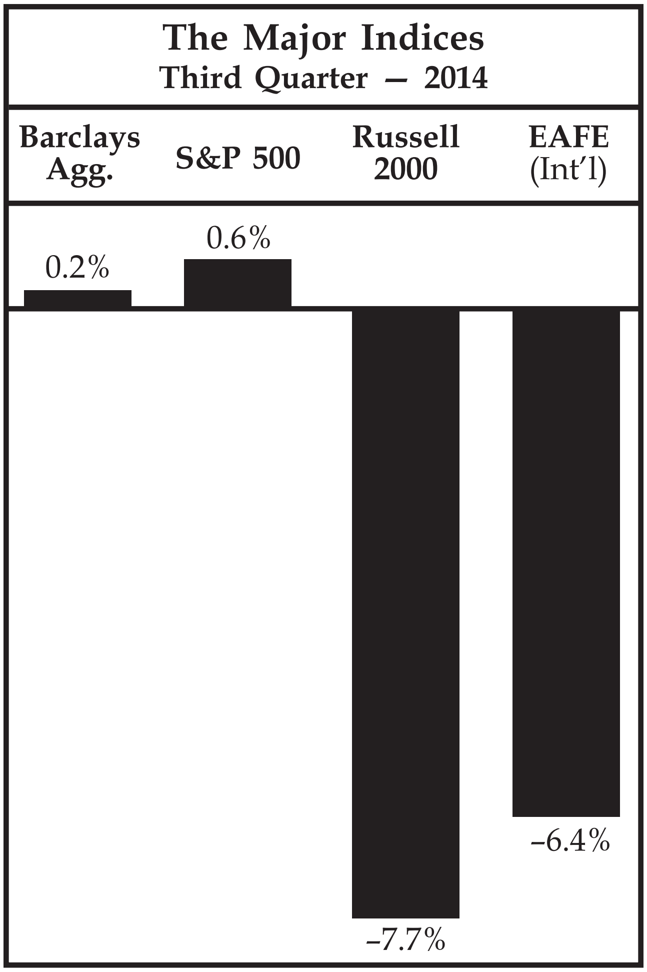
Any client who has requested that we move their portfolio to cash or cash equivalents may wish to review their decision in light of less-than-paltry returns on high-quality short-term investments. We would be pleased to talk with you about your allocation at any time.

Fall Open House. We hope to see you at our Fall Open House on October 24th from 4:00 PM to 6:30 PM here at our office. We hope you can make it and we look forward to seeing you!

Market Review and Forecast. Even though U.S. large-cap stocks eked out a minute gain last quarter, other stocks cratered as U.S. small companies got walloped, plunging 7.7%. International equities did not fare much better, declining 6.4%.

U.S. large company averages peaked September 19, setting all-time highs before declining two percent the last 11 days of the quarter. Then, on

October 1, the second 200-point-plus selloff in a week sent stocks down another 1.4%.



By October 7, when the Dow tumbled 273 points, U.S. large-company stocks were only down a mere 4% from their record-setting high September 19. Yet gloom and doom was common; for example, the USA Today's headline October 8 was "WallStreet Spooked." As often happens, investors saw the October 7 sell-off as a buying opportunity and promptly bid the Dow up 275 points the very next day. The spark for the best one-day gain this year was the release of the Fed's September minutes that indicated a "dovish" stance that would keep interest rates low.

How much lower will we go? Typically we get two or three 5% or more downturns every year — so far in 2014 we have dropped 6% in the winter and 4% last summer, and 4% through October 6. So it would seem reasonable for an additional two to four percent fall before a typical end-of-year rally begins later in October or early November..

The historical data is incredibly encouraging for fourth quarters of mid-term election years. Going all the way back to 1928, mid-term fourth quarters average a 6.5% gain. And the market has been up 100% of the time during mid-term fourth quarters when there is a lame-duck president — averaging 10.5% three-month returns.

Much of the blame for the recent market fall is geopolitical. Slower than expected growth in western Europe and China, riots in Hong Kong, increased warfare in the middle east, and Russian/Ukraine problems have all contributed to increasing volatility here.

Yet that doesn't explain the collapse of U.S. small company stocks that typically are less affected by overseas events. Perhaps they just became too expensive (selling at more than 22x earnings when the quarter began July 1) after rising nearly 40% last year, almost 7% more than the S&P 500. This year, through September 30, large U.S. companies have gained 6.7% (without dividends) while small companies lost 5.3%. That's the largest outperformance by large-caps since 1950.

International investing, so important to diversification, has certainly been a bummer so far this year. The average international stock, down over 6% in U.S. dollars last quarter, is down 3.5% for the year through September 30.

The average European stock fund lost 7.6% last quarter in U.S. dollars as the euro continued to fall. Even though stocks in Europe are much cheaper than here and have not recovered to reach their pre-crash highs, the slow growth (under one percent) on the continent is disheartening. Particularly worrisome is the slowing economy in Germany, Europe's largest and typically best economy.

On the other hand, compared to less than one percent growth in Japan and in Europe this year, the U.S. is much better off. We bounced back from a weather-induced nearly 3% decline last winter to grow 4.6% the second quarter.

Current predictions for third-quarter GDP growth, to be reported later this month, are averaging 2.5% to 3.5%.

Lower oil prices – at a two-year low near $86 on October 8 — and a stronger dollar are aiding Americans as the price of gasoline and imported goods drop. The dollar is at a four-year high against a basket of foreign currencies. Great news for consumers, but bad news for those investors owning international funds because their returns suffer when converted into a stronger dollar. The euro has fallen more than 8% against the dollar since last spring and the yen is down about 35% in less than two years.

Ever-increasing petroleum production here, up more than 30 percent since 2011, has pushed us ahead of Russia to the number two spot in the world behind only Saudi Arabia. Average U.S. gasoline prices fell 10 cents a gallon last quarter to $3.33 and continuing their slide this month. Each 10-cent drop in prices puts $13 billion in the pockets of American consumers. We believe oil prices will continue to fall despite the sanctions against Russia, civil war in Iraq, and potential violence in Libya where oil production has increased more than 50% this year.

Here at home, we are continuing to recover as unemployment fell to under 5.9%. Job growth for September was a sterling 248,000 and both July and August numbers were revised higher.

Back-to-school retail sales were somewhat disappointing. However, a 4.1% growth forecast for Christmas spending, if accurate, would be the best since 2011. Another bright spot is new car sales that are the best since 2007.

Sales of single-family houses totaled 504,000 for August, a third more than a year ago but still way below the almost one million long-term average. (The median sales price was $275,000.) First-time homebuyers are scarce. One reason is the huge college debt number that averages $32,600. Total college debt at $1.1 trillion is now 27 percent more than credit card debt. The average amount owed on credit cards, $15,600, is only half the student loan amount. The good news is that consumer debt, as a percentage of household debt, is the lowest in more than three decades.

Given declining energy prices and a strengthening U.S. economy, manufacturing here continues to improve. The nation's ISM manufacturing index hit a three-year high in August when it climbed to 59. (A rating of above 50 indicates growth while a number below 50 means contraction.)

Our advice is "hang in there." We don't plan on giving up on a diversified portfolio even though U.S. large caps are currently leading the way. We have, however, moved some of our allocation out of small caps and into mid-caps. We have also over-weighted U.S. stocks over international in recent months.

One more almost unbelievable historical statistic is that since 1950 U.S. stocks have averaged a 16% gain for the six months following mid-term elections. Given that the S&P 500 has been up the last seven quarters in a row, it seems doubtful we will come close to that number. However, given the low yields from bonds and CDs, stocks still seem like the best place to earn a decent return for the coming months.

Interest Rates. The 10 Year Treasury, which acts as a benchmark for fixed income, closed the third quarter yielding 2.5%, basically where it started the quarter. As of the writing of this newsletter, it is yielding 2.32%. Overall, most fixed income has performed well this year, pleasing investors. Bonds, as represented by the broad-market Barclays Aggregate Index, have gained 4.3% for the year through September 30. Corporations are taking advantage of the Federal Reserve induced low interest rates to refinance their debt where possible. While high yield (often called "junk") bonds started off strong in 2014, a summer selloff has raised yields, thus lowering their price and resulting in a year-to-date performance of just 3%.

In general bonds had a decent quarter, albeit a relatively boring quarter to say the least. There are however a few areas in the broader fixed income world worth mentioning, that are perhaps somewhat exciting. First, the European fixed income markets have seen a surge of investments, such that many issues were pushed to a negative yield. This negative yield occurred in Ireland, Germany, the Netherlands, Austria, Finland, Belgium and France. Much of this investor behavior occurred as the ECB (European Central Bank) cut rates and announced a program where they will buy bonds backed by residential mortgages (Europe's version of Quantitative Easing) in an effort to stimulate the sluggish European economy.

These type of central bank programs make it extremely tough for fixed income investors to find adequate yield in investment grade positions, thus forcing them into higher yielding bonds with higher risk. Many bond investors today would prefer to have some of their assets in a laddered portfolio of CDs at the bank but the Federal Reserve's (as well as other central banks) current monetary policy and stimulus programs that produce yields of only about one percent have prevented that from happening.

The second interesting development in the fixed income world, at least back here in the U.S., was the announcement from Pimco that its founder and manager of their flagship Total Return Bond Fund, Bill Gross, had resigned and taken a position with Janus Funds. This announcement comes after several months of leadership infighting and management changes. In January of this year, then Pimco CEO and Co-CIO Mohamed El-Erian abruptly resigned after strong disagreements with Bill Gross over the methods and direction of Pimco.

Since then Bill Gross has made numerous public remarks that have caused investors to question his leadership and investment capabilities. Billions of dollars have left Pimco since Mr. El-Erian resigned in January. At Woodard & Company, we had reservations surrounding our investment in the Pimco Total Return Bond Fund such that we made the decision to sell it over a year ago for our clients, long before the above-mentioned events occurred.

The last fixed income event we'll mention is Puerto Rico's dance with insolvency. Illustrative of its financial woes, Puerto Rico plans to issue June 2015 Notes with a alluring 7.75% tax-free interest rate. The notes will be issued in an attempt to raise $900,000,000 in its first sale since last March.

The news above comes amid a flurry of activity including a rebound in Puerto Rico bonds from lows hit this past July, following new legislation allowing some agencies the ability to restructure obligations. Investors have often complained of the lack of transparency by lawmakers regarding the commonwealth's financial struggles.

The Puerto Rican utility company, Prepa, is attempting to restructure debt that could prove to be the largest restructuring in the municipal bond market ever. While the economy in Puerto Rico continues to struggle the hope is that with success from the above mentioned events, brighter days are ahead for the island.

Commodities. In good news for consumers, the global supply of crude oil, with the U.S. leading the way in production, has resulted in oil dropping 15% since its June highs. OPEC plans to lower production in an effort to keep oil trading around $100 per barrel. The U.S. plans to cut production as well. Crude oil closed the third quarter at $91.16 per barrel and continued to slide in early October, touching $86 on October 9. With the winter heating season growing closer and a forecast for colder temperatures than last winter, some of the excesses in crude supply will no doubt be drawn down.

To the chagrin of many farmers, corn hit a five-year low after the U.S. Agriculture Department announced better than expected supplies of the grain. Gold continues to struggle, closing the quarter at $1,210.50 per troy oz.

Please let us know if your circumstances, needs, risk tolerance, or objectives shift which may have an impact on the way we manage your assets. We can and will respond to your needs by tailoring the allocation to meet your criteria. We are always pleased to talk with you and make certain you are comfortable with your investment allocation. Please call us at 336-998-7000; we always look forward to talking to you.