TRIVANT
CUSTOM PORTFOLIO GROUP, LLC

October 2014

Quarterly Insights

EXECUTIVE SUMMARY

U.S. Large Cap Stocks Are Lone Third Quarter Bright Spot

In the Third Quarter, the domestic S&P 500 Index rose 1.13%, but the rest of the world, as well as U.S. small cap stocks, lagged badly. Most dramatically, the MSCI EMU (European Monetary Union) lagged close to 10%. The main reason for the huge European lag was currency fluctuation. Fueled by the European Central Bank's change of heart in initiating quantitative easing, the Euro fell 7.72% versus the U.S. Dollar. The bond market was relatively uneventful as the Barclay's Aggregate Bond Index rose 0.15% in the Third Quarter.

Electronic Transactions: Great Secular Growth

Our style rotation framework still favors large U.S. growth stocks with secular earnings (earnings that grow regardless of the direction of the economy). One industry group we favor is electronic transactions. Since the Great Recession, U.S. Retail e-Commerce annual growth has consistently beat relatively tame U.S. Real GDP annual growth by a factor of 6 to 7 times. This is a phenomenal secular trend that should continue. For our portfolio, we favor large companies with diversified product lines versus smaller "pure plays". The diversification offers a better risk/return tradeoff.

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Third Quarter 2014

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Electronic Transactions: Great Secular Growth

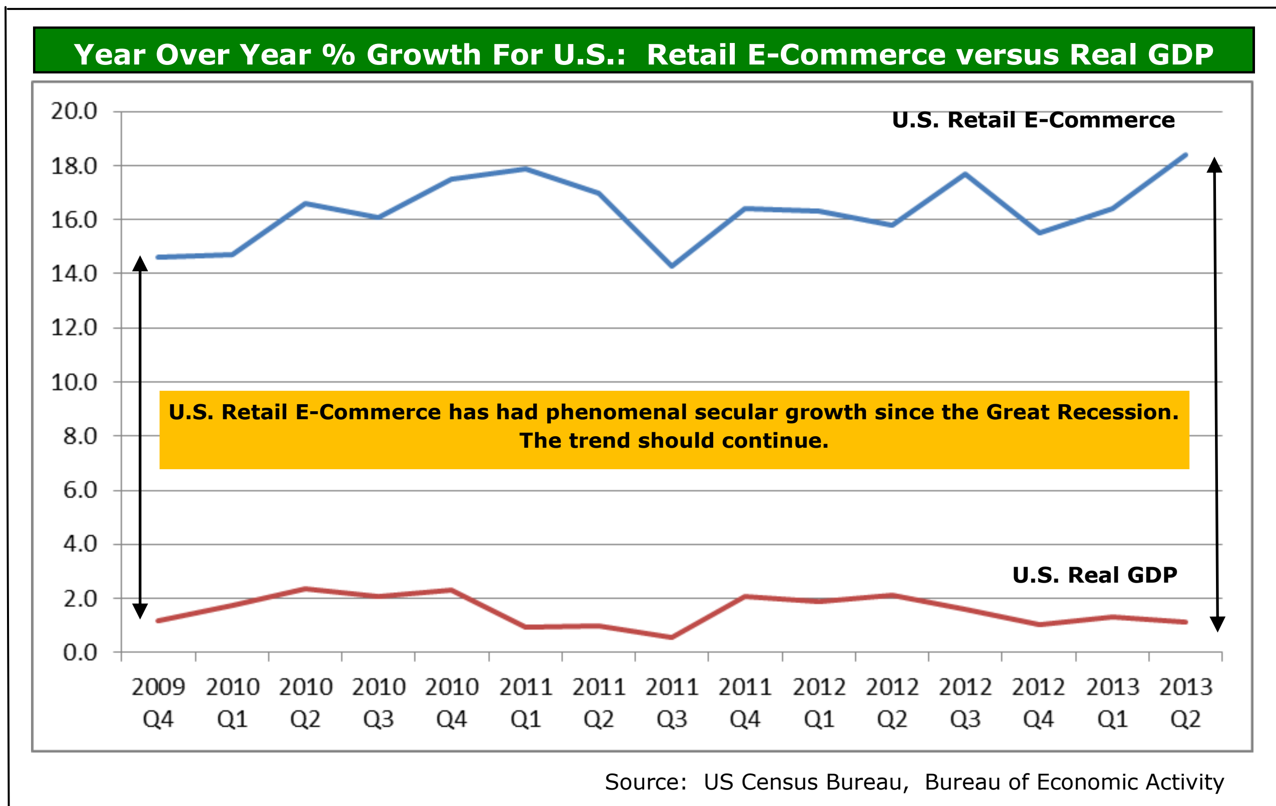
Our Style Rotation Framework Still Favors Large Growth Stocks With Secular Earnings

Styles go in and out of favor as the business cycle evolves. Smaller companies do very well off the bottom of a business cycle because their businesses (and hence their earnings) are more cyclical. We deem small companies' earnings as "low quality" (cyclical) because their earnings are closely aligned with the economy (they move up and down in cycles). As the market cycle matures, larger companies with "secular" (high quality) earnings often excel as their earnings are less dependent on an improving economy. We continue to favor large growth stocks because we are at the mature phase of the business cycle.

An example of a large cap stock we own with secular growth is Apple. People are buying iPhones because they want what they perceive as a better phone. Apple is not relying on U.S. economic growth - the desire for Apple products is great whether the economy grows or not. As we do on a stock by stock basis, we also seek strong secular growth among industry groups. One group we like a lot is electronic transactions.

The Electronic Transactions Industry Has Great Secular Growth

The electronic transactions industry includes payments made via credit cards, debit cards, online, and mobile phones. It is high volume, high growth, and fundamental to efficient commerce. Since the Great Recession, U.S. Retail E-Commerce annual growth has consistently beat relatively tame Real GDP annual growth by a factor of 6 to 7 times. This is a phenomenal secular trend that should continue.



Source: US Census Bureau, Bureau of Economic Activity

The Evolution Of Electronic Transactions

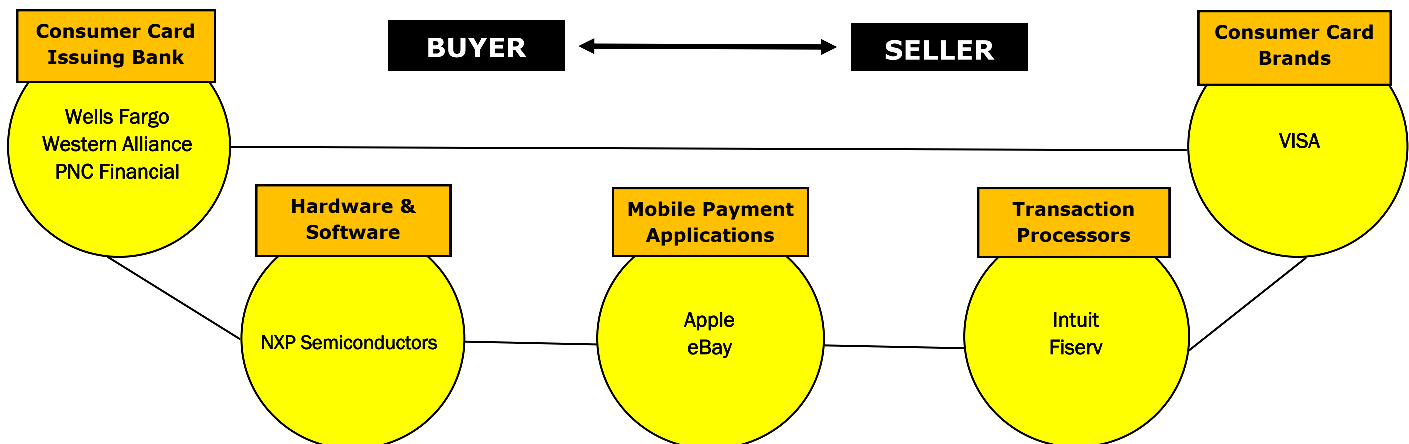
Over the years, the form of payment for business transactions has changed. Cash used to be the primary form of payment. Credit and debit cards replaced a large percentage of cash transactions, and now these "swipe payments" are gradually shifting to digital payments processed through various mobile devices. Electronic transactions has high secular growth because the industry continues to evolve very quickly.

The Evolution Of Electronic Transactions - A Timeline			
THE PRE-ELECTRONIC ERA			
1995	PHASE 1	CASH IS KING	60% of consumers paid by cash, 30% paid by checks, 2% paid by debit cards, 8% paid by credit cards
1998	PHASE 2	CHECKS	87% of U.S. households had a checking account Businesses processed 2.5X as many check versus credit card payments
THE RISE OF SWIPING AND DIGITAL PAYMENTS			
2003	PHASE 3	DEBIT CARDS CREDIT CARDS	31% of retail customers chose debit card transactions (magnetic strips) 21% of retail customers chose credit card transactions (magnetic strips)
2006	PHASE 4	GIFT CARDS	Gift card sales total $80 billion Two thirds of buying public reported their intention to give a gift card
2014	PHASE 5	EMV PAYMENTS NFC DEVICES	EMV stands for "Europay, Mastercard and Visa" Embedded microchip technology that is more secure than magnetic strips Mobile payments by phone or tablet made from any location with Internet Allows in-store payments NFC stands for "Near Field Communication" Use small embedded antennae to communicate with card readers Shoppers need to wave the card, fob, or other device to make purchase Antenna transmits payment information encoded in a chip within the device
LOOKING AHEAD			
2015	PHASE 6	MOBILE P.O.S. SELF CHECKOUT	**Mobile Point-of-Sale:** every employee with a phone is a potential cashier Apple currently uses this technology more than any other retailer Nordstrom has 6000+ salespeople handle purchases via mobile phone **Self-Checkout:** shoppers can pay whenever they want via mobile phone JC Penny aims to eliminate cash registers in favor of self-checkout stations
2016 2017			45% of mobile phones will have NFC abilities In-Store purchases with NFC devices will reach $180 billion

Source: Merchant Warehouse

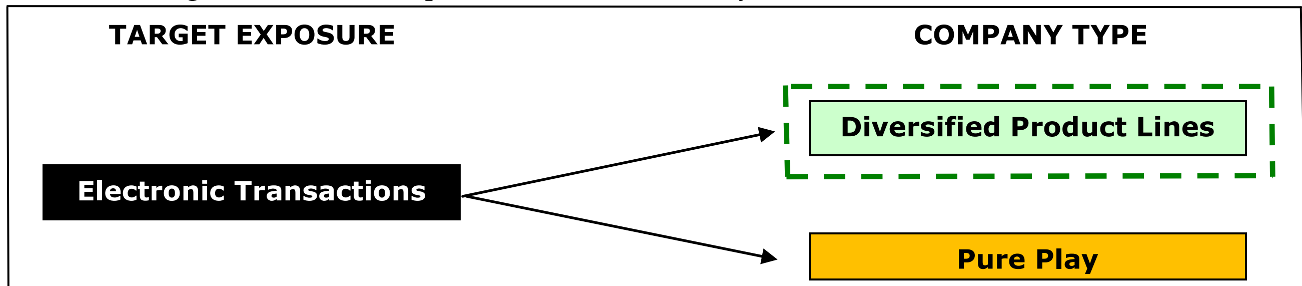
The Electronic Transactions Ecosystem

Our portfolio has diversified exposure to the various sub-categories of the Electronic Transactions Ecosystem.



Secular Growth In Large Diversified Companies: A Better Risk/Return Tradeoff

In terms of our style rotation strategy, we favor large companies with "secular" earnings. In terms of attractive secular growth, we like electronic transactions. As noted on the diagram on page 3, there are several sub-categories of the electronic transactions segment. For our desired portfolio exposure, we can choose companies that have diversified lines of business, and/or companies that are a "pure play". Right now, we favor large diversified companies - in our view, they offer a better risk/return tradeoff.



A "pure play" is a company that is focused on only one industry or product. Sometimes we choose a pure play company if the alternative choice (a diversified company) has areas of business we don't want. However, the diversified companies which currently comprise our electronic transactions exposure also have other areas of business we like.

The diversification of the product lines, from a portfolio management standpoint, gives us significant protection. If the electronic transaction component of a product line prospers, we believe the company stock will do well. If the electronic transaction component of a company product line is challenged, there is likely "cushioning" through the other product lines. In a sense, we collectively have a significant "call option" on electronic transactions if its secular growth continues.

One interesting development in our portfolio is a recent announcement from eBay. Over the next year, the company will be spinning off its "PayPal" division into a new company. Effectively, PayPal will become a "pure play" in electronic transactions (it already handles 30% of all electronic transactions in the segment).

We believe electronic transactions will continue to be a great secular growth story.

Stock Market Spotlight

Driven By The Strong Dollar, US Large Cap Stocks Lead The World Again By A Lot

In the Third Quarter, the domestic S&P 500 Index slightly increased, far out-pacing smaller companies and the foreign markets. Much of this out-performance was attributable to the extremely strong US Dollar fueled by the European Central Bank's (ECB) change of heart in initiating quantitative easing (QE).

Equity Index Performance

Index	Q3 2014	YTD 2014
S&P 500 (Domestic)	**1.13%**	**8.34%**
Russell 2000 (Small Cap)*	(7.65%)	(5.33%)
MSCI EAFE (Foreign)**	(5.83%)	(0.99%)
MSCI Emerging Markets	(3.36%)	2.75%
MSCI EMU (European Monetary Union)	(8.62%)	(3.56%)
MSCI Japan	(2.94%)	(3.21%)

* Performance data does not include dividends ** Europe, Australia and the Far East

The ECB's About-Face In Initiating QE - It's Deja Vue All Over Again

Mario Draghi, head of the ECB, recently announced a $1.3 trillion bond buying program (QE) with the hope of stimulating stagnant European economies much as Ben Bernanke previously did so successfully in the U.S. It is useful to re-visit what happened in the U.S. to fully appreciate the irony of the ECB's about-face.

The Fed In Late 2008

The Fed's dual mandate is to promote full employment and price stability. Since late 2008, the Fed has been stimulating the economy by keeping its Target Rate at zero and buying a variety of bonds (QE). By pumping money into the economy, the goal was to stimulate economic growth through more spending and lending. The net effects of QE included (initial) US Dollar depreciation and higher inflation.

Let's look at the U.S. scorecard. Unemployment has fallen from a peak 10% (October 2009) to a current 5.9%. Exports rose soon after QE was initiated, as did foreign investment. Inflation (under 1% in October 2010) is now 2.0%. GDP growth (2.5%) is steady. The US Dollar is very strong. The 10-Year US Treasury rate (2.54%) significantly exceeds its Eurozone counterpart (1.00%).

The ECB Right Now

In contrast to the Fed, the ECB has a lone mandate to aim for an inflation rate of below but close to 2% over the medium term. There are many challenges in the Eurozone: inflation is 0.3% (there is deflation in Greece, Italy, and Spain), GDP growth is 0.7%, (mostly propped by Germany), and unemployment is huge at 11.5% (source: The Economist). The Eurozone mess culminated in Q3 as the US Dollar appreciated 7.72% versus the Euro. Currency was the major factor for S&P 500 Index out-performance (+9.75%) versus the MSCI EMU.

The ECB made a huge error in 2011 by hiking interest rates twice. It took them three years to recently lower interest rates. In desperation to propel the economy and create jobs, the ECB is trying to take another page from the U.S. playbook with quantitative easing. Will it work? We have our doubts. So did the market in Q3.

Bond Market Spotlight

Bond Returns Are Flat In The Third Quarter

The Barclay's Aggregate Bond Index, a broad-based representation of fixed income performance, rose 0.15% in the Third Quarter and is now up a solid 4.17% for the year. Bear in mind that the bond index is "broad" in that it considers the full spectrum of bond ratings: highest quality (AAA) through junk (CCC). High quality bonds have a low probability of payment default. Junk bonds have a high probability of payment default. There is a risk/return consideration in bond selection. You don't get something for nothing. The higher the stated yield, the higher the chance your bond could default.

Don't Lend To Your Out-Of-Work Cousin In Las Vegas With The Gambling Problem

A bond is a loan. The lender charges an interest rate depending on the quality of the borrower. Eventually the principal loan must be returned. Your out-of-work second cousin who lives in Las Vegas with the gambling problem would be a low quality loan. Despite his promise to pay you back with a ton of interest, you may never see your money (or even him) again. Corporations are no different. Some have adequate assets and cash flow to safely meet their debt obligations - and some don't.

Ratings Agencies "Set The Odds" Of A Bond Default

Warren Buffett once famously quipped "only when the tide goes out do you discover who's been swimming naked". The "Big 3" bond rating agencies - Moody's, Standard and Poor's, and Fitch - effectively set the odds of a given bond's default. Although these agencies were much maligned during the 2008 crisis, their ratings have proven remarkably accurate before and after the crisis. We place a lot of faith in their determination of whether we are dealing with a safe company - or your cousin.

S&P Bond Ratings From 1971 to 2006 - % Issuers In Default After 3,5, & 10 Years

S&P Bond Rating	% In Default - 3 Yrs	% In Default - 5 Yrs	% In Default - 10 Yrs
INVESTMENT GRADE			
AAA	0.00%	0.05%	0.09%
AA	0.30%	0.46%	0.54%
A	0.11%	0.23%	0.71%
BBB	4.74%	6.62%	8.00%
LOWER GRADE			
BB	7.72%	12.10%	19.88%
B	16.08%	27.82%	37.06%
CCC (lowest)	36.86%	46.60%	59.36%

YOUR BONDS ARE SAFE

Your Cousin

High Quality Bonds Are In The "Sweet Spot" Of The Cycle

When bonds have problems, it tends to occur in economic downturns. Our current bull market began in March 2009 and is 67 months old. The average bull market since 1871 has been 67 months (source: Shiller). Although we believe the market still has legs, we want to be quite conservative with your bond selection right now and stress high quality - even if it means potentially missing out a small amount of interest. Put another way, we don't want to lend your money to your cousin in Las Vegas while he is at the craps table.

Your Portfolio

If there was ever going to be a quarter to validate our continued emphasis on U.S. large cap growth stocks, the Third Quarter was it. We were thankful we had minimal foreign exposure. The S&P 500 Index was a green oasis in a sea of red. Our conservative bond exposure held its ground. Three quarters through the year, the S&P 500 Index is up 8.34%. Our bullish 2014 prediction (the S&P 500 Index will rise 12% - 15%) is still possible.

During the quarter, we bought Aetna (symbol: AET), which is the third largest HMO (Health Maintenance Organization) in the United States. We also bought Myriad Genetics (symbol: MYGN), a biotechnology company that identifies genetic markers and creates molecular diagnostic tests.

We have not made many portfolio adjustments for the last six months. At the moment, there are no apparent reasons to deviate from our current position in terms of style rotation. The U.S. looks relatively attractive. The rest of the world looks unattractive, and the U.S. small cap stocks have been getting beat up. As we approach the end of the year, you may see transactions in your portfolio geared toward tax loss selling.

The current bull market (67 months duration) has reached its historical average. Mid-term elections are approaching and U.S. political turmoil often temporarily pressures markets. A pullback in the market over the next few months would not surprise us. It is not something we want to see and not something you want to see. But it would be completely normal if it happened.

We will continue to closely monitor the market and adjust your portfolio as needed. Please feel free to contact us anytime to discuss questions or comments you may have. We will keep you informed of portfolio progress.

Respectfully submitted,

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Disclaimer

The information presented herein is intended for informational purposes only. All views are subject to change based on updated indicators. The recommendations made in this publication are made without regard to individual suitability. Investors should consider their own needs and objectives before making any investment decision.

Commentary in this review reflects our portfolio strategy. Many of our clients have different objectives and circumstances which are reflected in unique portfolio considerations. Please note that accounts may not contain all elements of the strategy discussed here. Additionally, individual client customizations and start dates may preclude certain elements of this strategy from being implemented.

Past performance is no guarantee of future results. A risk of loss is involved with investments in stock markets.