Lucien, Stirling & Gray Advisory Group, Inc.

FOURTH QUARTER REPORT 2014

January 2015

LUCIEN, STIRLING & GRAY ADVISORY GROUP
"Smart Decisions About Serious Money"
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A MESSAGE FROM THE PRESIDENT

Thomas G. Twombly

We are pleased to provide you with our report for the period ending December 31, 2014.

If there is one truth I've learned about successful investing and investors in the last thirty years of my career as an advisor, coach, counselor and leader it's this: *You play this game chiefly against yourself. Your biggest opponents are your own worst proclivities*.

Our *behavior*, what we choose to do - and even more importantly, what we choose not to do – when provoked by perfectly natural human tendencies to act inappropriately, is a far greater determinant of our long-term financial success than any other factor. It's greater than our intellect, our timing, the quality of our research, our selection of investments, and our luck. Behavior trumps all.

This is why we focus so much attention on helping clients get their behavior right – by planning carefully, acting deliberately, and exercising patience and discipline in all they do. It's also why we call out the completely natural impulses that threaten to provoke all of us to react, break ranks, and abandon well-laid plans every day.

As we enter 2015, I observe two provocateurs in particular skulking about. The first is what financial writer Nick Murray recently called "*volatility fatigue*"; the second one is as old as the ages: "*performance envy*." Both prey on human anxieties, and both seek to undermine long-term discipline in favor of short-term respite or rewards. For the moment they seem to be stalking different quarry, but we would all do well to keep a wary eye out for them.

"You play this game chiefly against yourself. Your biggest opponents are your own worst proclivities.

Vince Lombardi, the famous coach of the Green Bay Packers, once said: "*fatigue makes cowards of us all.*" Volatility fatigue - the systematic erosion of investor resolve through repetitive bouts of market turmoil (accompanied always by myopic commentary from a fear-mongering press) is threatening to do that now. It's a predator most likely seen circling the camps of those aged 55 and up; people who experienced the 2008 - 2009 crash (and its 2000 – 2003 predecessor) relatively late in their working lives. Anxious that another is right around the corner, these investors in particular have been stressed throughout 2014 by market whipsaws. Small-cap stocks were volatile all year. Large-cap stocks experienced a couple of sharp drops late in the year (followed by equally sharp rebounds) along with the attendant narratives of global Ebola contagion, ISIS threats, and the "catastrophic" fall of oil prices. International markets as well have been roiled all year by volatility in exchange rates. Fatigued by this volatility, many are seeking refuge by holding outsized allocations of cash and short-term debt. Still others are being lured into untested "alternative investment" schemes that purport to offer high yields with limited risk. In most cases, they are losing proper perspective.

Performance envy, on the other hand, appears to be stalking a somewhat younger crowd. As we start 2015, we are well into the sixth year of a powerful bull market in U.S. stocks. It began in March of 2009 at the very depths of the terrifying 57% peak-to-trough decline that shook hundreds of billions of investor dollars out of equities during the previous 17 months – much of it at or near the very bottom. With more than five years gone since that panic capitulation of the great recession, and with a different set of articles and pundits now touting the obvious "outperformance" of the S&P 500 Index over virtually every other broadly diversified portfolio since that moment, those who didn't experience those past declines quite so personally are now being tempted, goaded, and lured into allocating more and more of their money into higher and higher concentrations in a single asset class. *"What? You missed out?"* the message goes. *"Somebody* (often, your advisor) *has been steering you wrong, because if you had only put all your investments here..."* Never mind that Americans were net sellers of equities all the way through 2012, and by an overwhelming margin. *"Others have gotten all these gains. It's easy…"* is the narrative. These people too are at risk of losing proper perspective.

There is nothing easy about exercising patience and discipline. There is also nothing easy about maintaining perspective. They both take diligence and effort – and strong defenses against our own worst proclivities. It's so much easier to buy when prices are up and the crowd is abuzz than it is to invest in an asset class (or several) when it's out of favor and the news has been gloomy. It's also much easier to get swept up in the apparent urgency of the moment than it is to look far ahead and allocate capital based on time horizons of 10, 20, or 30 years. It's so much easier to believe that the solution to our investment needs lies in finding a complex, exciting, cutting-edge approach than it is to stick to a diversified buy-and-periodically rebalance strategy that utilizes time-tested but boring investment vehicles. Just remember, the purpose of investing isn't to reduce boredom, it is to increase wealth.

Thank you again for your confidence and trust.

Thomas G. Twombly
President

INVESTMENT COMMENTARY

The final quarter of 2014, and indeed much of the entire year, proved to be a volatile period for many asset classes. A wide dispersion of returns shone great favor on certain sectors, while still other asset classes were beset by punishing setbacks at various points. Volatility in international currency markets magnified this effect substantially in some cases, and added an additional air of unpredictability to global financial markets, especially in the final three months of the year. The result was a wide disparity between winners and losers in more narrowly concentrated portfolios, and somewhat tepid, though positive, returns overall for those of us who follow a more broadly-diversified mandate.

For the quarter, the biggest winners were domestic Real Estate Investment Trusts (REITs) and small company stocks. REITs enjoyed a gain of 12.9% for the quarter, further stretching a lead established earlier in the year to finish 2014 as the top-performing asset class. Overall returns for 2014 came in at +28%. Continued low interest rates and relatively strong growth in the U.S. economy helped to drive demand, and limited new supply resulted in notable strength. The apartment, healthcare, and lodging sectors in particular enjoyed outsized returns, and all rose between +32% and +40% for the year.

Small-cap equities, after experiencing a pronounced sell-off earlier in the year, enjoyed a resurgence in the final quarter and rose by +9.7%. This brought overall results back into the positive column to +4.9% for the year. For their part, large-cap U.S. equities also performed well, recording new all-time highs during the quarter and ending 2014 with overall returns of +13.7%. However, with valuations getting nearer the high end of their historic range, they also experienced a couple of bouts of sharp volatility near the beginning and the end of the final quarter that left many speculators feeling nervous.

The biggest loser for the quarter and for the year as a whole was the commodity sector, which was particularly impacted by a precipitous drop in the price of oil. The Bloomberg Commodity Index fell by -12.1% for the final quarter, and by -17.0% for the year in total. Weak economic growth in Europe and emerging markets dampened demand, and a burgeoning supply of oil from U.S. producers led to oversupply concerns. This resulted in a 50% decline in spot oil prices between the mid-point and the end of the year. The concurrent sharp declines in the stocks of oil producers and transporters weighed heavily on the natural resource sector.

The decline in the price of oil (which is denominated in U.S. Dollars in global markets) was exacerbated by rapid strengthening in the U.S. Dollar. This Dollar strength also was largely responsible for the negative results experienced in both developed foreign markets and emerging markets for both the quarter and the year. For U.S. investors, the EAFE Index fell by -3.5% for the quarter and -4.5% for the year, and the MSCI Emerging Market Index declined by -4.4% and -1.8% during the same periods. In a sign worth noting, however, in local currency terms the EAFE and MSCI EM provided returns of +6.4% and +5.6% respectively for 2014, indicating that the underlying fundamentals of these economies may not be as dire as many in this country might believe.

Looking forward, we believe it's important for long-term investors to maintain a broadly-diversified approach and to resist the temptation to focus more narrowly on last year's winners. In the long run, low energy prices should be beneficial to U.S. consumers and also to U.S. businesses. Though equity valuations here have risen markedly during recent years, we believe there is still money to be made in this asset class (albeit with more caution.) At the same time, low energy prices are likely to benefit the major economies of Europe and Asia even more than the U.S. With price to earnings multiples overseas still generally much lower than those in the U.S., coupled with more attractively-priced goods and services now due to the Dollar's recent strength; we continue to find a compelling argument for owning great businesses outside the United States. Our portfolios reflect that belief.

As always, if you would like to discuss our perspective further, or if you have specific questions about your personal situation, please do not hesitate to give us a call.

Conservative Growth Model

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
2.35%	2.92%	2.92%	8.06%	6.11%	4.84%

Inception Date 06/03/1999

Core Growth Model

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
2.09%	3.04%	3.04%	10.47%	7.30%	5.34%

Inception Date 05/31/2003

Growth Model

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
1.97%	.93%	.93%	10.83%	6.93%	6.23%

Inception Date 10/16/1992

Specialty Model

Diversified Growth Model

4th Quarter	YTD	1 Year	3 Year	5 Year	10 Year
4.45%	5.42%	5.42%	15.08%	10.88%	6.41%

Inception Date 10/31/00

Education Models

UT ORP

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
2.87%	3.71%	3.71%	12.10%	7.54%	5.14%

Inception 08/10/1999

Retirement Growth

4th Quarter	YTD	1 Year	3 Year	5 Year	10 Year
1.90%	3.78%	3.78%	12.50%	8.82%	5.88%

Inception Date 06/03/1999

Growth & Capital Preservation

4th Quarter	YTD	1 Year	3 Year	5 Year	10 Year
1.23%	2.87%	2.87%	8.88%	6.31%	4.98%

Inception Date 11/30/2001

Upcoming Events

TRANSITION PLANNING?

Guest Speaker: Barry Izsak

Professional organizer and move manager

Tips for downsizing or helping your parents

February 19, 2015

6:30 – 8:00 p.m.

4005 Guadalupe Street

RSVP: 512-458-2517 or by email to info@lsggroup.com

General Market Results

	4th Qtr	YTD	One Year	Three Year	Five Year	Ten Year
CPI	-0.79%	1.33%	`1.33%	1.52%	1.80%	2.18%
Barclays Agg Bond	1.79%	5.97%	5.97%	2.66%	4.45%	4.71%
S&P 500	4.93%	13.69%	13.69%	20.41%	15.45%	7.67%
DJI	5.20%	10.04%	10.04%	16.29%	14.22%	7.91%
S&P 400	6.35%	9.77%	9.77%	19.99%	16.54%	9.71%
Russell 2000	9.73%	4.89%	4.89%	19.21%	15.55%	7.77%
NASDAQ	5.40%	13.40%	13.40%	22.05%	15.85%	8.09%
MSCI EAFE	-3.53%	-4.48%	-4.48%	11.56%	5.81%	4.91%
MSCI EM	-4.44%	-1.82%	-1.82%	4.41%	2.11%	8.78%

Lucien, Stirling & Gray Advisory Group, Inc. is a Registered Investment Advisory firm providing fee-only asset management, fiduciary-level advice and financial planning services to individuals, corporations, trusts and foundations.

For more information about our firm, please visit our website at www.lsggroup.com • Model holdings may change due to ongoing management • Sector and style breakdown is constructed with the best available information and therefore is only as accurate as the available information • Past performance is no guarantee of future results • It is impossible to invest directly in indices • Percentages may not equal 100 due to rounding

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