NELSON ROBERTS QUARTERLY COMMENTARY

2015 | SECOND QUARTER

ECONOMIC OVERVIEW

Debt Concerns Wipe Out Second Quarter Gains

For most of the second quarter the news was very quiet, and so too were the markets. Then, in the final week of the quarter, the Supreme Court announced its decisions affirming the legality of both the Affordable Care Act and same-sex marriage. On Monday, June 29th, the “Grexit” loomed again: Greece announced that it would not be able to make the $1.77 billion debt repayment due to the International Monetary Fund on June 30th, and that it was closing its banks to prevent a run in the face of a potential default. That same day, the Governor of Puerto Rico announced that the commonwealth’s $72 billion in debt was “not payable” by the taxes collected on its 3.6 million people. Additionally, after doubling in the first five months of 2015, the Chinese stock market (Shenzhen Composite) dropped over 20% since the June 12th high, prompting talk of a Chinese bear market. As was the case in the first quarter, the US stock markets gave up virtually all of the second quarter’s return in the final two trading days of June.

For the quarter, both large- and small-cap US stocks were mostly unchanged. The various European bourses were down anywhere from 2-7% in the second quarter in local currency, after seeing returns in the high teens during the first quarter. The US Dollar rose over 20% between June 30, 2014 and March 31, 2015, before declining a modest 3%. When converting the European stock market figures to US dollar-based returns, they are muted to a 5% increase in the first quarter and a 3% decrease in the second. From 2009 lows, both the S&P 500 and the Russell 2000 indices are up 120% while the EAFE is up only half this amount, a reflection of the economic difficulties in the European Union. Meanwhile, oil, which hit a low of $42 a barrel on March 19th, recovered this quarter, trading from $50 to $60 a barrel. The price differential between West Texas Intermediate (US) and Brent (European) fell from $80 per barrel to virtually nil. After the horrific drop last fall, it looks like oil prices have finally stabilized.

The debate continues over whether our economy is still disinflating or beginning a growth era. Personal savings have risen over the last few quarters as the “gas dividend” is being saved not spent. Real wage growth continues to be sluggish at around 2% annually since the ’08 financial crisis. The combination of low wage growth and rising costs for services, especially in health care, is not a recipe for a strong economy. There has been a broad recovery in housing and a rapid rise in residential rents, especially in densely populated coastal urban centers. It seems that these factors should have a greater effect on the Consumer Price Index (CPI) than they have so far.

INDEX PERFORMANCE	Q2’15	YTD
Dow Jones Industrials	-0.29	0.03
Standard & Poor’s 500	0.28	1.23
EAFE (international stocks)	0.80	5.93
Russell 2000 (small stocks)	0.42	4.73
Barclays Interm. Gov/Credit	-0.94	0.82
Barclays Municipal	-0.89	0.11

INSIDE THIS ISSUE

TOP FIFTEEN HOLDINGS

- iSHARES CORE S&P SMALL CAP
- AMAZON.COM INC.
- iSHARES CORE MSCI EMERGING
- SCHLUMBERGER LTD.
- WALT DISNEY COMPANY
- AKAMAI TECHNOLOGIES INC.
- UNITED PARCEL SERVICE
- T ROWE PRICE GROUP INC.
- COSTCO WHOLESALE CORP.
- INVESCO LTD.
- TJX COMPANIES INC.
- WW GRAINGER INC.
- HEALTHCARE SELECT SECTOR SPDR
- NOVARTIS
- WHITEWAVE FOODS COMPANY

ECONOMIC OVERVIEW

Debt Concerns Wipe Out Second Quarter Gains (cont'd)

This economic environment is causing the Federal Reserve Open Market Committee (FOMC) to fret. The Yellen Fed has been telegraphing an increase in interest rates for a long time, but it has habitually postponed action. The challenges in Europe could give it yet another reason to wait.

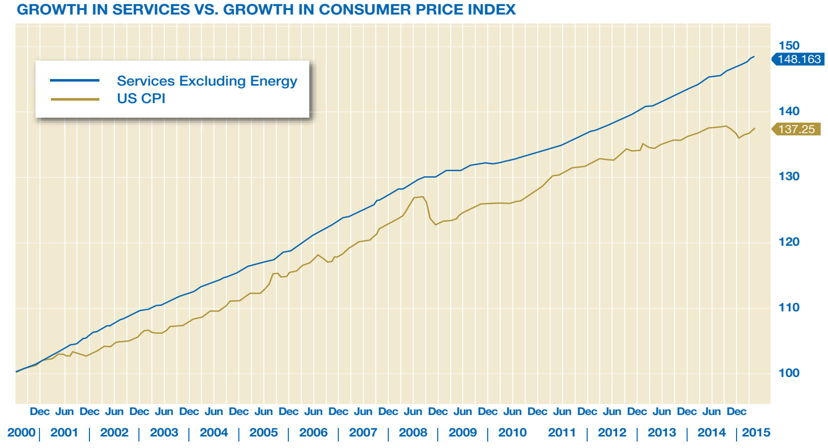
It has been seven years since the 2009 market low, but we still see weak demand and a general lack of optimism. There is definitely no euphoria. We are overdue for "something to happen," but we do not believe the Greek crisis is it (again).

If we step back and look at pervasive, long-term global problems, two stand out: sovereign debt levels are too high around the globe, and benefits costs, especially for government employees, are too high to sustain. These issues are big parts of the problem in Greece. The country may be worse off than other developed countries, but it is not alone. It has been five years since the Greek problem first arose. There has been plenty of time for all investors to eliminate exposure. Who still holds the risk? Very large and aggressive hedge funds, for the most part. These funds can dominate trading volumes, and with their Greek exposure, the market reacted badly on June 29th, wiping out nearly all of its meager gains year to date.

Puerto Rico's debt problem will likely spill over into the broader market for municipal bonds (munis). At over $20,000 per person, Puerto Rico has borrowed more per capita than any other state or territory. This issue has long been known, and prompted rating cuts by Moody's in 2012 and S&P in 2014. As far back as 2011, Vanguard, for example, cleaned all of the Puerto Rican bonds out of its funds. But this is not necessarily true for all muni bond funds, especially "high-yield muni" mutual funds. Additionally, many individuals have bought Puerto Rican debt because of the high yields and the fact that no state can levy taxes on income earned on debt issued by US territories. None of our clients are directly exposed to these bonds, but we believe this issue will still affect all tax-free bond prices.

Sometime in the third quarter, Congress will have to deal with raising the debt ceiling in the US again. The gulf between Democrats and Republicans being what it is, it will likely be politics as usual on this issue. This will cause some consternation in the markets, but this should be short-lived. Greece will continue to be a problem this summer. Whether the country exits the Euro now or at the next debt payment date, we think it is going to happen eventually. Until it does, however, the markets will worry that Greece is the first of the dominoes to fall. We think that post-default and Euro departure, the state of the economy in Greece will be so bad that it will discourage other weak countries from following suit. Interest rates will eventually rise to provide a real return to fixed income investors. This means bond prices have further, maybe even much further, to fall. We do not think price to earnings ratios have much room to rise, so the US stock markets will move in tandem with corporate earnings, while the overall economy continues to muddle along.

GROWTH IN SERVICES VS. GROWTH IN CONSUMER PRICE INDEX



“If we step back and look at pervasive, long-term problems, two stand out: sovereign debt levels are too high around the globe and benefit costs, especially for government employees, are too high to sustain.”

ASSET MANAGEMENT

A Slower Pace in the Second Quarter

After a busy first quarter, we had a much quieter second quarter. We made three major changes to the portfolio as we continue to follow our themes of domestic economic growth, a strengthening dollar, and prolonged low energy prices. We have otherwise been sensitive to the tax implications of higher portfolio turnover.

We trimmed our position in WhiteWave Foods (tkr: WWAV), which had appreciated to over 4% of the portfolio. We think the stock's rapid appreciation stretched its valuation, and to stay appropriately diversified, we took a profit from last year's investment while keeping a 2.5% exposure. We believe consumer trends still favor the company; its recent results have been strong, and it continues to have category-leading sales in nut milks, organic dairy milk, and organic greens and produce. On the potential downside, Whole Foods now compels WhiteWave to sell greens in its stores as lower-margin white label products, and the company faces some risk vying for shelf space for its plant-based yogurt and planning how to position its products in China. However, we still see substantial upside in its expanding margins and growth opportunities.

Against the backdrop of low oil prices, we sold our position in Royal Dutch Shell (tkr: RDS/B), exchanging it for ExxonMobil (tkr: XOM). In April, Shell agreed to buy BG Group, a British integrated natural gas company. We think that Shell overpaid, and that its disadvantaged refining assets and adverse currency exposure will also weigh on the stock over the next several years. Furthermore, the BG transaction will reduce Shell's ability to return capital to shareholders, one of the primary drivers of its outperformance in the first half of 2014.

Exxon is the largest nongovernment oil and gas company in the world. Its capital allocation and operating efficiency are superior to those of its peers, helping protect the company's cash flows from the oil downturn. While we doubt Exxon will grow substantially without an acquisition, it has historically returned sizeable amounts of cash to shareholders and its dividend is the best-protected of the major oil firms. It also reduces our currency exposure, which is beneficial as the dollar strengthens.

Trading Shell for Exxon replaces one oil “supermajor” with another, and does little to change our energy sector strategy. We expect oil prices to remain consistently low for the next few years, and have kept a small market overweight in integrated oil to partly hedge against extreme oil price swings. We also maintain a substantial overweight in oilfield services with our position in Schlumberger (tkr: SLB). The company has been quick to cut its own expenses, and part of its value proposition to oil producers is lowering their costs over time. This is of particular worth in this environment, and should help limit the stock's downside. We believe Schlumberger will rebound sharply if drilling picks up.

Finally, we added to our position in the iShares Core S&P Small-Cap exchange-traded fund (tkr: IJR), bringing it to 5% of the portfolio. The fund is comprised of companies with market values under $2 billion, which derive the vast majority of their revenues from the United States. With solid US growth, quantitative easing occurring abroad, and economic uncertainty in Europe and Asia, we expect companies with domestic, dollar-denominated revenues to, in general, report more favorable results. Investing in the fund rather than individual stocks diversifies the risks inherent in actively managing multiple small-cap names.

vision *[vizh' en] n. the ability to perceive or foresee through mental acuteness*

WHAT IS MONEY?

At its simplest, it remains a form of barter, an exchange of energy for goods. At its most complex, it's a symbol of mastery, a measure of power. At its center are people with vision, talent, skill, families, children, hope and dreams.

WEALTH MANAGEMENT

Getting Ready for Higher Interest Rates

The Federal Reserve has done everything in its power to prepare investors for an interest rate hike. However, the change in interest rates is still likely to catch some by surprise. We believe there is a high probability that the Fed will begin raising rates this fall, although we think the rate of increase will be very slow with periodic pauses due to macroeconomic conditions. Before the Fed makes its move, here are a few things to consider:

Create a Charitable Lead Trust

For those who are charitably inclined, the current low interest rate environment favors charitable lead trusts. A charitable lead trust is designed to shift wealth to beneficiaries in a tax-efficient manner. Under the terms of the charitable lead trust, a percentage of the trust is paid out to charity annually. At the end of the charitable lead trust's term, the remaining assets are distributed to the grantor's children or other non-charitable beneficiaries. Charitable lead trusts work well in a low interest rate environment because if the trust's investment performance exceeds an interest rate determined by the IRS (currently it is approximately 2%), then the excess earnings and growth at the end of the term pass to the remainder beneficiaries tax-free. The lower the interest rate, the larger the potential gift to family.

Adjust Your Bond Portfolio

Bond investors have benefited from a steady decline in interest rates over the last 35 years. As interest rates begin to rise from historic lows, investors need to be prepared for low to negative returns. Being defensive can help. Bonds with shorter maturities are less affected by interest rate changes than longer bonds because bond holders will get their money back sooner to reinvest at the new interest rate. Liquidity is an important component and an often-overlooked element when investing in bonds or bond funds. We recommend holding some cash or cash equivalents such as short-term US Treasury Notes as a way to protect portfolios if bond prices decline and liquidity dries up.

Refinance Your Mortgage

Higher interest rates will push up borrowing costs for home and auto loans. The majority of homeowners have already taken advantage of today's record low rates and refinanced their 30-year mortgages. Jumbo loan rates for a 30-year fixed mortgage are currently at 4.25%. But for those who opted for an adjustable rate mortgage, if rates rise, monthly payments could increase significantly. Now is the time to lock in a long fixed rate and erase any uncertainty over future interest rate increases.

Increase Exposure to Small Company Stocks

Think about increasing exposure to smaller US-based companies. Smaller companies do not face the same currency headwinds that negatively impact large US multinational companies. Rising interest rates and a strengthening of the dollar are highly correlated. If the Fed initiates rate hikes as European and Asian central banks hold their rates steady, the dollar will continue to strengthen. As a result, smaller companies' earnings will be stronger than those of their larger competitors. At some point, interest rates will rise. This will hurt fixed income investment portfolios and borrowers will be forced to pay more for home and auto loans. That said, rising rates are a sign that the economy is improving and will be a welcome sight for those net savers looking to generate higher income.

FIRM UPDATES

Nelson Roberts Investment Advisors is pleased to welcome Erin Rodriguez to our team. Erin is a California native who lived in New York for five years, where she worked for Citigroup as a financial analyst. She and her husband have a 22-month old daughter. Erin is happy to be putting down roots in California where she can cheer on the Golden State Warriors. She enjoys baking and shopping, and has the most perfect handwriting anyone has ever seen.

FEATURED EQUITY

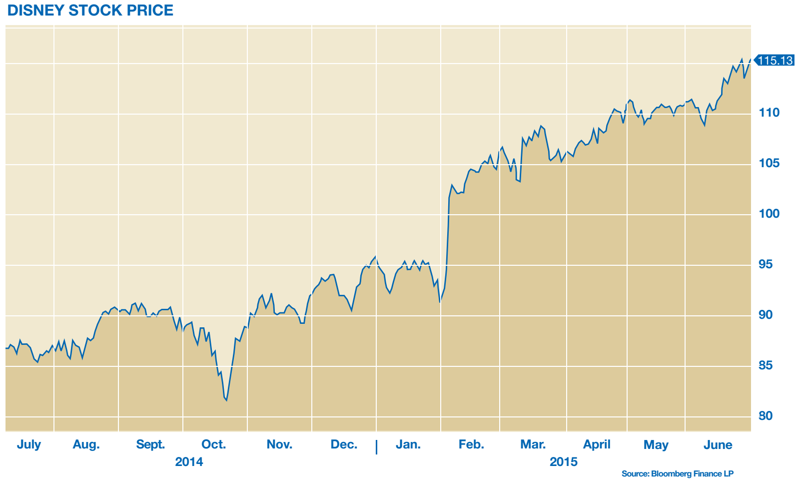
Disney

When most of us hear the name "Disney" we think of Disney World, Disneyland and princess movies. However, Disney (tkr: DIS) operates in five broad segments: Media Networks (including flagship ESPN), Parks and Resorts, Studio Entertainment, Consumer Products and Interactive. Revenues for 2014 were about $49 billion, with Media Networks driving just under half. Earnings per share have grown steadily in the last several years.

Our thesis for owning Disney is that the company continues to successfully create content "franchises" that can be monetized repeatedly across its business segments. For example, the movie "Frozen" was a huge box office success. It has been released to video in the US and overseas, has generated merchandise sales at Disney's retail stores and Elsa and Anna, the two main characters, are now part of the princess cast that wanders Disney's resorts. Robert Iger, CEO since 2005, has been the driving force behind this "franchise model." He has also made several strategic acquisitions, including Pixar, Marvel and Lucasfilm. The Marvel franchise in particular has been extraordinarily lucrative, as individual characters (for example, Iron Man) and groups of characters (the Avengers) have been featured in multiple movies. The first "reboot" of Star Wars is scheduled for release in December 2015, and lest anyone think that audiences have lost interest during the long dry spell since the last movie, 88 million people watched the trailer in a 24-hour period.

While Disney's valuation is higher than that of its peers, its ability to create and monetize content is unparalleled, which is why we find it an attractive core holding.

DISNEY STOCK PRICE



Previous featured equity follow-up:
Whole Foods Market

Whole Foods' (tkr: WFM) stock price has taken a "round trip" since we bought it in November, rising over 40% and then returning to our cost basis in June. The market's concerns about slowing same-store sales growth and the company's announcement of what sounded to many analysts like a half-baked small store concept more than outweighed what we believe to be the stock's strong fundamentals and low valuation. We elected to hold the stock while the company's growth strategies play out; we think the market has already priced in potential downside and perhaps overreacted. As the leading retailer of organic foods in the US with a strong reputation for quality, Whole Foods has ample opportunity to gain market share as it expands its footprint.

(The preceding information regarding the featured equity should not be construed as a recommendation to purchase the security. It should not be assumed that future returns will be profitable or will equal the historical performance. Please contact us for a complete list of holdings.)

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SPECIAL TOPICS

Over-the-Top Content

In the past six months, we have seen an aggressive acceleration in the amount of streaming content available via the Internet, otherwise known as "over-the-top" content. We believe this is part of a broader paradigm shift in the way people consume video content. More people are viewing streaming content on TV's, computers, tablets or smartphones. Historically, people watched television using cable subscriptions, which increased in popularity in the late 1970's as cable operators started investing in original programming to boost subscriptions.

The 1990's saw the rise of satellite television. The 1992 Cable Act, which allowed broadcasters to charge distributors to carry their signals, precipitated an explosion in the number of channels available. Despite pay TV providers offering hundreds of channels to their customers, the average subscriber typically only watches about 17 channels regularly. In the mid-2000's, Netflix started offering streaming video in addition to its mail-order DVD rental service. At first, the Netflix streaming library was very limited and hardly a replacement for a full pay TV package. But Netflix began striking deals with content owners to license popular TV shows and movies, in addition to creating original programming. Hulu increased its number of network partners in order to offer new content from providers such as Disney and BBC. In the past year, Sony, CBS, and Time Warner's HBO all announced plans to debut an online video service without the need for a traditional cable or satellite subscription.

With much of the popular content now available via some sort of streaming option, canceling one's $189/month pay TV subscription (or "cutting the cord") has finally become an enticing option. In fact, this trend has begun to show up in recent data. In the past year, according to Nielsen, US households have increased subscriptions to video-on-demand services, while US pay TV subscribers have decreased and people spend less time watching traditional live television. "Millennials," as the 18-34-year-old age group is called, have begun cutting the cord at a particularly impressive rate. Traditional TV usage by this group had been falling about 4% per year since 2012. This trend has accelerated sharply. Between September 2014 and January of 2015, TV usage by millennials fell a whopping 10.6%.

Subscribers hesitant to cut the cord cite the main reason for their reluctance as the ability to watch live sporting events or news. While a TV episode or movie can be watched at any time after the premiere without losing much value, a live event is almost "worthless" once time has passed since the initial broadcast. Nevertheless, we believe it is just a matter a time before streaming becomes the norm for these live programs as well.

As more video programming goes online and consumers become more price-sensitive, we think the original content providers such as Disney (see "Featured Equity" on page 5) will retain pricing power. Viewers do not care whether they watch their favorite shows via cable or streaming, as long as they have access to their preferred content.

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