CLAYTON
FINANCIAL SERVICES, INC.

the Quarterly

Q4, 2014

Strong End to 2014 and Early Thoughts on 2015

by James Walden, CFA®
Director of Portfolio Management

Wrapping Up 2014

The fourth quarter of 2014 provided a solid conclusion to another solid year for the U.S. equity markets. Including dividends, the broad-based S&P 500 was up 4.9% for the quarter, pushing its full-year total return to 13.7%. Also, the Dow Jones Industrial Average and the small-cap Russell 2000 index returned 10.0% and 4.9%, respectively, in 2014. And once again, U.S. equities finished the year better off than international stocks and U.S. bonds (as measured by the MSCI EAFE, MSCI Emerging Markets and Barclays U.S. Aggregate Bond Indexes, respectively).

But it certainly wasn't a smooth ride during the quarter. The S&P 500 fell about 8% in October around concerns the Federal Reserve was finally ending its massive "quantitative easing" bond-buying program, and on widespread fears around the Ebola outbreak and the European economy. Stocks slipped again right after Thanksgiving, when the Organization of Petroleum Exporting Countries surprised financial markets by deciding not to cut oil production despite a global glut of the slick stuff. (The price of oil fell 10% on the day after Thanksgiving alone.) As of this writing, the price of oil is now down about 50% from June's 2014 high and is at a five-year low. It wasn't until the Fed provided soothing comments at its most recent meeting when stocks found a bottom and rallied into the end of the year.

According to The Economist, *the average American driver spent $3,000 at the gas pump in 2013, and the big drop in oil could result in gas savings of around $800, which is equivalent to an average pay raise of 2%, all else equal.*

We think oil prices will stay depressed for a while; it should take some time for any changes in supply and demand dynamics to have an impact. And while this will create some relative winners and losers, we think that, on balance, lower oil prices are a meaningful positive for the U.S. economy. Consumer spending accounts for more than two-thirds of U.S. GDP, and lower oil prices should act as significant stimulus for the U.S. consumer. According to *The Economist*, the average American driver spent $3,000 at the gas pump in 2013, and the big drop in oil could result in gas savings of around $800, which is equivalent to an average pay raise of 2%, all else equal.

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Strong End to 2014... *continued from page 1*

Early Thoughts on 2015

Turning our gaze toward 2015, we anticipate continued economic expansion. We don't know yet whether we'll see the sustained liftoff for the economy that everyone has been holding their collective breath for since the financial crisis, but we also don't see the makings of a recession any time soon, either. In fact, economic growth has accelerated, with the most recent estimate for real GDP growth at a 5.0% annual rate--an acceleration over the second quarter's read and the strongest single quarter since 2003. Benefits from the decline in oil prices should provide a boost in the New Year.

We continue to favor equities over bonds. While we won't call stocks "cheap" at this juncture, we think equity valuations are reasonable with such low inflation. Our investors should expect continued and occasional modest pullbacks (perhaps with one sooner, rather than later, given the chance the market might want to take a breather after the relatively strong rally to end 2014), but they should be short and shallow. If we foresee something more, we would look to get more defensive.

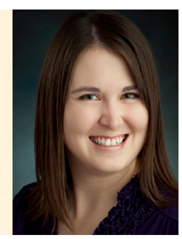
For bonds, we anticipate a few more headwinds in 2015 than what we experienced in 2014. Most importantly, we think this will finally be the year that the Fed decides to start raising its target interest rate after keeping it near zero for years. (As interest rates go up, bond prices typically go down, but the total return for bonds and bond funds can also be positively impacted by interest income and credit spreads.) Good economic growth tends to put upward pressure on interest rates. However, there are plenty of other factors that should limit how high rates will rise this year, and we think bonds remain a very important element of a well-diversified portfolio for most investors.

Secure File Sharing

CFSI will be testing new software (Citrix ShareFile) that allows for secure file sharing between you and us. This new software will allow electronic file exchange without the hassle of remembering passwords. As we test this over the next quarter, we welcome your feedback!

FAFSA Reminders and Deadlines

Barbara Heller
Senior Financial Planner



With the start of a new year, it's time for those with college-age dependents to be thinking about financial aid and scholarships. The FAFSA (Free Application for Federal Student Aid) is the starting point for all federal financial aid and for many private scholarships as well. Even if you believe that your dependent would only qualify for loans and you do not plan to accept any, it can be worthwhile to file. Many institutions require a student to file a FAFSA to receive private scholarships. The main thing to remember is that there is no harm in filing – you do not have to accept any loans or other aid that the student is eligible for if you decide they are not needed.

Another thing to be aware of is that there are quite a few companies that may have a website that appears to be legitimate, but is not the actual FAFSA website. The only website you will want to use for filing is fafsa.ed.gov. Make sure you use the .gov website! Many of these other companies want to charge a fee to help you file.

DEADLINES: There are numerous deadlines to consider for the FAFSA. The Federal deadline is misleading, as it is June 30, 2016 for the 2015-2016 school year. However, states have their own priority deadlines that you should be aware of. In Kansas, this is April 1, 2015. Schools can also set their own priority deadlines. Below are a few examples from local institutions:

Washburn University, Topeka:
February 15, 2015

University of Kansas, Lawrence:
March 1, 2015

Kansas State University, Manhattan:
March 1, 2015

Market Volatility

I know this sounds somewhat insensitive, but… we do not worry about market fluctuations nearly as much as you do.

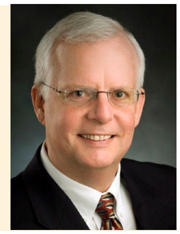
As of January 2015, it has been 38 months since our last 10% correction ("correction" sounds so much nicer than "decline"). Since 1900, the Dow Jones Industrial Average has had a 10% correction every 12 months, on average. So, based on historical averages, we are 26 months overdue. We expected a 10% correction in 2012, in 2013, and in 2014, but it never came. It probably goes without saying … we expect it to occur in 2015.

The longest period of time between 10% corrections was 82 months (during the 1990-1997 bull market run), according to the Wall Street Journal's data group. So we are not close to setting a new record, but averages eventually catch up with you.

A 10% correction in a Moderate portfolio, comprising approximately of 60% stocks and 40% bonds, would have a 6% overall portfolio impact ("impact" also sounds better than "decline"), assuming the 40% bond portion was flat, having no gain. And although a 6% decline in a portfolio is stressful, it should be expected annually, based upon averages. The "insensitive" part is that we are not worried and believe this type of decline is healthy for markets. Our answer to your question "What are you going to do about it?" as we get close to a 10% stock-market decline—which translate to a 4-6% portfolio decline for most moderate portfolios—also appears "insensitive," because the answer is "we are watching, we are aware, and will make changes accordingly." The answer just doesn't feel good, even though it is true.

Twenty-percent declines, also called "bear markets," are truly worrisome and require a doubling of our medication. Twenty-percent or more declines have happened, on average since 1900, every 3 ½ years. The last one ended in March 2009. Gulp! That was almost 6 years ago. And yes, that could happen in 2015.

Randy Clayton
Founder and Principal of Clayton Financial Services, Inc.



As most of you know, we are one of the most experienced advisory firms in the area. We have lived and invested through all sorts of declines and we would be foolish not to have a number of preplanned strategies to reduce the impact of a bear market. Hopefully we will not have to implement these plans this year, but we will be vigilant. Being vigilant does not mean that your portfolio won't decline, nor be pain free. But our vigilance will help to keep you on track for your long-term financial goals.

Technology in 2015

As we ring in the New Year at Clayton Financial Services, we are excited about employing new technology to help improve office efficiencies and continue to provide a high level of service to our clients in the coming year, and beyond.

New offerings from Fidelity, including mobile check deposit and account opening with eSignature, will allow us to reduce processing time when making check deposits and establishing new accounts. The financial planning team has been busy learning new financial planning software, which features a more interactive and collaborative experience. In addition, a new online financial questionnaire is being implemented to help make the data collecting process as easy as possible for our clients.

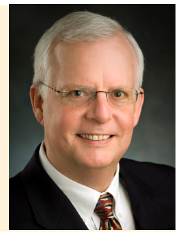
As always, we will continue to look for ways to improve the experience our clients have when working with our firm and appreciate any feedback you may have. We look forward to helping you enjoy a prosperous 2015!

Elizabeth Young, CFP®
Senior Financial Planner

Portfolio Name Changes

About twenty years ago we made a decision to name our various portfolio types in a way that reflected the primary objective of that particular portfolio. For example, a portfolio that was approximately 95% equities (stocks) was labeled **Capital Appreciation**. Conversely, a portfolio that only had 15-25% in equities, we labeled **Income**. While the names do reflect the primary objective, they do not reflect the risk characteristics (volatility or standard deviation) of that particular portfolio. We have decided this is important information to communicate to clients, so starting in 2015 we will begin using new portfolio labels. The underlying portfolios will remain the same; only the name will change. Here is a summary of the new labels:

Randy Clayton
Founder and Principal of Clayton Financial Services, Inc.



Income will now be **Conservative**

Income & Growth = Moderately Conservative

Growth & Income = Moderate

Growth = Moderately Aggressive

Capital Appreciation = Aggressive

You may catch us slipping up periodically by referring to the old labels (old habits die slowly), but in the end we believe the new labels are more descriptive and logical, and we hope you agree.

SAVE THE DATE!

Economic and Investment Seminar

Plan to attend our Economic and Market Update Seminar to hear Clayton Financial Service's outlook for 2015.

Space will be limited so let us know if you plan to attend!

Presenters: Randy Clayton, CFP® James Walden, CFA

Times: **Wednesday, February 25, 2015**
Noon, light lunch included

Thursday, February 26, 2015
Noon, light lunch included
6:00 pm, wine & cheese

Place: Clayton Financial Services Office, 716 S. Kansas Ave. Topeka, KS

2014 Holiday Open House

On Thursday, December 4, over 150 clients attended our annual Holiday Open House party. It was an evening full of great food, drinks, music, and holiday spirit. As always, we enjoyed sharing an evening with all who were able to attend, and wish everyone near and far a happy 2015!

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