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Sound Investments Inc.

Third Quarter 2014

DJIA 17042.9 S&P 500 1972.9 NASDAQ 4365.3

Is this a Repeat of the Financial Crisis?

We don't think this is a repeat of the internet bubble of 2000 or the financial crisis of 2009. The problem, in brief, is that stocks were expensive enough that further gains required an upbeat economic backdrop and the recent economic news has been far from that. However, the U.S. remains a relative bright spot in an otherwise gloom picture, particularly its job market, which is gaining traction (see article on Page 4), after years of fitful growth. All of the leading economic indicators show our financial system is slowly, but surely, getting better. With the S&P index at 1850 we think a lot of the selling is done and there is firm support around the 1650 mark. (See excellent chart on page 4). The S&P index has suffered a 10% pullback or correction in 34 of the 88 calendar years since 1925. We have not had a correction since 2011, and so perhaps the current decline feels a bit more jarring.

The Investment Letter is mailed quarterly to our clients and friends. The intent of this publication is to share some of our more interesting views and research with our clients and friends.

Gains Narrow as Concerns Increase Over Global Growth

Large-capitalization U.S. stocks, overcame negative markets in July and September, to finish the third quarter of 2014 with modest upside progress. However, shares of small and mid-size U.S. companies, foreign stocks from developed and emerging markets, and high-yield bonds struggled, as investors took a more risk-averse approach.

Trouble overseas was one reason for increased investor caution in the market, and there was a lot of it. From Argentina defaulting on its bonds, Portugal's largest Bank had to seek new funding, continued conflict between Russia and the Ukraine, and the emergence of ISIS which captured large swaths of territory and beheaded 2 American journalists.

Despite these developments, the negative impact on U.S. markets was relatively fleeting, as investor sentiment was buoyed by encouraging news about the U.S. economy. Data reported at the end of July showed that gross domestic product (GDP), a broad measure of economic activity, advanced a robust 4.6% in the second quarter.

Against this backdrop, the blue-chip Dow Jones Industrial Average gained 1.87% during the third quarter of 2014. The S&P 500 Index delivered comparable results, up 1.13%, while the technology-heavy NASDAQ rose 2.24%. For these benchmarks, it was the seventh consecutive quarter of gains. Small caps were laggards, as reflected in the Russell 2000 Index's decline of 7.36%.

We are Not Out of the Woods Yet!

As I write this, on Oct 15th the S&P 500 had a sharp selloff of 7.4% from its mid Sept peak. Other indexes, like the foreign developed and emerging market, lost 15% and 11.4% respectively. The stock market is looking

This is the U.S. DOLLAR compared to a basket of 6 other leading currencies. It increased from 80 to 86¢ in a month.

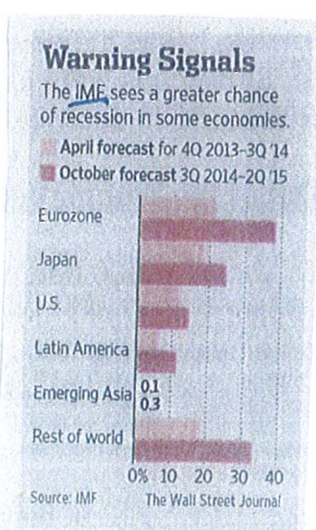
Crude Oil

WTI September 2011 (NYMEX) Price

End of day Commodity Futures Price Quotes for Crude Oil WTI September 2011 (NYMEX)

Select Timeframe: 6 Months

Crude Oil dropped from the 95/100 range per barrel to the low 80 in 6 weeks.



Darker Red columns shows increased chance of a Recession.

ahead at a high U.S. dollar, decrease in oil prices and the global slowdown.

On page 2, there is a chart of the U.S. dollar, which shows it moving up from 81 to 86, or 6%, in less than a month. This is big news to U.S. firms, as they have increasingly followed global growth, with about 40 percent of profit for firms listed in the S&P 500 stock index now coming from overseas. It is going to make it harder for our companies compete and may potentially lower profits in 2015.

A chart on page 2 shows the sagging price of oil. It has dropped from $100 a barrel to 82, or 19%, in little more than 1 ½ months. It's good for manufacturers in the long term but it puts a squeeze on the energy sector and we don't know how it will affect the employment trends in the oil patch.

The International Monetary Fund (IMF) sounded the alarm, on Oct 9th by cutting the forecast for global growth, adding another down grade to four years, of what it called, "serial disappointments. (See chart 3 on page 4) In the meeting which ended Sunday, Oct 12th, the world's finance ministers, issued some of the sharpest warnings in years about the consequences of an economic slowdown joining other threats – from the Russian-Ukraine stand off, to West African's Ebola crisis, to turmoil in the Middle East.

There is a general recognition that the economic recovery in Europe has become weaker than expected in the spring. The fund pegged the risk of recession in the Euro Zone over the next year, at almost 40%. It put the odds of declining consumer prices there, known as deflation, at about 30%. This is far higher than 6 months ago.

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Conclusion

As we discussed in our last 3 client letters, corrections, or pullbacks, are pretty routine. Our sense is, that strong earnings reports, will be needed by Corporate America, if equities are going to overcome the script of dour news from abroad. Still, at this point, we feel, this a correction, although we have lightened up a bit.

We continue to monitor the situation and welcome your calls

Number of Job Openings Hits 13-Year High

By Josh Mitchell

The number of job openings across the U.S. reached a fresh 13-year high in August, a sign this year's strong job growth could stretch into the fall.

Employers had 4.84 million open positions in August, up from 4.61 million in July and the highest level since 2001, the Labor Department said Tuesday.

Meanwhile, steady job creation has decreased the number of job seekers, a sign the labor market is tightening and raising the prospect of stronger wage growth. In August, there were just under two unemployed workers per job opening, the lowest level since the recession. In 2009, that figure was nearly seven.

A tighter labor market eventually could lead to higher wages for U.S. workers. Salaries have been growing at a tepid pace in recent years. In September, average hourly earnings for private-sector employees increased 2% from the previous year, barely faster than consumer-price inflation, Friday's employment report showed. But as companies seek to fill more jobs and the pool of job hunters shrinks, they may have to offer higher wages.

"The survey is now screaming that upward pressure on wage gains is just a matter of time," Pantheon Macroeconomics chief economist Ian Shepherdson said in a note to clients, referring to Tuesday's report. The last time the proportion of job openings to overall employment was at August's level, wages were growing at a 4% rate, he noted.

Still, other figures suggest the labor market is growing below its potential. Despite the pickup in job openings in August, the number of hires actually fell to 4.6 million from 4.9 million in July. That could be a sign that while employers are ready to expand, they are having trouble finding the right workers or they lack urgency to hire immediately.

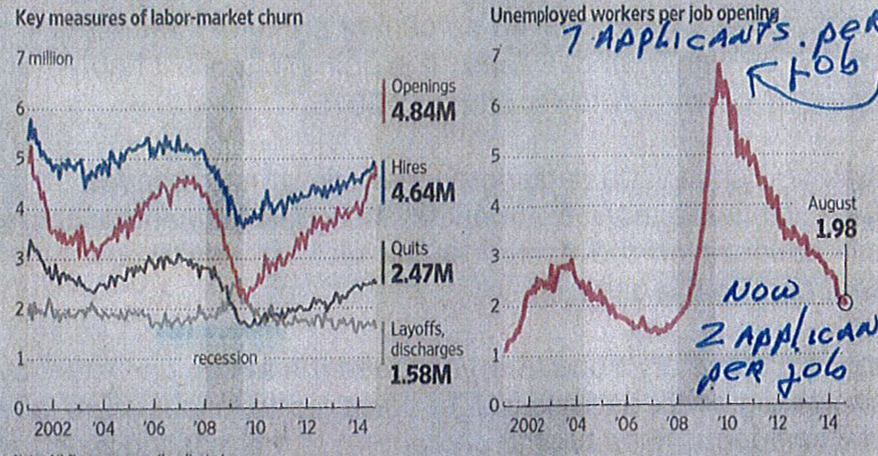
Moreover, the number of workers quitting their jobs has remained flat in recent months. That shows that despite stronger employment growth, many workers still aren't confident enough to quit their jobs for better opportunities.

Friday's employment report showed overall job creation returned to a robust pace in September, with employers adding 248,000 jobs and the unemployment rate falling to 5.9%.

Federal Reserve officials are scrutinizing such reports to gauge the strength of the labor market as they consider when and how to raise short-term interest rates.

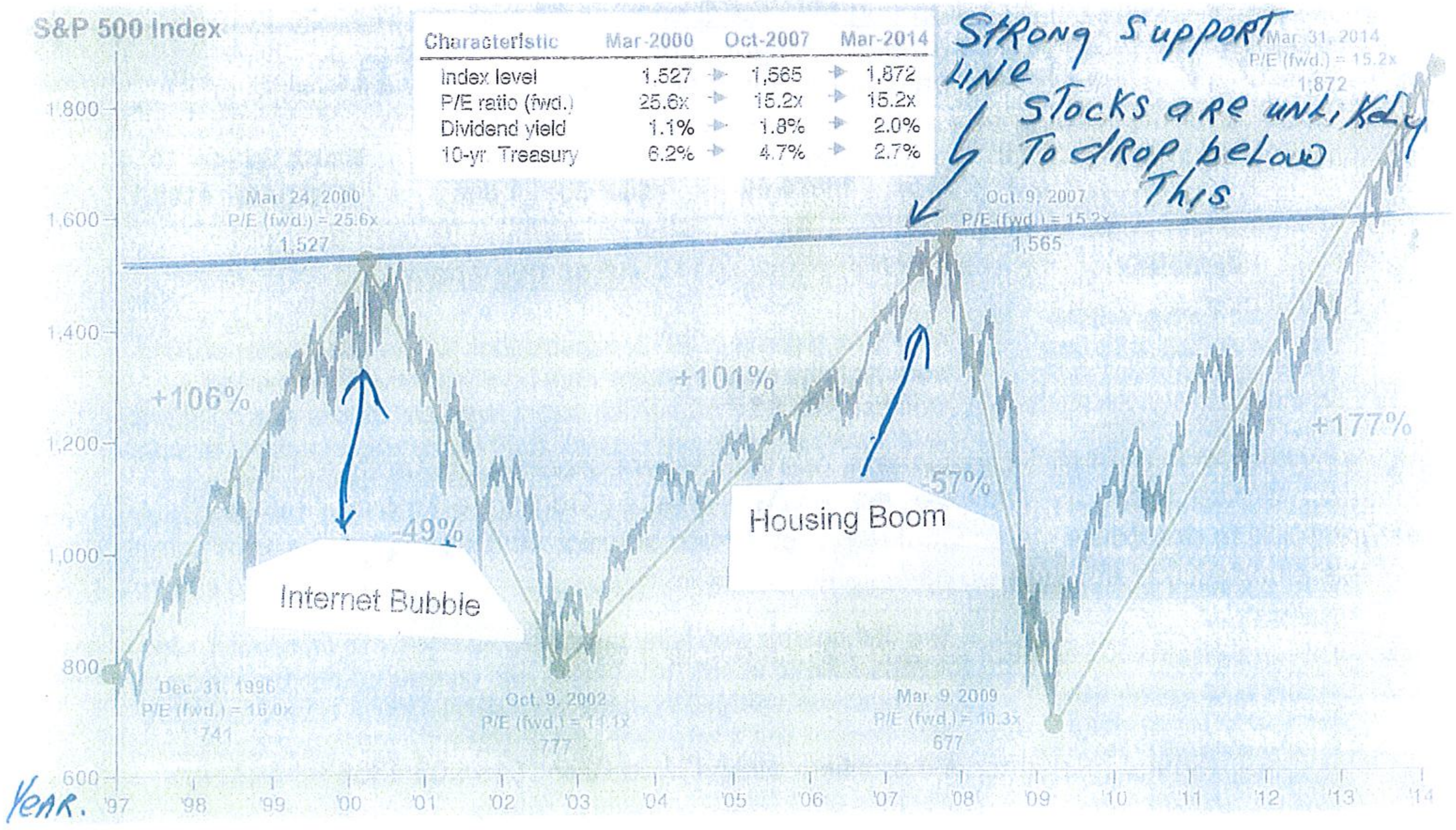
Churning Point

Hires and job openings have steadily climbed since the recession, suggesting more vibrancy, or churn, in the labor market. There are also fewer job seekers per opening compared with earlier in the recovery.



Note: All figures seasonally adjusted
Source: Labor Department

The Wall Street Journal



Characteristic	Mar-2000	Oct-2007	Mar-2014
Index level	1,527	1,565	1,872
P/E ratio (fwd.)	25.6x	15.2x	15.2x
Dividend yield	1.1%	1.8%	2.0%
10-yr. Treasury	6.2%	4.7%	2.7%