4th Quarter 2014

VAAM's economic outlook has differed from the consensus in that we forecasted for 2014, and continue to forecast for 2015, higher real GDP growth. There are four primary reasons for our outlook. We believe that the labor market will continue to gain traction. 2014 was a year that saw total employment rise by 2.95 million, the largest advance since 1999. Wage growth should also pick up more broadly in coming months. This will help the consumer sector which represents 70% of GDP. Secondly, continued improvement in corporate fundamentals have led to stronger coverage and leverage ratios in addition to higher cash balances on balance sheets. Thirdly, improving fiscal deficits (only 2.8% of GDP for the fiscal year ended September 2014) will result in less fiscal drag. Finally, the Federal Reserve's quantitative easing has supported lower interest rates. Even though the Fed has terminated this program, their debt purchases have been largely replaced by an increase in foreign purchases of U.S. debt.

There were two negatives in the December employment report that cannot be overlooked. The fall in the participation rate, as the Fed is well aware, exaggerates the improvement in the unemployment rate. Yellen who has mentioned on occasion a broad measure of unemployment (U6) must have noticed that this measure, while improving, is still above 11%. In addition, average hourly earnings actually declined by 0.2% in December. This development will concern members of the FOMC, who consider wage gains an important factor in monitoring inflation vis-à-vis their 2% target. The recent hiring trends support the Fed's plans to tighten monetary policy but a lower participation rate and slow wage gains complicate the Fed's job.

Third-quarter real GDP showed broad based improvement in the U.S. economy: business investment grew steadily, exports were strong against a backdrop of slowing global growth, and government outlays, which had been a drag on growth, increased. Third quarter real GDP grew 5.0%. Real final sales (which exclude inventory swings) also grew 5.0% versus 3.2% the previous quarter; this is the largest increase since 2006. When combined with the second quarter's GDP, the economy expanded by a rate of 4.8%-the best six-month pace since 2003. The core personal consumption expenditures index (excludes food and fuel), which is the Fed's preferred way of measuring inflation, is at 1.4%. This is well below their target of 2% thus indicating no imminent inflationary pressures. In addition, the stronger U.S. dollar and falling commodity prices are placing downward pressure on inflation. All this taken together will keep the Fed on hold until mid-year.

The steep decline in crude oil prices is a major variable that reinforces our economic forecast. Crude oil prices have declined approximately 50% since June (see graph below). It is important to distinguish the impact of lower oil and gas prices upon the overall macroeconomic level versus the micro level for oil and gas exploration and production companies. If these lower prices sustain themselves, there are positive economic and political implications. The U.S. will not only be energy independent but will also be the leading producer of energy on a global basis. Just like a tax cut, on a macro level there should be stimulative effects from increased spending power on the part of both consumers and business investment.

Lower crude prices have the potential to lead to a significant increase in infrastructure spending on bridges, highways and mass transit systems. These facilities are in need of new investment and the national Highway Trust Fund is nearly depleted. This Fund relies on gasoline taxes for revenue. The national gas tax has been fixed since 1993. A tax increase would barely be noticeable with falling gas prices. Such a measure makes economic sense if the politics in Washington can be resolved.

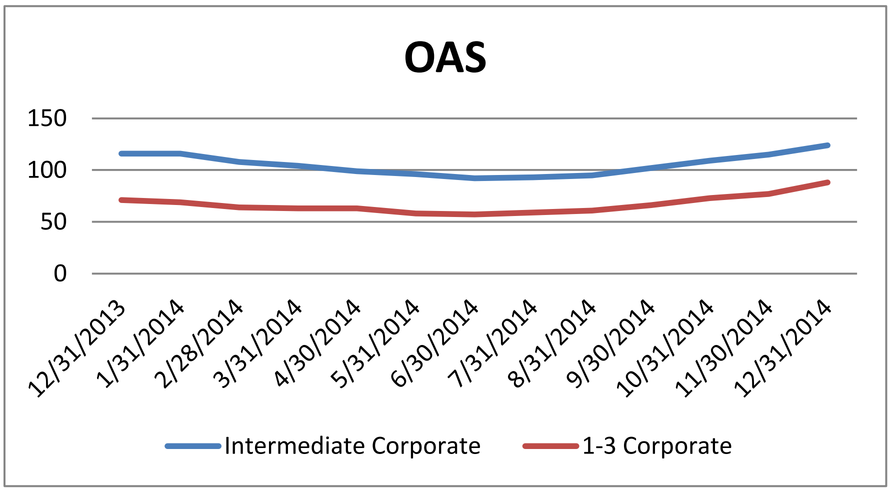
There is a debate as to whether the decline in crude oil is more an indication of slowing growth rates around the world and resultant lower demand rather than increased energy supplies. Driving the decline in oil prices is a global supply glut, caused by a combination of rapidly rising production in the U.S. and elsewhere and modest demand growth. Significantly increased U.S. production, due to hydraulic fracturing, is on a course to make the United States the largest crude oil producer in the world in the next year. The U.S. is already the world's largest overall energy producer (natural gas in addition to crude oil). The IMF attributes approximately 80% of the fall in oil prices to supply-side causes and only 20% to declining demand from slowing growth. Many of the world's top policy makers are raising their economic forecasts with the view that plummeting oil prices will lead to an overall boost in the global economy by delivering a windfall to consumers and the business sector.

The yield curve flattened during the quarter as the short end rose modestly in yield while the intermediate to longer end declined:

	Sep 30	Dec 31	Change
3-monthTreasury Bills	0.02	0.04	0.02
6-month Treasury Bills	0.03	0.12	0.09
2-year Treasury Note	0.57	0.67	0.10
5-year Treasury Note	1.76	1.65	-0.11
10-year Treasury Note	2.49	2.17	-0.32
30-year Treasury Bond	3.20	2.75	-0.45
10-year vs. 2-year	192	150	-42

Corporate Securities

Corporate bonds struggled during the fourth quarter. Worries over the global growth slowdown outside of the United States and increased volatility in equity prices weighed on the market. Corporate spreads over comparable U.S Treasury yields had reached their tightest levels in mid-summer from the last recession peak. For instance, intermediate corporate bonds reached a tight spread of 0.90% and 1-3 year maturity corporate bonds 0.56% before retracing the first-half of the year tightening trend. By year-end spreads were 1.24% versus the 1.16% spread at the beginning of the year for the intermediate corporate bond market and 0.88% versus 0.71% for the shorter 1-3 year corporate bonds. The higher coupon income of the sector versus similar U.S. Treasuries fully offset the negative impact of the modestly wider spreads as both intermediate and one-three year corporate bonds enjoyed positive excess returns for the year of 0.94% and 0.53% respectively. The movement in corporate spreads over the past year is illustrated below:



The overweight allocation to corporate bonds negatively impacted performance during the fourth quarter but was positive for the full year. This overweight position is being maintained as 2015 begins. Ongoing economic expansion in the United States is expected to provide support to the corporate bond sector. As a point of comparison, corporate spreads during the economic expansion of the 1990's reached a tight spread of approximately 0.50% and 0.40% for intermediate-term and short-term corporate bonds. These spreads reached a tight of about 0.70% and 0.50% during the last expansion, which ended in 2008. As a comparison, year-end spreads are 1.24% for intermediate and 0.88% for one-three year maturity corporate bonds. Corporate earnings have remained supportive of the corporate bond market. During the last quarter, 80% of the S&P companies reported positive or in-line earnings. The weakest sectors for the past year and quarter were the economically sensitive mining and energy sectors. Currently trading at a significant discount to the overall market, individual companies within these sectors could provide attractive incremental returns during the coming year if global growth picks up outside of the U.S. and oil prices stabilize. The best performing sector was financials led by brokerage companies such as Goldman Sachs and Morgan Stanley which are held in our portfolios.

During the past quarter several new issuers were added to our portfolios. Becton, Dickinson and Company is a global medical device and disposable manufacturer. The firm reported a positive earnings surprise and has strong financial fundamentals. For instance, EBITDA-to-Interest Expense was 15.3 times and Net Debt-to-EBITDA of just 0.57 times for the last quarter. BAML Lighthouse quantitative screen estimated that their debt was trading 0.50% cheap to their credit risk at the time of purchase. Buckeye Partners, a petroleum pipeline, was also purchased during the fourth quarter. As a pipeline, the company is less exposed to the movement in energy prices and as such their financial performance tends to be more stable and allows for a higher debt to cash flow ratio than other industries. EBITDA-to-Interest Expense was a relatively strong 4.2 times along with modest short-term debt levels. During the past quarter their earnings provided a positive surprise.

Mortgage-Backed Securities

Short duration mortgage-backed securities (MBS) outperformed comparable U.S. Treasuries during the fourth quarter. MBS yields tightened substantially during the period, ending the quarter down 28 basis points from September 30.

We maintained only a modest exposure to MBS during the fourth quarter, as the yield associated with this asset class remained near historic lows. Our portfolios includes both FNMA & FHLMC securities.

Given the continued improvement in the U.S. economy, interest rates are expected to eventually rise. This in turn will negatively impact duration. Accordingly, we maintain a cautious stance on this asset class. We continue to monitor market developments and will adjust our position if conditions warrant such a change.

Asset-Backed Securities

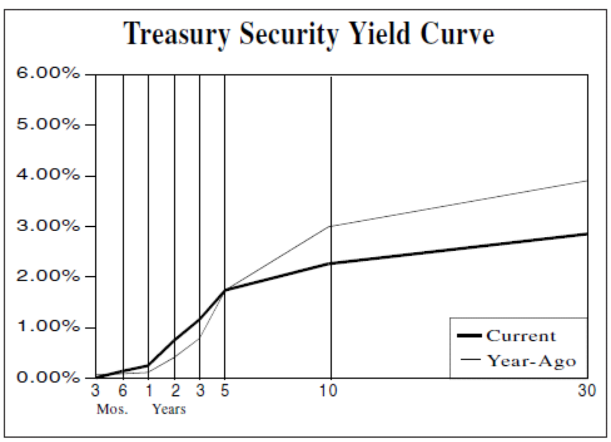
Short duration asset-backed securities (ABS) performed in line with comparable U.S. Treasuries during the fourth quarter. Fixed rate ABS were virtually unchanged over the past three months, with option-adjusted spreads (OAS) ending the quarter at approximately 58 basis points.

The ABS included in our portfolios are high quality (i.e. AAA-rated), stable and liquid securities. They include credit card receivables, auto loan/lease receivables and dealer floor plans, as well as equipment leasing transactions. We use these securities as a cash substitute, with relatively attractive yields versus U.S. Treasury and Agency bonds.

A few new ABS positions were added during the fourth-quarter. Two examples added to our portfolios are: 1) BMW Vehicle Owner Trust 2014-A A3 (BMW Financial servicer / US Bank trustee); and 2) Synchrony (GE Capital) Credit Cards 2014-1 A (GE Capital servicer / Deutsche Bank trustee). These securities typify the type of ABS structures we prefer, with AAA ratings, high quality collateral and substantial credit enhancement.

	Recent (12/23/14)	***3 Months Ago (9/24/14)***	***Year Ago (12/24/13)***
TAXABLE			
Market Rates			
Discount Rate	0.75	0.75	0.75
Federal Funds	0.00-0.25	0.00-0.25	0.00-0.25
Prime Rate	3.25	3.25	3.25
30-day CP (A1/P1)	0.11	0.09	0.10
3-month Libor	0.26	0.23	0.24
Bank CD's			
6-month	0.16	0.15	0.07
1-year	0.27	0.25	0.09
5-year	0.85	0.82	0.58
U.S. Treasury Securities			
3-month	0.01	0.01	0.07
6-month	0.14	0.03	0.09
1-year	0.25	0.09	0.12
5-year	1.74	1.80	1.74
10-year	2.26	2.57	2.99
10-year (inflation-protected)	0.60	0.56	0.77
30-year	2.85	3.28	3.91
30-year Zero	2.96	3.42	4.15

	Recent (12/23/14)	***3 Months Ago (9/24/14)***	***Year Ago (12/24/13)***
Mortgage-Backed Securities			
GNMA 5.5%	1.69	1.41	2.18
FHLMC 5.5% (Gold)	1.50	1.90	2.20
FHLMC 5.5%	1.34	1.63	2.00
FHLMC ARM	1.89	1.83	2.12
Corporate Bonds			
Financial (10-year) A	3.50	3.64	4.24
Industrial (25/30-year) A	4.05	4.33	4.76
Utility (25/30-year) A	4.04	4.24	4.68
Utility (25/30-year) Baa/BBB	4.43	4.58	5.06
Foreign Bonds			
Canada	1.90	2.20	2.72
Germany	0.59	1.00	1.89
Japan	0.34	0.53	0.70
United Kingdom	1.85	2.48	2.98
Preferred Stocks			
Utility A	5.96	5.96	6.15
Financial A	6.60	6.53	6.55
Financial Adjustable A	5.47	5.47	5.47



Source: Value Line, Inc.

Federal Reserve Data

BANK RESERVES

(Two-Week Period; in Millions, Not Seasonally Adjusted)

	Recent Levels			Average Levels Over the Last...		
	12/10/14	**11/26/14**	**Change**	**12 Wks.**	**26 Wks.**	**52 Wks.**
Excess Reserves	2354363	2413884	-59521	2551461	2594143	2549717
Borrowed Reserves	103	125	-22	203	217	174
Net Free/Borrowed Reserves	2354260	2413759	-59499	2551258	1593927	1549543

MONEY SUPPLY

(One-Week Period; in Billions, Not Seasonally Adjusted)

	Recent Levels			Ann'l Growth Rates Over the Last...		
	12/08/14	**12/01/14**	**Change**	**3 Mos.**	**6 Mos.**	**12 Mos.**
M1 (Currency+demand deposits)	2856.6	2847.5	9.1	7.0%	4.0%	9.1%
M2 (M1+savings+small time deposits)	11607.7	11602.4	5.3	4.8%	5.2%	5.9%

Source: Unites States Federal Reserve Bank

Tracking the Economy