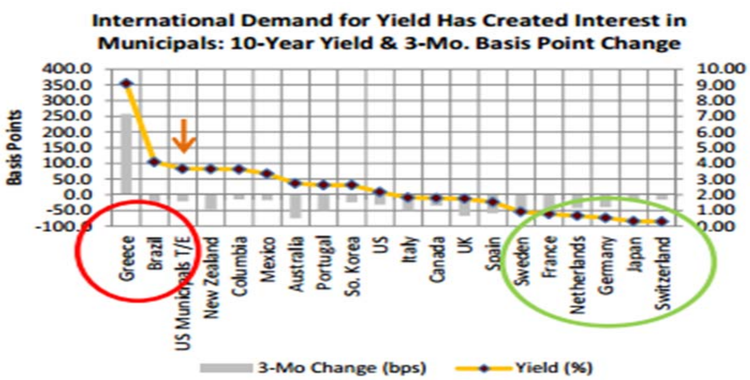
2014: A Year In Review

Municipals Defied Forecasts and Performed Strongly Throughout the Year

The strength of the municipal market in 2014 took many market participants and analysts by surprise, as an unexpected decline in long-term yields, a dearth in supply, and steady investor demand resulted in an impressive year long rally. Steady gains throughout the year more than helped offset last year's disappointing performance when the market was plagued by Detroit's bankruptcy, Puerto Rico's financial distress and investor concern over rising interest rates. The sell-off at the end of 2013 set the stage for an attractive buying opportunity that served as a catalyst for this year's rebound. Investor demand was strong and steady this year, as higher tax rates increased the relative attractiveness of tax-exempt bonds for top earners. According to Lipper US Fund Flows data, investors added roughly $21 billion in mutual funds in 2014 after withdrawing a record $63 billion in 2013. Crossover interest in municipals from non-traditional buyers also increased this year on an international scale. As seen in the figure below, the MMA 10-year benchmark offered the third highest taxable equivalent return among global bonds at year-end, only surpassed by Greece and Brazil.



Source: Municipal Market Analytics

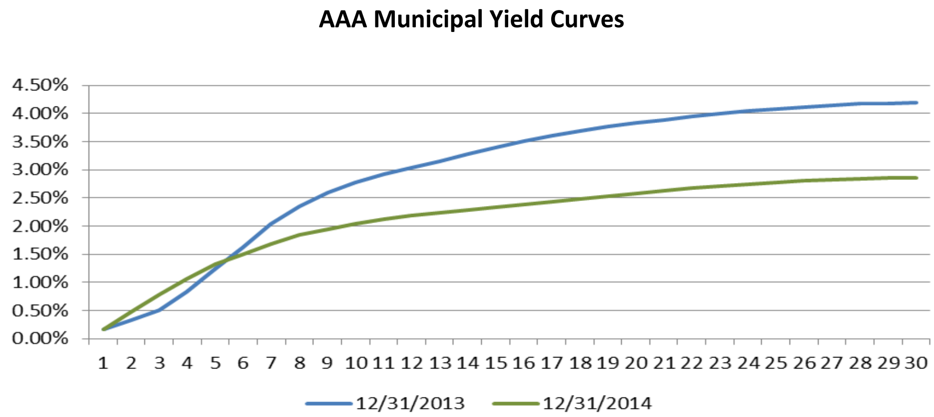
Light issuance for much of the year resulted in a favorable supply/demand dynamic that contributed to overall market performance. The total supply of municipal bonds shrank over the year, as many bonds were issued to refinance older higher-rate debt, and maturing debt exceeded new supply. Issuance has been low in recent years due to fiscal austerity measures taken by cities and states to reduce expenditures. APA believes that issuance will gradually increase in the first half of 2015 as issuers seek to take advantage of current low interest rates. There is a critical need to fund aging infrastructure systems that have been delayed as a result of cost cutting measures. The overall credit quality of municipals continues to be a positive factor on the market, with state and local government finances continuing to improve, albeit at an uneven pace across the nation. Defaults continue to decline and distressed credits appear to be isolated events not indicative of the health of the general market. According to year-end data reported by Moody's, the median rating for U.S. states is Aa1 and the median rating for local governments is Aa3. The number of downgrades has outpaced upgrades for 23 straight quarters, and we feel this trend may continue in the near future as many governments work to address multi-year structural imbalances and underfunded pension plans. APA therefore believes that in-depth analysis and credit selection will continue to be imperative in the upcoming years.

Municipal investors were nicely rewarded in 2014, as yield curve flattening, spread compression and favorable supply/ demand dynamics contributed to strong overall market performance.

In This Issue

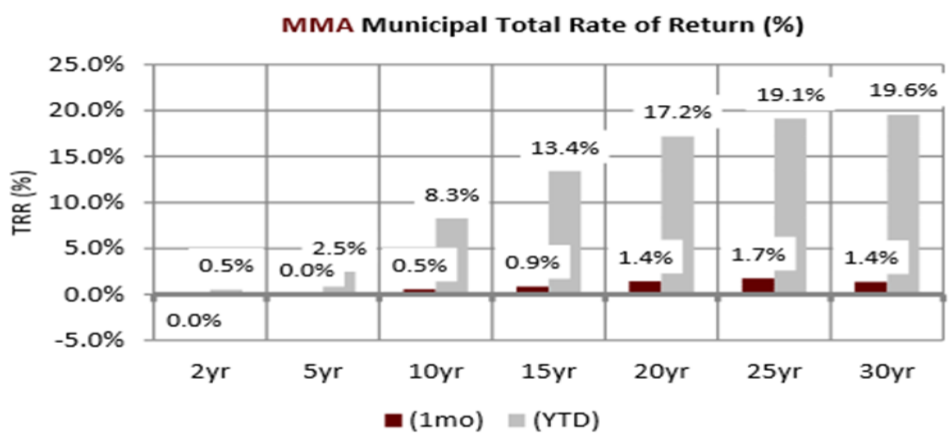
Muni Default Update

Great news for municipal investors: the municipal market had fewer defaults in 2014 than in previous years. According to data compiled Municipal Market Analytics (MMA), through December 26 there were 57 issuers filing notice of missing a payment. This compares to 68 issuers in 2013 or a 16% reduction and 108 issuers in 2012 or a 47% reduction. The bulk of the defaults (82%) were issuers in states such as Texas, California, Florida, and Colorado. In 2015, MMA expects the number of defaults to be even less than the 57 having occurred in 2014. However, there were a few more bankruptcies in 2014 than in 2013; According to Chapmen Strategic Advisors James Spiotto, there were ten Chapter 9 municipal bankruptcies in 2014, an increase from eight in 2013. Positively, there were not any cities, towns, villages or counties filing for bankruptcy.



Source: Municipal Market Data "AAA" Yields

Price appreciation was a major contributor to performance in 2014, as evidenced by the yield curve shift since the beginning of the year. Yields on the 30-year benchmark triple-A general obligation bond fell by 133 basis points according to Municipal Market Data. Yields on the short end of the curve rose slightly in anticipation of future higher interest rates, resulting in a flatter yield curve at year-end. The sharp decline in long-term yields resulted in strong total returns for the year, with longer-dated bonds performing considerably better than shorter-dated bonds.



Source: Municipal Market Analytics as of December 31, 2014

A number of factors contributed to the decline in municipal yields including declining Treasury yields, below average economic growth during the first half of the year, low inflation rates, favorable supply/demand dynamics, and improving credit quality at the state and local level. Another defining theme of 2014 was investor demand for yield, which was achieved by either extending out on the yield curve or down the rating scale. As a result, longer-dated and lower-rated bonds outperformed the general market. Credit spreads tightened over the year, aided by a decrease in negative credit headlines that soothed investor concerns and resulted in limited volatility amongst investment grade bonds. New developments in Detroit's bankruptcy proceedings and Puerto Rico's continuing financial struggles carried over from 2013, but investors for the most part were able to compartmentalize these credit issues, and therefore they did not have a significant impact on market performance.

2015: A Look Ahead

Will The Muni Rally Continue?

Many of the factors that supported the municipal market in 2014 are still in position going into the new year; however, there are a number of headwinds facing the market that could temper performance in 2015. APA believes the trajectory of interest rates will be the primary driver of market performance. There is still much uncertainty surrounding the timing of when the Fed will begin to raise short-term interest rates amid an unsettled global marketplace. APA forecasts that the Fed will begin to raise rates in a slow and gradual manner sometime during the second half of 2015, probably closer to the end of the year. We predict that the municipal yield curve will flatten further, nonetheless, we believe 2015 market performance will largely be determined by income in the form of coupon payments, with less support from declining yields. APA believes it will be difficult to match last year's strong performance, but we feel that the municipal market is well-positioned to post positive returns in the new year and continues to offer investors valuable, steady tax-free income.

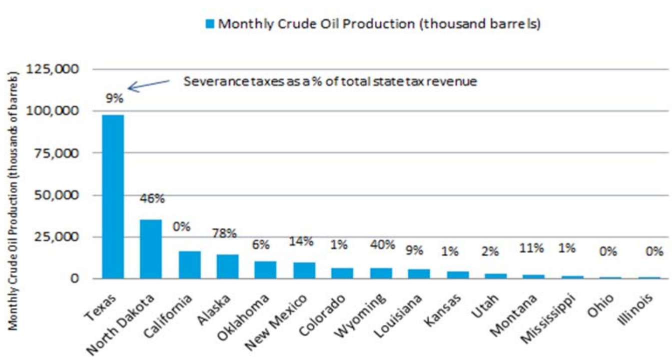
As Republicans assume control over Congress this year, the full tax-exempt status of municipal bonds may be included in future tax reform discussions. APA believes that the probability of a reduction or elimination to municipal bond tax-exemption remains rather low, as it would increase borrowing costs and adversely impact infrastructure funding. We believe there will be much discussion, but very little action taken that will alter the current tax-exempt status of municipal bonds. A proposal to revive the Build America Bonds (BABs) program may be introduced, yet APA does not see it garnering much support because of cuts to subsidy payments of existing BABs from sequestration.

Possible headline risk going into the new year will most likely involve underfunded pension plans. States such as Illinois, New Jersey and Kansas have come under public scrutiny for their large pension liabilities, and a number of other states have or are planning to propose reforms to address pension challenges. Moreover, newly enacted accounting standards that require more conservative earnings assumptions for public pensions could result in lower funding ratios nationwide. APA continues to take into account both state and local government pension liabilities when assessing underlying credit fundamentals.

Potential Impact of Falling Oil Prices on The Municipal Market

As the dramatic fall in oil prices continues to affect world markets, we examine the potential impacts on the municipal market. When reviewing the potential effects, it is important to identify the states and local municipalities which rely heavily on oil and gas revenues. At the state level, the production of oil is highly concentrated in a few states with the top 5 producing states accounting for approximately 75% of oil production. As shown in the graph below, the largest producer of oil is Texas. Despite this large output, the severance taxes, or taxes on the extraction of non-renewable resources, account for only 9% of total state tax revenues. We consider Texas' economy very diverse and do not expect the state to be significantly impacted by the drop in oil prices. We also feel that Alaska's large financial reserves should be sufficient despite nearly 80% of the state's economy being tied to severance taxes.

We continue to monitor and remain selective on local municipalities reliant on oil and gas production. While states typically have diverse revenue streams which can withstand a decline in oil prices, local governments may lack the reserves to weather a sustained drop in oil prices. We will also closely monitor transportation bonds supported by a gas sales tax as dedicated revenues decline. Positively, we expect some sectors to strengthen with the decline in oil prices. As gas prices decline we expect toll road revenues to increase resulting in improved financial metrics. As oil prices drop we also remain positive on airport bonds, utilities and GARVEE bonds which are backed by a per gallon gas tax.



Final Thoughts

APA has been in the municipal investment business since 1989 and in that time, we have learned forecasting interest rate changes is a difficult task. While some forecasters may be correct for a few years, they eventually get it wrong, and when it happens their investment decisions (and their clients) suffer the consequences. For example, many economists called for the 10 year Treasury to end 2014 in the 3.50-4% range, yet it closed closer to 2.20%. For many years, *The Wall Street Journal* has surveyed leading economists every six months regarding their forecasts of various key economic numbers like GDP, the unemployment rate, inflation and interest rates. Usually, their predictions are close on most of the numbers except one: interest rates. As one study of the historical performance of interest rates stated, interest rate forecasts are at best random numbers. As the old saying in the bond market goes: "there are two types of interest rate forecasters: 1) forecasters who don't know they don't know where rates are going and 2) those who know they don't know where interest rates are going".

The trade off today of keeping your cash allocation in a money market account as opposed to a short term bond account may be considerable. Using Fidelity's Municipal Money Market Fund (FTEXX) as an example, the yield is currently 0.02% for 1 year and 0.01% for 3 years before taxes. As a comparison, on December 31 the APA Short Term Tax-Exempt Bond Composite with a duration of 2.13 years had an annual gross yield of 0.93% using only investment grade bonds. APA believes this strategy is a more efficient alternative, producing better risk adjusted returns than a money market fund. Nonetheless, when it comes to investing, investors know there is no such thing as a "free lunch". There is usually a trade-off between higher returns and taking on more risk. The obvious risk in a short term bond portfolio is higher interest rates and their effect on the value of the portfolio.

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Composite Description: Asset Preservation Advisors ("APA") uses a fixed income strategy that purchases high quality short-term municipal bonds. The investment objective of the APA Enhanced Short-Term Tax-Exempt Composite is total return, through income, which is exempt from federal income taxes, while providing liquidity and preservation of principal. Securities selected for these portfolios are typically investment grade issues with an average duration of 0-3.5 years. A small allocation of the portfolio may include lower credit quality issues due to certain credit spread and default risk considerations.

Not every client's account will have these exact characteristics. The actual characteristics with respect to any particular client account will vary based on a number of factors including but not limited to: (i) the size of the account; (ii) investment restrictions applicable to the account, if any; and (iii) market predicaments at the time of investment. APA reserves the right to modify its current investment strategies and techniques based on changing market dynamics or client needs. The information provided in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed may not represent an account's entire portfolio and in the aggregate may represent only a small percentage of an account's portfolio holdings. It should not be assumed that any of the security transactions, holdings or sectors discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

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Disclosures

The Composite contains fully discretionary, fee paying accounts with a minimum asset level of $1MM. For comparison purposes, the Composite is measured against the BofA Merrill Lynch Municipals 1-3-Year Index. This index tracks the performance of tax-exempt investment grade debt publicly issues by US states and territories, and their political subdivisions, in the US domestic market. Qualifying securities must have at least 1 year and less than 3 years remaining term to final maturity, a fixed coupon schedule and an investment grade rating (based on average of Moody's, S&P and Fitch). The volatility (beta) of the portfolio may be greater than that of the indices. It is not possible to invest in this index. Leverage, derivatives or short positions are not used in this Composite. The annual composite dispersion is an asset-weighted standard deviation calculated for the accounts in the composite for the entire year. For this Composite, APA defines a significant cash flow as greater than or equal to 30% of an account's market value at the beginning of the measurement period. Accounts removed from the composite due to significant cash flows will be excluded for a grace period of one month. The U.S. Dollar is used to express performance. The APA Enhanced Short-Term Tax-Exempt Composite was created December 31, 2009.

Asset Preservation Advisors, Inc. claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Asset Preservation Advisors, Inc. has been independently verified for the periods January 1, 2004 through December 31, 2013. A copy of the verification report is available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

The three-year annualized standard deviation measures the variability of the composite and the benchmark returns over the preceding 36-month period. The standard deviation is not presented for 2002 through 2010 because monthly composite and benchmark returns were not available and is not required for periods prior to 2011. Prior to January 2010 composite returns were calculated quarterly, therefore monthly returns for the 36-month period ended December 31, 2011 are not available and the standard deviation of the composite and benchmark are not presented.

Returns are presented gross and net of investment advisory fees and include the reinvestment of all income. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. For example, a 0.50% annual fee deducted quarterly (.125%) from an account with a ten year annualized growth rate of 5% will produce a net result of 4.4%. Actual performance results will vary from this example. Net returns are calculated using actual management fees. The Firm's policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

Information was obtained from third party sources which we believe to be reliable but are not guaranteed as to their accuracy or completeness. The fee schedule for APA's investment advisory services for separately managed accounts in the APA Enhanced Short-Term Tax-Exempt Composite is .25% on net assets under management. Actual investment advisory fees incurred by clients may vary. A complete description of APA's fee schedule can be found in Part 2 of its FORM-ADV which is available at www.assetpreservationadvisors.com or by calling (404) 261-1333. APA-15-25

	Total Firm	Composite Assets		Annual Performance Results				3 Year Standard Deviation	
Year End	Assets (thousands)	USD (thousands)	Number of Accounts	Composite Gross	Composite Net	ML 1-3 Muni Index	Composite Dispersion	Composite	ML 1-3 Muni Index
2013	1,901,186	141,103	40	0.77%	0.52%	1.07%	0.4%	1.1%	0.4%
2012	1,864,572	177,777	48	1.61%	1.36%	1.03%	0.8%	1.1%	0.6%
2011	1,874,243	176,966	45	4.12%	3.86%	2.37%	1.5%	NA	NA
2010	1,479,044	121,814	26	1.27%	1.01%	1.29%	0.6%	NA	NA
2009	1,213,819	93,524	22	3.91%	3.65%	4.21%	2.2%	NA	NA
2008	1,108,248	81,130	21	3.76%	3.51%	5.16%	0.4%	NA	NA
2007	600,205	46,422	7	4.47%	4.21%	4.70%	0.4%	NA	NA
2006	556,826	74,879	9	3.77%	3.51%	3.25%	0.8%	NA	NA
2005	465,087	68,335	10	2.36%	2.10%	1.41%	1.2%	NA	NA
2004	304,455	45,071	5	1.42%	1.16%	1.28%	0.2%	NA	NA