FIRSTwestern TRUST

4Q14 Economic & Market Review

Points of Interest

- Fed concludes bond-buying program, set to begin raising interest rates in 2015.
- Oil declines by over 40% as supply outpaces demand.
- Global economic growth remains elusive as evidenced by further slowing in the Euro Zone, China, and Japan.
- U.S. mid-term elections result in the Republican Party capturing control of Congress.
- 2015 will likely see increased volatility and more muted returns as the Fed begins to normalize monetary policy.

Inside this Issue:

Fourth Quarter Recap

Fourth quarter proved to be a roller coaster, marked by two short selloffs, a steep decline in oil prices, additional stimulus by several global central banks, ongoing concerns about global economic growth, and further improvements in the U.S. economic recovery.

The quarter began where the third quarter ended, with markets declining on concerns over global growth. The first reported case of Ebola in the U.S. and further gains by ISIS in Iraq also impacted sentiment. Markets rebounded, however, as concerns about the latter two issues quickly passed, and companies reported solid third quarter earnings. In December, plunging oil prices impacted energy stocks and exacerbated concerns about global growth. However, a generally benign FOMC statement following the Federal Reserve's December meeting and surprisingly strong third quarter GDP effected a quick rebound in domestic equity markets, propelling them to new record levels.

Fourth quarter again illustrated the growing divergence in monetary policy between the U.S. and many other central banks. As expected, the Fed concluded its tapering in October, and in December indicated that it plans to begin normalizing monetary policy in 2015. In Europe, Japan and China, central banks unveiled new stimulus measures intended to spur economic growth, with more expected in 2015.

Oil prices, which peaked in late June, continued to decline throughout the fourth quarter, as U.S. oil production reached multi-decade highs and OPEC refused to cut its own production. While a negative for oil producers and other energy-related companies, on the whole, lower energy prices should benefit the U.S. economy, effectively serving as a tax break for consumers and, in turn, spurring increased consumer spending.

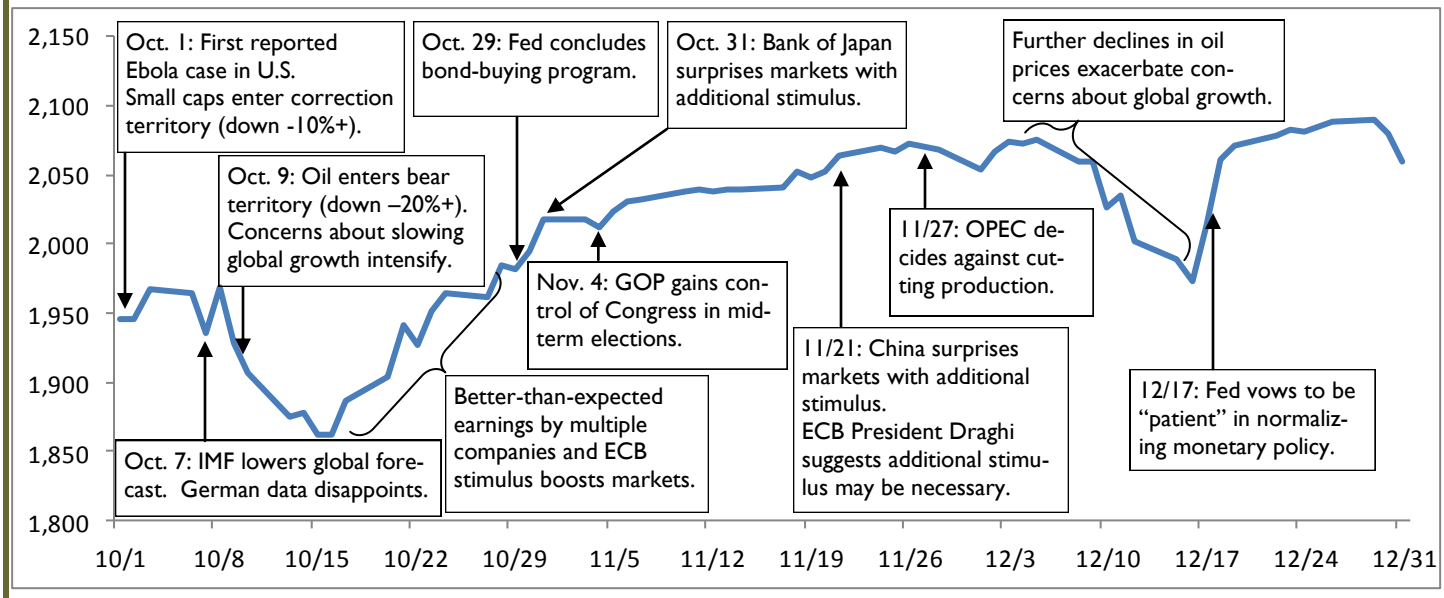
U.S. mid-term elections resulted in the Republican Party increasing its majority in the House while gaining control of the Senate, thus capturing overall control of Congress. Though expectations for bi-partisanship remain low, the two parties were able to work together to successfully pass a $1.1T budget to fund the majority of the government through September 30, 2015, the end of the current fiscal year.

Since the current bull market began in 2009, equity markets have enjoyed an unprecedented rise, supported in part by the Federal Reserve's accommodative monetary policy. A by-product of that policy has been muted market volatility. As we enter 2015, the Fed has concluded its quantitative easing and is expected to begin raising interest rates sometime after the first quarter. As the Fed begins to normalize monetary policy, we would anticipate increased volatility and more modest financial market returns. However, we believe that the normalization of monetary policy is ultimately in the long-term interest of investors as it will allow market forces to better determine winners and losers among asset classes and individual securities.

OVERVIEW

4Q14 S&P 500 Chronology

Fourth quarter was marked by two short selloffs followed by even quicker rebounds. Oil prices declined further, reaching levels last seen in 2009. While concerns about global growth persisted, the U.S. economy continued to improve.



Source: First Western Trust

Economic Scorecard

Indicator	Level	Outcome	Trend*	Comment
3Q14 GDP	5.0%	BTE	↑	Best level since 3Q03. Led by improved consumer spending, international trade and a sharp increase in federal gov't. spending.
U.S. Unemployment (Dec.)	5.6%	BTE	↑	Best level since June 2008. Down -1.1% from Dec. 2013. Nonfarm payrolls added 2.95M jobs in 2014, the most since 1999.
Housing Starts (Nov.)	1.028	WTE	↓	Starts fell on a M/M and Y/Y basis but surpassed the 1M mark for the third consecutive month, the longest such streak since 2008.
Case-Shiller Home Price Index	0.8%	BTE	↑	Month-over-month increase was relatively strong, however, modest Y/Y increase of 4.5% was slowest since Oct. 2012.
Core CPI (Nov.)	0.1%	Inline	↓	While headline inflation fell by –0.3% due to a sharp decline in energy prices, core CPI registered a slight gain. Y/Y, up 1.7%.
Consumer Spending (Nov.)	0.6%	BTE	↑	Y/Y, up 2.8%, better than the average gain of 2.4% through the first 11 months of 2014.
Personal Income (Nov.)	0.4%	WTE	↑	Boosted by a 0.5% gain in wages and salaries. Y/Y, up 4.2%. Fastest increase in nearly two years.
Consumer Confidence (Dec.)	92.6	WTE	↑	Second best reading of the recovery. Current conditions sub-index at new recovery high. Jobs-hard-to-get component improving.
ISM Manufacturing (Dec.)	55.5	WTE	↓	At a six-month low, but capped the best quarter since 1Q11 when economy was still rebounding from depths of recession.

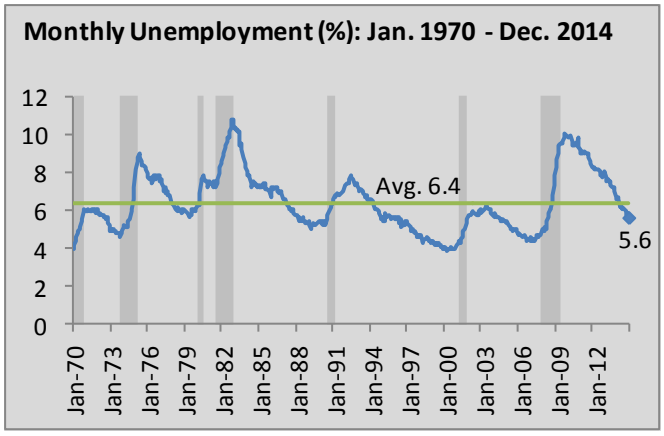
Outcome: BTE= better-than-expected; WTE= worse-than-expected; Inline= as expected. * Trend reflects month-over-month change except GDP which is quarter-over-quarter; ↑indicates improvement from prior month; ↓ indicates deterioration from prior month.

DOMESTIC ECONOMIC REVIEW

The U.S. economy continued to improve during the fourth quarter supported by evidenced by strong employment gains, increased consumer confidence, and continued strength in manufacturing and services data. A sharp reduction in energy prices provided an additional lift, effectively serving as a tax break for consumers, helping spur spending on other goods and services.

GDP- Third quarter GDP surged to 5.0%, marking the best quarter for U.S. economic growth since 3Q03. Improved consumer spending and international trade, along with a sharp increase in government spending, drove the performance.

Employment- The U.S. employment situation continued to improve in the fourth quarter as the economy added an average of 289k jobs/month and the unemployment rate fell to 5.6%. For the year, nonfarm payrolls added 2.95M jobs, marking the best year since 1999. While job creation across the economy is clearly accelerating, wage growth continues to be modest. The lack of sustained wage growth, a key driver of inflation, means that the Fed does not have to rush to raise

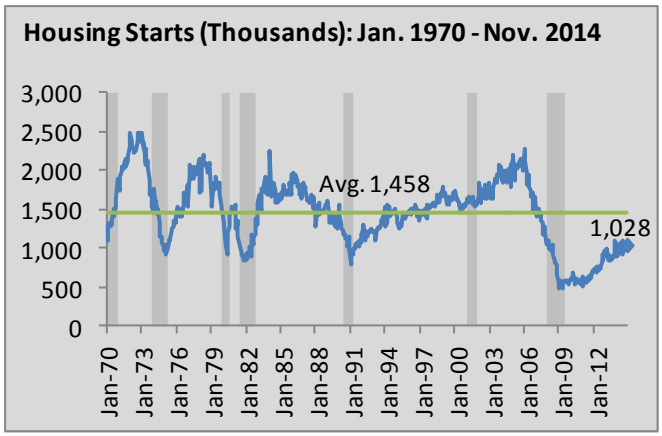


interest rates should it choose not to, as it takes a "patient" approach to normalizing monetary policy.

Consumers remained upbeat in the fourth quarter as evidenced by consumer confidence which reached a new recovery high in October. The heightened optimism was no doubt helped in part by falling energy prices which saw the average cost of unleaded gas fall from $3.35/gallon at the end of the third quarter to just $2.30/gallon at the end of the fourth quarter.

Despite modest wage growth, consumers continued to spend during the all-important holiday season, with holiday sales increasing 4.0% from 2013, the largest gain since 2011. While retail store sales actually fell from 2013, consumers made up for fewer trips to the mall with increased online shopping.

Housing data continued to moderate in the fourth quarter as evidenced by home prices and housing starts. In November, the median price for existing homes dropped to $206k, the fifth monthly decline since reaching a recovery high of $223k in June. The October reading of the Case-Shiller Home Price Index (most current available) corroborated this, slowing to just 4.5% on a Y/Y basis. October marked the 11th consecutive monthly decline since price increases peaked

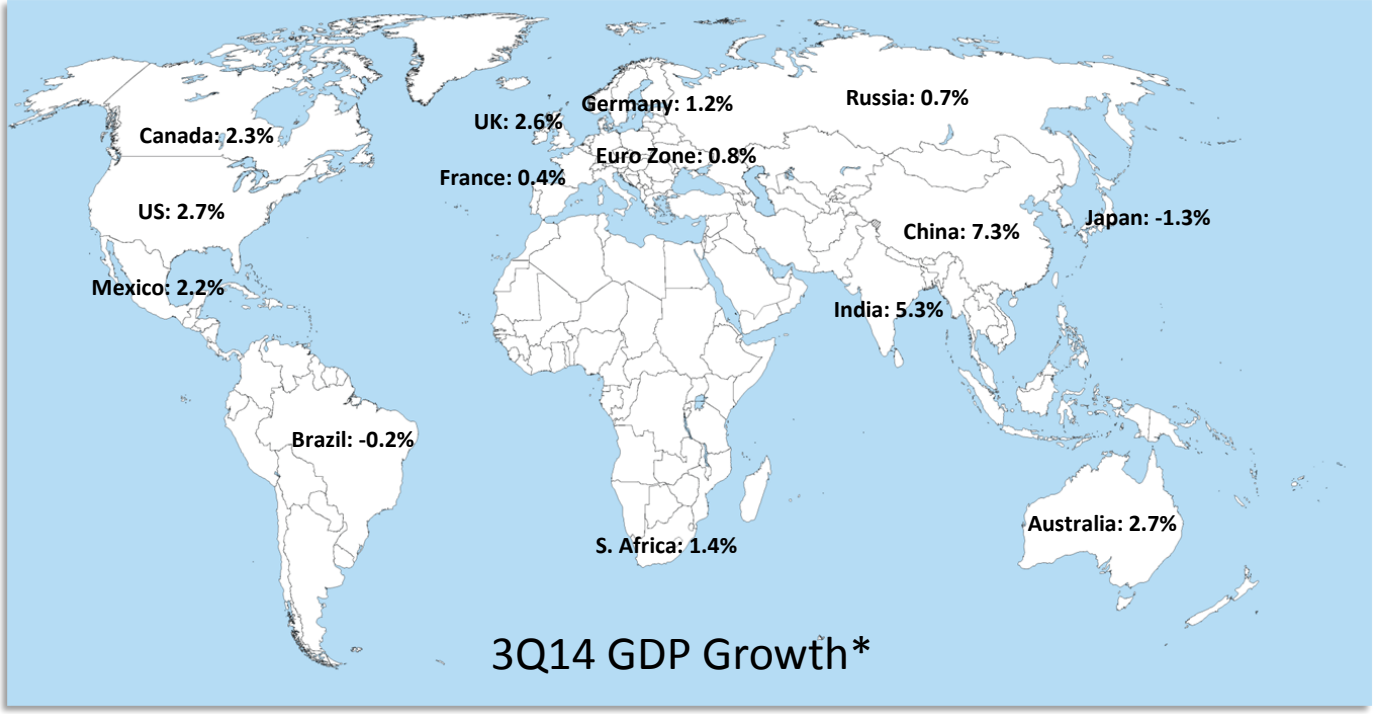


at 13.7% Y/Y in November 2013. While housing starts in November slipped slightly from October to 1.028M, November marked the third consecutive month in which starts exceeded 1.0M, the longest such streak since 2008.

In another sign of economic healing, the Treasury Department announced in December that it was selling its remaining shares in Ally Financial, formerly General Motors' financing division. The announcement marked the end of the U.S. government's efforts to bail out the auto industry as well as its last major investment in the Troubled Asset Relief Program (TARP) which began in the Fall of 2008.

Outlook- Entering 2015, we expect the U.S. economy to continue improving, riding the strong momentum of 2014. While GDP growth should slow from the 5.0% rate recorded in 3Q14, we nonetheless expect 2015 GDP growth to average a respectable 3.0%. One area of potential concern is international growth. While the U.S. economy is clearly on an upward trajectory, spillover effects from further slowing in the Euro Zone, Japan and China cannot be entirely discounted. Additionally, a stronger dollar could limit foreign demand for U.S. goods, thus impacting corporate earnings.

INTERNATIONAL ECONOMIC REVIEW



Source: Bloomberg, First Western Trust. *All GDP growth figures shown as year-over-year percent change. U.S. GDP is typically expressed as a quarter over quarter rate that is then annualized.

Concerns about global growth persisted in the fourth quarter as Japan unexpectedly reentered recession, China's economy continued to show signs of slowing and growth remained sluggish in Europe. In response, the European Central Bank (ECB) and the central banks in Japan and China announced additional stimulus in an attempt to spur economic growth.

Euro Zone– The region continued to struggle with sluggish growth, highlighted by third quarter GDP which grew by only 0.2% from the second quarter. While the region's two largest economies, Germany and France, managed to avoid recession by reporting positive GDP, growth by almost any measure remained sluggish and concerns about deflation persisted. In response, the ECB unveiled a plan to purchase asset-backed securities, but disappointed investors by stopping short of announcing U.S.-styled quantitative easing (the purchase of sovereign bonds). However, ECB President Mario Draghi hinted throughout the quarter that additional stimulus remains likely, leading many investors to believe that the bank will move forward with quantitative easing in 2015 barring a sustained rebound in economic data.

A development towards the end of the quarter that warrants close attention is the political upheaval in Greece. After being largely absent from the headlines over the past year, Greece, the poster child for the European debt crisis, reemerged in December as the country's prime minister dissolved parliament, clearing the way for general elections. Investors are nervous that a victory by the anti-austerity party Syriza, which currently leads in polls, could reignite the Euro crisis. Many analysts, however, believe that, unlike 2011 and 2012, when fears of "contagion" were rampant, the Euro Zone as a whole, and the ECB in particular, are better positioned and prepared for whatever outcome the Greek elections produce. As a result, many view the current Greek situation as a country-specific issue with a low probability of roiling global markets. Nonetheless, as the election, currently set for Jan. 25, draws closer, there could be increased volatility linked to Greek headlines.

Japan– Despite Abenomics, economic growth continued to weaken in the fourth quarter, leading the government and the Bank of Japan (BOJ) to announce several new measures designed to stimulate the economy. The slowdown in growth was highlighted by new GDP data which showed the economy slipped back into recession in the third quarter as the impact of April's sales tax increase continued to reverberate. Due in part to weaker-than-expected consumer spending, third quarter GDP contracted by –1.9% vs. forecasted

growth of 2.1%. In response, PM Abe announced that the next sales tax increase, scheduled for October 2015, would be delayed by a minimum of 18 months.

In addition to poor 3Q GDP growth, inflation slowed to less than 1% in the fourth quarter, when adjusted for the effects of April's sales tax increase. In response, the Bank of Japan (BOJ) announced further stimulus in an effort to achieve its goal of generating 2% annual inflation. The BOJ further stated that it will continue easing as long as needed to achieve its 2% inflation target. The action served as a tacit acknowledgement by the BOJ that its current stimulus, launched in April 2013, will not achieve the goal of 2% inflation within two years as originally planned.

Emerging markets as a whole were impacted during the quarter by slowing global growth as well as falling commodity prices, the strengthening of the dollar and in some cases, country specific issues.

China's economy continued to show signs of slowing in the fourth quarter leading the central government and bank to announce several new measures intended to stimulate the economy, including a 0.25% decrease in the benchmark interest rate. Other actions included direct liquidity injections in the country's five largest banks in an attempt to support credit and growth.

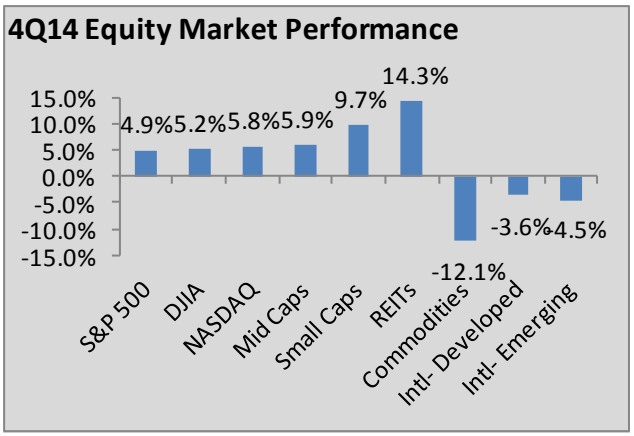
In the clearest sign that China's economy continues to slow, third quarter GDP growth declined -0.2% from the second quarter to 7.3% Y/Y. While that beat economists' forecasts by 0.1%, it nonetheless marked the slowest rate of growth since 1Q09 (6.6%). For the full-year, GDP growth is likely to be 7.3%, slightly below the government's target of 7.5%.

Russia's economy continued to be buffeted by the twin forces of falling oil prices and economic sanctions imposed by the West. As a result, the ruble lost a third of its value during the quarter, prompting the central bank to raise interest rates by 6.5% to 17.0% in an attempt to slow capital outflows. Third quarter GDP slowed to just 0.7% Y/Y, its lowest level since 4Q09 and the economy is now forecasted to enter recession in 2015.

Geopolitical headlines were relatively muted in the fourth quarter, especially compared to the third quarter. While the U.S. continued its air campaign against ISIS, no new significant headlines emerged. The same was true for the Ukraine, where government forces and pro-Russian rebels maintained an uneasy cease-fire.

EQUITY MARKETS

U.S. equity market returns for the quarter were broadly positive, while international market returns, both developed and emerging, were negative. Volatility was more pronounced, marked by two short selloffs, followed in both cases by even quicker recoveries that saw markets (S&P 500) set new all-time highs.



REITs were the best performing asset class, benefitting from investors' search for yield as interest rates declined further. The Federal Reserve's December statement that it will take a "patient" approach to normalizing monetary policy also benefitted REITs.

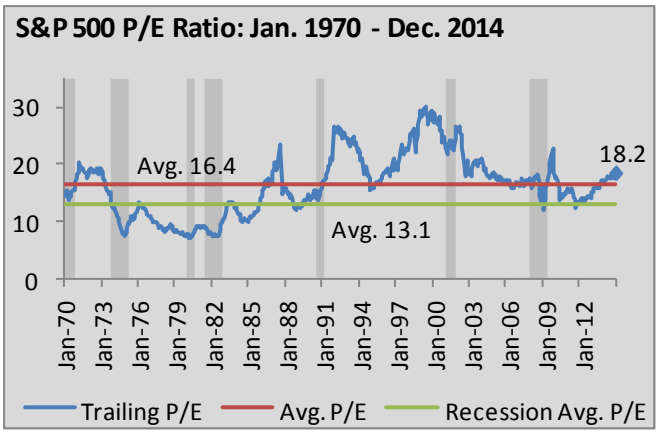
Commodities were the worst performing asset class as oil officially entered "bear" territory in early October, falling by over 20% from its high in June. By the end of the quarter, oil had fallen by more than 50%, reaching levels last seen in 2009 as the global economy was emerging from recession. The steep decline in prices was driven primarily by increased global production, largely from U.S. shale producers. A decision by Saudi Arabia to lower prices rather than cut production exacerbated the decline. By abdicating its role as the swing producer, Saudi Arabia chose to defend its market share rather than the price of oil. The move was done ostensibly to pressure U.S. shale producers into cutting production. Whether or not U.S. producers actually curb production and to what degree will ultimately help determine global oil prices in 2015.

International developed market returns for the quarter were negative, impacted primarily by weak Euro Zone and Japanese economic data.

Emerging market returns were negative for the quarter, impacted by concerns about global economic growth,

as well as falling commodity prices, the strengthening dollar, and in Russia's case (as previously discussed), country specific issues.

By market cap, small cap stocks outperformed mid cap stocks which in turn outperformed large cap stocks. The strong performance by small caps allowed them to



recoup their losses from the third quarter when the lost over –7.0%.

Within market caps, there was little dispersion between Growth, Value, and Core stocks. Value stocks were the best performing style within the large and mid cap spaces while Growth stocks led within small caps.

Domestic equity market valuations expanded further in the fourth quarter, while international valuations contracted, reflecting the performance of the various markets. While the S&P is trading above its longer-term average, we do not view the current level as excessive. On a relative basis both international developed and emerging stocks look attractive compared to the S&P 500. However, one must weigh the potential headwinds faced by international markets when considering whether the current discount is appropriate. Within domestic stocks, on a P/E basis, Value and Core stocks are currently trading at a slight premium to their 20-year averages, while Growth stocks across all market caps are trading at a slight discount. This may reflect some concern on the part of investors about global economic growth prospects.

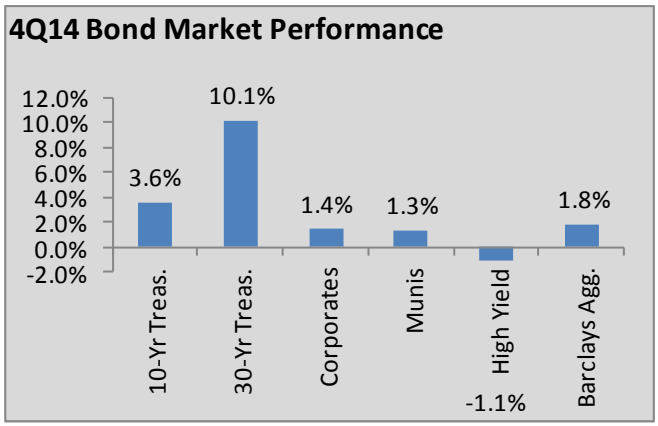
Since bottoming in March 2009, the S&P has gained just over 200% through the end of 2014. Given the strength of the recovery and the amount of time since the last significant correction (2011), many pundits believe that the markets are overdue for a correction. While we do not disagree, we would view a correction as a buying opportunity, rather than signaling the end of the bull market, barring any fundamental change to our global economic outlook.

Outlook- For 2015 we expect mid– to high-single digit gains for equities, supported by further improvements in both economic data and corporate profits. While the Fed's decision to raise interest rates will likely result in some near-term volatility, we ultimately believe that the normalization of monetary policy will benefit markets, ostensibly signaling the Fed's confidence in the long-term sustainability of the U.S. economic recovery.

FIXED INCOME MARKETS

Fixed income markets posted positive returns for the quarter as disappointing European and Asian economic data drove investors to the safety of U.S. bonds, particularly Treasuries. As a result of the increased demand, the 10-year Treasury yield dropped over -0.3% by the end the quarter to 2.17%, just shy of its lowest level in the past year-and-a-half. The broadest measure of the U.S. bond market, the Barclays Aggregate Bond Index, gained 1.8% for the quarter, bringing its full-year gain to 6%, marking the best year for the U.S. bond market since 2011.

Similar to the third quarter, the yield curve flattened slightly in the fourth quarter as the short end of the curve moved up on rate expectations, while the long end of the curve fell as investors moved money into bonds as concerns about global growth increased. Additionally, further declines in already low Euro Zone yields increased the relative attractiveness of U.S. debt.

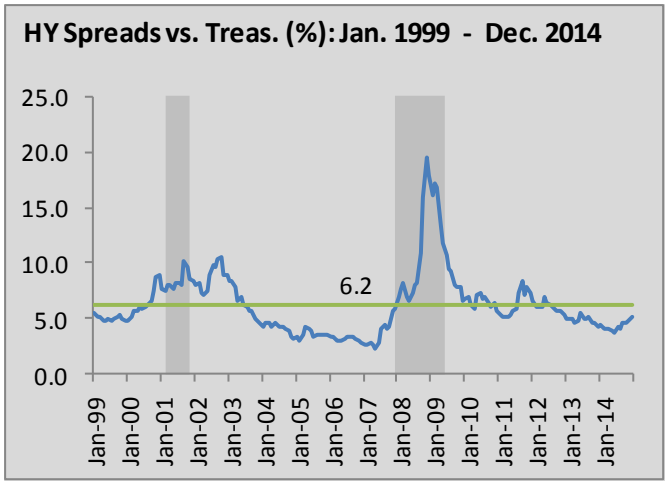


Munis recorded positive returns for the quarter, capping their best year since 2011. For the quarter and the year, munis benefitted from low supply coupled with

strong demand, improving fiscal conditions at both the state and local level and the general decline in interest rates. With such strong drivers in place, munis posted positive returns in each month of 2014.

Corporates- 2014 marked another record year for U.S. corporate bond issuance as companies sold just over $1.5T in debt, of which nearly 80% was issued by investment grade companies and the remaining 20% by high yield companies. A significant portion of the proceeds were used to fund M&A (mergers and acquisitions) activity and share buybacks.

High Yield was the worst performing fixed income sector for the quarter. Hurt by falling energy prices and



concerns about the increased potential for defaults within the energy sector, spreads widened significantly. Interestingly, despite the concerns of increased defaults, according to J.P. Morgan, 2014 witnessed the best increase in high yield fundamentals since 2010, as measured by revenue and EBITDA growth.

Fed Watch- As expected, the Fed concluded its bond-buying program following its October meeting. At its December meeting, the Fed announced that it would take a "patient" approach to normalizing monetary policy. Most analysts interpreted this to mean that the Fed will not raise rates prior to the end of the first quarter. Bond investors and financial markets in general cheered the news by driving markets higher. As it has done so often in the past, the Fed stressed that its actions will be data dependent.

Outlook– Current market expectations are for the first Fed rate hike to occur in June. We believe the first hike will not occur until the third quarter as the Fed wants to see faster wage growth before raising rates. By year-end we expect the Fed funds rate to be at 0.75% following two 0.25% increases made in the second half of the year. As the Fed's actions will have the effect of raising the short end of the curve, we expect the overall shape of the curve to become more flat. Specifically, we do not anticipate the 10-year Treasury yield surpassing 3.0% in 2015 given our benign inflation outlook and the likely continued demand for Treasuries as a safe-haven investment. That will be particularly true if global economic growth decelerates further in 2015.

DISCLOSURE INFORMATION

- The information provided in this presentation is for illustrative purposes only. Actual individual account results may differ from any performance shown herein.
- All performance is shown gross of fees.
- Past performance is not a guarantee of future results.
- "Risk" as used in this presentation is presented on the historic volatility of returns, generally measured as a function of standard deviation from the mean investment return. Clients should note, however, that there is substantial risk of a permanent loss of capital in most, if not all, asset classes presented herein.

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