REFLECTIONS

4th Quarter Newsletter 2014

WINDGATE
WEALTH MANAGEMENT

A PICTURE SAVES A THOUSAND CENTS ... AND COUNTING

What do falling oil prices mean for your portfolio?

Depending on your region you may not have seen gas prices below $2.00 a gallon, as shown in this picture, but you've certainly noticed the rapid drop in prices at the pump. Oil prices peaked at nearly $150 a barrel in 2008 and are now about $50. Gasoline selling at $4.00/per gallon seems like a far distant memory. We know what these plummeting prices mean for your wallet (if you're like us, you are still pleasantly surprised and smiling once a week when you pull in to refill), but what do falling oil prices mean for your portfolio?

Quickly, a recap of why prices are falling. First, the global demand for energy worldwide is somewhat reduced. The United States is the world's biggest consumer of oil, and domestic energy demand hasn't picked up as is typical following a recession, which may be attributed to alternative forms of energy such as natural gas gaining popularity. Second is the fact that

INSIDE THIS ISSUE

All Weather Portfolio Review

Spotlight: Grandeur Peak Global Advisors

Global Growth Portfolio Review

Blue Chip Portfolio Review

Small Companies Review

2014 Market Returns

Quotes on Money, Work, and Humor

If you have any questions or comments, or if you know of any friends or family that might benefit from our services, please give us a call

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oil is priced in dollars and as the dollar increases in value as it has over the past five years, the price of oil (or any commodity purchased with dollars) declines. Finally, and perhaps most importantly, is oil supply. The arrival of fracking and other improvements in energy production have increased the supply of oil worldwide. The U.S. has nearly doubled its production in the past decade – from approximately 5 million barrels a day in 2000s to over 9 billion today. At the same time, Saudi Arabia and other OPEC nations have decided not to cut back on their own production, keeping supply high and pricing pressure going downward.

Short term, falling oil prices have had a negative impact on investors. The many unknowns about our future oil environment has created volatility in the broad markets. More directly, there has been an immediate decrease in energy sector profits – about 10% of the S&P 500 Index. The energy sector has also been one of the largest job-creating industries in recent years, creating many jobs and investment in capital expenditure. With falling prices, much of this spending will likely stop.

Long term, lower oil prices can help both consumers and the economy. Think of the last time you filled up your car. It felt like you were saving money. The recent sense that you are receiving a small windfall every time you refill at the pump is being felt and repeated by millions of Americans every week. Collectively, this adds up to a significant stimulus. In fact, according to some estimates, Americans are spending $2.4 billion less each week on gasoline than they were in early 2014. This savings can cycle through into other parts of the economy, leading to increased consumer spending and corporate profits, both of which are good for your portfolios.

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REMINDER: IRA CONTRIBUTIONS DEADLINE APRIL 15, 2015

Don't forget, 2014 contributions for IRAs and Roth IRAs can be made by April 15th. Maximum contributions are $5,500 per individual ($6,500 if you are age 50 or over). Income limits for contributing to Roth IRAs or making deductible contributions to Traditional IRAs are below. You can also still benefit from tax-deferred growth in a traditional IRA by making non-deductible contributions should your income exceed the limits. Remember, contributions can be made from both cash on hand or from your taxable investment accounts, give us a call to determine if this is the right option for you.

Give us a call to determine if making a 2014 IRA contribution is the right option for you.

IRA 2014 Income Limits

Filing Status	Roth IRA Can contribute if your Modified AGI is	Traditional IRA Can deduct contributions* if your Modified AGI is
Single or Head of Household	< $129,000	< $70,000
Married Filing Jointly	< $191,000	< $116,000
Spousal IRA (Those with spouse who earns no income	N/A	<$193,000

**If you are not covered by an employer plan, you can deduct 100% of IRA contributions regardless of income*

Source: IRS.com

ALL WEATHER PORTFOLIO: YEAR IN REVIEW

We build diversified portfolios for clients that are at or near retirement, have a need for portfolio cash flow, or are generally more adverse to risk. This All Weather approach is designed to provide exposure to the financial markets while mitigating downside risk. We made several changes in 2014 to the portfolios based on our analysis of market signals and investment valuations.

Our first investment was to compliment passive exposure to emerging markets with an active manager that specializes in finding attractively priced small companies in those markets. Grandeur Peak Global Advisors is a firm we are confident in after following the founders' work for decades, as described in the highlighted box on the next page.

Another portfolio rebalance made last year was a shift from the S&P 500 Growth sector to the S&P 500 Value sector. We made this adjustment based on our analysis of the valuations of growth stocks versus value stocks within the S&P index. In general, growth stocks are younger companies that are experiencing higher levels of revenue and earnings growth versus. Because they are investing their earnings back into their own growth, these companies tend perform well during periods of economic expansion, though they can carry more risk. Alternatively, value stocks tend to be older, established companies that produce staple products which less subject to economic volatility but grow at a slower rate. Rather than invest their earnings back into their own companies, these businesses tend to pay out a portion of their earnings in the form of dividends or stock buybacks, which can provide more stable returns. Now five years out from a recession, growth stocks have outperformed value stocks during this economic expansion. The outperformance in growth stocks has reached a level that historically has indicated a "reversion to the mean," or shift back toward outperformance in value. With this idea, we elected to shift the focus from growth to value.

A final move was to reduce our exposure to US small cap

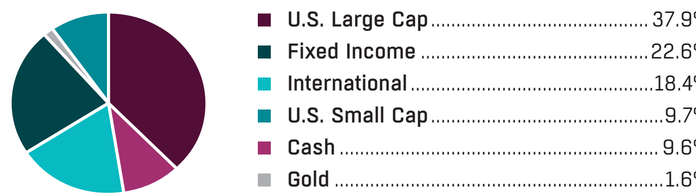
"This All Weather approach is designed to provide you with exposure to the financial markets while mitigating downside risk."

ALL WEATHER PORTFOLIO (CONTINUED)

exposure by eliminating our investment in the Russell 2000 Index. Small-cap stocks had a number of years of strong performance and we elected to take profits. While pockets of value exist within the small-cap space, the overall index has been partially driven by sectors that appear to be expensive. We decided to move away from investing in the overall small-cap market in favor of the actively managed Perritt MicroCap Opportunities Fund. Here, where we meet with 3-5 small company executives in our offices each week, we are finding opportunities that aren't as well represented by investing in the index.

Our plans for 2015 include reducing exposure to the US markets after the outperformance versus other markets over the course of the last half a decade, looking for opportunities in developed Europe after their decision to pursue quantitative easing, and looking to eliminating our high yield exposure in lieu of an alternative investment with similar yield and better capital appreciation opportunities. We may also hold elevated cash levels until appropriate investment opportunities present themselves in the fixed income market. We make all decisions based on valuation analysis from the perspective of a long term investor in order to keep portfolio turnover to a minimum.

All Weather Asset Allocation



Spotlight - Grandeur Peak Global Advisors

At Windgate, you are able to invest with professional money managers often only available to institutions or investors able to commit many millions. Last year we added Grandeur Peak Global Advisors to many of your investment programs. This Utah-based firm was founded in 2011 by Robert Gardiner, who previously served as an Investment Committee Member/Portfolio Manager for the Wasatch Funds for 25 years. Based on his team's reputation and experience, the new endeavor was met with enthusiasm and the firm closed its funds to new investors shortly after launch. We were early investors with Grandeur Peak and visited with the firm in our offices early this year.

Because of our institutional relationship, Windgate clients can continue to invest in Grandeur Peak Funds which are now closed to outside investors. In addition, you have access to the Institutional Share Class, typically reserved for investors with a minimum purchase of $100,000 and which carry a lower expense ratio than the Investor Class. We are pleased to offer our clients access to a money manager of Grandeur Peak's caliber, dedication and experience. According to Mr. Gardiner's 2014 newsletter, his firm has visited 1856 companies on site, touched another 2221 via visits in the US or conf. calls, and traveled to 39 counties in their mission to find undervalued small companies around the globe. We look forward to a continued partnership with Grandeur Peak as we strive to build portfolios to help you reach your goals.

GRANDEUR PEAK FUNDS
ELEVATED GLOBAL INVESTING®

GLOBAL GROWTH PORTFOLIO: A YEAR IN REVIEW

For clients with a Global Growth objective, we build diversified portfolios focused on high growth and international opportunities. International and emerging markets currently look considerably less expensive than domestic equities. Following a year when US equities saw the S&P 500 Index rise 13.69% and lead most developed markets. With this relative value in mind, we continue to rotate further toward an international stance.

We began the rotation process early last year by making a new investment in The Grandeur Peak Emerging Markets Opportunities Fund (GPEOX). This portfolio invests in small companies based in emerging market economies, a combination we find compelling. Grandeur Peak Global Advisors is a firm recently founded by Robert Gardiner, a former portfolio manager of the Wasatch Funds, and who we have respected for decades. We have a high degree of confidence in his team being able to uncover true "hidden gems," globally. After becoming increasingly convinced of the relative value in emerging markets, and of Mr. Gardiner's execution in finding them, we stepped further into our international rotation by doubling our allocation to GPEOX during the third quarter.

On the other end of our rotation process we made the decision to reduce our domestic US technology exposure by exiting our position in the PowerShares QQQ Trust (QQQ) during the fourth quarter. This was a long-term profitable investment, however, we felt we could no longer justify a position in a sector that presented more risk than potential reward. We ended the year with only having made incremental progress toward our greater goals for portfolio rotation toward international markets. Though valuations seem disconnected between international and domestic markets, we never believed the market provided the right set of circumstances (or possibly too many headwinds - a China slowdown, European malaise, US dollar strength, etc.) to dive further into international exposure.

We found a reason to accelerate our process of making

"International and emerging markets currently look considerably less expensive than domestic equities, following a year when US equities lead most developed markets."

changes to the portfolio in January of 2015, and here we will provide some details on our early 2015 investments. As with much of the financial world, we were shocked by the abrupt move of the Swiss National Bank in January to remove the Swiss franc currency peg that the Bank had supported vis-à-vis the Euro dollar. Believing the Swiss Bank no longer wanted to accumulate what would soon become a currency in heavy supply, we interpreted their move as a signal that the European Central Bank (ECB) would soon embark on a much debated quantitative easing (QE) program in an effort to stimulate Eurozone economies. In anticipation of a QE announcement by the ECB, we rotated investments from US markets to the Euro area. This was accomplished by reducing our allocation to S&P 500 Growth (IVW) and S&P Mid-Cap (IJH), and initiating a position in iShares Europe (IEV). We simultaneously increased our position in Oil Equipment and Services (IEZ), as we believe Euro QE will stimulate some additional risk taking, and generally believe the battered energy sector will see a near-term lift. On January 26, 2015 the ECB announced an open-ended QE program of a greater scale than even the most optimistic had forecasted, totaling €60 billion per month.

We are pleased with the opportunities the market has recently presented and the shifts we have made to take advantage of them. Our goal is to continue to rotate the Global Growth Portfolio toward markets that offer relatively more attractive valuations, and represent a better reward for the risk.

Global Growth Asset Allocation

U.S. Large Cap	30.4%
International Large Cap	19.3%
U.S. Small Cap	18.5%
Cash	13.2%
U.S. Mid Cap	12.5%
International Small Cap	6.0%

SMALL COMPANIES : A YEAR IN REVIEW

Michael Corbett,
CIO and Portfolio Manager

It's often hard to believe that Perritt Capital Management/ Windgate Wealth Management has reached nearly three decades in the financial services industry. During that time, we have experienced a wide range of economies and financial markets. There have been three recessions in the past three decades, and they have occurred on average about every eight years. There have been 47 recessions since 1790, which equates to one every 4.8 years. Given that the last recession ended more than five years ago, one might think the averages dictate that another recession could come shortly. However, this past recession was very different than the average recession. First, the 2008-09 recession was deeper and lasted longer than average. The average recession lasts about 12 months, but the 2008-09 recession lasted 18 months. The economic recovery following the recent recession has also been very modest versus the average recovery. We think the most interesting fact is that while the recession ended five years ago, the average person stills believes that we remain in a recession. In fact, a recent poll conducted by *The Washington Post* found that more than 70 percent of people surveyed believe we are still in an economic recession.

While volatility has increased during the past year, the overall indexes have not experienced a bear market (20% decline). However, a closer look shows that while the indexes have not shown a bear market, the average stock held in the indexes have in fact experienced a bear market. We would define this situation as a "stealth bear market". A "stealth bear market" is a market where the average stock is down more than 20 percent, but the index is not down 20 percent. The Russell 2000 Index hit a record 1,208

"I am often reminded what the famous investor Sir John Templeton said, "Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria."

on March 4, 2014, and closed 13.2 percent lower on October 13, 2014. While that performance does not meet the bear market definition, there were more than 40 percent of the stocks in the index that were down more than 20 percent from their highs. In other words, the average small company stock was well into bear market territory! This recent performance reminds me of the late 1990's. In that period, the indexes performed well and hit new highs regularly, but underneath the overall markets there was a stealth bear market. These "stealth bear markets" are where we find our greatest opportunities. There is saying in the financial markets that history does not repeat, but that it rhymes. If the current period does rhyme to the 1990's, then the next few years could be positive for smaller company stocks.

When I review volatile stock performance, such as the small-cap markets today, I am often reminded what the famous investor Sir John Templeton said, "Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria." Given the level of lingering negative sentiment toward the economy and the weakness in smaller company stocks, it seems clear to us that the equity markets are not at the end of the bull market.

BLUE CHIP PORTFOLIO: A YEAR IN REVIEW

As we are constantly reminded, stock markets do not go up (or down for that matter) in a straight line. We dealt with a number of headlines throughout the year that caused short-term anxiety. Geopolitical concerns such as the annexation of Crimea by Russia, Israel's military strikes on Gaza, and the rise of the Islamic State in Iraq and Syria (ISIS). We also saw the price of a barrel of oil plunge over 50% from the mid-year high to close the year around $50 USD/barrel and the potential impact of the end of the Federal Reserve quantitative easing bond buying program. There was a health scare with the Ebola virus outbreak, however, investors who rode out the ups and downs of the market in 2014 were rewarded with another solid return. Large-cap US stocks as measured by the S&P 500 rose by double digits for the third year in a row. During the year, the index set 53 new closing highs, more than the 45 set in 2013.

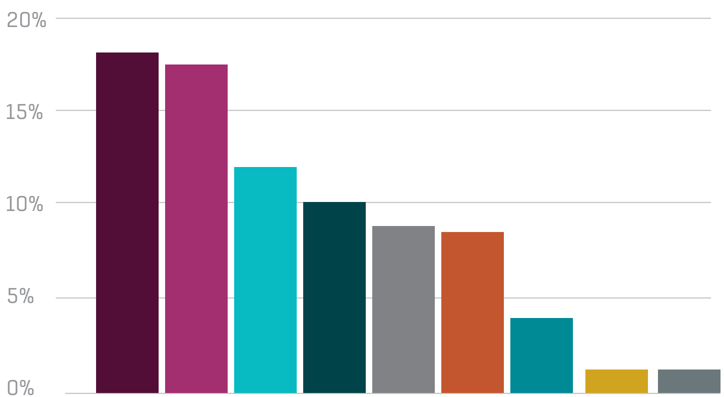
Given the stock market gains of the past few years, US large-cap stocks are trading at higher valuations than in the recent past. However, this doesn't mean that they can't achieve gains in 2015 because the US economy is improving. Low oil prices have resulted in lower prices at the pump, translating into more disposable income for most Americans. This could bolster the earnings of companies in several sectors. The potential impact of the Federal Reserve raising rates is an unknown, and there are bound to be other headlines that will cause market fluctuations. Blue Chip portfolios had another solid year in 2014. Individual returns may differ as a result of a number of factors such as desired cash levels, individual positions, position sizes, etc. Protecting capital is the main goal, yet we strive to generate returns for our investors that meet their financial needs. We continue to look to invest in companies that generate strong cash flows, have high return on equity, and maintain a solid balance sheet.

Information Technology and Healthcare were the best performing sectors for the Blue Chip portfolio in 2014. Within Information Technology, Skyworks Solutions Inc. (SWKS) posted the best return by more than doubling this past year. The best performing stock in the Healthcare sector was Amgen Inc. (AMGN) which returned just under 40% for the year. Other outstanding performers included MicronTechnology Inc. (MU), Intel Corporation (INTC), McKesson Corporation (MCK), and The

"We continue to look to invest in companies that generate strong cash flows, have high return on equity, and maintain a solid balance sheet."

Home Depot Inc. (HD). Energy names were understandably under pressure during 2014 given the sharp drop in crude prices. We were able to mitigate some of the impact by selling most of our energy related names during the fourth quarter. We are currently holding an above average level of cash. We hope to redeploy this cash to more attractively priced securities within the first or second quarter. As we saw last year, the answer is not to panic and make rash decisions. As of 12/31/14, the average blue chip portfolio held a 4.0% position in SWKS, 2.5% in AMGN, 2.3% in MU, 2.1% in INTC, 3.5% in MCK and 3.7% in HD.

Blue Chip Account Market Sectors as of 12/31/14



IT	18.2%
Healthcare	17.5%
Industrials	12.1%
C. Staples	10.2%
Financials	8.9%
C. Discretionary	8.5%
Materials	4.0%
Energy	1.2%
Telecom Services	1.2%

2014 MARKET RETURNS

Foreign Markets	
U.K. (FTSE 100)	0.74%
Germany (DAX 30)	2.65
France (CAC 40)	-0.54
Canada (MSCI)	-0.61
Japan (NIKKEI 225)	7.12
Hong Kong (Hang Seng)	1.28
India (Sensex)	29.89
Russia (MSCI)	-48.54
China (Shanghai)	52.87
Mexico (iPC)	0.98
Brazil (Ibovespa)	-2.91
Argentina (Merval)	59.14

U.S. Stocks	
Dow Industrials	10.04%
Nasdaq Composite	14.75
S&P 500	13.69
Russell 2000	4.89
Wilshire 5000	10.57

U.S. Industry Performance	
Basic Materials	7.18%
Consumer Discretionary	9.46
Consumer Staples	15.72
Financials	15.05
Health Care	25.14
Industrials	10.36
Energy	-8.68
Technology	17.84
Telecomm	0.68
Utilities	28.75

USD vs	
Euro	13.77%
British Pound	6.30
Canadian Dollar	9.01
Yen	13.94

Bond Yields (Change)	∇ bps	Ending Yield
30-yr T-bond	-1.21	2.75%
10-yr T-bond	-0.87	2.17
3-month T-bill	-0.03	0.04

MONEY CAN BUY HAPPINESS, BUT WORDS ARE FREE

Here are a few of our favorite quotes regarding money, work and humor.

- "An investment in knowledge always pays the best interest." *– Ben Franklin*
- "In the long run, it's not just how much money you make that will determine your future prosperity. It's how much of that money you put to work by saving it and investing it." *– Peter Lynch*
- "What we think, or what we know, or what we believe is, in the end, of little consequence. The only consequence is what we do."
  – John Ruskin
- "Sometimes I think the surest sign that intelligent life exists elsewhere in the universe is that none of it has tried to contact us." *– Bill Watterson*
- "You know that children are growing up when they start asking questions that have answers." *– John J. Plomp*
- "Investing is the intersection of economics and psychology." *– Seth Klarman*
- "It has been my experience that folks who have no vices have very few virtues." *– Abraham Lincoln*
- "I haven't slept for ten days, because that would be too long." *– Mitch Hedberg*
- "Buy not on optimism, but on arithmetic." *– Benjamin Graham*
- "If winning isn't everything, why do they keep score?" *– Vince Lombardi*
- "I hope that while so many people are out smelling the flowers, someone is taking the time to plant some." *– Herbert Rappaport*

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WEALTH MANAGEMENT

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To Your Future Prosperity...