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2015 OUTLOOK

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A Message from the Chairman

When we entered 2014 in the midst of an unprecedented five year run, the question on everyone's minds seemed to be, "does this market have staying power?" The answer was a resounding yes, with the S&P 500 posting double digit gains and the Dow up nearly 9% as well. But as the calendar turns and with the economy showing continued signs of improvement, the staying power theme is even more relevant for the markets in 2015.

At Haverford, staying power is always top of mind, but perhaps never more so than it was in 2014. Because as we celebrated our 35th anniversary it was clear that we've never been in a more powerful position. We have more power to serve our clients, to take advantage of market opportunities and to grow our business than ever before.

A large part of that power comes from our people. In 2014 we added new team members across the organization. While we're in the investing business, we know that our greatest asset is our talent and we're doing what it takes to attract the top talent that will drive our business and our clients' success today and for years to come. We also understand that you have to continually nurture and train that talent. That's why we're investing in new training programs in the coming year and investing in new technologies that will help our people work more efficiently and deliver information to our clients in a more seamless fashion.

Our people are at the heart of our growing community initiatives as well. In 2014 we continued to invest in our community through charitable giving as well as having members of our team participate in Habitat for Humanity build days throughout the region. It's refreshing to see their shared passion and it's something that carries over into the work we do every day. We continue to expand the list of nonprofits we serve, adding the highest number of nonprofit clients in several years. We also continue to build out other areas of our business, including our 401(k) and retirement plan offerings among others.

We're committed to doing what it takes to keep moving forward because if you're staying put, you may as well be going backward in today's fast-paced business environment. It's not about innovating for the sake of it — it's about evolving for the sake of our clients. It's about delivering insights. It's about adding value. It's about staying power.

Our *2015 Outlook* is just one way we look to add value. It's full of insights and commentaries on the trends and topics that we believe will be critical to the economy, the markets, and of course, our clients in the coming year.

We expect this *Outlook* will be as insightful for you as it was engrossing for our team to put together. We're confident it will shed some light on that "staying power" question too. We welcome your questions and feedback, and we look forward to working together in 2015.

Sincerely,

JOSEPH J. MCLAUGHLIN, JR.
Chairman & *CEO*
The Haverford Trust Company

All data as of December 24, 2014, unless otherwise noted.

2014: A Look Back

The global economy delivered several surprises during 2014, with oil's rapid 45% plummet likely the most memorable. The U.S. energy renaissance continued apace, but OPEC's surprise decision to step aside and hold volumes flat rattled energy markets around the globe. Investors failed to predict the rapid rise in the Islamic State or the Crimean Crisis, but geopolitical instability is a constant symptom of the human condition. Investors waiting for a sustained increase in stock market volatility are still waiting, and like a date who never shows up, interest rates never rose.

The world equity markets performed relatively in line with their respective economies. The U.S. economy started to separate itself from the world's stagnant economies as the run rate for second- and third-quarter GDP was the highest in ten years. The U.S. economy showed signs of stable growth, with workers benefiting as the unemployment rate fell from 7% to 5.8%. Investors and market pundits waited yet another year — now more than 1,100 days — for a market correction as the S&P 500 advanced 13.7% through December 31, 2014.

Investors started the year optimistic about European economic growth, but continued stagnation quickly reminded participants of the structural issues facing the region. European Central Bank cheerleading has failed to make an impact and economic participants are no longer believers as the Euro fell against the dollar. The path forward for Europe was further complicated by consumer pricing data that showed the European Union could be staring into the face of deflation. In response to these uncertainties, European equity markets significantly lagged the U.S. markets, finishing in negative territory, down approximately 8%.

Japan received its first report card for Prime Minister Shinzo Abe's stimulus and it wasn't what investors had hoped. Recent GDP data puts the Japanese economy in a technical recession. Abe responded by calling for a snap election to garner political capital and stay the course. The jury is still out on Japan's ability to escape its trap.

The eyes of the world remained focused on China's ability to engineer a soft landing for the world's second largest, but highly levered, economy. Xi Jinping, General Secretary of the Communist Party of China, showed the world he was serious regarding corruption and no politician was too powerful.

Haverford Trust was not surprised to see that our high quality companies performed well in 2014. In a rapidly changing world, investors can count on companies with large economic moats and durable competitive advantages to perform well in a range of economic or geopolitical environments.

2015 Economic Outlook

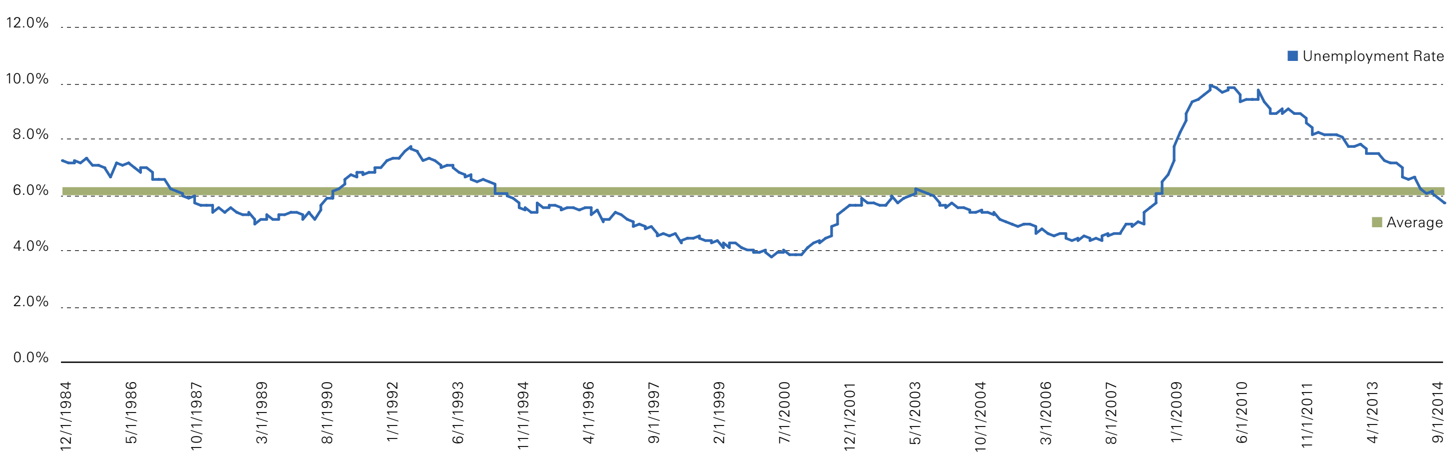
3% Growth at Last

After an unexpectedly slow start due almost entirely to adverse weather, the U.S. economy ended 2014 on a strong note. Looking ahead to 2015, we believe the economy is poised to deliver growth in the 3% range as compared to the 2% pace that has characterized much of the six-year-old expansion. One positive aspect of this below-average growth is that the economy hasn't generated enough steam to create major excesses, such as inflation or inventory build-ups, which could lead to a recession. By mid-2015, the economy will enter its seventh year of expansion, which would be longer than the average (63 months) or median (52 months) expansion since WWII.

Economic expansions do not die because of age. They usually end because of excesses, of which we see few at this point. Economic growth has been broad based, with most sectors of the economy contributing to the recent acceleration. The labor market continues to show steady progress, with job gains continuing to average over 200,000 a month. Importantly, most of the added employment has occurred in the private sector. The unemployment rate is now below 6% and continues to fall. The U-6 "under-employment" rate (which includes part-timers who want full-time work and those who want a job but have given up looking) is now under 12% compared to more than 18% five years ago. Weekly jobless claims, an important leading indicator, continue to trend lower at less than 300,000. Finally, wage gains have slowly increased to an annualized rate of 2.2%, which is slightly above the inflation rate. These are all positive labor trends heading into 2015.

We have previously written about the U.S. energy renaissance and how it should serve as a near- and long-term tailwind for the economy. The initial stages of the energy renaissance favored both the producers and the refiners. This showed up in the economic data through higher capital spending and a flurry of high-paying private sector jobs. With crude oil prices collapsing more than 40% during the second half of 2014,

Unemployment Rate



Source: FactSet Research Systems

end-users of energy (consumers and businesses) now stand to benefit the most. This should have a far greater impact on GDP growth throughout 2015, provided oil doesn't spike back to the $100 range.

The benefits of lower oil prices are numerous: reduced consumer and business energy costs, lower inflation, more competitive manufacturing, and more flexibility for U.S. foreign policy. The average price of a gallon of gasoline is down almost a dollar from the beginning of 2014. Depending on miles driven, the savings can be substantial. Looked at more broadly, energy spending (including heating, gasoline, etc.) as a percentage of disposable income is approaching 4.5%, below the previous peak of 6% prior the 2008-2009 recession and the long-term average of 5.5% (1960-2014).

Consumer spending represents nearly 70% of GDP, so the consumer is critically important to the U.S. economy. As we enter 2015, the U.S. consumer appears in better shape than at any previous point during the expansion. According to the New York Federal Reserve Bank, the five-year run of household debt deleveraging is now over. At the same time, the savings rate is holding steady around 5%, slightly below the long-term average but well above the near zero rate in the mid-2000's. The ratio of debt payments to disposable income (the financial obligations ratio) remains near multi-decade lows thanks to the combination of lower interest rates and deleveraging. Combined with the tailwinds of lower energy costs, better wage and job growth, and continued low interest rates, the consumer appears poised to lead the U.S. economy to 3% growth.

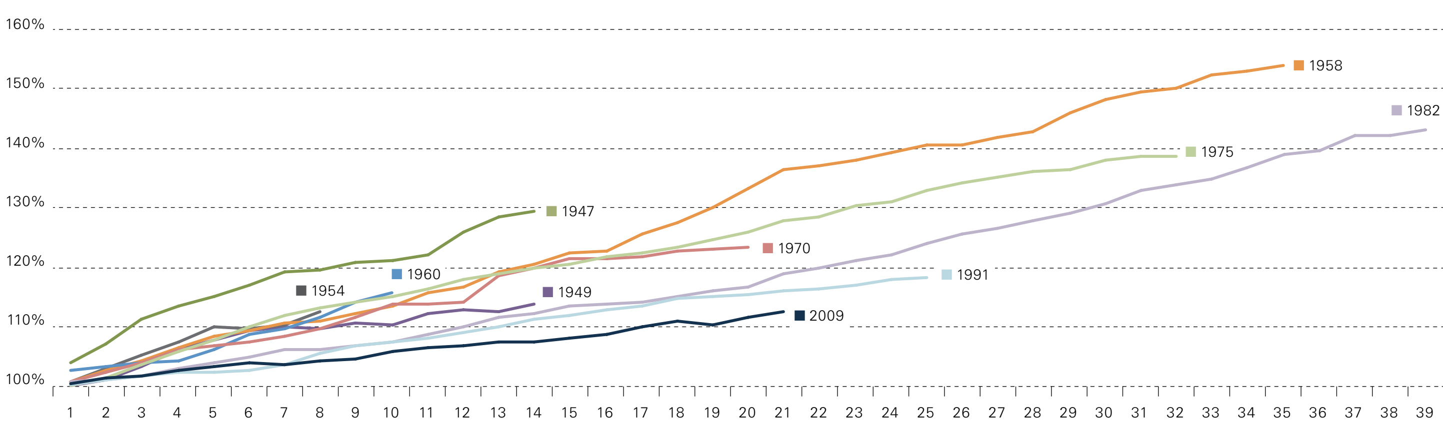
We do not mean to sound Pollyannaish. The consumer still faces several challenges including underemployment, a low job participation rate, and years of stagnant, albeit improving, wages. On top of that, the regulatory environment remains challenging for business. This, along with slowing global growth (particularly in the Eurozone), is a big reason that U.S. GDP growth shouldn't grow much faster than 3%. Many are now calling the economy a "Goldilocks" economy: not too hot, not too cold. Not too much growth to create excesses, but enough that the risks of a recession remain very low.

Unless the U.S. economy reverses course in early 2015, we continue to expect that the Fed will start the process of raising the Fed Funds rate sometime in the spring or early summer. We expect this to be a slow and drawn out process. We take the Fed at its word that "rate hikes will be data dependent." More importantly, even after the Fed raises rates several times, Fed policy should still remain extraordinarily accommodative. With inflation tame, Fed policy will be a supportive backstop for the economy.

The typical signposts of a recession are not evident in the current environment, but many point to the length of the expansion as a reason to expect an impending recession. This is a lazy argument that is used only because it fits the recession narrative. The economic cycle has been lengthened on average, while the pace of expansionary growth has declined. The lackluster growth we have experienced these past five years may be one reason why inflation has remained benign and no sectors of the economy are overheating, thus allowing for an even longer economic expansion. The current expansion may be above-average in length, but in aggregate growth it ranks last.

The Current Expansion Ranks Last in Aggregate Growth

Real Increase in GDP During Economic Expansions

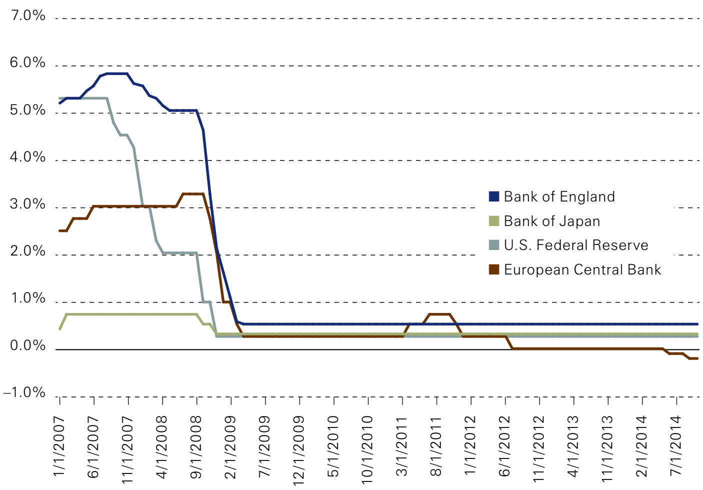


Source: FactSet Research Systems

A Central Bank Role Reversal

The U.S. has resumed its traditional role as leader of the global economy. Both the United States and the United Kingdom were quick to embrace aggressive easy-money policies early in the recession. Both economies are now benefiting from this decision, with their unemployment rates much improved at 5.8% and 6.0%, respectively. The U.S. Federal Reserve is taking the early lead among central banks in constraining easy-money policy with the end of Quantitative Easing. The world waits to see how capital markets will respond in 2015 to a potential rate increase as the Fed begins to tighten. Currency markets are already voicing their opinion, pushing the U.S. dollar to multi-year highs against a basket of global currencies.

Interest Rate Targets



Source: FactSet Research Systems

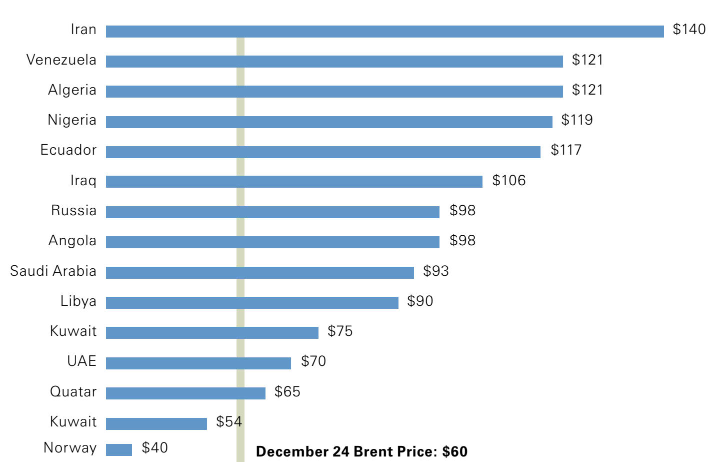
The European Union continues to struggle with lackluster growth and high unemployment. Even Germany, the traditional growth engine in Europe, is struggling to grow their economy. The European Central Bank (ECB) was late to adapt easy monetary policy in the recession and some would argue they are still suffering the consequences. It's likely that Mario Draghi, President of the European Central Bank, will not be able to "talk" his way out of the EU's economic difficulties and the ECB will be forced to expand its asset purchase program in 2015. Expanded asset purchases, especially of sovereign bonds, will continue to strain the tumultuous relationships that form the European Union. Beyond monetary policy, without structural reform sluggish growth likely remains the best case scenario for the Eurozone.

In Asia, China's economy is starting to show signs of slowing just as Japan's Abenomics seem to be losing steam. While China is clearly confronting growing pains as they transition to a more consumer-based economy, the long-term prospects remain bright. What China's leadership has achieved over the past 30 years, where economic growth averaged more than 10%, is a feat unmatched in modern economic history. We expect their leadership to continue investing for the long-term success of China.

Although lower energy prices are, on balance, favorable for the global economy, there are most certainly winners and losers. Most notably, Russia, Iran, and Venezuela, whose budgets rely heavily on oil exports, are being squeezed by the sharp decline in oil. Russia is particularly vulnerable, as the decline in oil is exacerbating existing economic turmoil. This is apparent in the currency markets, where the value of the Russian ruble has been cut in half relative to the U.S. dollar.

As investors, we understand the global economy will always have obstacles to overcome. However, it's essential to look beyond near-term circumstances with a focus on long-term opportunities. The growing middle class in emerging economies is slowly but surely shifting from subsistence living to global consumerism. This dynamic represents a secular shift not seen since the early stages of the industrial revolution.

Estimated Oil Price Needed to Balance 2014 Government Budget



Source: *The Wall Street Journal*, December 10, 2014

Surprise: Oil Below $60

The biggest surprise of 2014 may very well have been the dramatic decline in the price of oil from a high of $106 in June to $60 in December. In past *Outlooks* we have discussed our view that there was a "geopolitical risk premium" on the order of about $20 per barrel, driven by financial buyers and not indicative of natural supply/demand dynamics. This risk-premium has been abolished by the Saudi Oil Ministry, which in early November cut its official price in the U.S. and on Thanksgiving Day reiterated their pledge to continue to supply the oil markets at current levels.

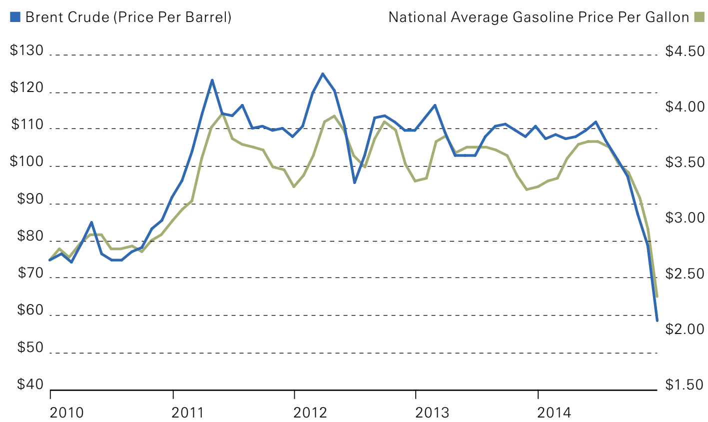
Conventional producers of oil (e.g., OPEC) have seen their sway over market prices diminish due to the near doubling of oil production in the United States. Unconventional oil, most notably hydraulic fracking, is more costly to produce than OPEC's legacy production and, ostensibly, this move is meant to drive out high-cost competition. Lower oil prices also exacerbate the economic turmoil already present in Russia as a result of economic sanctions. It is nearly impossible to predict where the price of oil will be in the future, but technological advancements, efficiency standards, global demand, and the marginal cost of the supply curve all point to a reasonable trading range more akin to $60-$90 rather than $90-$120.

Lower oil prices give us much to be thankful for. An increasing cost of energy is rightly called a tax on the consumer. Energy is an input cost into every part of our economy: transportation, distribution, plastic, electricity, fertilizer, etc. The cost of energy for transportation is by far the most direct and punishing tax on the lower and middle classes. At $4 per gallon, the average household spent approximately $4,500 on gasoline per year. Every one cent decline in the price of gasoline is equal to $1.3 billion in total savings. Consumers, according to Mark Zandi of Moody Analytics, are likely to spend two-thirds of their newfound gasoline savings.

"If oil prices stay between $75 and $95 a barrel, we would see the kind of stimulus package that the Federal Reserve or Congress could never do," said Douglas R. Oberhelman, the chief executive of Caterpillar. Noted energy consultant Dr. Dan Yergin estimates that global economic output would grow an additional four-tenths of a percent with oil at $80 dollars a barrel. Lower oil prices bode well for energy import dependent economies such as China, India, Germany and Japan.

Not all economies benefit from lower oil. For those countries where oil production and exports are a primary source of revenue and higher oil prices (in some cases much higher) are required to balance government budgets, trouble lurks. Over half of Russia's annual budget is financed by oil and gas revenue. The Russian economy recently fell into recession, which is likely to be exacerbated by lower oil. Rogue nations such as Iran and Venezuela suffer mightily with low oil prices. Even the militant group ISIS, which funds its terrorist operation from oil sales, will feel the impact from lower oil. For now, the geopolitical consequences of low oil seem aligned with U.S. foreign policy interests.

Energy Prices Have Fallen More Than 40%



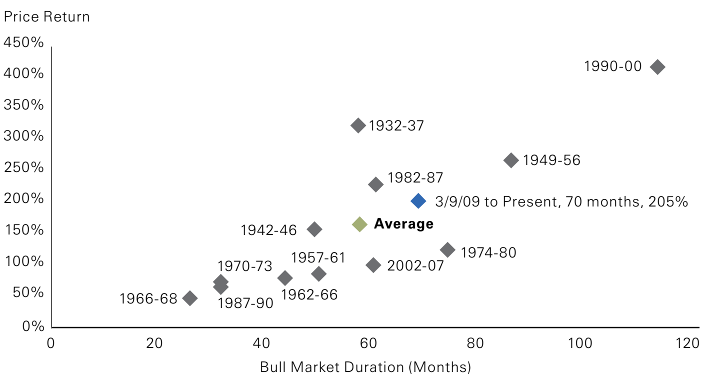
Source: FactSet Research Systems

In the United States, we believe low oil prices will eventually drive down production in higher-cost fields, drive marginal highly levered companies out of business, and encourage major companies to slow their investment in new wells. 2015 exploration budgets are being slashed. This should have a near-term negative impact on capital expenditures and employment in the energy patch. Over time though, American energy producers will likely employ technology to keep improving the efficiency and output of their wells. This should bring down the breakeven cost of exploration and production. It is important to note that the energy companies comprising Haverford portfolios are integrated and service oriented. Haverford does not own companies that are overly reliant on unconventional drilling or pure-play exploration and production. Companies such as Chevron, ExxonMobil, Total, and Schlumberger appear well positioned to prosper at current prices and may even be able to use a major decline in asset prices to purchase competitor's assets, bolstering their market share.

The Bull Market: How Far Have We Come, How Far To Go?

Since March 9, 2009, the total return of the S&P 500 has been 248%. This puts the current bull market in fourth place both in terms of magnitude and duration out of the 11 bull markets since the start of World War II. That said, a bull market does not end solely because it has grown old or because the market has achieved a specified return. The longest bull market over this time period was 113 months — 50% longer than the current one. While the total length and strength of this bull remain uncertain, it is likely that investors cannot expect the bull market performance of more than 24% per year to continue. Going forward, it is important to calibrate our expectations for more moderate returns that are roughly in-line with earnings growth and dividends.

S&P 500 Historical Bull Markets 1928 to 2014



Source: Strategas Research Partners

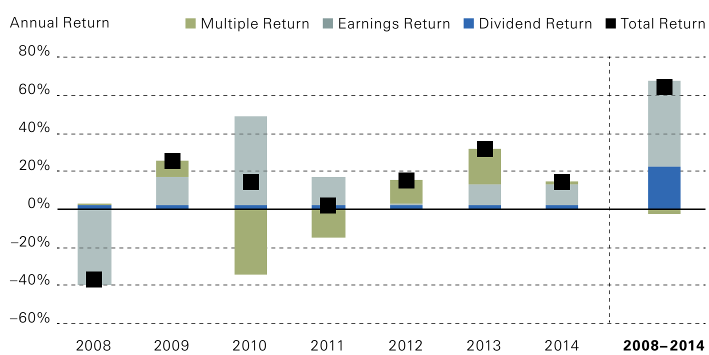
Time and time again forecasters have been confounded by the markets when predicting future returns over a one-year period. However, accuracy does improve when taking a longer view. In the short run, the vicissitudes of investor sentiment rule the day. But over longer periods of time, there are fairly well-defined sources of returns which are significantly easier to predict. The three primary sources of long-term returns are:

- closing the gap between current price and intrinsic value (price/earnings multiple expansion or contraction),
- growth in intrinsic value (earnings growth),
- cash returns (dividends and share repurchases).

While price/earnings multiple expansion or contraction can have profound effects over a short time period, earnings growth and cash returns ultimately dictate long-term stock returns. We see this in historical results. Over the past fifty years, the S&P 500 generated approximately 10% annualized returns, derived from 7% profit growth and 3% cash yield (dividends plus buybacks)[1]. Virtually the entire return is explained by earnings growth and cash return, not multiple expansion. In other words, valuations at the time of purchase have historically been less important than actual corporate performance in determining long-term investment results.

The primary drivers of returns during bull markets can often be broken into two segments. In the beginning of a bull market the majority of returns come from multiple expansion. At a stock market trough, market prices are far below intrinsic values, and multiples expand to close the gap. In the second part of the bull market, when valuations have normalized, returns are primarily driven by earnings growth and cash returns. We would categorize the period between the stock-market bottom in 2009 through the end of 2013 as the first segment of the bull market, where more than half of the return can be accounted for by multiple expansion (50.4%) while the other half was from earnings growth (34.9%) and dividends (14.6%). We believe 2014 was the start of the second period of the bull market, with returns driven largely by fundamentals. About 80% of the S&P 500's 13.7% return through December 31, 2014 has come from earnings growth and cash return, while only 10% is attributable to multiple expansion. With multiples back near the long-run averages, we would expect the primary source of future investor returns to be earnings growth and cash return, totaling approximately 10%, very close to the 50-year historical average.

Market Return Attributable to Fundamental Growth



Source: FactSet Research Systems

1 *Whither the U.S. Equity Markets?*, McKinsey & Company

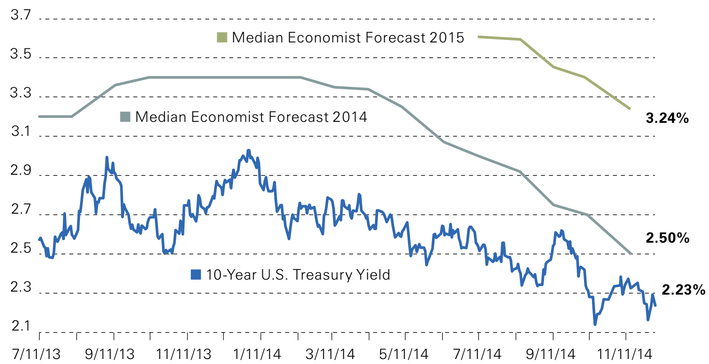
Interest Rates Continue to Confound

Over the past four years, the number one question we have been asked is, "when will rates rise?" Our response has been consensus (i.e., it is the response common to the vast majority of financial professionals) in that rates will rise sooner rather than later and we don't expect a substantial increase when they eventually do rise. As often happens in economic forecasting, consensus has been proven wrong. 10-year interest rates both domestically and abroad have fallen to unthinkably low levels this year, which leads us to the second most asked question, "won't rising rates take the bloom off this bull market's rose?"

We have therefore decided to republish several paragraphs below from the *2014 Outlook*, as the message is as apt today as it was twelve months ago.

10-Year U.S. Treasury Yield Forecast for Year-End 2014

Bloomberg Median Economist Forecast for Year-End 2014 and Actual 10-Year U.S. Treasury Yields



Source: Bloomberg; DoubleLine

"While the Fed will clearly anchor short-term rates for the next several years, once the Taper is well under way and the economy proves it can grow without the assistance of quantitative easing, intermediate and long-term rates may well increase. *[Note: We believed 10-year Treasuries could yield 3.5-3.75% in 2014, but have reduced the high end of our expectation to 3.25% for 2015.]* Market prognosticators will invariably debate whether higher interest rates will spell trouble for the stock market. Rising rates, they say, present a significant headwind for equities.

While we agree that low interest rates are good for stocks — they spur economic growth and render stocks more attractive relative to bonds — we believe equities can still post good gains despite higher interest rates. The adjustment period is often a time of increased volatility for stocks, but history has shown us that after a period of acclimation, stocks usually resume their upward bias.

It is important to understand that interest rates have been extraordinarily low for a very long period of time. As such, despite the substantial rise in rates during the latter eight months of 2013, interest rates are still well below their historical average *[Note: the 10-year peaked at 3.04% on January 2nd, 2014, and has been in a downward trend ever since.]* Any further upward climb in rates will likely be toward a historically "normal" level of interest rates, not a level of rates that will choke economic growth and capital investment. In other words, we are not headed for a 1970's-era period of high inflation and slow economic growth that would obviously be bad for stocks. On the contrary, we would be revisiting levels of interest rates that have already proven to be quite conducive to capital formation.

Most research has shown that rising rates from a low base are not detrimental to equities. In fact, when 10-year interest rates are below 6 percent, as they are today, rising rates have historically coincided with higher price-to-earnings multiples.[2] Why may this be the case? Likely because 6 percent represents the "long-run equilibrium" of nominal economic growth (Real GDP + Inflation). The economy and rates being well below this level means equity prices could continue to rise even as rates rise.

It is important to recall that rising interest rates will likely be accompanied by stronger economic growth and increasing corporate profits. That is usually a good environment for stocks. In fact, since 1919 the U.S. has experienced 16 economic expansions, not including the current one. During each of the expansions, the 12-month period when rates increased most rapidly saw the S&P 500 advance 11.5% on average. Our two most recent experiences of rapidly rising rates in an expansionary period occurred in 2004 and 1994, during both periods the market advanced.[3]"

2 *Economic and Market Perspective*, March 22, 2013
3 *Financial Advisor* Magazine, November 2013

Stocks Have Had Positive Performance in Prior Periods of Rapidly Rising Rates

12-Month Period	10-Year Yield at Beginning of Period (%)	10-Year Yield at End of Period (%)	Return on S&P 500 (%)
10/31/93 – 10/31/94	5.43	7.81	3.87
5/31/03 – 5/31/04	3.37	4.66	18.33
5/2/13 – 12/6/13	1.63	2.86	12.98

Most recent period in 2013 is not a 12-month period but shown for illustrative purposes.

Portfolio Positioning

Haverford's investment philosophy has proven over time to deliver competitive risk-adjusted investment returns. Our process, which seeks to take long-term ownership stakes in financially strong, dividend-paying companies that have competitive sustainable advantages, meets two fundamental truths for those who wish to build and sustain wealth. First, consistently act as an investor and not as a speculator. And second, know what you own and know why you own it. Haverford's portfolios are constructed with these principles in mind.

Our portfolios own leading companies across every global industry. In most cases they have exhibited decades of innovation, consumer loyalty, profitable business growth, and the ability to adapt to an ever-changing world. The thirty companies currently owned in our flagship Quality Growth Portfolio have cumulative sales more than $2 trillion (equivalent to the seventh largest economy in the world) and have spent more than $155 billion on capital expenditures and research & development. Their revenues, on average, grew 5% during the past year while their earnings and dividends grew at 9% and 16%, respectively.

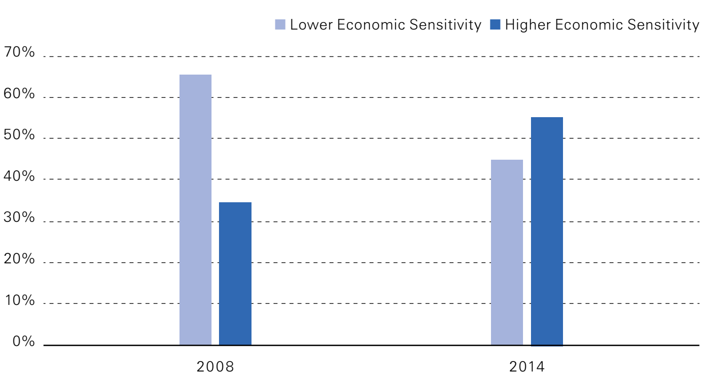
Quality Growth Portfolio

For the better part of four years, investments and positioning in Haverford's Quality Growth Portfolio have sought a balance between offense and defense. Our overarching theme has been to balance investments in high-quality, economically sensitive stocks with holdings in traditionally economically defensive companies. Generally speaking, the offensive side of the ledger is comprised of companies within the Industrial, Materials, Energy, and Financial sectors. Consumer Staples and Healthcare — whose earnings are least affected by economic conditions — comprise the defensive side of the portfolio. The Consumer Discretionary and Technology sectors are not as easily characterized, but our holdings tend to tilt towards economically sensitive.

The portfolio's position today is quite different from 2007-2008 when it was significantly over-weighted in the Consumer Staples and Healthcare sectors. This is a big reason why the Quality Growth Portfolio outperformed the S&P 500 by a wide margin in 2008. At the start of 2009, in anticipation of an eventual economic recovery, we began taking profits in our defensive holdings, investing the proceeds in cyclical companies whose share prices were depressed due to the recession.

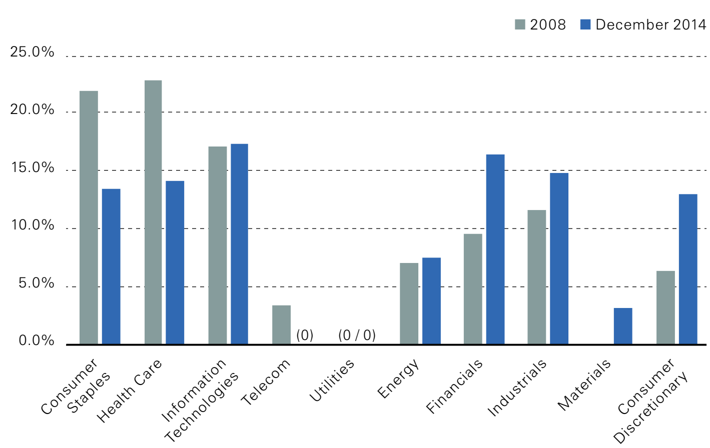
This process continued throughout 2009 and into 2010. Without sacrificing quality, we trimmed classic "steady Eddies" to make way for companies with higher economic sensitivity. New stocks included Air Products, DuPont, Union Pacific, Caterpillar, Disney, Blackrock, and Chevron.

Quality Growth Economic Sensitivity Allocation (2008 vs. 2014)



Source: The Haverford Trust Company

Quality Growth Sector Allocation (2008 vs. 2014)



Source: The Haverford Trust Company

This brought the portfolio to a closer balance between offense and defense, where it remains today.

Our rationale for maintaining this balance rests on our view that we are in a slow-growth economy with little risk of a recession. At the same time, we view much faster growth as a low probability event. Any acceleration in U.S. growth will likely be offset by a sluggish Eurozone and slowing emerging economies. This argues for more of the same: balance between offense and defense.

This balanced approach comes with a twist, which we have focused on for the past couple of years. We are focused on building positions in companies that are able to generate strong internal growth despite an economic environment characterized by below-average growth. In 2014, we increased our exposure to companies with growth strategies unlikely to be derailed by changes in economic policy, variations in GDP growth rates, or geopolitical events. For example, early in the year we de-risked the portfolio by trimming Eaton (a leading company of electrical products and services, a major beneficiary of non-residential construction, and sensitive to global growth trends) and added to our position in W.W. Grainger, which we believe can generate organic revenue growth above and beyond GDP. We also trimmed and ultimately sold McDonald's, whose growth strategy has become increasingly strained, to build new positions in MasterCard, Comcast, Anheuser-Busch InBev, and Twenty-First Century Fox. These companies have unique growth drivers and business characteristics which we outline later.

Dividend Yield Portfolio

An important theme throughout the current bull market is the income advantage of equities versus bonds. At the conclusion of the 2008-2009 bear market, more than 50% of S&P 500 companies paid a dividend that yielded more than the U.S. ten-year Treasury note, and in many cases more than they paid on their own ten-year debt. Fast forward to today, even with a nearly threefold increase in the broad averages, more than 30% of S&P 500 companies still have yields greater than the 10-Year Treasury.

This has been and continues to be a generational opportunity for investors. For two decades after the great depression, stocks yielded more than bonds. Scarred from the bear markets of the 1930's, investors demanded higher yields from their equities in order to assume the risk of owning stocks compared to bonds. It was not until 1958 — more than a generation removed from the effects of the depression — that bonds began yielding more than stocks.

More than fifty years later, after "a decade of no returns" bookended by two severe bear markets, we are back again to the post-depression environment where many stocks yield more than bonds. The Haverford Quality Dividend Yield strategy continues to take advantage of this opportunity. Throughout all sectors, we continue to invest in stocks that have a yield advantage over the 10-Year Treasury. In addition to higher current yield, the long-term advantage of the Quality Dividend Yield strategy comes from the potential for capital appreciation and income growth through consistent dividend increases.

Following several years of outsized returns for high-dividend-paying stocks, over the past 18 months yield-oriented investors have enjoyed good returns, but lower than that of the overall market. Two reasons come to mind. The price investors are willing to pay for current yield has, in many cases, exceeded the fair value of the investment. As price gains outpaced increases in the intrinsic value of high-yielding companies, future returns are constrained. Investors are also eyeing an increasing probability of higher interest rates that will compete for investment dollars. Although we do not anticipate a dramatic reversal in interest rates in the near-term, the "easy" gains from declining rates are likely behind us. When rates do inevitably rise, stocks with dividend yields as their primary attractive characteristic (e.g., utilities and REITs) are most at risk.

For this reason, it is important to weigh the company's current yield against their total-return prospects. We recently sold some growth laggards within the Dividend Yield portfolio to make room for companies with better prospects for long-term dividend growth. Examples include the sales of AT&T and Darden, and the purchases of Target and Leggett & Platt.

Global Allocation

Sometimes proper diversification results in owning laggards. This can test investors' mettle, especially given the past two years in which U.S. stocks beat international markets by over 15 percentage points and emerging markets by a similarly wide margin. Global investors may be tempted to throw in the towel, but diversification should remain a fundamental principle of one's investing strategy.

Haverford's Global Strategies is designed to provide diversification, thus giving investors a smoother ride over the long-term. We believe the case for global exposure has grown stronger after several years of U.S. outperformance since lagging assets often become more attractive looking forward. We invest with the knowledge that we will hold both relative winners and losers in the global marketplace and that no one is good enough to pick the best-performing asset class in a single year. (Surprisingly, REITs were the best performing asset in the strategy in 2014, up 25%). We will underweight unattractive assets and overweight those we believe to be more attractive. We size positions relative to long-term expected return, historical volatility, correlation, and the global market capitalizations.

Haverford's Global portfolio remained overweight to U.S. equities throughout all of 2014, which led to strong performance relative to the MSCI All Country World Index (ACWI). The ACWI provides a representative breakdown of the investable globe. While the U.S. represents approximately 25% of global GDP, our equity markets comprise close to 48% of global market capitalization. Ostensibly, emerging and international developed markets are cheaper than the U.S. These markets trade at P/E multiples of 11 and 14 times expected earnings, respectively, compared to the U.S. at 16-17 times. But relative "cheapness" does not always equate to "value." We believe more value remains in domestic stocks due in part to a stronger and more diverse economy and friendlier business environment. We are always on the lookout for opportunities to adjust position size to improve the portfolio's risk/reward characteristics.

Quality Investing in 2015: The Competitive Advantages of Economic Toll Roads

On a warm Midwestern evening in the summer of 1940, a nine year old boy sat on a friend's porch watching the cars roll by. "All that traffic", he remarked. "It's a shame you aren't making money from the people going by." The boy imagined a toll booth, collecting a small fee from each captive motorist who had no choice but to pay up. That boy was Warren Buffett. This story, as recounted by Roger Lowenstein in his excellent book, *Buffett: The Making of An American Capitalist*, highlights an important economic concept and element of *Quality Investing*; the competitive advantages of economic toll roads.

The elements of an economic toll road are fairly simple:

- Small fee on captive traffic
- High traffic volume
- Entrenched infrastructure
- Essential or highly demanded service

Businesses with these defining characteristics often make for compelling investments, and fit well within the framework of *Quality Investing*. The entrenched position of the infrastructure and essential nature of the service create powerful competitive advantages, marked by strong pricing power and significant barriers to new competitors. As these businesses operate predominately on fixed infrastructure, incremental price and volume increases fall largely to the bottom line. This dynamic of rising revenue on a relatively fixed-cost base can create what is referred to as operating leverage, where profits increase at an even faster rate than revenue. These businesses can also act as highly effective hedges against inflation, as the upfront infrastructure investments are made in old dollars while revenues typically grow with inflation. The Haverford portfolios contain a number of companies that exhibit the characteristics of economic toll roads and we are always on the lookout for more.

Quality Growth Portfolio

Union Pacific — Railroads are excellent examples of economic toll roads, with competitively advantaged positions in our nation's infrastructure. Developed over the past 150 years, towns and cities have been built around the existing rails, leaving little room for new competing lines. Today, freight railroads compete largely with truck and air transportation, against which rail is structurally advantaged. On average, rail is approximately four times more fuel efficient than trucks and can move a ton of freight over 450 miles on a single gallon of fuel. Further, unlike trucks which have to compete with commuters for congested roads, trains have the rails largely to themselves. Against these structurally advantaged industry dynamics, Union Pacific is particularly well positioned with a diversified revenue base and unique access to all six entry points to Mexico. As the demand for long-haul freight transportation continues to increase over time, we are pleased to own one of the most vital economic toll roads operating in the U.S. circulatory system.

MasterCard/American Express — If you have made an electronic payment recently, there is a good chance a toll was paid to MasterCard or American Express. Along with Visa, these companies own "the rails" upon which 97% of U.S. electronic debit and credit payments travel. American Express and MasterCard charge a fee for each transaction on their network in exchange for providing a convenient means of payment. To consumers, the value of the network depends on the level of acceptance by merchants, and to merchants the value depends on the number of consumers carrying MasterCard or American Express cards. Thus, high market shares are vital to a successful payment network, and act as a daunting barrier to new competition. This principle is known as a "network effect," which is the fundamental source of any network's competitive advantage. As transactions continue to shift electronically from cash and check, we expect MasterCard and American Express to continue to collect their tolls.

Comcast — Like railroads, it has taken the cable industry decades to build out the massive infrastructure required to deliver television and internet services throughout the country. The first cable TV system in the United States was built in 1940 in Mahanoy City, PA, an area where tall mountains blocked over-the-air signals. The Comcast Corporation dates back to 1963, and today provides cable TV and internet to over 30 million households through a vast network of cables. Due to the high upfront costs of laying the cable network, the economics of the industry typically support only one or two competitors per service area, which is a significant advantage to the incumbent provider. While wireless technology has improved dramatically, there is a limit to how much data can be transmitted over the air, entrenching physical cable delivery. In many service areas, if consumers want cable TV or high-speed internet, they have no choice but to pay Comcast a toll.

Dividend Yield Portfolio

Verizon Communications — Mobile communication has revolutionized the way we interact with the world since the first mobile phone call was made on a prototype Motorola DynaTAC in 1973. Wireless networks made this revolution possible. Without these networks providing the infrastructure for fast and reliable service, ever-improving handset technology would not have been possible. Today, Verizon operates the largest wireless network in the country. Together with AT&T, Verizon owns the most attractive wireless spectrum, which allows for efficient coverage of wide swaths of the country. The scale of Verizon's installed base of physical tower infrastructure is also unmatched by its competitors. The Verizon monthly bill is the toll we pay to participate in mobile communications, which has become inextricably entrenched in our daily lives.

United Parcel Service — The world has come a long way since UPS first began delivering parcels in a single Ford Model T in 1913, but the fundamental dynamics of the business remain largely unchanged. Businesses and consumers require safe, secure, and low cost solutions for door-to-door package delivery and logistics, and nobody does this better than UPS. While the railroads dominate the transportation of bulk, low value-to-weight goods such as steel and grain, UPS leads an effective duopoly with FedEx in the delivery of individual packages. Every day, UPS now delivers over 15 million packages to more than six million customers. Most recently, the rise of e-Commerce has accelerated the demand for package delivery as business-to-consumer (B2C) shipping increasingly replaces a visit to a physical retail outlet. UPS's scale and existing infrastructure also promotes a potent network effect, explaining the lack of more than one or two competitors in most markets. UPS sits at the intersection of commerce, collecting tolls from the millions of packages that need to be delivered each day.

Fixed Income

The Loneliest Man in the World, 2015 Version

In the old TV commercials, the Maytag repairman was portrayed as "The Loneliest Man in the World". It is likely that title is now held by the solitary borrower who has not refinanced their debt. One of the goals of a sustained policy of lower interest rates is for borrowers to refinance their debt at lower interest rates and with longer maturities. After six years of low rates, it appears that every class of borrower has taken full advantage of this opportunity.

The low rate environment has changed corporate behavior such that capital expenditures and acquisitions are funded in long-term markets rather than relying on short-term commercial paper, as would have been the case a decade ago. Total global corporate debt issuance for 2014 broke previous records set in 2012, topping $4 trillion. Domestically, $1.5 trillion of investment grade issuance exceeded previous records as well. Four separate financings have been in excess of $10 billion, an amount that would have been inconceivable only a few years ago.

State and local governments have also benefitted, refinancing as much as current tax laws permit. Rates are so low that some municipal issuers have been able to lower their borrowing costs by issuing taxable debt to replace tax-exempt debt. Seemingly, every homeowner who was able (i.e., has a job and equity in their home) has lowered their mortgage rate.

This unprecedented issuance of debt has several implications as we look toward 2015. First, a reduction in refinancing will reduce supply, resulting in less upward pressure on tax-free municipal yields. Second, from the Fed's perspective, the refinancing into longer-term debt eases the way towards the first interest rate increase sometime during 2015.

Municipal Bonds

The municipal bond market was one of the better performing fixed income sectors in 2014, supported by improved fundamentals and positive technical factors. State and local governments should continue to see improved budgets as the effects of the recession diminish over time. California, arguably the epicenter of the housing crisis, has seen dramatic budget progress. The state has gone from a $25 billion deficit three years ago to a projected $3.9 billion surplus for the current fiscal year, and is currently running $2 billion ahead of that forecast. According to the National League of Cities annual survey, more city financial officers reported improved conditions in 2014 than in the 29-year history of the survey.

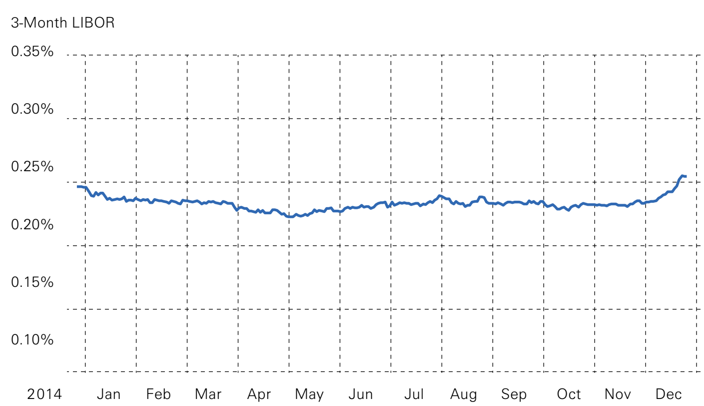
Eighty percent reported that their cities were better able to meet fiscal needs than in 2013. The recent decline in gas prices helped operating budgets considering the miles driven by school buses, police cars, trash trucks and public transit vehicles. Certainly, there are many of us who hope that snow removal costs are lower than last winter. The recent elections provided another indicator of improved sentiment as voters approved the most new bond proposals since 2007. Improved financial markets eased some of the pressure from pension liabilities. That magnitude of broad based financial improvement overwhelmed the negative press from distressed municipalities such as Detroit and Stockton.

Unlike the corporate bond market which is awash with new issuance, municipal supply was low throughout 2014, providing support for the market. 2014 was the fourth consecutive year in which new issue supply is less than the available funds from bond redemptions and coupon income. Supply and available funds should be more balanced next year as newly approved projects are added to existing debt issuance.

Too Soon for Floating Rates

Anticipation of higher rates in 2015 has increased investors' interest in floating rate bonds, which in theory will increase coupon payments faster than overall rates. With yields this low and a continued lack of volatility, we continue to believe that it is premature to consider floating rate notes. The accompanying chart shows the narrow range of 3-month LIBOR for the past year. The high was 0.248% and the low 0.223%, a range of only 2.5 basis points. That was despite Ebola fears, conflicts in the Middle East and Ukraine, commodity price volatility and currency fluctuations among the factors that could have been expected to result in at least one sharp swing in short-term rates in any other year. Most investors would have expected at least one quarterly reset on a floating rate note, which they did not receive, to catch a pop in yields from that list of headlines.

Limited Volatility in LIBOR

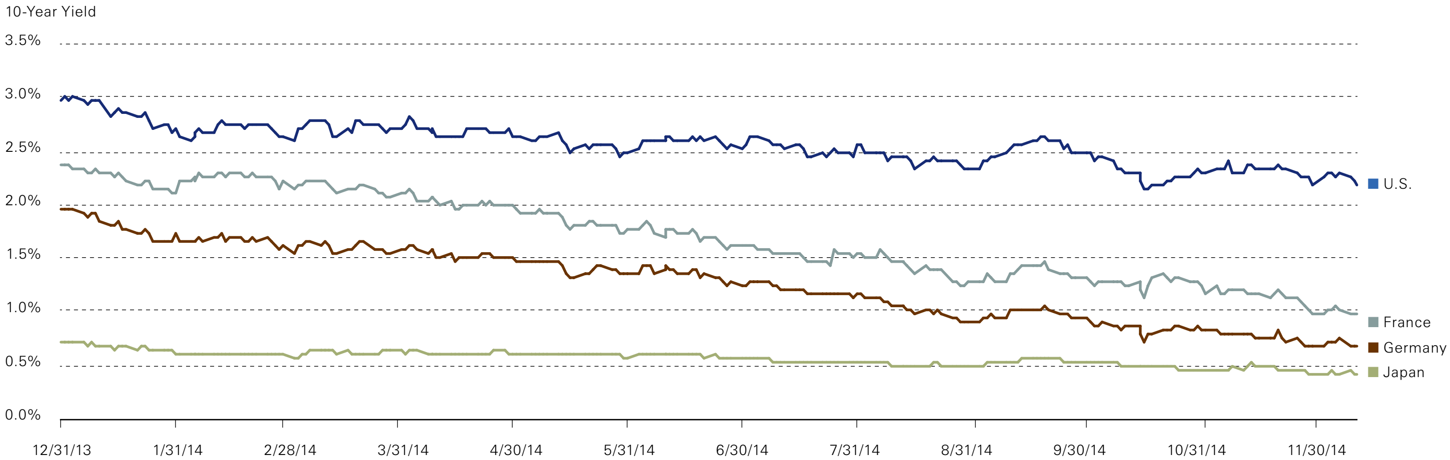


Source: FactSet Research Systems

Positioning in 2015

Yes, the Federal Reserve will eventually raise policy rates. It is pure speculation to guess whether that first move will take place at an April, June, or September meeting. The most important aspect to remember is that this will be merely the first step to normalize rates and is not an attempt to tighten credit. In that context, we expect that the FOMC will be very deliberate in its actions. A deliberate Federal Reserve will likely result in the fixed income markets continuing to be less volatile than historical norms.

Global Rates Fell throughout 2014



Source: FactSet Research Systems

There are many factors that argue for interest rates to remain relatively low. Inflation is contained at modest levels. The supply of bonds from both the public and private sectors should be able to be absorbed without difficulty. Global interest rates will likely continue to remain low relative to U.S. yields. We believe that these factors will serve to keep interest rates lower than they otherwise would be given decent economic strength. That is not to say they will stay at ultra-low levels, but they will likely be lower than investors might expect and lower than levels seen in previous periods with similar economic fundamentals. To a degree, the combination of constrained inflation, reasonable supply, a strong dollar, and little competition from global yields would seem to be an ideal environment for the Fed to begin to normalize rates.

The large amount of issuance in the 4th Quarter caused relative yield spreads on corporate bonds to increase compared to benchmark U.S. Treasury yields. Our portfolios continue to be positioned with durations near their appropriate benchmark indices, between 4.0 and 4.4. Supply pressure on corporate bonds has been most acute in the 7-10 year maturity range. As a result, we favor corporate bonds relative to U.S. Treasury and other sectors in that range. Tax-exempt municipal bonds remain attractive for tax-paying U.S. investors. Relative to the corporate market, value is present in the municipal market in the 7-10 year maturity range as its yield curve remains steep. Considering market performance for these issues has caught up with improving fundamentals, the magnitude of relative value that was present a year ago has dissipated to a degree.

About Haverford

Refined over three decades, the Haverford *Quality Investing*® strategy is committed to maximizing returns while minimizing risk throughout the entire market cycle. *Quality Investing* focuses on "A" rated equities that deliver consistent earnings and dividend growth and investment grade fixed income securities that seek to protect both principal and income over the long term.

Haverford Products

EQUITY

- Quality Growth
- Quality Dividend Yield
- Quality Growth & Income
- Quality Core Global Strategies
- Quality ETF Global
- Quality SRI

FIXED INCOME

- Quality Taxable
- Quality Municipal
- Quality Total Return ETF
- Client Specific Mandates

BALANCED

- Customized Allocations

Haverford Clients

Haverford serves a range of clients including:

- Individuals & Families
- Institutions & Institutional Consultants
- Private Foundations
- Employers
- Employee Benefit Plans
- Nonprofit Organizations
- Trusts & Estates
- Religious Organizations
- Endowments
- Financial Advisors

Haverford Services

Haverford clients enjoy a range of investment options designed to provide the best in personalized service and sophistication. Some of our additional offerings include:

Banking Services

Haverford is a member of the Federal Reserve System and is a state-chartered trust company with banking capabilities. We offer two products: certificates of deposit, and loans secured by assets with us.

Nonprofit Services

Tailored to the unique needs and vision of your organization, we work to identify strategies that enable growth with purpose.

Personal Trust & Estate Services

Caring and continuity are the hallmarks of our approach — securing your family's financial future, for generations.

Retirement Services

Our approach to retirement plans matches our strength as an investment manager. Haverford's own employees are covered by the same program and investment menu we offer to our clients.

To learn more about Haverford and our services, or to schedule an appointment to review your financial future, please call us at 888-995-5995 or visit www.haverfordquality.com.

Investments in securities are not FDIC insured, not bank guaranteed, and may lose value.

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