MONONGAHELA CAPITAL MANAGEMENT

PERCEPTIONS

4th Quarter, December 31, 2014			
	12/31/14	**% Change 4th Quarter**	**% Change Year**
Dow Jones Industrials	17,823.07	5.20 % *	10.04 % *
S & P 500	2,058.90	4.93 % *	13.69 % *
Russell 2000	1,204.70	9.73 % *	4.89 % *
BC Aggregate BD Index		1.79 %	5.97 %
10 YR Treasury Yield	2.17 %		
30 YR Treasury Yield	2.75 %		

*** Includes reinvested dividends**

As 2014 drew to a close, the offices of Monongahela Capital Management were relocated to Historic Harmony, Pennsylvania. This community was originally settled by followers of George Rapp who emigrated from the Wurttemberg region of Germany in 1804. The Harmonists are noted to have been an industrious people, building the town and a prosperous community. In 1806 they constructed an inn on the town square. This original frame structure was destroyed by fire around 1859; only the foundation of the building remained. In 1862, the structure was rebuilt in brick as the Hotel Beam. Over the years the building served a myriad of uses, most recently as a locally owned and operated grocery store. In 2014 the building was purchased to serve as our investment office. Renovations are underway, and we believe the setting is ideal for the research and contemplation which are the hallmarks of our style of investment management.

Importance of Earnings

As we review the performance of the various markets and indices in 2014, we are struck by the power of the finance driven economy and the resulting bull market in asset prices. The markets' recent primary drivers have been liquidity and momentum, propelling the S&P 500 to outsized gains. As the economy has sputtered since the financial crisis, regulatory powers have expanded credit by keeping interest rates low and implementing unconventional ideas like "quantitative easing" to stimulate the economy.

While we believe the stimulus served its purpose in the crisis, it is having minimal impact in creating demand in world economies. As the United States and China can no longer serve as clearing houses for global demand, excess supply is being cleared through lower prices. The most visible deflationary impact has been on commodities, like copper, iron ore and petroleum.

Our concern looking ahead is that the deflationary trend will extend to profit margins and ultimately lower earnings. We believe the total earnings for the S&P 500 will be lower in 2015 than 2014 and in the long term, equity prices are determined by earnings. As the transition to an earnings driven market from a liquidity driven market unfolds, equity leadership will change.

Our focus on bottom up value stocks with growing earnings potential should allow us to deliver higher relative returns in the next three to five year cycle.

Halyard Health is a healthcare company that fits the growing earnings mold. It is focused on preventing infections, eliminating pain and speeding recovery. Formerly part of Kimberly Clark, Halyard was spun off in November of 2014 and trades on the New York Stock Exchange under the symbol HYH.

While we may know Halyard for their ubiquitous medical exam gloves, their infection prevention division has a broad product line extending from protective apparel to infectious disease outbreak and pandemic event preparedness. In addition, the company provides products for respiratory health, surgical solutions, pain management and advanced wound care management.

The company is in its first independent year and we anticipate sales of $1.8 billion and earnings per share in excess of $2.60 in 2015. Halyard Health should experience sales and earnings growth faster than the United States economy. Because it is a spin-off, very few analysts follow Halyard and over time, new coverage should add to demand for the stock.

As the market transitions to an earnings driven base, we will add well-run companies like Halyard that advance sales and earnings. At the same time, we will prune those equities that will be affected by declining profit margins.