CORE EQUITY REVIEW

Fourth Quarter 2014

PERFORMANCE COMMENTARY

"The same people who laugh at science fiction listen to weather forecasters and economists," Anonymous

As the historic, monster blizzard of 2015 passed through New York City, economists and investment strategists took solace that they were not the only fallible forecasters. In spite of the vast amount of time and energy expended in the creation of erudite prognostications, on both the buy and sell sides of the financial markets, history shows them to be less than accurate and of dubious predictive value. However, this "wisdom" is increasingly being produced with great passion and consumed with blind confidence in its credibility.

The 2014 stock market confounded the forecasters by registering its sixth consecutive year of gains. The alarmists, ever concerned over subpar economic growth, political discord, geopolitical upheaval, and an impending reversal of Federal Reserve policy, husbanded their cash reserves and rationalized their risk adjusted returns. The realists, sensing the US was repairing economically and financially at a much faster pace than its global competitors, continued to participate in the strong bull market advance.

For the fourth quarter of year, the S&P 500's total return was +4.9%, bringing the full year advance to +13.7%. The five year compounded return stands at +15.5%. Leadership resided in large capitalization, quality stocks as investors here and abroad sought safety in premier US companies.

The final quarter S&P strength was broad based with only energy a significant underperformer, down over 11%. For the calendar year, investors searched for income favored utilities, up +29%, and growth with health care, up +29%, and information technology advancing +25%. Energy was the sole losing sector, down -8%

In contrast, smaller capitalization stocks lagged with the Russell MicroCap Growth Index up only +4.3 for the year. More dramatic was the aversion to many early stage science oriented, developmental companies; an area in which we have interest and expertise. Meaningful price setbacks were suffered by a number of young enterprises in spite of their strong portfolios of intellectual property.

PORTFOLIO COMMENTARY

The strongest contributor for the quarter was **United Continental Holdings (UAL)** with a gain of +43%. With jet fuel as a major cost component for an airline, the dramatic fall in crude oil prices will have a very positive impact on 2015 and 2016 earnings. **Universal Electronics (UEIC)**, a manufacturer of wireless remote control devices, had strong revenue and earnings growth. Strong free cash flow and debtless balance sheet added to its attractiveness. The shares rose +32%. After a setback earlier in 2014, **Unisys (UIS)** rallied +26%. As an emerging factor in the cyber security business, the stock benefited from continued news of the hacking of corporate systems with Sony the notable example. New management was installed during the quarter, lifting expectations of more aggressive growth strategies.

On the negative side, **Cree (CREE)**, a leader in LED lighting, fell -21%. Retail price competition for residential products, as well as lower margins for components due to Chinese pricing pressure caused an earnings shortfall and stock correction. As a technology leader with many new applications both residential and commercial ahead of it, longer term the stock is still attractive. In October, **Sanofi-Aventis (SNY)** dropped dramatically as the corporate board ousted the CEO who had been pushing more aggressive restructuring. The stock declined -19 % for the quarter. After a strong (+21%) gain in the third quarter, **America Movil (AMX)** pulled back -12%. As a major telecommunications company in Mexico, which is going through regulatory reform, there are continuing cross currents affecting the company.

PORTFOLIO ACTIVITY

An evolving investment theme is the onset of a more positive environment for infrastructure spending. We established an initial position in **Martin Marietta Materials (MLM)** with the expectation of improving aggregates, asphalt and cement demand.

We added to our **America Movil (AMX)** holding given our positive stance on the growing demand for the transmission of voice and data in Latin/South America.

The purchases were funded by the elimination of **FMC (FMC).** We were concerned with a corporate restructuring and its resultant mix of businesses.

MARKET COMMENTARY

Over the last few decades, economics and its first cousin investment management have undergone remarkable transitions from arts to sciences which facilitated the intellectual excesses that lead to the Great Recession and financial collapse of 2008-2009. What had been behavioral, social sciences had morphed into mathematical disciplines. The study of human behavior had been replaced by multi-factor macro asset allocation models and sophisticated mathematical algorithms. The greater the complexity, the greater the credibility, the greater the confidence, the greater the risk allowed and unfortunately the assurance of an eventual collapse.

The forecasts generated by meteorologists and those imputed in modern economic/investment models are convictions gained by great effort. Both, unfortunately, are less than dependable. Notable economic misestimates would include the GDP forecasts of the Federal Reserve, interest rate outlooks by bond gurus, and sadly the assurances by investment bankers of ever rising housing prices. All were key factors in forecasting future investment returns and building portfolios.

"Tell us what the future holds, so that we may know you are gods." Isaiah 41:23

Amen!

Now that the gods have been at least temporarily discredited, the fundamentalist can regain the stage and recapture the audience. Factors such as scientific discovery, innovation, and changing demographics can, once again, drive investment decisions. Sound business plans and strong managements can be rewarded.

We continue to find very attractive opportunities in health care (biochemistry and oncology), information technology (big data, cloud computing, and consumer/social media), advanced industrial technologies (materials and manufacturing processes), telecommunications (pipes and towers) and an initial interest in the rebuilding of our infrastructure (construction).

Our view on the overall US market remains constructive. Continued economic growth, sustained levels of profitability, and reasonable valuations argue for a continuation of the six year advance. The ends of bull markets have historically been caused by an economic accident, recession, or tight monetary policy. Since few if any excesses exist in the economy or equity market today, the likelihood is that any problems lie in the future.

This not to infer we are not aware that investor sentiment has moved from cautious “risk/reward” to a more optimistic “reward/risk” and that there are pockets of speculation. Therefore, we remain, as ever, vigilant with regard to capital preservation.

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