February 2015

Dear Client,

Enclosed are the 2014 return calculations for your account(s). Where applicable, three, five, ten year and returns since account inception are included as well. The S&P 500 returned 13.69% including dividends in 2014. Our composite returned 8.72% in 2014 (individual results may vary). Since inception on 01/01/2000, our composite has returned 230.89% vs. 86.39% for the S&P 500 with dividends. That represents a compound annual return of 8.32% for the composite vs. 4.24% for the S&P 500 with dividends.

Last year represented our sixth consecutive year of positive returns since the 2008 financial crisis. This year's underperformance (versus the S&P 500) had more to do with the relatively large cash balances in our managed accounts than with our stock selection. Indeed, many of our larger holdings including Berkshire Hathaway, Sealed Air, Bank of New York and Hospira Inc. enjoyed excellent performance with returns of +26.64%, +20.29%, +18.31% and +48.38% respectively (earlier this week, Hospira received a takeover offer from Pfizer Inc. sending the shares up an additional 35%). The increased cash positions in the accounts are purely a by-product of sales of fully-priced securities coupled with an inability to identify bargain priced replacements. With cash yielding next to nothing and high grade/government bonds offering yields in the low single digits, equities have been "the only game in town" for quite a while. Like a well-attended auction, this makes uncovering bargains increasingly difficult.

While we have always emphasized that we are business analysts and not "stock market" analysts, it would be hard to argue that the general level of almost all cash generating assets are not elevated due to the abnormally low level of interest rates. We operate under the premise that ultimately the stock market is a weighing machine- it will value a company based on its ability to generate future cash flow. When interest rates are abnormally low due to Federal Reserve policies, the weighing placed on corporate cash flows is distorted; as Paul Singer of Elliot Capital Management recently noted, it is as if "someone had their finger on the scale."

Our investment activity in 2014 was limited. We trimmed some fairly-priced, large capitalization companies (Quest Labs, Lab Corp. & Williams Cos.), added to an existing mid-cap position (Calgon Carbon Corp.), and initiated two new positions in Starwood Waypoint and Synutra Ltd. Towards the end of the year, the dramatic sell-off in oil also created some opportunities. We have found bargains in the high yield bonds of well positioned oil & gas exploration companies. Many of these issues dropped sharply in price creating very attractive yields for comparatively short-dated bonds. While we don't pretend to know whether or not oil prices will rebound soon, our guess is that the situation will play-out much as it has in the past; lower prices means less exploration and less production from marginal oil plays, oil demand continues to grow over time with world growth, supply and demand reach equilibrium and then begin to rise as consumption outpaces production. The bonds we have purchased are in companies with valuable reserves and assets that are readily marketable. We are fairly certain they will be amongst the survivors and may themselves be acquired by larger oil gas companies seeking to add to their own proven reserves at favorable prices. In either case, the current yields and price declines make them compelling opportunities.

We ended last year's letter with a laundry list of macro concerns that had the potential to rattle markets. Those concerns still exist, along with a host of others; an expanding war in the Ukraine, ISIS and the continued instability in the Middle East, the Ebola scare, etc. I mention these concerns because they remind me of a wonderful article I recently read in the October 28th issue of Barron's magazine. The article was entitled "The Timeless Allure of Stock-Market Timers". It's a fascinating piece about the relationship between stock market pundits and anxious investors who eagerly await their predictions on where stock prices are headed in the coming months. Using various "tools", they advise investors to make wholesale shifts from one asset class to another; for example, to sell all stocks and go to cash when it appears stock prices are about to decline. This appeals to people because it seems to offer some control over an uncertain future. The problem with the strategy is that it doesn't work largely because the future is by definition always uncertain.

As advisors, we cannot eliminate volatility from portfolios however we can use it to our advantage. In general, we intend to maintain a significant exposure to equities. To the extent that cash builds as the result of sales, our intent is to invest the funds as soon as an attractive opportunity presents itself; *irrespective* of macro concerns. Frequently, it is the negative macro or company headlines that create the volatility necessary to make bargain purchases.

This year may prove to be particularly interesting as the Federal Reserve switches to a less accommodative policy than the one that has been in place for the last several years. Despite being well telegraphed, this withdrawal of stimulus may affect markets and increase volatility. We look forward to it.

Please feel free to contact us with any questions or comments. As always, we thank you for your trust and patience.

Very truly yours,

Eckart A. Weeck
Senior Managing Director