KINGS POINT
CAPITAL MANAGEMENT LLC

4th Quarterly Review and 2012 Outlook

With the recent favorable spate of economic news and the rise in the worldwide equity markets, one could come to the conclusion that the global economies are healing. Regardless of whether the economies are improving or not, it is clear that the central banks are continuing to implement accommodative monetary and fiscal policies that could mask the underlying trends. While the long-term ramifications of these programs are unknown, it is clear to us that, in combination, these programs will serve to "kick the can down the road." With this in mind, we continue to emphasize our "less is more" strategy to navigate through the current economic environment. Owning a smaller number of investments that are geared to generate a higher risk-adjusted rate of return over the long-term will serve us better than owning a broad basket of securities should the macro environment change for the worse in the coming quarters.

Even with the overriding concern that Europe may well invariably stumble in its effort to stabilize its' sovereign debt problems, investors have recently pushed the global financial markets in a positive direction. Additionally, it is interesting to note that the U.S. debt and equity markets are beginning to act a bit more independently from their European equivalents. This "constructive independence" is probably reflecting the fact that recent U.S. data supports the view of improving economic trends in employment, housing and corporate profits. The more favorable data in housing (which indicates more of a bottoming process than an improvement) is important since it was the origin for all our recent financial problems.

When we wrote our last quarterly report, investor sentiment for the global financial markets was decidedly more pessimistic. Aside from the improving U.S. economic data, what we think has been the big turning point in sentiment is the apparent acknowledgement by the leaders of the European Union that time has run out and decisive actions must be taken. Most notable are the vocal statements and actions taken by Angela Merkel of Germany and Nichols Sarkozy of France. Both seem to be driving for a more immediate and aggressive response to the debt crisis encapsulating their respective countries and the EU in total. In addition, the change of leadership in Greece and Italy with more politically astute administrations, has also added to the belief that Europe may avoid a financial disaster.

While one would like to believe that a final resolution will be forthcoming in short order, the timing of a resolution to this global Rubik's Cube remains in question. It is clear that the European problems with sovereign debt and default will linger over the coming months. Additionally, our own Congressional leaders continue to wrangle and avoid dealing with our own mountain of debt. As we work through this election year, it is unlikely that any significant resolution will come to pass before 2013 and beyond.

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On January 25th, the Federal Reserve provided its quarterly update and held interest rates at current levels. However, there was a dramatic change in the update in that they now expect to maintain the current rate environment through 2014; a full 18-months longer than had been anticipated only three months ago. One could argue that the FED sees future softness in the economy as a real possibility (even though current economic data might refute this view). If we were Machiavellian, we could argue that the board members recognize that any rise in interest rates could put a significant burden on the U.S. Treasury in terms of financing the country's debt. Moreover, it could also suggest a fear that a robust, global economic recovery is unlikely to occur. Regardless, if the Federal Reserve's view is correct, it will continue to add liquidity with the hope (in part) of reflating the economy to its' stated target inflation rate of 2%.

At the same time, the European Central Bank (ECB) has implemented a new program in which European banks can borrow funds at a 1% rate. The hope is that these funds will be reintroduced into the economy through future bank lending and/or through the repurchase of sovereign debt. While the latter is both preferable and necessary to keep certain governments from defaulting, the former is what traditionally drives the economy. In essence, the ECB's highly attractive "carry trade" in which banks borrow from the ECB at 1% and reinvest in much higher yielding sovereign bonds may at least be partly responsible for the decline in rates across the region (especially in Italy and Spain). So, while Germany and France have not increased their own lending amounts, each has allowed the ECB to implement a very attractive low interest rate loan program. As mentioned previously, we see this type of action as "kicking the can down the road" well into 2013. The bad news is that the banks on both sides of the Atlantic are not aggressively offering these cheap loans to the more traditional outlets that drive the economy (businesses and individuals). As a result, we may continue to see muted overall economic growth in both the U.S. and Europe for quite some time.

With this macro-economic outlook in mind, at KPCM, we believe our "less is more" strategy is better suited to provide a better risk-adjusted rate of return versus broad and more traditional diversification. Within the fixed income, we are generally limiting the duration of the portfolio to less than 5 years through callable structures and/or bullet maturities. In corporates, we continue to seek out a smaller number of uniquely attractive bonds that appear mispriced based on underlying company fundamentals. At times, we are finding strong companies with debt yielding in excess of 6%. In both cases, we think this approach is prudent given the fact that inflation may be the ultimate outcome from either a general economic recovery or the stimulative nature of government programs.

Within equity investments, our focus continues to be in identifying uniquely attractive companies with managements that have the ability to grow earnings (and in many cases – dividends) based on core business fundamentals rather than on hoping for improved macro-economic trends. In addition, we are focused on finding solid dividend payers which are both attractively priced and offer a better after-tax income stream than government securities in this low interest rate environment.

We are also searching for companies that are sensitive to shareholder interests. Jarden is a great example of this particular focus. The company sells such well known branded appliances as Sunbeam, Oster, and Crockpots. It also owns the camping brand Coleman and maintains exposure in sporting equipment through K2 skis and boards, Bicycle playing cards, and even Marmot apparel. Management has always been focused on enhancing shareholder value and, more recently, has announced an extension to their current share repurchase program through a Dutch Tender process. In this process, a company will repurchase a maximum amount of shares within a pre-determined price range for a given period of time. Any investor that wants to sell shares within this price range will be accommodated subject to the size limitations announced in the program. This type of program generally proves to be highly accretive to earnings through a significant reduction in share count. Management has also revealed the long-term growth goals that fit well with our strategy of investing in category dominant companies that generate significant cash flow and return on invested capital. Finally, selling at less than 10 times earnings, we find the valuation very compelling.

A second company, Verizon, is a good example of a corporation paying a very attractive dividend (which yields approximately 4%), and has the ability to increase the dividend over time. We like the strong position the company enjoys in mobile communications and its' expanding footprint in digital cable to the home and workplace. In fact, we expect the company to generate 8-12% earnings growth over the coming years.

Lastly, a final example of our focus on long-term value creation is our position in CVS/Caremark, a large drug retail and pharmacy benefits manager. Despite the problems of integrating Caremark into CVS over three years ago, we retained our ownership in the company due to its' strong position in its two main areas of concentration and management's commitment to ultimately get the integration to work smoothly. The pieces came together in 2011 as the company's earnings and cash flow are finally accelerating. More importantly, despite the periodic integration problems, the stock price continued to appreciate significantly faster than the overall market during both the last 2 and 5 years. Now that the wave of generic drugs is accelerating due to patent expiration, we expect continued outperformance for this long-term core holding.

While only three are cited here, each and every one of our investments is geared to generate superior risk-adjusted growth and return over the coming years even under a muted macro-economic environment. Whether Central Bank policies are effective or the global economies continue to struggle, this focused strategy should offer better overall returns versus indexing or owning an excessive number of securities in the name of diversification.

Overall, we view our core portfolio of fixed income, selected equities, and Master Limited Partnerships (MLP's) as the right approach to generate good, risk-adjusted returns in this very complex global economic matrix. We will retain our focused, and defensive posture until it is clear to us that any systemic financial risk on a global scale is no longer a concern.

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