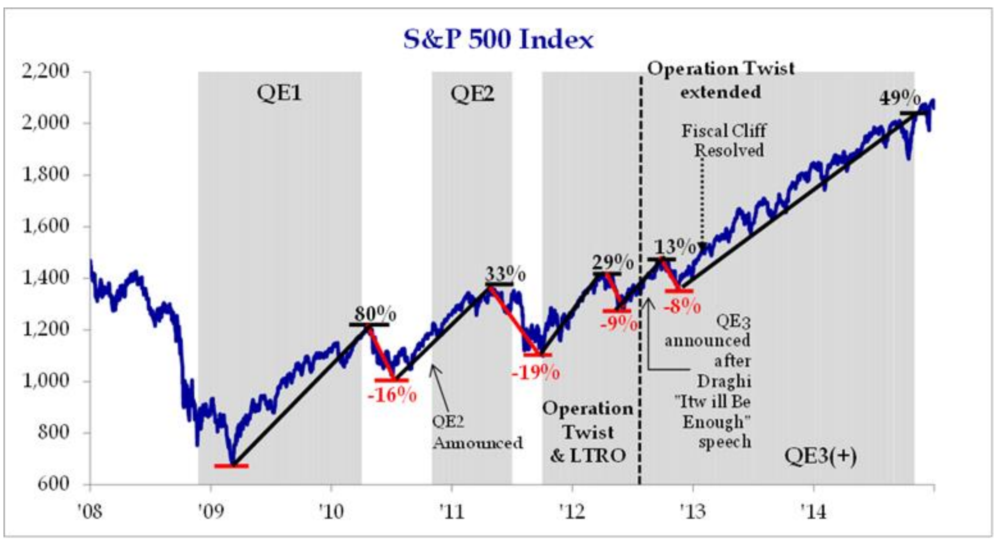
KINGS POINT
CAPITAL MANAGEMENT LLC

2015 COULD BE A ROLLERCOASTER

After the strong equity market returns of 2013, expectations were somewhat muted for 2014. While the financial community predicted a higher level of corporate profits, predictions were also for higher interest rates. In January 2014, the yield on the 10-year U.S. Treasury was 3.0% and many were forecasting a move to 3.5% or more throughout 2014. However, the rate actually closed the year at approximately 2.2%. This, along with the unexpected 50% decline in oil prices during the last six months of the year, helped to propel the U.S. equity markets to a strong finish in 2014.

We want to emphasize the point that the brightest minds in economics and commodity analysis got these major trends dramatically wrong. In fact, this is equivalent to the Federal Reserve not seeing the debt and derivative bomb ticking away underneath the housing bubble in 2007.

Chart I



Source: Strategas

The good news, of course, was that the move in oil and interest rates had a positive influence on the equity market and on consumer spending in general (Chart I). Indeed, the decline in oil prices should have a continued positive impact on consumer spending in 2015. This should help bolster U.S. economic growth throughout the year. Consumer spending should pick up while hopefully non-farm payroll growth stays above 200,000 a month (the number needed to allow for GDP expansion of about 2%). Moreover,

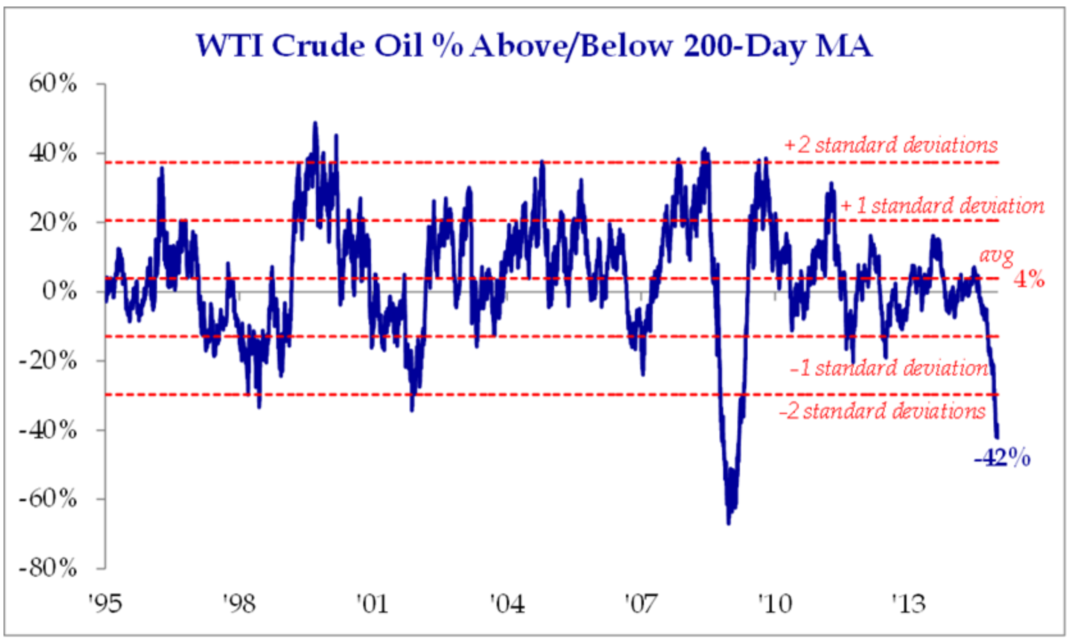
KINGS POINT
CAPITAL MANAGEMENT LLC

corporate profits are again likely to rise 5-10% excluding severe foreign currency headwinds from a strong U.S. dollar.

We believe that Europe and ECB policies will indirectly have a significant impact on the continued strength of the U.S. stock market in 2015. The lack of growth throughout all of Europe has finally moved Mario Draghi and the ECB to begin a real quantitative easing program similar to the U.S. and Japanese models. While European interest rates are already low, the added stimulus should help strengthen banks and give a boost to most financial asset valuations. If the policies work and Europe does finally begin to show accelerating GDP growth, we should expect the current bull market in the U.S. to continue at a modest rate of expansion. However, should Europe and secondly Asia, slow from current levels, we would be concerned that the U.S. economy may ultimately follow a similar pattern.

Why Is Oil Down So Much (Chart II)?

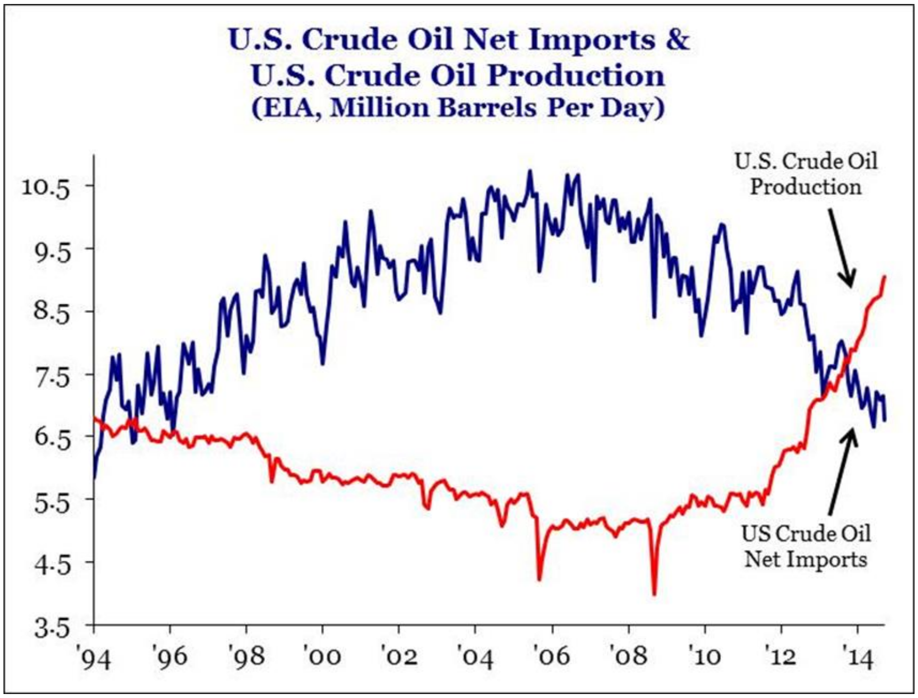
Chart II



Source: Strategas

Notwithstanding the fact that almost every expert on oil did not expect the current collapse, we offer a few observations. First, it is well known that fracking in the U.S is a real game changer. In the last few years the U.S. has gone from a period of declining oil production to one that is growing (Chart III). Indeed, the U.S. is now producing about 2-3 million more barrels of oil per day than in the recent past. We believe that production and productivity will continue to increase over the next few years regardless of the near term decline in oil prices. The bulk of lost market share from U.S. production gains has come at the expense of Saudi Arabia.

Chart III



Source: Strategas

Ultimately, we expect that OPEC and other non-OPEC countries will reduce production to get oil prices back to higher levels. The current supply/demand imbalance is only 1-1.5 million barrels a day. Stronger global GDP and small cuts in OPEC production could get this in balance fairly quickly. While we loathe trying to predict oil prices for 2015, it seems to us that ultimately OPEC countries need higher prices to sustain their economies. Thus, prices are likely to recover. How fast and to what level is more likely to be determined by geopolitical events than simple supply/demand free and cartel market adjustments.

Why Are Interest Rates So Low?

Like oil, the experts for the most part incorrectly forecasted the direction and absolute level of interest rates in 2014. Instead of rising to approximately 3.5% for the 10-year government bond, it declined to about 2.2% at year end. As of this writing it has fallen even lower to approximately 1.9%. Interestingly, the experts have again forecasted this bell weather rate to rise to 3–3.5% this year (2015). With a 3% plus GDP growth, strong job creation, and the possibility of rising wages, interest rates should move higher.

KINGS POINT
CAPITAL MANAGEMENT LLC

We point out that there are two other factors at play that could continue to hold down interest rates this year. First is that 10-year sovereign rates in Europe are at or below those of the U.S. equivalent.

As of 1/12/21015
Yield on
<u>10-year Sovereign Bond</u>

Germany	0.48%
France	0.75%
Spain	1.64%
Italy	1.81%
U.S.	1.90%

Source: Bloomberg

Secondly, the strength in the U.S. dollar against the Euro has been significant. When you realize that Europeans can buy our 10-year bond at a considerably higher yield **<u>and</u>** get a stronger currency as well, we wonder why so many forecasters expect the U.S. rate to charge higher this year? If Europe does not show any significant improvement in growth **<u>with</u>** the ECB moving to quantitative easing, then the U.S. would have to be in a very sharp economic recovery to see rates rise. At this juncture, we have our doubts.

The Federal Reserve, Valuation and the S&P 500 ETF's

<u>Chart IV</u>

Compound Annual Rates of Return by Decade

Asset Class	1930s	1940s	1950s	1960s	1970s	1980s	1990s	2000s	2004-13
Long-Term Government	4.9	3.2	-0.1	1.4	5.5	12.6	8.8	7.7	6.1
Long-Term Corporate	6.9	2.7	1.0	1.7	6.2	13.0	8.4	7.6	6.4
Small-Cap Stocks	1.4	20.7	16.9	15.5	11.5	15.8	15.1	6.3	9.3
Intermediate-Term Gov't	4.6	1.8	1.3	3.5	7.0	11.9	7.2	6.2	4.4
Treasury Bills	0.6	0.4	1.9	3.9	6.3	8.9	4.9	2.8	1.5
Gold	5.3	0.1	0.1	0.0	30.7	-2.4	-3.3	14.3	11.2
Inflation	-2.0	5.4	2.2	2.5	7.4	5.1	2.9	2.5	2.4
Large-Cap Stocks	**-0.1**	**9.2**	**19.4**	**7.8**	**5.9**	**17.6**	**18.2**	**-0.9**	**7.4**

Style	1930s	1940s	1950s	1960s	1970s	1980s	1990s	2000s	2004-13
Small-Cap Value	-0.3	21.0	20.0	15.4	15.0	21.1	14.5	10.6	10.3
Large-Cap Value	-5.5	17.2	22.2	10.7	12.2	20.2	13.9	0.3	7.5
Small-Cap Growth	7.4	11.6	17.7	10.7	5.8	10.8	15.0	-1.1	8.9
Large-Cap Growth	**1.5**	**7.3**	**17.6**	**7.9**	**3.4**	**15.8**	**19.9**	**-1.8**	**8.0**

Source: Strategas

Looking back over many decades, it seems that at least part of the strength in the S&P 500 can be attributed to rising valuation levels. This was certainly the case in the decade of the 1980's and 1990's (Chart IV). As the above table indicates, large capitalization stocks (which are a good proxy for the S&P 500) outperformed all other equity classes over a 20 year span. Prior to the 1980's, large cap stocks were the worst performing equity asset class in the 1970's. Again, in the 2000-2010 decade (after the tech bubble burst), large capitalization stocks actually moved negative versus high single-digit gains for other equity asset classes. Clearly, valuation played a fairly large role in these extended time periods.

With the Federal Reserve moving to aggressive quantitative easing in the past five years, we find ourselves again benefiting from rising valuations and the subsequent strength of the S&P 500 and large capitalization stocks overall. In fact, the Federal Reserve program has made it almost impossible to get a respectable yield on any safe debt instrument. Thus, investors have been pushed into equities and more risky debt instruments to get a reasonable yield. Clearly, this would suggest an environment where bubbles can occur.

Chart V

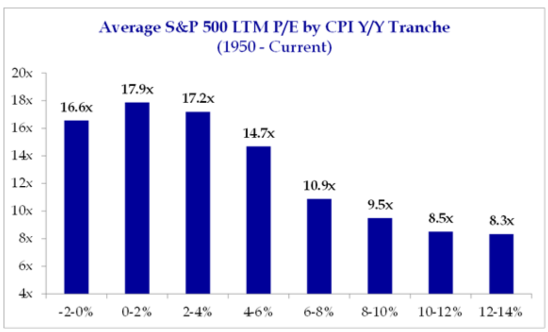
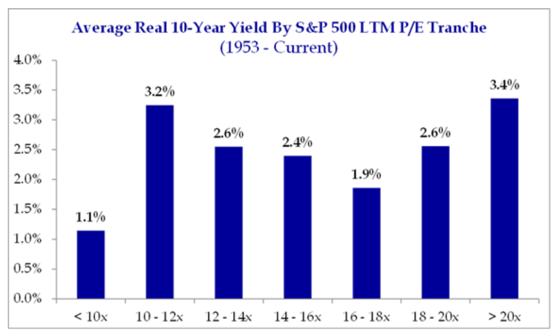


Chart VI



Source: Strategas

With the completion of quantitative easing, we suspect that any future rise in interest rates would have at least a neutral if not negative impact on valuations. While the equity markets can sustain 17-18 times earnings with moderately higher interest rates (Chart V & VI), it needs to be coupled with rising corporate profits, and strong economic growth.

Many investors have flocked to the S&P 500 index to benefit from this trend of the last five years. We suspect should the equity gains in the future be less robust and other asset classes perform better, owning this ETF may not be as rewarding in the future.

Our recurring theme is that the massive equity market collapse of 2008-2009 and the subsequent recovery are true aberrations. However, the methods employed to create this recovery are untested, unique in application, and have not been fully vetted through a complete economic cycle. This does not have to end badly. We are suspect, however, on how it does end. In reality, too many major shifts in macroeconomics have occurred to

KINGS POINT
CAPITAL MANAGEMENT LLC

call this normal, much less typical. Thus, at this juncture, while we are still positive on the market, we are becoming increasingly alert to signs of stress.

Portfolio Strategy

In the last few years, we have focused on investing in companies that have a significant footprint in the growing digital space. Because we are valuation sensitive, we have not gone to companies such as Google due to the excessive premium valuation investors have put on the company's stock price. Interestingly, Google has underperformed the S&P 500 for over five years despite generating earnings growth far better than the market. P/E compression from the lofty levels of years past has caused the stock to underperform. Given our sensitivity to valuation, we have chosen to invest in companies that are secondary beneficiaries to the growth in digital. American Tower is a good example. The increasing demand for more bandwidth has helped cell tower companies consistently grow. Additionally, American Tower has expanded into foreign markets to further drive growth over the long term. A second name to highlight is eBay. Although the stock stumbled in 2014 due to slowing growth in a number of e-commerce markets, the excellent franchise value of both its Marketplace and PayPal assets have attracted an investor base that is pushing management to maximize asset values. More recently, a similar development has occurred with EMC, a major supplier of enterprise cloud storage systems and networks to business. Our position in Apple rounds out the technology exposure in our portfolio.

Another theme that we have embraced is category dominant service companies. These companies tend to be in oligopolistic markets and generate significant free cash flow to be used in share repurchase, debt reduction and/or dividend growth. Companies in our portfolio with these attributes include Moody's, the large financial rating agency and Nielsen NV. The latter is the world's largest information measurement company specializing in the advertising and retail industries. The company is moving to create sound techniques for measuring advertising impact in the burgeoning digital space as well.

Importantly, we are seeking more companies in the business service area. We believe these kinds of companies can generate consistent growth, are less cyclical than the economy in recession periods and can generate superior long term growth relative to most other traditional companies. To that end, we have added Aramark to our mid-capitalization portfolio. Aramark is a large commercial food service company that manages corporate dining rooms and cafeterias as well as sports venues among other key customers.

Our goal is to continue to find attractive companies that can be resistant to future economic slowdowns, generate free cash flow, have returns on invested capital in excess of capital costs, and produce healthy long-term earnings growth.

KINGS POINT
CAPITAL MANAGEMENT LLC

While we have become a bit more cautious in our positive outlook, many signs are emerging to sustain corporate and global economic growth. Lower commodity and energy costs, quantitative easing programs in many foreign regions, accelerating growth in the U.S. economy and improving real spendable income in the U.S. and some overseas consumer markets are some of the continuing positives that have recently emerged. We will also be sensitive to possible strains in global economic growth as the year progresses. However, at this juncture, the positive trends continue to outweigh the negative.

If there are any questions, do not hesitate to contact our offices at your earliest convenience.

Jack L. Salzman
Senior Managing Partner

Jeffrey P. Bates
Managing Partner

John A. Marshall, IV CFA, CFP®
Investment Advisor

Beth C. Webb, CFP®
Investment Advisor

Nathan T. Fend
Investment Advisor

Jason D. Beaird, CFA
Investment Advisor

t: 516.439.5100 f: 516.439.5102
111 Great Neck Road, Suite 310, Great Neck, NY 11021

t: 800.259.1331 t: 615.620.3900 f: 615.620.3920
112 Westwood Place, Suite 210, Brentwood, TN 37027

www.kingspointcap.com