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### *It's All Greek to Us!*

Just as Europe finally looked like its economic growth would begin to accelerate, Greece's financial problems took center stage again. The Greek problems are well understood and its impact to the global banking system is dramatically lower than the dark days of the global financial crisis of 2008-09. Greece is less than 0.04% of world GDP. Its debt is now largely owned by European Union sovereign governments or by agencies backed by these governments (Table I). We believe that world stock markets are reacting more to the potential political risks of a Greek default and possible exit from the Euro and European Union versus defaulting on its debt obligations. If Greece leaves, cuts its debt obligations and then rebuilds its economic foundation, other countries saddled with debt may do the same. While a long-term positive for the Greek economy, this action could ultimately lead to the unravelling of the European Union. Given the steps taken thus far, we feel this scenario is unlikely to happen.

**<u>Table I</u>**

*Source: Bank for International Settlements*

In retrospect, the myriad of problems in Greece could have been avoided if the EU had policed its financial policies with more vigor. Now, with Greece unlikely to pay off its debts, the EU's only hope is to extend out payments in return for more fiscal tightening by the Greek government. That recipe has consistently failed to produce a successful outcome. If a Greek exit leads others to leave (which is the biggest fear), then the EU's conceptual structure is destined for failure. However, if Greece restructures and the EU continues to generate modest GDP growth in the

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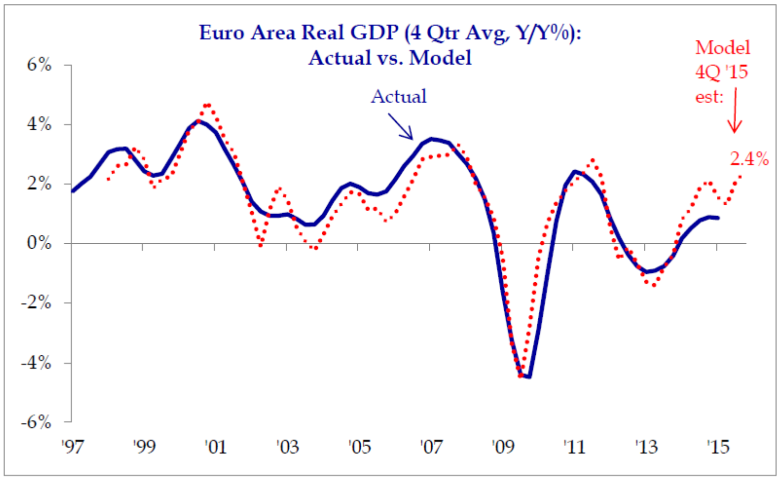
future, the organization would have survived another key test to its foundation (Table II). As of this writing, this Greek tragedy seems to be moving in this direction.

**Table II**




*Euro Area (EA) Real GDP 4Qtr Avg Y/Y% = -7.0 +0.1*EA Consumer Confidence Index + 0.2 ISM EA Mfg PMI Estimated 2003-2014; All RHS variables lagged 2Q; $R^2$=86%*

*Source: Strategas*

Perhaps our bigger economic worry is China. Holding the Olympics in China in 2008 probably marked the peak of its economic power and financial influence in the world. Since that time, the Chinese economy has slowed, its outstanding debt has risen sharply and its cash has dwindled. Concurrently, its shift from building infrastructure to a more focused effort of stimulating a consumer-based economy has had limited success to date. The more recent volatility of the Chinese stock market and the government's efforts to directly manipulate these markets higher underscore how aggressive the government is in trying to maintain stability. It also underscores the fact that China continues to govern as a Communist Society. However, due to the huge potential of the Chinese market, global investment has been and will continue to be massive. We view the current policies of the government as potentially creating an unintended negative impact to economic growth longer term. The more heavy handed and intrusive the Chinese government acts, regardless of its good intentions, the more foreign investment may adjust their long-term plans.

Within the broader markets, a number of factors are moving toward a favorable conclusion. Greece has "blinked" and accepted almost all the requirements of fiscal policy dictated by the European Union. Iran and the U.S. may well ink an agreement on nuclear weapons. Should that

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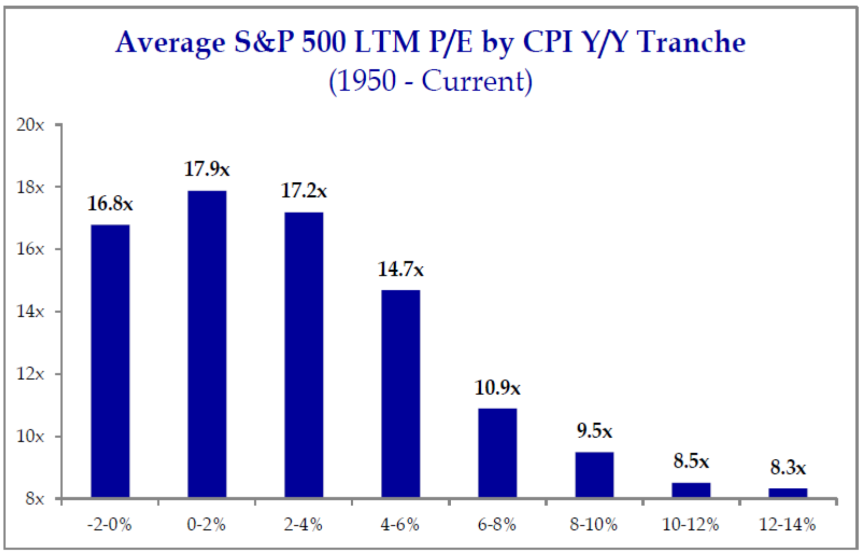
occur, we would expect oil prices to remain subdued for quite some time as Iran begins to ramp up its oil exports as economic sanctions are gradually lifted.

Additionally, the U.S. and Europe continue to show signs of modest economic growth. Moreover, global interest rates (including the U.S.) may continue to stay low for years to come thus continuing a movement by investors into riskier equity assets. While the global equity markets appear fair to slightly elevated in valuation, the current economic trends do not suggest an end to the bull market any time soon. If inflation remains subdued, the current market valuation of 17 ~ 18 times earnings is within the "sweet spot" of historical norms (Table III).

**Table III**




*Source: Strategas*

However, we do see signs of early stress. The breadth of market leadership peaked in 2013 and continues to recede. Merger and acquisition activity is surging as companies begin to accelerate their expansion plans prior to the shift to gradually rising interest rates. Profit margins remain at uniquely strong levels and are not likely to dramatically expand in the intermediate future. This suggests to us that the equity markets are probably in the last half of the bull market that began in March 2009. But bull markets do not die of old age. Extreme valuations and/or weakening fundamentals are usually the catalysts. At this juncture, we do not see these stress signs in evidence. More likely, equity markets should generate less appreciation in the coming years than over the past five years.

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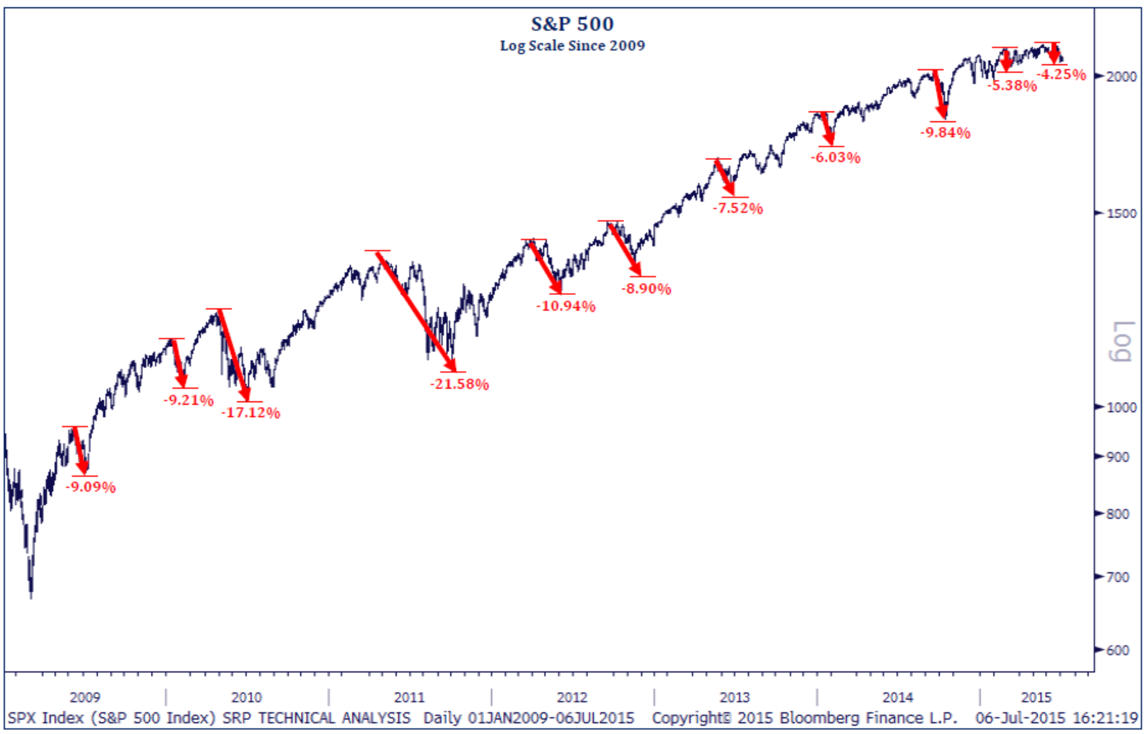
The U.S. stock market is also focused on the prospect of a rise in interest rates sometime this year. We believe that the modest growth in GDP is likely to delay any rise in interest rates until later this year. Additionally, we expect interest rates to rise at a slow, subdued rate for the foreseeable future. Expectations of a rise in interest rates have already impacted many equity valuations. Global multi-nationals struggle to overcome the impact of the appreciating dollar against most major currencies. Yield sensitive stocks have been under pressure for most of 2015. Conversely, any equity that offers strong growth is rewarded with expanding P/E multiples.

We also believe that modest economic growth in 2016 in the U.S. and Europe should result in a very modest rise in interest rates next year. Thus, the bull market is likely to grind higher throughout 2016 given the likelihood of a very gradual rise in long-term interest rates (Table IV).

**<u>Table IV</u>**




*Source: Strategas*

Our core portfolio has straddled a middle course. More recent additions are companies with strong growth prospects and valuations that are consistent with those prospects. More importantly, each is less susceptible to any slowdown in the global economy. One such example is Allergan PLC. Actavis (now Allergan) is a global specialty pharmaceutical company engaged in the development and distribution of generic, branded generic, brand name, biosimilar, and over-the-counter drugs. The firm also develops and licenses generic pharmaceuticals primarily in

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Europe. As of this writing, the company may be close to selling its generic business. Actavis acquired Allergan in May 2015 and took the target's name. The acquisition provided it with Allergan's therapeutic franchises in ophthalmology, neurosciences, medical aesthetics, dermatology, and plastic surgery (including key products, Botox and Restasis) and completed its transformation into a growth pharma company. We are attracted to AGN because of its category dominance in branded and generic pharmaceuticals, exposure to healthcare industry tail winds, and a management team that is operationally strong and shareholder friendly. We view Allergan as a highly diversified, global drug distributor that possesses scale and exposure to attractive healthcare product categories. Its current product growth is augmented by a number of pipeline launches, and continued R&D investments over time should yield sustainable high-single-digit growth.

Finally, as mentioned previously, the strength in the U.S. dollar against most major foreign currencies has had a significant impact on reported corporate profits for almost all U.S. based multinationals. To date, the U.S. dollar has appreciated an average estimate of 16% against major currencies. Depending on the geographic mix of a multinational corporation, the impact has reduced earnings growth by approximately 5-10%. We expect this headwind to persist (at least at a less onerous pace) through the first quarter of 2016. However, by this time next year, currency shifts should be neutral and possibly be a tailwind. This could add considerable earnings strength to many of our multinational positons.

While we are sensitive to any signs of global economic weakness, at this juncture it appears that global growth trends remain intact despite the obvious headwinds discussed earlier. As a result we remain constructive on the market.

As always, if you have any questions regarding the portfolio, please call at your earliest convenience.

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