ALTMAN
INVESTMENT MANAGEMENT

EQUITY STRATEGY FOCUS

MAY, 2015

IN FOCUS:

We have prepared this update in an effort to provide our clients with a macro overview of our investment program, as well as a brief review of market performance.

- Data is mixed but we believe growth will pick up in the 3rd and 4th quarters.
- Bond investors appear to be discounting the possibility of an interest rate hike in September.
- In Q2 value stocks began to outperform growth stocks as investors look to reduce valuations after a period of multiple expansion.

Our remarks that follow will elaborate on these highlighted points. For further information and discussion, please don't hesitate to give us a call and speak with one of our portfolio managers.

The Economic Landscape

On May 29, the second revision of real GDP for the first quarter will be announced by the Bureau of Economic Analysis and it is expected to be negative growth of 0.2% because of the large trade deficit of $51.4 billion announced in March after the first estimate of a 0.2% growth rate. The weak first quarter results were blamed on a severe winter and the West Coast port strike, now resolved. However, the second quarter will also be weaker than earlier consensus forecasts of economists, as well as the Federal Reserve, based on a number of economic statistics through the April and May period. At present, real GDP looks like it is growing at a sluggish 1.0% to 2.0% rate. There is a mounting controversy among economists as to why the seasonally adjusted data over the past thirty years consistently understates economic growth during the first quarter based on output data versus income data. To address this aberration beginning July, the Bureau of Economic Analysis will change its methodology to one that averages the two approaches aforementioned and hopefully produce a more accurate picture of the economic progress.

Not only has the U.S. economic growth rate slowed in the first quarter of the year, but a slowing in the global economies is evident as well, largely because of the continuing policies of slower growth in China which accounts for approximately 40% of global growth. The Chinese economy has grown at 7.0% in twelve months through March but the first quarter growth was 5.3%, lowering the current annual consensus outlook. Based on electricity output year-to-year which has just turned negative, the above growth outlook could be overstated. Overall, global consensus outlooks are approximately 2.4% with many countries close to recession. The euro area, however, has picked up slightly to a 0.4% growth rate in the first quarter (a 1.7% annual rate). The combination of a strong U.S. dollar and weaker foreign economies has slowed the growth rate of U.S. exports. Based on the first quarter estimate of real GDP, exports fell 7.2% while imports increased 1.8%, subtracting 1.25% from economic growth. While consumption improved, private domestic investment added to growth only marginally, and the government sector detracted from growth by approximately 0.15%.

Current data is presenting a mixed picture but nevertheless one of gradual growth which we believe will pick up in the third and fourth quarters similar to last year. The Manufacturing ISM Index is 52.8 in May, compared to 51.5 in April and while having declined from earlier numbers in the middle to high 50s is still representing economic expansion over the 50 level. Services (and the U.S. is primarily a service economy) rose to 55.7 based on the Non-Manufacturing Index versus 57.8 in March. Unfortunately, unit labor costs increased to a 5.0% annual rate in the first quarter – this is up from 4.2% in the fourth quarter, which will either put upward pressure on inflation or downward pressure on profits. Should this trend continue, the net effect would result in lower productivity to an estimated decline of 1.9% in the first quarter after a 2.1% decline in the last quarter of the year. The employment trends, however, have been strong with 3 million jobs created over the past twelve months with an unemployment rate of only 5.4% as the sixth year of recovery approaches in June.

While the leading indicators are slowing, a measure of 10 indicators measuring the health of the economy put out by the Conference Board, they are not indicating that a recession is imminent. In April, they increased by a strong 0.7% and over the past six months have grown at a 4.0% annual rate. This compares to an annual rate of 7.2% over the prior six months. Industrial production however did fall in April, largely because of a major drop in the drilling of oil and gas wells which are down significantly year over year by as much as 47%. Output of motor vehicles continued strong again in April, marking a year over year advance of 7.2%.

Industrial production is also still positive by 1.9% year-over-year through April. In contrast to the Federal Reserve comments in the FOMC minutes, we still emphasize that low inflation numbers are beneficial for the purchasing power of the consumer, as evidence by the effect on consumption as energy prices declined this past year. The Consumer Price Index rose slightly in April but still negative year over year, while the Producer Price Index is still weaker both monthly and annually. These good results are a result of falling food and energy prices. Ex food and energy, the CPI is actually up 0.3% y/y and the PPI is up over 0.8% y/y.

In conclusion, we should mention that one of our worries with regard to capital spending is dissipating. After five months of decline, the orders for non-defense capital goods, ex aircraft (core capital goods orders), increased 1.0% in April with March revised upwards as well. The economy needs capital spending to create jobs as well as profits. Our revised forecast remains at 2.75% real GDP growth for 2015 with corporate profits rising 5.0% and CPI inflation of 2.5%. We believe that the U.S. dollar is close to peaking and that oil will form a base around $55 per barrel as it forms a new uptrend.

IN VIEW: The Equity Investment Outlook

The most significant development since the first quarter closed has been the sharp rise in interest rates, while a more volatile stock market has moved sideways. Also, after a brief respite, the U.S. dollar has continued its rise while commodities have been somewhat mixed. At present, 10-year Treasury bonds yield at 2.38% as compared to 1.92% a month ago, with long-term high quality corporate bonds currently yielding 4.18% versus 3.77% last month. A similar pattern applies to municipal bonds and mortgages. Long-term municipal bonds presently yield 3.44% versus 3.10% a month ago, and 30-year mortgage bonds yield 3.95% compared to 3.78% last month. The reason for the increase is not rising inflation but the belief, based on recent comments by Federal Reserve members - including Janet Yellen, Chairwomen of the Federal Reserve - that they would like to begin a program of normalizing interest rates after six years of pursuing a zero interest rate policy. Economic data based on the last five months would not support an increase in interest rates since the data has been weakening. However, most members of the Federal Reserve believe that economic growth will increase in the coming months and CPI inflation, ex food and energy, currently at 1.8% will rise in the ensuing months. The Federal Reserve tends to view inflation, ex food and energy, as giving a more accurate picture of inflation by removing the volatility of food and energy prices from the calculation. In addition, wages have been gradually moving upwards against the background of low unemployment while many states have been increasing the minimum wage. In our opinion, September appears a likely time to make the decision to raise rates, and bond investors appear to be discounting this possibility.

The S&P 500 (2086) is essentially unchanged since the quarter end. Foreign markets, as measured by the Morgan Stanley EAFE Index (1865), have also given up the May gains (down from 1950). On valuation, the S&P sells at 16.9 times our $123 per share estimate of earnings for 2015, a 5.0% gain. Historically, forward P/E ratios are about 14 times. Looking ahead, we would expect earnings to grow at a higher rate 6.0% - 7.0% in 2016, as economic growth continues to expand after the brief pause in the first six months of 2015. In addition to the current economic and earnings slowdown, geopolitical discord, particularly involving Russia and the financial disagreements with Greece over the reform of their economy constitute growing concerns. We would add that the possibility has increased that any cooperation between the President and Congress, or between both political parties before the 2016 election, creates further uncertainty. Since we have yet to have a 10% correction since 2011 a cautious stance with regard to increasing equity exposure is warranted at this time.

Our current asset allocation for balanced accounts remains at the high end of our range with duration lower than the intermediate indices and a higher than average cash position otherwise dedicated to fixed income instruments. We believe this represents a reasonable allocation strategy despite that valuations for the stock markets are at the higher end of their range against a backdrop of growing uncertainties, many geopolitical in nature. As long term believers in equities we remain constructive that the average company will be able to maintain their operating margins in the current low inflationary environment.

IN BRIEF: Equity Investment Strategy

Rising oil prices at subpar growth and a steepening yield curve set the backdrop for financial markets as we enter the second quarter. Oil prices, as measured by WTI, finally gained significant momentum during April as prices rose over 20% to levels not seen since last year. The price appreciation was felt across the energy complex as energy-related sectors were overwhelming the outperformer so far in Q2. The recent stability in prices was also enough to stop the recent declines in the Consumer and Producer Price Indices. With deflation concerns temporarily on the side lines, investors have turned to growth to demonstrate signs of economic resilience.

Benchmark Performance Highlights

EXHIBIT I

S&P 500 Index – 1st Qtr. Performance

	Sector Wgt. As % of S&P as of 03/31/2015	1st QTR Return 12/31/214 - 03/31/2015	1st QTR Sector Contribution of S&P 500
S&P Index		0.95	
Consumer Discretionary	12.6	4.8	0.6
Consumer Staples	9.7	1.0	0.1
Energy	8.0	-2.9	-0.2
Financials	16.2	-2.1	-0.4
Health Care	14.9	6.6	0.9
Industrials	10.4	-0.9	-0.1
Information Technology	19.7	0.6	0.1
Materials	3.2	1.0	0.0
Telecommunication Services	2.3	1.5	0.0
Utilities	3.0	-5.2	-0.2

Source: Bloomberg

S&P 500 Index – Sector Performance Summary

- The S&P 500 index ended the first quarter at 2067 just 2% below its all-time high reached on March 2nd.
- The benchmark index returned .95%, during Q1, led by small caps stocks which climbed 4.32%.
- Value stocks lagged growth stocks by over 300 basis points. However, it appears that in the second quarter the tide is beginning to shift. Value stocks are ahead by 40 points and large caps are ahead by 25.
- Sector results were somewhat mixed in Q1. As Utilities, Energy, and Financials all realized losses, Healthcare, Consumer Discretionary, and Telecommunication stocks outperformed the overall market.

AIM's Attribution Highlights

EXHIBIT II
AIM Composite – Q1 2015

	Sector Wgt. as % of Portfolio as of 03/31/2015	Relative Wgt. versus S&P 500 Index	1st QTR Total Return of AIM Composite	1st QTR Total Attribution of AIM Composite
AIM Composite			-0.6	-1.5
Consumer Discretionary	9.7	-2.9	4.9	0.0
Consumer Staples	11.4	1.7	7.2	0.7
Energy	10.8	2.8	-3.6	-0.2
Financials	18.3	2.1	-4.9	-0.6
Health Care	14.3	-0.6	3.6	-0.4
Industrials	9.2	-1.2	3.3	0.4
Information Technology	17.7	-2.0	-5.6	-1.2
Materials	2.7	-0.5	-3.0	-0.1
Telecommunication Services	2.1	-0.2	-1.3	-0.1
Utilities	2.2	-0.8	-4.0	0.1

Source: Bloomberg and Altman Research

AIM Composite Attribution Analysis

- The total return of the AIM composite during the 1st quarter was -.6%. This compares to the market benchmark return of .95%.
- We added 68 basis points to relative performance by way of owning Kraft Foods. Heinz and Kraft announced merger intentions at the tail end of the quarter lifting shares of KRFT up 39%.
- Industrials added 36 basis points of relative outperformance thanks to shares of Northup Grumman, up 9.7%, versus a total return of -.86% for the Industrial sector as a whole.
- Apple which accounts for nearly 4% of the benchmark index shot up 13%, as the rest of the technology sector was flat overall. Not owning Apple accounted for almost ½ of our underperformance in that sector. The rest is attributable to Intel, Applied Materials, and Microsoft down -13%, -9%, and -11% respectively.

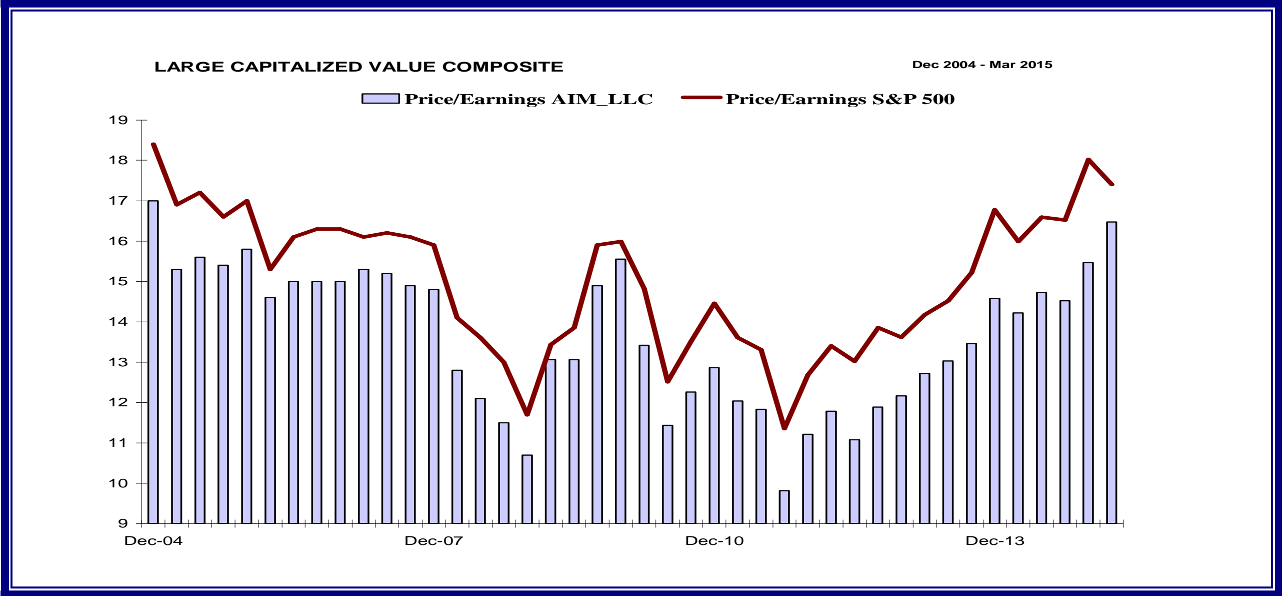
S&P 500 – Sector Valuation Characteristics

EXHIBIT III

	SPX	Energy	Materials	Industrials	Con Desc	Staples	Healthcare	Fincl	Tech	Telecom	Utilities
# holdings	502	41	29	65	85	38	55	86	67	5	30
Beta	1.00	1.23	1.06	1.09	1.00	0.74	0.95	1.08	1.04	0.78	0.53
P/B	2.88	1.74	3.53	3.64	4.97	5.10	4.44	1.40	4.10	3.34	1.73
TTM P/E	18.02	13.84	18.42	17.79	20.21	19.68	23.71	14.96	18.78	14.77	16.82
P/E cur	17.40	25.91	17.97	15.99	19.83	20.08	18.13	14.40	16.53	13.66	16.63
P/E FY1	15.62	20.52	14.98	14.86	17.25	18.44	16.25	12.98	14.90	13.08	16.01
P/S TTM	1.77	1.08	1.52	1.60	1.50	1.26	1.98	2.26	3.34	1.40	1.60
Div yield	2.04%	2.93%	2.02%	2.18%	1.52%	2.61%	1.55%	1.90%	1.56%	4.93%	3.67%
P/CF	11.09	6.62	11.46	12.09	13.32	14.28	17.14	8.87	12.45	5.84	7.36

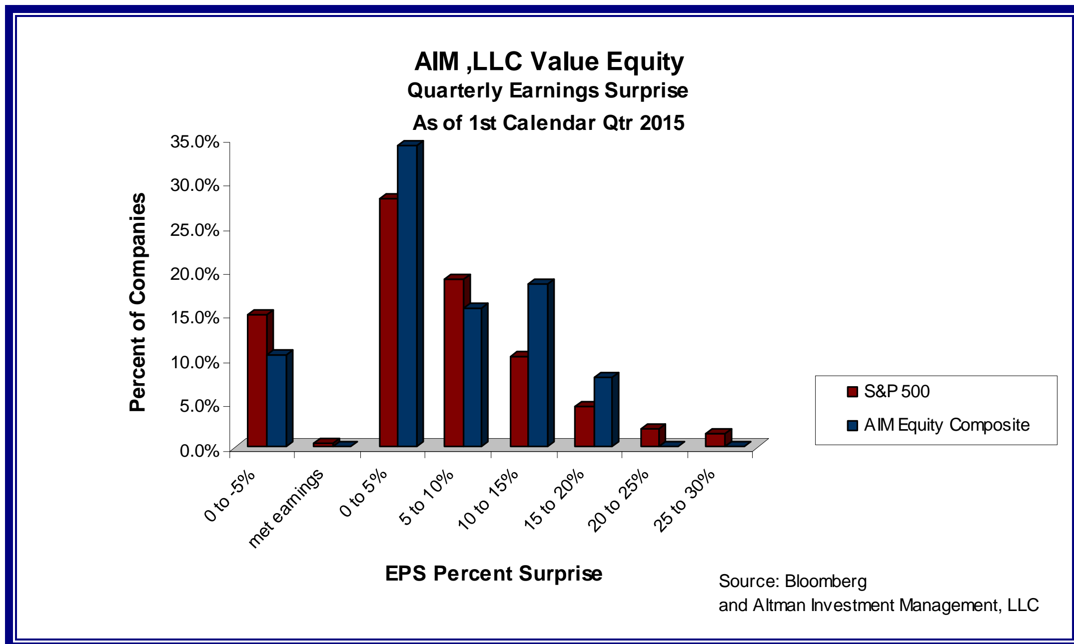
Source: Bloomberg and Altman Research

EXHIBIT IV



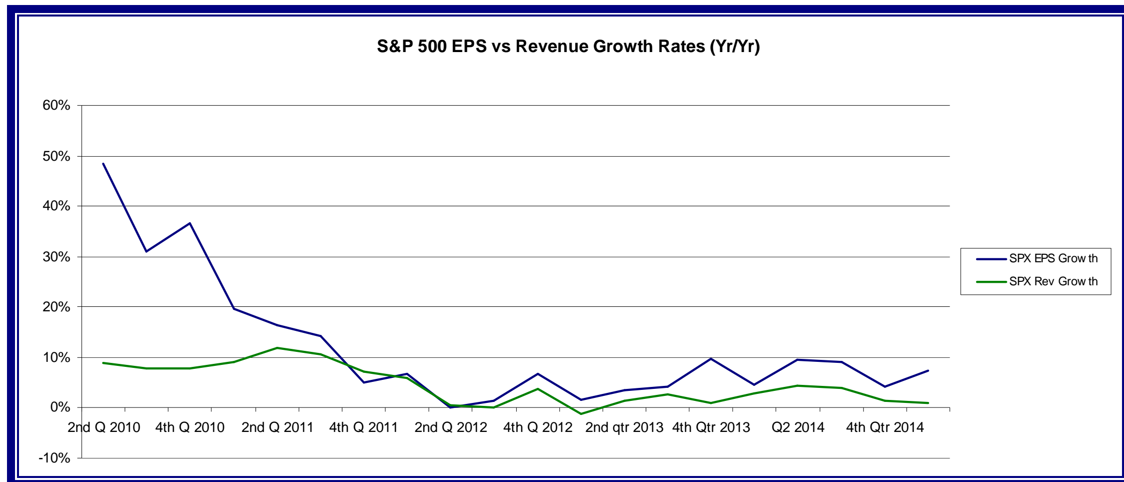
Source: Bloomberg and Altman Research

EXHIBIT V
Quarterly Earnings Surprises



The chart above illustrates the percentage of investment holdings within our value portfolio that exceeded street estimates during the 1st calendar quarter of 2015. Most notably, 82% of our investments exceeded street estimates and 72% of the companies in the S&P 500 exceeded street estimates. Looking at top line sales, 53% of our investments exceeded street estimates as compared to 46% for the S&P. As of May 13th, 2015, 93% of the AIM composite and 92% of S&P 500 companies have reported.

EXHIBIT VI



Source: Bloomberg and Altman Research

IN SUMMARY:

The soft patch may be over. The latest batch of economic indicators is certainly more upbeat than previous ones. A sharp rebound in May retail sales appears to confirm that the near term weakness has abated. May auto sales rose to 17.8 million units, the highest levels since July 2005. However we still have some concerns that rapidly rising tenant rent and out-of-pocket health care costs may be offsetting some of the positive impact of rising incomes. Another upbeat housing-related indicator was April's Pending Home Sales Index, which rose to the highest level since May 2006. It tends to be a good leading indicator for existing home sales.

And, of course, there was plenty of good news in the employment reports. Most impressively, full-time household employment rose by 630,000 during May, having risen 2.6 million over the past 12 months. While wage gains remain relatively subdued around 2% on a y/y basis, the latest three-month changes are mostly around 3%, on average, at an annual rate.

If we attempt to eliminate the seasonality and the west coast strike in Q1, we estimate that real GDP actually rose 2.7% during the past quarter on a y/y basis. Our calculations show that the economy continues to grow at a slow but steady pace and maintain that this will expand near the 3.5% level by the fourth quarter this year and warrants current premium valuations.

The opinions expressed in this commentary are those of Altman Investment Management, LLC as of the date appearing on this material only and are subject to change. The material is based upon information we consider reliable but we do not represent that it is accurate or complete and should be relied upon as such. This material does not take into account the particular investment objectives, financial situation or needs of the individual client and should not be viewed as an endorsement of any particular investment. Certain investments give rise to substantial risk and are not suitable for all investors.