ALTMAN INVESTMENT MANAGEMENT

EQUITY STRATEGY FOCUS

OCTOBER, 2015

IN FOCUS:

The decisive reversal from deeply oversold conditions and excessive pessimism in August improved global market valuations. This quarter delivered positive surprises during the U.S. earnings season (a 72% beat rate among S&P 500 stocks), a bullish shift in seasonal and cyclical influences in markets globally, and significant breadth improvement. Thanks to another rate hike delay by the Fed and more easing initiatives by the ECB, Bank of China, and perhaps the Bank of Japan, liquidity remains abundant.

The Equity Market Outlook

- **September 28th marked the start of a yearend rally in global equities that should continue well into 2016.** Up 3.3% since the end of August, the MSCI World Index turned in a September-October performance exceeding its 0.9% median rise during past secular bull markets. The secular bull tendency points to an even better showing in the November-December period. The median two-month return has been 3.7% according to Ned Davis Research.

- **But the most significant support for the market's rally prospects has been the decisive breadth improvement.** From the September 29 low through the October 23 high, the MSCI All Country World Index sectors rose in bullish agreement, with gains ranging from Health Care's 6% move to a 14% rise by the Materials and Energy sectors. The regional indices also rose together, ranging from Canada's 7% advance to Japan's 13% rise.

- **Among the world markets, all but two have risen over the period**, while 91% are now above their 50-day moving averages. That indicator's buy signal, together with a five-day momentum indicator, has lifted investor enthusiasm to increase stock exposure.

IN BRIEF: The U.S. Economic Backdrop

The Fed once again left rates unchanged in October, leaving the door open for a possible rate hike in December. Stocks and the dollar rallied while bonds, commodities, and emerging markets sold off on the report. The Fed cited "that the underutilization of labor resources has diminished" even as employment growth statistics have moderated somewhat. Therefore, upcoming job reports will be an important gauge for the next meeting.

To quickly recap our September 4th *Brief Market Insights*, we suggested that the current market volatility is focused on three main issues: 1) plummeting commodity prices, 2) economic challenges in China, and 3) the timing and pace of the Fed's normalization of interest rates. In light of the uncertainties, we remain focused on what we *do* know. The fundamental earnings outlook is positive, the dollar appears to be stabilizing, oil demand is higher than year ago levels, cash hoards generally find their way back into equity markets, and P/E ratios remain resilient. We believe the drag from low commodity prices and a stronger dollar will not disappear but will moderate and an economic rebound will kick in, bolstered by labor market and wage growth.

The risk of deflation from a rising USD coupled with low energy prices is muted due to the opposing force of lackluster wage growth. A rising USD and falling energy prices have historically been deflationary. However as the slack in the labor market moderates and housing prices recover, these could work against deflationary pressures and keep inflation range bound. The fed is labeling the aforementioned events as transitory and is more focused on the long term implications of inflation due to a tightening cycle.

If economic fundamentals continue to improve, a gradual and deliberate Fed tightening cycle (roughly ¼ point every other meeting) should prove positive for stocks over bonds. Stocks have historically out performed bonds during the first year of interest rate hikes. Returns for stocks have been even stronger when rate hikes have been slow and deliberate.

Uncertainties surrounding oil supply and demand have been exacerbated due to struggles within China's economy and its impact on other emerging market currencies. Weaker currencies will likely further diminish demand for oil and other commodities and may exert continued pressure on prices, pushing out the recovery in prices levels. The U.S. Energy Information Administration forecasts production to continue to decrease throughout mid-2016, bringing their projection for Brent crude prices up to $54 and $59 for 2015 and 2016 respectively. As a reference point, West Texas Intermediate (WTI) crude prices are about $5 below Brent.

CLOSE-UP: Equity Investment Overview

Benchmark Performance Highlights

EXHIBIT I
S&P 500 Index – 3rd QTR Performance

	Sector Wgt. As % of S&P as of 09/30/2015	3rd QTR Total Return	3rd QTR Sector Contribution of S&P 500	YTD Total Return	YTD Sector Contribution of S&P 500
S&P Index		-6.46		-5.29	
Consumer Discretionary	13.1	-2.4	-0.3	4.21	0.47
Consumer Staples	9.9	-0.3	0.0	-2.06	-0.19
Energy	6.9	-17.5	-1.3	-21.32	-1.71
Financials	16.5	-6.8	-1.1	-6.97	-1.20
Health Care	14.7	-10.7	-1.7	-2.17	-0.41
Industrials	10.1	-7.0	-0.7	-9.78	-1.00
Information Technology	20.4	-5.8	-1.0	-3.08	-0.61
Materials	2.8	-17.1	-0.5	-16.8	-0.52
Telecommunication Services	2.4	-6.9	-0.2	-3.93	-0.09
Utilities	3.2	5.5	0.1	-5.78	-0.18

Source: Bloomberg and Altman Research

S&P 500 Index – Sector Performance Summary

- The market sold off in Q3, trading down over -6% in response to falling energy prices, Chinese economic woes and concerns over the timing and pace of Federal tightening.
- After a moderate uptick in the first half, the market closed the quarter with a YTD decline of -5.29%.
- As expected, large cap stocks out-performed small caps, as investors sought out higher quality to weather the volatility.
- Surprisingly, it was the Healthcare sector that took a turn to the downside in the latest quarter, due to recent proposals from Democratic Presidential candidate Hillary Clinton in relation to lowering healthcare costs. Although in negative territory year to date, Healthcare remains in the top three performing sectors alongside Consumer Staples and Consumer Discretionary.
- Material stocks sold off over -17% this past quarter, primarily due to falling prices within the aluminum and diversified metals industries. Weak economic releases out of China have raised concerns over demand for these metals.

- Energy stocks traded off -17% in Q3, also in response to weakening demand from China among other global supply related issues. Energy was the largest negative contributor to overall year to date performance.
- Financials and Industrials, down -6.97% and -9.78% respectively, were the next largest contributors to negative year to date returns for the benchmark.

AIM's Attribution Highlights

EXHIBIT II
AIM Composite – Q3 2015

	Sector Wgt. as % of Portfolio as of 9/30/2015	Relative Wgt. versus S&P 500 Index	3rd QTR Total Return of AIM Composite	3rd QTR Total Attribution of AIM Composite	YTD Total Return of AIM Composite	YTD Total Attribution of AIM Composite
AIM Composite			-7.8	-1.3	-7.7	-2.5
Consumer Discretionary	9.2	-3.9	-4.6	-0.4	-5.4	-1.1
Consumer Staples	11.6	1.7	-3.3	-0.4	13.4	0.6
Energy	9.1	2.2	-24.8	-1.1	-27.2	-1.1
Financials	19.2	2.7	-8.1	-0.3	-7.4	-0.2
Health Care	15.6	0.9	-8.3	0.5	-7.4	-0.6
Industrials	8.8	-1.3	-5.3	0.1	-3.4	0.6
Information Technology	17.6	-2.8	-5.1	0.1	-11.6	-1.7
Materials	2.1	-0.7	-21.8	-0.1	-32.1	-0.4
Telecommunication Services	2.2	-0.2	-7.0	0.0	1.2	0.1
Utilities	2.4	-0.8	14.3	0.1	-1.7	0.1

Source: Bloomberg and Altman Research

AIM Composite Attribution Analysis

- The AIM composite lost -131 basis points versus the market during the 3rd quarter. Oil prices plunged -24% subtracting 100 basis points from our relative performance.
- Excluding the Energy sector, the relative performance of our AIM composite would have been almost neutral.
- In Q3, as Healthcare stocks sold off, shares of Pfizer and Cardinal Health held up better than the averages and added 19 basis points to relative performance.
- On a year to date basis, Consumer Staples was our best performing sector supported by shares of Kraft Heinz, Mondelez, and Conagra.
- In the AIM composite, it was the Consumer Staples, Telecommunication, Utilities, and Industrials sectors that outperformed the overall market.

Top Down Portfolio Strategy:

Throughout the 3rd quarter market sell off and subsequent rebound off the bottom, we held our equity exposure steady, avoiding panic selling. The S&P 500 has historically rebounded after peak periods of market volatility. Admittedly, this takes some patience. However, investors who stay the course, while navigating volatile markets, as opposed to those who try to market time, repeatedly come out ahead.

In the spirit of emphasizing U.S. equities at this time, we reviewed some industry groups and specific stocks based on revenue exposure and our "quantitative" discipline. For Financials in particular, our thesis is that defensive attributes like the successful implementation of adequate capital adjustments during periods of financial stress should drive strong growth in shareholder returns. The lack of currency exposure should also fuel above-average estimates for the sector. Moreover, this is an economically-sensitive sector that does not discount much of a recovery in terms of today's relative valuation.

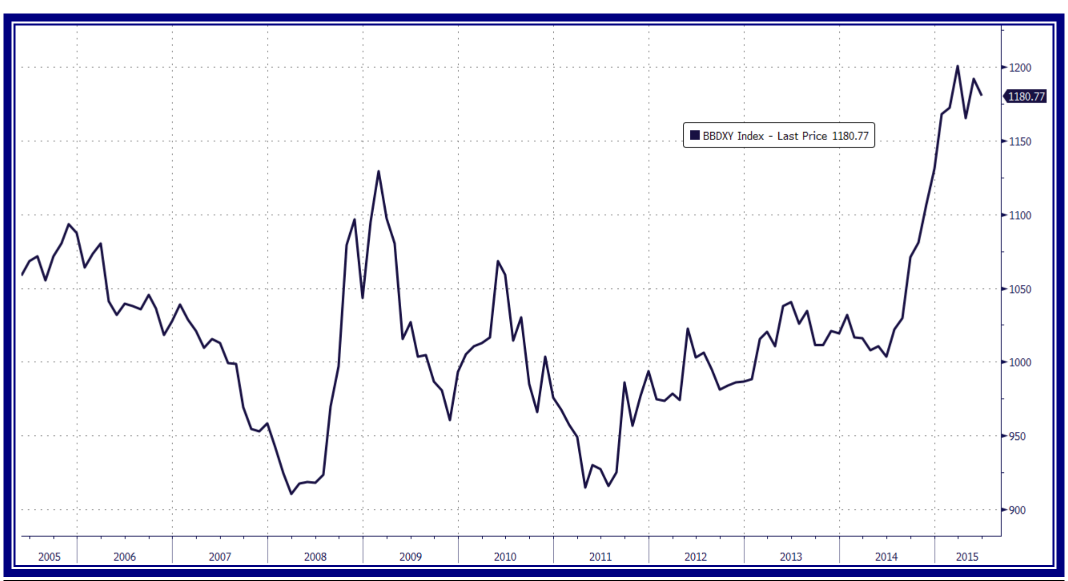
We also see sentiment continuing to improve as the timing signal from the Fed on the first rate hike becomes more apparent. And although recent survey results showed investors think Financials will be the best performing sector in the coming months, our conclusion is that investors are not yet positioned there. The overweight sectors in our core portfolio are Financials, Energy, and Consumer Staples.

Higher optimism regarding the global economy has already driven the recent rally in oil prices and the Energy sector – pushing the group from an oversold condition in the 3rd quarter to a leadership position in the current quarter. We would expect the industry to continue consolidating as the weaker players get swallowed by those with stronger balance sheets. Although it may take a few years to reach $70, we believe oil is in a bottoming process and is slowly beginning to wind back up to levels that will round out supply and demand.

The other sector leading the markets in the current quarter is Information Technology. We expect spending on software to strengthen and capex to accelerate in the coming quarters. Financials have also gained traction and are one of our largest portfolio overweight positions. As rates rise, the banks and life insurance companies tend to correlate closely to the 10 year treasury yield which has moved up in recent weeks. Financials have struggled recently due to a prolonged falling long-term rate environment. A large part of profits for these companies depends on how much they can earn on their assets relative to what they are paying out on their liabilities. Rates on liabilities have remained relatively stable, but yields on assets have plummeted. As a result, net interest spreads have narrowed for commercial banks and life insurers. A rise in rates could resurrect margins.

The companies in our AIM composite on average have roughly 40% of revenues coming from foreign sources so we are paying particular attention to the trajectory of the U.S. dollar. We have stated previously that we believe the current heightened level of the U.S. dollar will moderate. However, at current levels the heightened level impacts domestic based companies in several ways. On the positive side a stronger dollar attracts foreign investment, lifts consumer confidence and spending, and improves the terms of trade with the United States. On the other hand, a strong dollar can limit domestic competitiveness in foreign markets and weigh on profit margins. Technology companies on average have the highest exposure to foreign currencies and we have heard from a number of them this year claiming that currency rates have had a negative impact on earnings and have lowered projections. As value investors we are proponents of "reversion to the mean", which means over time we would expect the heighted dollar to moderate, and then slowly revert back to its historical averages.

EXHIBIT III
U.S. Dollar Trajectory



Source: Bloomberg and Altman Research

Throughout the first 3 quarters, market sectors with higher valuations (i.e., higher relative P/E's and P/B's and P/CF's) out-performed. For example, Consumer Discretionary, Consumer Staples, Healthcare and Technology each performed better than the overall market. What this tells us is that investors have been willing to pay up for predictability during what is turning out to be a very volatile year in equities. While in hindsight this may have been beneficial, we believe this to be shortsighted. Market sectors such as Energy and Financials both are positioned as future beneficiaries of a recovering economy and higher interest rates. As patient investors, we believe these sectors are worth an overweight position.

Bottom Up Portfolio Investment Highlights:

The portfolios' investments in Financials and Energy caused the largest drags on relative returns. Its seven financial holdings trailed those in the benchmark, -8.1% versus -6.4%. Our regional bank Regions Financial led the banking sector lower with a decline of -15.2%. Like other banks involved in traditional spread lending, Regions net interest margin has remained under pressure because of ultra-low interest rates and disappointment on top line growth. We continue to believe that the market is overly discounting the company's long-term prospects.

In the life insurance segment, MetLife also struggled, falling -15.1%. Life insurance premium growth among the millennials has been struggling, as interest moves away from traditional life insurance towards other asset management products. In response, life insurers are concentrating in two key areas. First, efforts are shifting toward direct marketing initiatives to target middle markets that don't necessarily demand agents/brokers. Second, MetLife could benefit from the growth in retirement assets via opportunities in the pension risk transfer business.

In the Energy sector, the portfolio's investments dropped -24.7%, on average, versus -18.0% for those in the benchmark. Brent crude oil fell -22% in the third quarter, from $63 to $49 a barrel. Exploration and production company Marathon Oil was the weakest holding in the sector. Its profitability has one of the highest sensitivities to the commodity and greatest percentage exposure to North American shale. Also, investors' concerns about the potential for more dividend cuts in the Energy sector appear to have negatively impacted the performance on a near term basis. We continue to watch Marathon closely for signs of continued financial stress. Much will depend on the path of oil prices and management's ability to divest nonessential assets.

Investments in Industrials and Information Technology contributed the most to relative performance. The portfolio's three industrial stocks declined the least -5.1%, on average, compared to a decline of -9.4% for the sector in the benchmark. The less-cyclical holdings exposed to aerospace and defense contracts benefited, as concerns over slowing global economic activity dragged down much of the sector, including stocks in the machinery and electrical equipment industries. Northrup Grumman was the strongest performer, up 14.2%. The defense company raised its sales guidance and share buyback plan, and expressed greater optimism about the effect of its recent acquisition of Websense, a cybersecurity firm.

Honeywell declined less than the overall sector, bolstered by margin expansions across all three of its major segments. In the midst of modest industrial demand, Honeywell continues to make accretive acquisitions, its most recent being Elster, a thermal and gas solutions provider. Honeywell also has exposure in areas such as internet connectivity on airlines and auto turbochargers - both in the early stages of growth. Headwinds remain in currency translations from a stronger dollar and lower energy prices. While many of its segments may have neutral or even positive impacts as a result of lower oil prices, Honeywell produces integrated solutions to help companies control process automation costs and improve safety in the North Sea region. Low oil prices have indeed reduced demand from its E&P customers. Overall, despite the current slow growth environment it finds itself in, we have faith in Honeywell's execution and cost cutting initiatives to continue to deliver positive earnings growth.

In Technology, the portfolio's six holdings fell -5.5%, on average, versus a decline of -6.2% for technology stocks in the benchmark (Russell 1000 Value). Intel was the strongest sector performer, posting a -0.1% return. Despite flagging PC sales, revenues grew 10% quarter to quarter with gross margin trends 63% were in line with analysts' expectations. In addition, the company has been vigilant in reducing its capital expenditure budget for the current year by several hundred million reflecting the weak environment. Furthermore, the company's pending acquisition of Altera, which should enhance its offering in programmable chips, appears to be on track.

There were no full-position sales or purchases during the third quarter. In July, Kraft completed its merger with Heinz to form Kraft Heinz Co. We retain a target weight position in the company, believing it offers an attractive risk-reward opportunity within the Consumer Staples sector. DuPont completed the spin-off of its performance chemicals business, which became Chemours. We anticipate moving this small position, 0.15%, back into DuPont. Baxter International split into two separate companies of nearly equal size: We sold the Baxalta (biopharma) spinoff of Baxter (medical devices and infusion therapies) since we already have an overweight in the sector, and the valuation parameters were not overly compelling.

Archer Daniels lost -13.5% in Q3, accounting for 29 basis points of our underperformance against the benchmark. Higher inventories and over supply were both headwinds to ethanol margins. Agriculture Services, which include grain transportation and storage saw healthy demand, but results were hindered by lower export margins and competitive pressures brought on by a stronger U.S. dollar. Positive oil seed results in grain milling were offset by weak global vegetable oil demand. Looking ahead we view the negative impacts form a stronger U.S. dollar as transitory. Archer Daniels has made some operational adjustments to improve efficiencies while at the same time making acquisitions and divestitures in order to improve profitability. Management continues to be focused on ROIC and improved product mix.

IN SUMMARY:

The Earnings Rebound Supports a Yearend Rally

The 3rd quarter season started with a bang, especially with several large-capitalized Technology names beating estimates. As we broached in previous commentaries, estimates have been slashed from 13.7% to -4.5% for the Standard and Poor's 500 single quarter operating earnings growth, enabling about 72% of companies to beat estimates. More importantly, the 3rd quarter is shaping up to be far better than the 2nd quarter on a year over year basis, and the recent quarter could turn out to be a trough in earnings growth for the 2015 calendar year. The bar has been raised for the 4th quarter of the year. This is partly due to tougher comparisons with consensus operating earnings estimates looking for a 6.6% growth in the current quarter followed by 13.4% in the first quarter next year. The expectations accelerate as much as 19.7% growth in the second quarter of 2016. We would expect these estimates to typically drift downward over time. Like many other non-recession corrections, the August decline did not materially alter the market's current price to earnings valuations. Through October, the average Standard and Poor's stock trades at 17 times current earnings and a slight premium to the historic averages. While the earnings rebound supports the case for a yearend rally, for stocks to climb substantially higher from current levels the economy needs to reaccelerate from its near stall speed.