ALTMAN INVESTMENT MANAGEMENT

MARKET PERSPECTIVE

APRIL, 2016

"American GDP per capita is now about $56,000. As I mentioned last year that – in real terms – is a staggering six times the amount in 1930, the year I was born, a leap far beyond the wildest dreams of my parents or their contemporaries. U.S. citizens are not intrinsically more intelligent today, nor do they work harder than did Americans in 1930. Rather, they work far more efficiently and thereby produce far more. This all-powerful trend is certain to continue: America's economic magic remains alive and well."
Warren Buffett

IN VIEW: Economic Indicators Point to Positive Equity Market Returns for 2016

The Federal Reserve's forecast, after their December twenty-five basis point increase in the targeted Federal Funds rate, was for four additional tightening moves in 2016 as the strengthening U. S. economy continued to foster employment gains and inflation climbed towards the Fed's 2% target. We forecasted in our yearend commentary that four moves seemed unlikely given sluggish global growth and still muted inflation. Our presumption proved correct. At the conclusion of the mid-March Open Market Committee meeting, Fed Chairwoman Yellen indicated that global economic and financial uncertainty pose risks to the U.S. economy and justify a slower pace of interest rate increases. She specifically pointed to slowing growth in China and weak oil prices as cautionary indicators prompting the need for patience. Market forecasters and the futures market are now suggesting that only one tightening move is probable this year, and later in the year rather than earlier. Fed guidance continues to emphasize that future moves will be data-dependent with inflation and employment gains being key factors in their consideration.

Economic indicators and corporate earnings, on balance, we believe will continue to bolster positive equity market returns for 2016. Our view has not changed over the past quarter. We continue to expect moderate U.S. economic growth, with real GDP advancing at a 2.5% rate accompanied by additional employment gains and inflation trending slightly higher but remaining moderate. We support the notion that the Fed is taking a slower path towards interest rate tightening, and that the U.S. economy is not in recession. This suggests that earnings growth will resume and support improving year over year earnings comparisons and higher equity valuations from current levels.

CLOSE-UP: The Economic Landscape

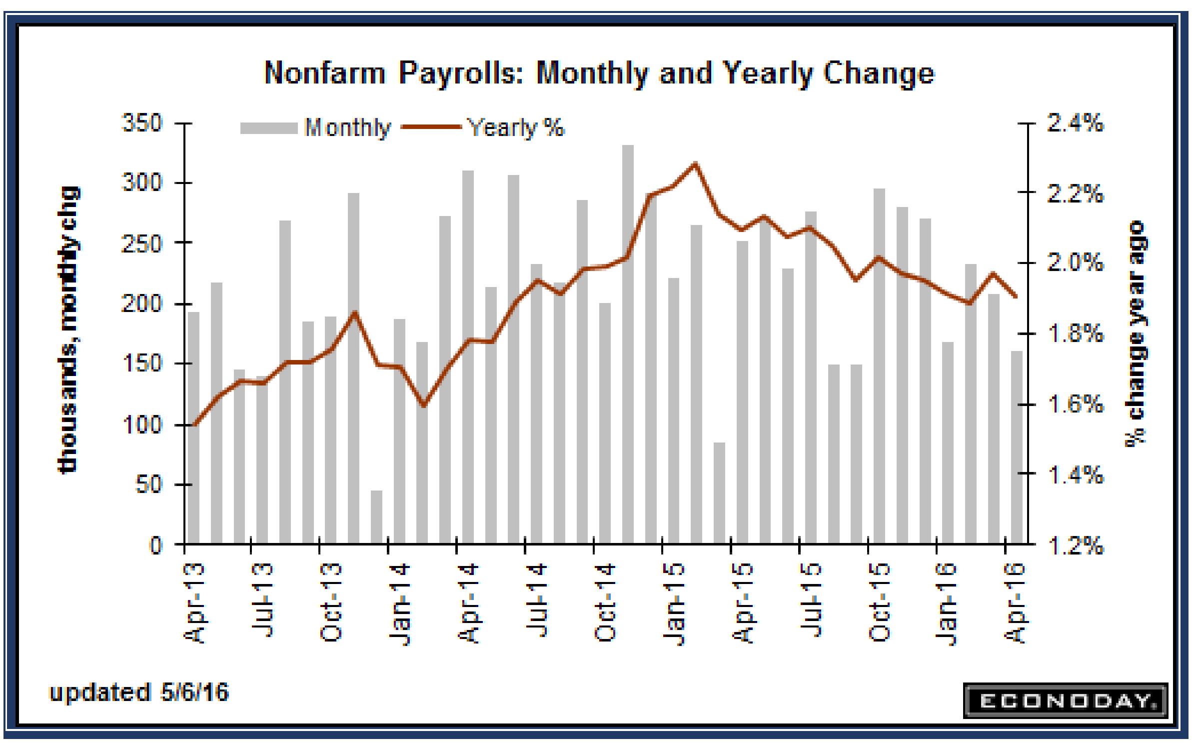
The consumer-related economy remains relatively healthy (personal consumption expenditures), although year-over-year real growth is only up a paltry 1.9% during the first quarter. Equity market performance has broadened from last years' narrow group of winners. The equity markets appear to be heavily correlated with the price of oil, which has fluctuated from fears of continued oversupply and the uncertainty related to global demand. Our conviction to stay overweight the Energy sector is supported by the conclusion that overall demand will push oil prices higher based on overall global growth forecasts improving as the year unfolds. A stabilization in oil prices at higher levels would be positive for most economies and financial markets.

The outlook for the economies and financial markets around the world in recent months have been characterized as uncertain, as the wars in the Mideast intensify and the mass migration into Europe only magnifies the threat to the European Union. The political uncertainty on domestic shores has also overshadowed investor enthusiasm for equity participation. Political uncertainty can paralyze corporate decision making and consumer spending. It is against this setting that the global investment outlook has to be measured. After the Great Recession of 2008-9, global annual growth was 5.0% at the beginning of 2010, as measured by GDP, and now stands at 2.5%. China's slowing growth and the subsequent collapse of commodity prices explains the paradox of slowing growth during the recovery period from the Great Recession. The U.S. has nevertheless held up better than many of the emerging economies throughout this period. Our view remains that the U.S. is in a long slow economic cycle of subpar growth because of structural problems involving high levels of debt, regulation and taxation. In addition, international trade is hampered by slowing global growth against a backdrop of excess capacity financed by excessively easy monetary policies.

The modest 160,000 gain in non-farm payrolls in April caught analysts off guard, as the consensus forecast was as high as 200,000. One can't expect employment to continue rising at more than 200,000 a month indefinitely especially in light of the fact that the U.S. economic growth path is stuck at a rate of 2.5%. Fortunately, U.S. employment has recovered and the unemployment rate is currently unchanged at 5.0% with labor participation rates still rising. For those worried that a slowdown in employment growth could be a sign of broader economic weakness, the rest of the employment report was reassuring. In particular, average weekly hours worked actually increased and the annual growth rate accelerated. As the labor market gets ever closer to full employment, hourly wage growth will continue to accelerate. We conclude that consumer spending should continue to be the driver of GDP over the rest of the year. Consumers should continue to benefit from solid employment gains, record high real incomes and wage gains that are modest but outpacing price increases.

EXHIBIT I

Non-Farm Payrolls



Source: Bloomberg and Altman Research

The U.S. is largely a consumption economy with strong technological leadership emanating from Silicon Valley and the biotechnology industry. Likewise, the added production in energy was primarily a result of U.S. technological innovation in shale fracking that led to the U.S. becoming the leader in global energy production. It is the above advantages, along with a strong agricultural economy, that makes the U.S. a global leader with a strong currency. One might add that strong military and security leadership is paramount in maintaining a strong currency that results in a higher standard of living. Keep in mind that policies that permanently weaken the dollar will ultimately lead to higher rates of inflation if engendered.

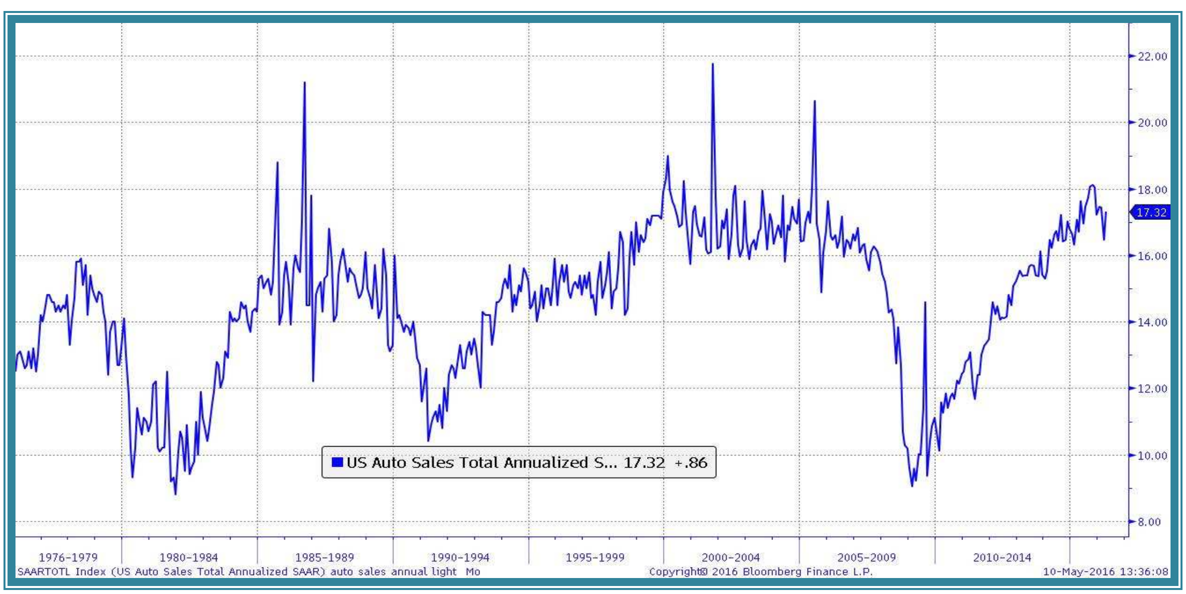
While current growth for the first quarter was below our previous tend line forecast, our view is that the second half of the year should experience a recovery leading to a resumption of annual growth of 2.5%. Our expectation for CPI inflation remains low at 1.7%, with corporate profits still modestly higher but down from our initial forecast of a gain of 5.0%. As mentioned earlier, we are living in a period of great uncertainty and the current elections are a large part of that sentiment.

Recent Economic Data Confirms a Second-Quarter Rebound

The slowdown in real consumption growth in the first quarter was disconcerting, despite the continuing strength of employment gains and the savings generated by the further declines in gasoline prices. In particular, the softness in March meant a weak starting point to the second quarter as well. Much of that weakness, however, was due to a big drop back in motor vehicle spending. Thankfully, we learned last week that unit vehicle sales subsequently rebounded to 17.3 million annualized in April, fully reversing the decline a month earlier. That bounce back suggests real motor vehicle consumption increased by as much as 6% m/m last month. Looking back on 2015 as a record year for sales, a slowdown at some point was inevitable. There does not appear to be a visible deterioration in the fundamental drivers of car sales and, looking ahead, we believe conditions remain favorable. With auto sales apparently back on track, real consumption growth should rebound to our forecasted rate in the second quarter**.**

EXHIBIT II

Real Consumption – Auto Sales Year/Year (Seasonally Adjusted)



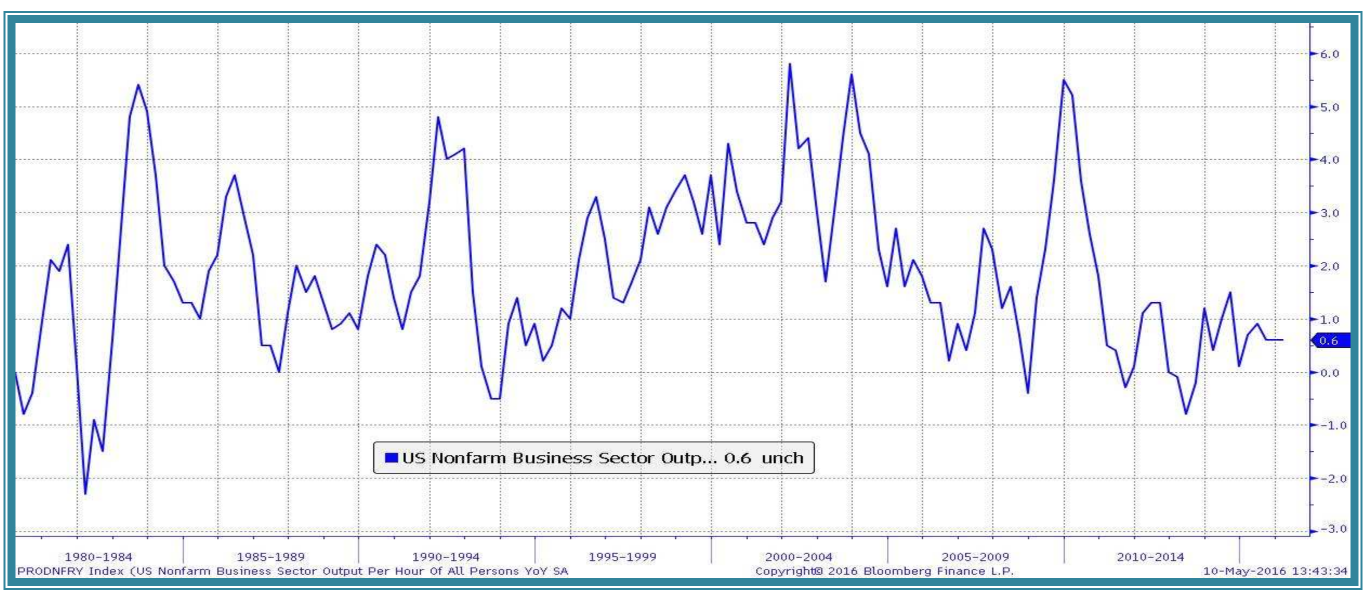
Source: Bloomberg and Altman Research

On a positive note, the latest survey evidence suggests that domestic activity should strengthen in the months ahead. The ISM non-manufacturing index rose in April again bringing it to its highest level this year. Although the survey evidence suggests that growth in the service sector continues to strengthen, the signals from the manufacturing sector have been more mixed. Admittedly, the ISM manufacturing index has rebounded sharply in the latest months, but then fell back recently. The dollar's decline over the past few months does suggest that manufacturing activity will trend higher in the months ahead. However, we are not expecting a material improvement in the sector for some time. Nonetheless, an average of the last two ISM surveys shows a level that has been historically consistent with GDP growth of better than the 2.5% annualized rate. The more encouraging prospects for activity in the service sector, together with an expected rebound in real consumption growth, suggest that real GDP should approach our expectation of trend line growth this year.

Over the last 12 months, productivity growth was a meager 0.6%, in line with the trend over the past five years. This productivity performance has deteriorated close to levels of the early 1980s. Accordingly, even if the labor force maintains the current more rapid pace of growth and increases by 1% this year, potential GDP growth could be sluggish and falling closer to the 2%. We do expect productivity growth to rebound modestly over the next year or two, since firms will find it a lot harder to add additional workers now that the economy is approaching full employment. Instead, firms will need to expand production by investing in additional capital and boosting efficiency. In the short term, however, even lackluster GDP growth of around 2% should be sufficient to generate additional inflationary pressures. The implication of the weakness in productivity growth is that firms have seen a rapid increase in unit labor costs. We are reminded that it is unit labor costs, rather than hourly wages, that is the biggest driver of domestic price pressures. Unit labor costs increased by 4.1% annualized in the first quarter and 2.3% over the past 12 months. As the economy moves even closer to full employment, a marked acceleration in the growth rate of average hourly earnings should keep upward pressure on unit labor costs, even if productivity growth recovers. Faster unit labor cost growth could push higher core inflation.

EXHIBIT III

U.S. Non-Farm Productivity

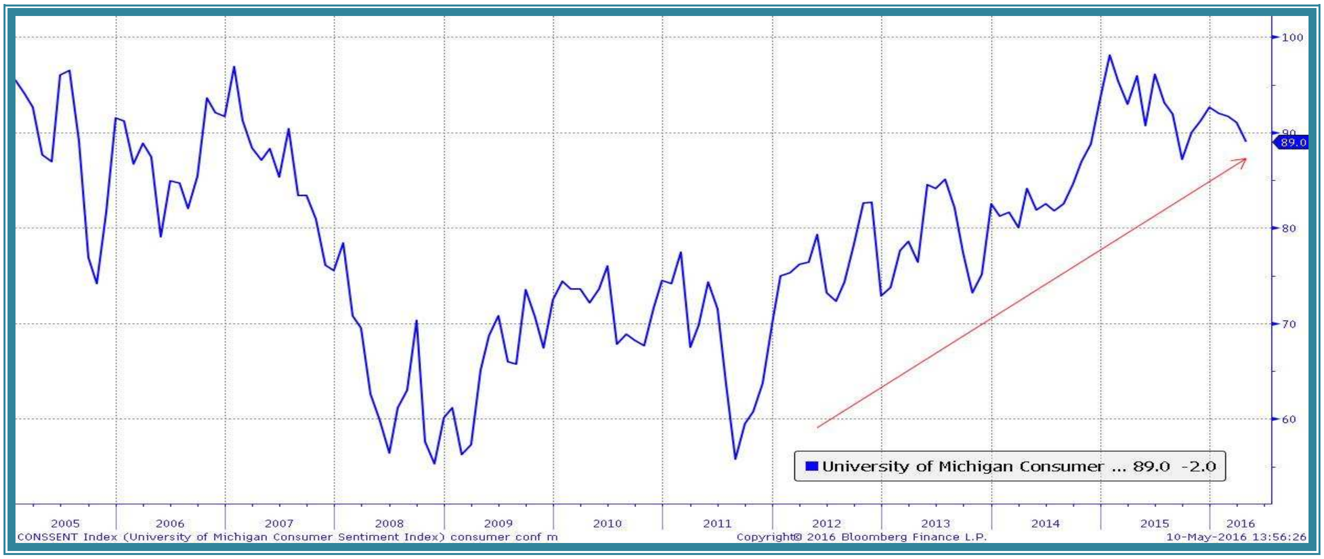


Source: Bloomberg and Altman Research

The University of Michigan measure of consumer confidence is expected to rise in May, putting a stop to the recent downward trend. This was recently confirmed by the Investor Business Daily Confidence Survey which rose in March. The usual drivers of confidence have delivered mixed signals in recent weeks. Although gasoline prices have continued to edge higher, the U.S. stock market has eased back from its recent highs. The labor market has remained unusually strong, with initial jobless claims still close to their lowest level since the early 1970s. On balance, however, with interest rates low and real incomes rising at a decent rate, there seems little reason why consumer confidence should continue to trend lower.

EXHIBIT IV

University of Michigan- Consumer Confidence Indicator

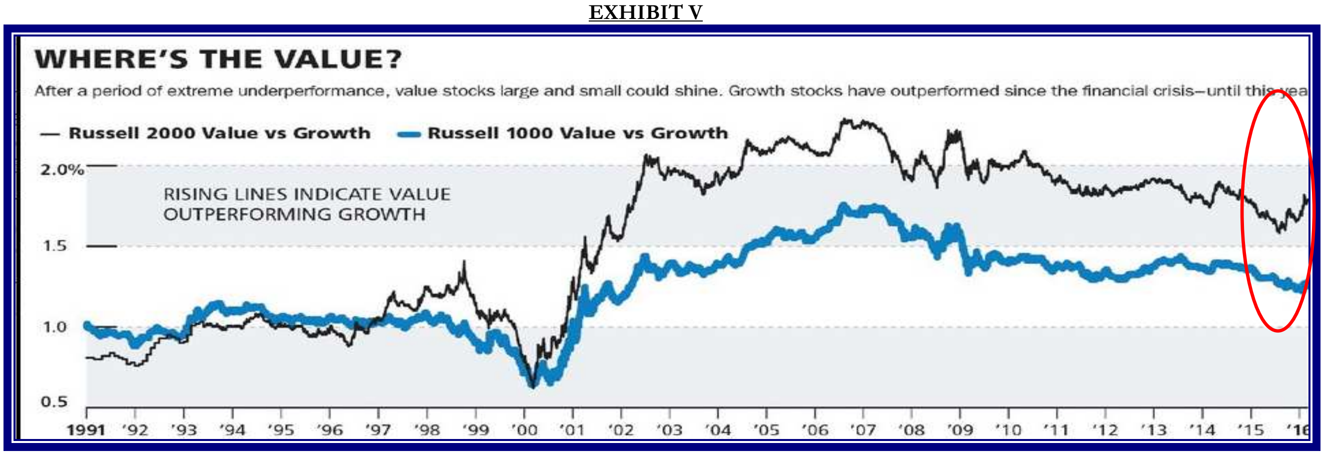


Source: Bloomberg and Altman Research

The Outlook for the Financial Markets

Value stocks within the Russell 1000 Value index (large cap) and the Russell 2000 Value index (small cap) are outpacing their growth counterparts by 395 bps and 760 bps respectively year-to-date. This has gained the attention of Barron's associate editor Andrew Barry who highlighted two important themes: 1) Growth stocks are getting expensive, and 2) a leadership change is due after Growth has had its outperformance tenure. We would expect as profit growth begins to accelerate that Growth stocks will lose momentum.

EXHIBIT V



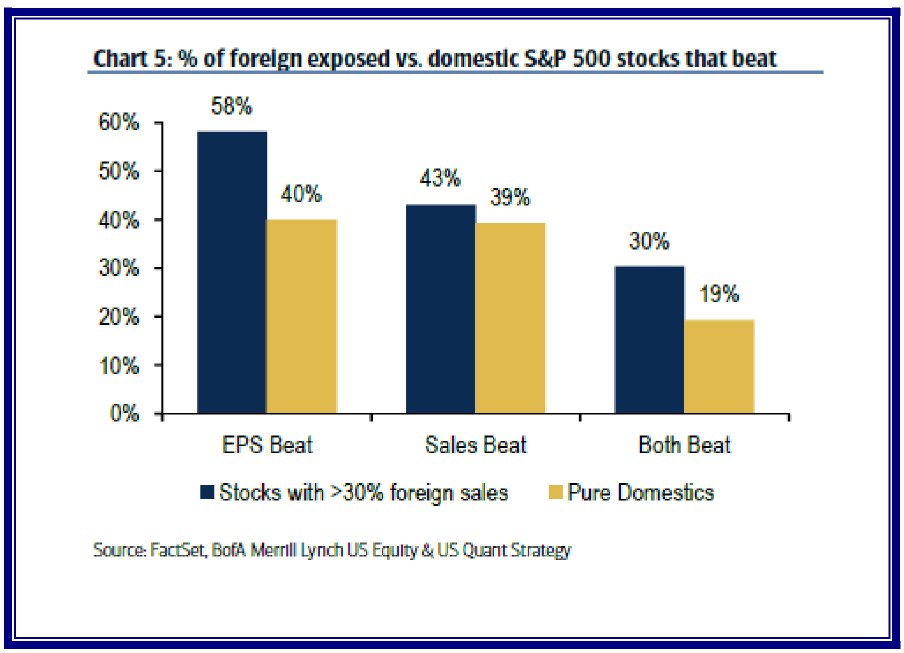
Source: Barron's

Given the heightened volatility in the marketplace, coupled with the collapse in earnings growth, one would expect stocks of predictable earnings trends to continue to attract investor interest. The common perception is that "lower quality" companies require greater access to capital, which has been limited during the past few years since the financial crisis. While predictable earners ("quality stocks") have outperformed in the recent past, we continue to scan the universe of neglected securities that have the potential to surprise in the future.

The headwind against earnings from a strong U.S. Dollar (USD) appears to have diminished some during Q4 2015 and into the new year. Corporate management teams not only reported success resulting from hedging activity, but year over year growth rates in the dollar appears to have peaked in Q3. Since that time, it has been the multinational companies who produced a greater share of beats on both earnings and sales metrics as compared to their domestic counterparts. As consensus views of a stronger dollar are beginning to unwind the focus is shifting in favor of multinational corporations. Currently our AIM composite generates approximately 40% of it revenues outside of the United States.

EXHIBIT VI

Q4 2015 EPS Surprises Were More Plentiful Amongst Multinational vs. Domestic Companies



Low oil prices have yet to spark a significant boost to consumers worldwide, and remain a challenge for the global economy and therefore earnings growth. Last July, the Federal Reserve conducted a study that quantified the degree that falling oil prices and a rising dollar cut into U.S. direct investment income receipts. Between September 2014 and March 2015, when the dollar appreciated 14.9% and oil prices dropped by $41, U.S. income receipts were cut by 14.5%; one third of this figure was attributable to the rising dollar. Since this report, oil prices have rebounded 56% off January lows and the dollar has fallen 6% from Q4 highs. Both trends have been supportive of financial markets which have rebounded 14% off February lows.

IN SUMMARY:

The popular market averages ended the quarter almost where they started. But the overall results masked the volatility during the quarter where the Standard and Poor's 500 bottomed on February 11th to a 22 month low then rebounded 13%. The 2016 slide was reversed by two catalysts: the Federal Reserve and crude oil. Coming into the year, the FOMC forecast implied at least four rate hikes in 2016 which was quickly altered as Chairwoman Janet Yellen confirmed a more dovish view following the March conference. The second factor was the backup in crude oil prices, having dropped to their lowest level since May of 2003. After Saudi Arabia and Russia agreed to freeze production at pre-sanctioned levels, crude prices surged some 52%. On closer examination, large capitalized companies surpassed smaller ones, and gold and long term bonds outperformed in anticipation of rising inflation and a weaker dollar.

Value oriented stocks outpaced their Growth counterparts, with the disparity widening as the month of April unfolded. The explanation offered was that during the subpar economic recovery growth stock valuations have been stretched and the universe of outperforming stocks within the category has narrowed down to a select few companies (dubbed "the FANG") described in previous commentaries. The best performing stocks within the large capitalized universe continued to support the highest dividend payers as the single best characteristic cushioned by stubbornly low bond yields.

The Year Ahead

Is the rally sustainable? As the second quarter unfolds, we maintain a more optimistic conclusion than the conventional wisdom, despite coincident economic headwinds, generally weak first quarter earnings reports and skepticism with regards to China's ability to transition their economy from an export-driven to a consumption-driven model. On closer examination, we believe that a peaking in U.S. dollar strength and the decline in energy prices will bolster quarterly profits in the second half of the year - especially among companies that emphasize a global business model. These companies have been characterized as value-oriented investments with greater sensitivity to the expectation of improving macro-economic developments. The good news is that the recovery continues. The not-so-good news, however, is that the recovery remains too slow for too long, which has been reflected by the electorate concerns during the primary season. The current uncertainty in global economic and financial markets has encouraged the Federal Reserve to continue along a path of accommodation, with the core rate of inflation up a modest 1.7% and still below the Fed's target rate of 2.0%.