DANN ASSET ADVISORS, LLC

Third Quarter 2015 Interim Update

August 24, 2015

Recent Events

- U.S. stock market declines 9% thus far in August and is now down 8% for the year
- Despite the stock market, moderate economic growth continues in the U.S.
- Agreement reached for Greece to remain in the euro zone
- China modestly devalues its currency and fails to prop up its stock market
- Commodity prices continue to decline, in some cases significantly

Since the May 2015 market high the S&P 500 (broad index of large U.S. stocks) has fallen 11%. While this is not an insignificant decline, it is normal in the context of historical market moves – what has been unusual for the market has been the lack of volatility and generally steady upward march since late 2011. In addition, this decline comes from valuation levels that were on the high side of fair value, so it should not be a huge surprise. In isolation, we are not overly concerned by the current decline.

However, when the U.S. market's fall is viewed in the context of other recent events, we believe it's possible we could be in for a more prolonged period of stock price weakness. Speaking generally, over the medium to long term, stock prices are driven by the earnings of the companies the stocks represent. Earnings, in turn, are driven by the health of the economy.

In our July 17 second-quarter update we tried to highlight what we viewed as increasing risk for the U.S. economy, noting that our biggest concern for the U.S. was the divergence between the consumer (relatively strong) and industrial/manufacturing (weak) sectors of the economy. We concluded that, "[w]hile we continue to think consumer demand will win out, weakness in the industrial sector could be signaling a more significant economic slowdown ahead and, if that were to be the case, we'd expect a tougher period for the stock market." We also noted that our biggest international concern was China – "[w]ith the country representing the world's second largest economy, mistakes [in government policy], if they're made, easily could have a broader impact."

So, to frame our thinking five weeks ago, we were concerned about conflicting signals for the U.S. economy and also by the Chinese government's efforts to control the decline in the Chinese stock market. With respect to the latter, it wasn't the government's stepping in that surprised us; rather, we believed their actions potentially indicated much deeper concern about their country's economic health.

Over the past five weeks we've observed the following:
On the positive side:

- Recent U.S. consumer spending and employment data have been decent, auguring well for the U.S. economy. Industrial/manufacturing numbers have not worsened. Assuming the U.S. economy continues to grow, we believe the probability of a further significant decline in the U.S. stock market is low.

On the negative side:

- Since peaking earlier in 2015 international stock markets are down significantly more than the U.S. – the non-U.S. developed markets and emerging markets indices have declined 15% and 30%, respectively, from their highs.
- Oil has fallen nearly 40% from its May highs and many commodities have declined to levels last seen during the 2008/09 recession. Chinese consumption has driven more than 50% of

90 Riverside Drive, Ste. 4D · New York, NY 10024 | T. 917.575.5307 | F. 646.304.3017 | www.dannasset.com

incremental demand for many industrial commodities over the past decade, so the relationship between commodities and Chinese demand/economic strength is important.
- China has modestly devalued its currency, and several smaller countries have followed China's lead.

Finally, while not opining on whether positive or negative, it is worth noting that the U.S. Federal Reserve and other central banks' easy money policies over the past several years throw a wild card into the mix as, in our opinion, it's very possible those policies may have unforeseeable, unintended consequences.

Back on a more concrete level, our biggest near term concern is the substantial decline in commodity prices. We believe part of the decline is due to excess supply built up over the past few years in expectation of continued robust Chinese demand (energy markets currently have their own unique oversupply issues). But to the extent the declines reflect weak demand the signal is that worldwide economic growth is taking a significant step down. Whether the U.S. economy continues to grow even as other countries slow is in our opinion the key question.

We make the following observations (appreciating that more than one likely will be inaccurate):
- We doubt the Fed will raise rates in September. If markets remain volatile and/or inflation does not pick up, there likely will be no increase in 2015.
- Commodity prices are unlikely to bounce back quickly. However, supply and demand will work as usual and today's low prices likely will fuel significant price increases down the road.
- While the actual numbers may never be disclosed, we believe China's reported GDP growth in the 7% range is highly overstated.
- We appreciate that China does not import a lot from the U.S. and thus has little impact on direct U.S. exports/economic growth. However, being the world's second largest economy it has important impacts on other U.S. trade partners. Combining China's issues with the decline in commodity markets and worldwide stock prices leads us to believe the odds have increased that the U.S. will have several quarters of slower growth (even though second-quarter GDP revisions likely will be positive).
  - Even if we're wrong on the U.S. economy, we expect that U.S. corporate earnings will be down modestly in the third and fourth quarters.
- Putting the foregoing together for the U.S. stock market, we believe it unlikely the market will move up consistently and meaningfully until earnings show signs of improving. If we're too optimistic and earnings decline significantly there's likely more downside for the market.
  - There almost always are temporary rebounds following downward moves as sudden and rapid as currently occurring – we believe these will happen but not be lasting.
  - As has occurred numerous times over the past several years, actions by the Fed may move the market higher near term than we currently anticipate.

With respect to investing, we are not changing our approach. For clients with diversified (fixed income and equities) portfolios we believe that we have the right mix of assets to balance risk and reward for the long term. For most equity only clients we've been reasonably conservatively positioned carrying 10%-15% in cash and, more recently, purchasing a couple of stock mutual funds (to replace individual stock positions) that historically have done better than the markets during downturns. With only a few, small exceptions, clients own what we judge to be high-quality securities/funds.

Finally, we're cognizant that, assuming earnings don't collapse, the market and individual stocks are more attractively valued than they were just five weeks ago when the market was nearly 12%

higher. Given our baseline assumptions outlined above we're not in a huge rush to put cash to work but certainly are monitoring potential opportunities.

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