INVESTMENT PARTNERS ASSET MANAGEMENT
One Highland Avenue, Metuchen NJ 08840 Tel: 732-205-0391 Fax: 732-205-0395

Excerpts from Quarterly Report written by Investment Partners Asset Management – Q4 2015

"The year 2015 started out with market participants believing that U.S. gross domestic product ("GDP") growth would at long last return to a trend of at least 3% by the 4th quarter as a result of Federal Reserve stimulus of over $4 trillion over the past six years. Historically, equity valuations were felt to be in line with prior expansionary periods. Technology, healthcare and energy related businesses were able to attract debt and equity growth capital, because these sectors were growing domestically and internationally.

At the beginning of 2015, investors became complacent, because there was sufficient liquidity in both the fixed income and equity markets. Interest rate spreads were historically narrow. There was very little difference in yields between investment grade issues, U.S. Treasuries and corporate credits. The banks had repaired their balance sheets since the financial crisis and were being encouraged to lend for projects they deemed worthwhile. Surprisingly, lending did not return to normal because there was not enough clarity about the longevity of the U.S. economic recovery. However, banks did find comfort in lending to corporations that had decided to shrink their capitalizations by using cash to fund buybacks and pay dividends or engage in mergers and acquisitions. It was quite clear to certain companies that they would benefit by using leverage while rates were low. Those that were labeled as growth companies saw their share prices increase, seemingly irrespective of valuation. Never was it more evident than the market's labeling companies either "Old Tech" or "New Tech". We observed a similar phenomenon in 2000 when growth minded investors shunned Old Tech and embraced New Tech, often paying multiples of the "hereafter" for top line revenues with disregard for profits. Old Tech companies were viewed as mature, stodgy, wed to the past and vulnerable to disruption. They often had pristine balance sheets as well. This, one would think, would make them particularly vulnerable to attack by activists or by private equity buyers in an attempt to bring out values and improve share price performance - at least in the short run.

2015 was also a year marked by varying degrees of volatility in the equity markets generally, and unhinged commodity prices specifically. Few recognized the direct impact that Saudi Arabia's decision to increase production would have, with the effect of driving down the price of oil and eliminating leveraged U.S. energy producers. With respect to Fed action, initially our belief was that tapering of Central Bank purchases of Treasury debt would be perceived as risky. As time went on, the Fed reassured the markets that it would not raise rates until sometime in late 2015 or 2016 when they thought the economy had recovered. The equity markets were conditioned to an inevitable increase but rationalized that there would be minor impact to economic growth. Much to everyone's dismay the credit markets in 2015 did begin to anticipate a rise in interest rates. By mid-year, interest rates trended lower and bond prices climbed higher in an environment that waited for the Fed to increase rates. U.S. financial markets exhibited higher levels of volatility largely due to slow-downs in economic growth in Europe, Japan and the developing world. The Fed also suggested that it was willing to accept greater inflation as a means to spur demand, encouraging consumer spending and business borrowing. Yet, inflation remained stubbornly below the Fed's 2% target. There clearly was a focus in the fixed income markets on credit quality with a widening of credit spreads. During the year, whenever the Federal Reserve hinted at a change to a more restrictive policy, the equity markets receded, only to be followed by a period of complacency and reduced market volatility. A belief system was forming that only when the economy was about to spurt at a healthy clip would there be a sustained credit tightening. When economic growth was called into question, Fed action was delayed. It was no wonder that the markets in the U.S. were roiled in 2015."

GLOBAL ECONOMIC BACKDROP

History normally provides some precedent, possibly making the path easier to navigate. However, from what we are seeing thus far – little about 2016 appears normal.

First Forecast: In 2016 making historical comparisons to past events may have little or nothing to do with how markets behave this coming year.

Markets have responded well to central planning enacted by the Federal Reserve for the past six years. Any honest examination of the facts would suggest that a less accommodative Federal Reserve could negatively impact a fragile economy. The mid-December 2015 increase in interest rates in our view was ill-timed and potentially dangerous. Any further increases likely will add additional uncertainty and volatility.

Second Forecast: The Inflation-Deflation Debate will continue to influence behavior, affect consumer behavior, challenge corporate purchasing and investment decisions, and impact the mobility of citizens.

Inflation (especially wage inflation) seems to have been the goal of our Central Bank since the financial crisis. While inflation is generally considered detrimental to the economy, a modest level actually can be very helpful as it increases GDP in nominal terms and facilitates the repayment of fixed-rate debts. The downside is that increased interest rates typically follow cost of living increases shortly thereafter, which can, in turn, put a strain on corporate profits. The other side of the coin, deflation, occurs when price levels generally decrease over time. While this keeps the cost of living low, it also forces interest rates to remain abnormally below long-term historical trends. This scenario may favor asset owners in certain circumstances, but it can be very harmful on consumption, corporate debt service, capital expenditure, and economic growth. Up to this point, the lack of inflation has largely benefited "haves" perhaps at the expense of the "have nots," in our country. The strain of that dichotomy is palpable in the rhetoric of the various candidates who are seeking their parties' endorsement to run for President.

Third Forecast: Asset values and security prices will swing wildly, adding to an already supercharged volatile environment.

Volatility produces both opportunity and heightens risk. Nowhere is this truer than in energy related investments. Not all companies involved in fueling the world's energy needs are created equally, yet it seems every company is expected to curtail production to balance the supply/demand relationship or to exit the market altogether. No doubt from this adversity there will be incredible opportunity, but it has proven difficult to predict the timing and beneficiaries of a recovery – particularly in the small-cap arena.

Fourth Forecast: China and emerging markets throughout the world will focus on their own wellbeing and adjust their currencies to reflect the new reality. How China deals with its own economic and financial issues will significantly impact the rest of the world.

China's banking system appears to be under stress as its economy slows down. The stronger U.S. dollar is having a profound impact on global trade, leading to a revaluation of the Chinese currency. Additionally, bond markets have recently become less liquid, adding a level of complexity when handicapping companies. In short, the situation in China needs to stabilize for the global growth story to stay on track and for risk assets to regain their footing.

ISSUES AND CHALLENGES

We have now entered a dangerous period with the unknown impact of rising rates. We have also been cognizant that interest rate sensitive stocks could be vulnerable. If interest rates rise, small firms, and companies which utilize debt financing, may find it more difficult to grow. Additionally, their distributed cash may be less, which could make their share prices vulnerable. Another offshoot of higher rates could be an overvalued US dollar and a smack-down in commodities, real estate, preferred stocks, and other interest rate sensitive issues.

At the end of 2015, analysts were predicting a continuation of market momentum with rising equity prices based essentially on the following beliefs:

- A change in Federal Reserve accommodative policy would have minimal impact on the economy.
- Normal domestic economic growth would be sustainable.
- There would be a consumer led demand cycle accompanied by a decrease in unemployment and increased discretionary spending.
- Equity markets would anticipate better times ahead, and price to earnings multiples would rise modestly.
- The "wealth effect" would encourage consumer spending.
- Industry would get more confident and invest in plant and equipment once they could forecast demand with more certainty.
- Industrial production would rise.
- Global expansion with rising world trade, improved capital availability and functioning credit markets would sustain a worldwide boom.
- Decreased energy prices would boost investor confidence and consumer purchasing.
- The dollar would remain strong.
- In spite of declining oil and gas prices, the U.S. would continue on its path to energy independence.
- With the implementation of the Affordable Care Act, health care costs would come under better control.
- China's slowdown would not cause contagion.

As we enter 2016 we find ourselves wondering if the consensus views mentioned above will hold water. Yes, the domestic economy has somewhat improved, but these are not quite boom times either.

Ironically, instead of spending, consumers are paying down debt. The anticipated rise in spending has not been impressive. In support of our skepticism were government statistics indicating to us that there were no measurable, tangible, sustainable benefits from prior quantitative easing experiments. Creating over $4 trillion in liquidity should have created a healthier economic rebound.

We believe that the eventual unwinding of massive public debts will impact virtually every American because taxes at the local level will rise along with interest rates. When government curtails spending, unemployment (already a problem, both politically and economically) will rise, leading to cuts in entitlements, and rising interest rates. Access to credit will be limited and will be based on the credit worthiness of the borrower rather than be set by Federal Reserve meddling. Simply put, this is not exactly the environment that should have rewarded investors in 2015, and we don't see much improvement in 2016.

DISCLAIMER

Any information contained in this report should not be considered a complete analysis of every material fact with respect to any company, industry, or security. Any and all investments discussed herein may not be suitable for all investors, and may be subject to a high degree of risk. For this and other reasons, Investment Partners Asset Management ("IPAM") does not recommend that investors buy or sell any of the securities mentioned in this report. Furthermore, there is no certainty, and we make no guarantee, that any views expressed herein or strategy discussed in this report may be executable in an appropriate size or amount and/or at the prices described herein. Moreover, although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed. Investment Partners Group and/or its affiliates (including but not limited to IPAM) may effect transactions, including transactions contrary to any views expressed herein for themselves or their clients (including but not limited to pooled investment vehicles managed by IPAM, and/or their affiliates).

Furthermore, Investment Partners Group and/or its affiliates (including but not limited to IPAM) may have positions in the securities mentioned herein, (or options with respect thereto) and may also have performed investment banking services for the issuers of such securities. In addition, employees of Investment Partners Group and/or its affiliates (including but not limited to IPAM) their families and other affiliated persons, may have positions and effect transactions, including transactions contrary to any views expressed herein, in the securities or options of the issuers mentioned herein and may serve as directors of such issuers.

FORWARD LOOKING STATEMENTS

This discussion and analysis contains certain forward-looking statements and projections that involve a number of risks and uncertainties. Actual events or results may differ materially from IPG's expectations and projections. Past performance does not guarantee future results. Market and other risks may affect actual results achieved.