Grisanti Capital Management

High Income Equity Portfolio -- First Quarter 2013 Letter to Investors

April 1, 2013

Dear Clients and Friends of Grisanti Capital Management:

	For the Period Ending March 31, 2013				
	Year To Date	Since 9/30/11	Since Inception 2/28/2010	Current Yield	Current Beta
Grisanti Capital Management LLC High Income Equity Portfolio[1]	***+7.3%***	***+42.6%***	***+40.4%***	***5.0%***	***0.6***

As a rule, value investors are terrible party guests. We arrive too early, keep an eye on the clock and as dancers start to climb onto tables, we sidestep toward the exit, mumbling our good-byes. While we may not be much fun, we end up with fewer regrets in the morning.

With that in mind, the market threw quite a party in the first quarter of 2013, and your high income equity portfolio (HIEP) participated nicely, even as we edged toward the door. **Remember, the goal of the HIEP is to offer upside potential in a low-volatility, high yielding product.** It recorded strong performance in the first quarter (up 7.3% net of fees), and over the past 18 months, the high income equity portfolio is up 42.6% (net of fees), maintaining a 5.0% yield and a volatility that is 40% less than the market (as measured by the S&P 500 Index). The focus of this portfolio is mitigation of risk while still being invested in equities, and for that reason, we do not – and you should not – expect this portfolio to return as much as the S&P 500, which exhibits substantially more volatility. **The purpose of the HIEP is not to "beat the market." It is constructed to offer solid equity returns in the context of less risk and a higher yield. Having said that, over the past 18 months, the market is up 43.5% and the HIEP is up 42.6%, even though it is 40% less volatile. In other words, it delivered virtually all of the market's return while taking 40% less risk (as measured by volatility) and offering twice the market's yield.** We are particularly pleased with these results.

Capital appreciation, however, is a double-edged sword. As a consequence of this strength, we now hold in the common stock portion of the HIEP investments that are still promising, but are no longer the bargains they once were. As the market surged, we held more cash than normal and gravitated towards common stocks with lower volatility and strong

[1] We use Beta, a widely recognized measure, to assess volatility. The Beta of the HIEP is 0.6, compared to the market's Beta of 1.0. All other things being equal, a portfolio with a Beta of 0.6 will fall (or rise) 40% less than the market. Of course, all other things are rarely equal and Beta is a measure of past volatility, which may or may not hold true in the future. The performance is for the Grisanti Capital Management High Income Equity Portfolio Composite, based on our model portfolio and after the deduction of management fees.

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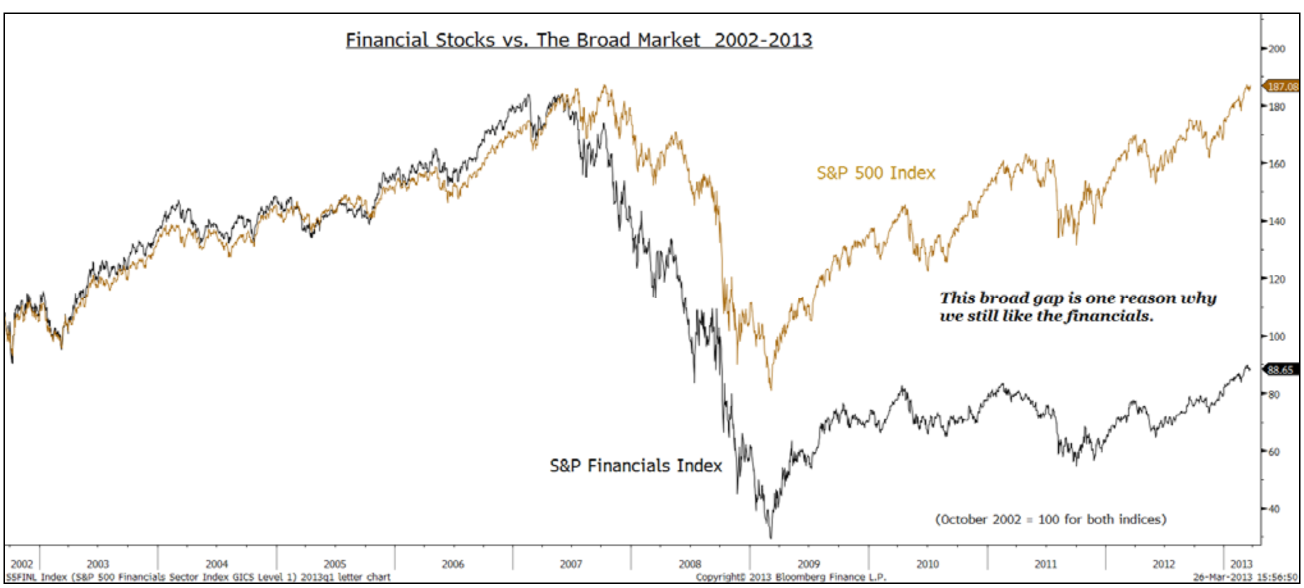
dividends. Our cautiousness does not indicate that we expect a sharp sell-off. It's simply getting harder to find undervalued investments, so until we do, we will remain cautious.

A Review of the Portfolio

The fundamental difference between the HIEP and other products that offer equity-income strategies is the HIEP's "barbell" structure. The HIEP is currently 30% preferred stocks and 70% common stocks. The preferred securities both lower the volatility and raise the dividend yield, while the common stocks contain the potential for strong capital appreciation. Unlike other equity-income products that rely solely on high yielding (and often slow growing) common stocks, the HIEP's barbell approach allows it to obtain its higher yield and lower volatility characteristics from the *preferred* stocks that are considerably lower in volatility than virtually all common stocks, even those blue-chip securities that populate many equity-income funds. This allows the rest of the portfolio to be composed of common stocks that have higher growth (and capital appreciation) potential than the slow-growth stocks found in other equity-income portfolios. Why don't others follow this "barbell" strategy? One reason is that the market for preferred stocks is small compared to common stocks, and big firms that manage billions of dollars in popular equity-income funds would be hard-pressed to find enough preferred stocks at attractive prices to re-create the barbell strategy. Sometimes small is good.

The preferred portion of the portfolio is invested in high quality securities that yield between 5 and 7 percent. These preferred stocks are the "anchor" of the portfolio, as they do not rise or fall in price very much in most market environments, yet the yields are much more attractive than corporate debt of the same issuer. The common stock portion of the portfolio continues to invest in three major themes, the American oil renaissance, financial recovery and the smartphone revolution. We have talked at length about the oil renaissance theme in past letters, so here we wanted to review our continued investment in the financials, especially in light of the fact that they have done quite well over the last 18 months. With Morgan Stanley up 64% from our initial purchase price of $13.80 and JP Morgan up 149% from our initial purchase price of $20.36, why do we still like the financials? The answer is best presented in the following chart, which shows just how badly the financials were thrashed in 2008 and how, even after a strong 2012, they have a long way to go to "catch up."



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The caveat, of course, is that we buy individual companies and not "The Financials." In this way, we try to ensure we invest in a company not simply because it had lagged the market, but because it has unrecognized quality and growth potential. Bears will correctly point out that financials shouldn't really make up all that lost ground, because the regulatory environment is less favorable now than in 2007, when the financials parted ways with the rest of the market. We don't disagree with that, and we've adjusted our financial models to reflect a less profitable environment. But, as you might intuit from the chart, even with some headwinds, there's a lot of room for improvement. We still favor **JP Morgan** and **Morgan Stanley** in the banking and brokerage businesses. In addition, our two mortgage REITs, **Annaly Capital** and **American Capital Agency** add financial exposure while lowering the volatility of the overall portfolio and raising its yield. Our holdings in asset manager **Blackrock** and financial services company **American Express** round out the diversified financial sector of your portfolio.

As the market surged this quarter, we sold our investment in **Disney**, because it hit our sell target after good appreciation. Disney is still a great company, but we believe it no longer offers superior returns over the next several years as it has already risen over 60% in our portfolio in an 17-month period. It now trades at 18.5 times earnings, so we have sold it, and are retaining the cash while evaluating future investments. We also sold **Lockheed Martin** for a gain of 15%, less than we had hoped for, but with the sequester cutting back defense spending, we felt the thesis was impaired and we took our profit. We have also trimmed but not eliminated a number of other investments as they have approached fair value, even in groups that we continue to favor, like financials and refiners.

In conclusion, while the market may be ahead of itself in the short term, its exuberance is understandable in light of decent economic statistics and the absence of attractive fixed income alternatives. We will continue to be prudent in allocating your capital and we are optimistic about the longer-term prospects. We would be happy to answer any question you have, and we look forward to reporting back to you at the end of the second quarter.

Very truly yours,

Christopher C. Grisanti