Grisanti Capital Management

July 7, 2014

High Income Equity Portfolio Second Quarter 2014 Letter to Investors

	For the Period Ending June 30, 2014			
	Year To Date	Since Inception 2/28/2010	Current Yield	Current Beta
Grisanti Capital Management LLC High Income Equity Portfolio[1]	***+6.9%***	***+61.4%***	***3.4%***	***0.8***

Dear Clients and Friends of Grisanti Capital Management:

The Grisanti Capital Management High Income Equity Portfolio (the "HIEP") had a strong second quarter, meeting its goals of risk aversion, strong yield and capital appreciation. Specifically, the HIEP was up almost 5%, while taking substantially less risk than the market and offering almost double the yield (currently 3.4%). For the first six months of the year, the HIEP is up about 7%. We are pleased with this performance for two reasons. First, we have kept up with a strong market this year, even though risk aversion and not capital appreciation is our primary goal. In other words, you got the market's strong return with a portfolio that is considerably more conservative. Second, your portfolio's performance compares favorably to other conservative equity income managers. We credit the HIEP's innovative barbell structure, which we discuss in more detail below.

We have included with this report a Summary of Investments. It contains an analysis of each of your portfolio holdings, so you can see what you own and why you own it.

Further, while this was a good quarter, it should have been an exceptional one, and for the first 85 days, it was. The HIEP benefited from *three* takeover bids, unusual for a 27 stock portfolio. But on June 25, the Wall Street Journal ran a negative story about oil refining, and our refining investments declined by 10 percent. We have faith that these investments will rebound, but the sudden drop in these stocks in the last three days of June hurt our quarterly performance by more than a percent. Taking the long view, since we restructured our firm in the 4th quarter of 2011, the results of the HIEP have been strong: It is up 19% annually, while taking much less risk than the market and having an average yield during that period of about 4%.

[1] Performance for the High Income Equity Composite is shown before deducting advisory fees and transaction costs, if any. GCM's advisory fees are described in Part II of its Form ADV. The HIEP Composite includes all accounts that are fully discretionary, managed in the HIEP strategy and over $200,000 in total assets. Past performance is no guarantee of future results. As with any investment vehicle, there is always the potential for gains as well as the possibility of losses. We use Beta, a widely recognized measure, to assess volatility. The Beta of the HIEP is 0.8, compared to the market's Beta of 1.0. All other things being equal, a portfolio with a Beta of 0.8 will fall (or rise) 20% 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.

Grisanti Capital Management

As we mentioned in the first quarter letter, the market is having a more difficult time moving forward this year than in 2013. The economic backdrop remains mostly benign, with an extremely accommodative Federal Reserve, but valuations are extended after last year's surge. Higher equity prices translate into more risk and the market getting more selective. This plays to our strength, as a more discriminating market tends to reward intelligent, concentrated stock picking. Putting aside our energy investments for a moment, several portfolio investments bear mentioning.

The portfolio benefited from three takeovers this quarter, satellite television provider **Direct TV,** pharmaceutical company **AstraZeneca** and medical device company **Covidien**. Direct TV was offered a 10% premium to its previous market price by AT&T, while Covidien agreed to be bought at a 25% premium from competitor Medtronic. AstraZeneca, meanwhile, successfully fought off a bid from Pfizer, but the stock rose 25% and we sold it in the midst of the battle. It has risen more than 50% since its purchase in August of last year. We have also sold Direct TV, because the proposed deal will be subject to a long regulatory process that may not end successfully. The investment has appreciated 97.6% since its purchase in June 2012. We continue to hold the Covidien, and are evaluating whether the synergies of an alliance with Medtronic will result in an even higher valuation over the long term. Covidien is up 48% since its purchase last September.

Most high income equity portfolios emphasize only stocks that have high yields but grow slowly (if at all). The HIEP differentiates itself by having a "barbell" structure. It emphasizes safety on one side of the barbell, typically using securities that are more stable, but with less appreciation potential than a regular high income portfolio. On the other side of the portfolio it invests in companies that grow faster and are less stable, but have more appreciation potential. It is the effect of this *combination* that we believe adds value.

Currently, the "safety" side of the barbell structure is invested in high yielding but stable (one might say boring) investments in senior loan (bond-like) securities, business development corporations that pass through their income, and master limited partnerships in businesses like pipelines and toll roads. These make up about 35% of the portfolio, and are performing as expected this year, up slightly in price but not much, while delivering stability and a strong yield. Some of these investments may not seem like household names, so each of these investments is explained in detail in the accompanying Summary of Investments.

On the "capital appreciation" side of the barbell you will find contrarian stocks that we try to buy when they are washed out and the risk is therefore reduced. **General Motors** is a good example. Our investment was made this year, in the middle of the recall mess, and is already up 8%. GM continues the onerous job of overcoming its safety issues. During the quarter it released an outside legal report and established a compensation fund for all victims of its now infamous faulty ignition switch. It has cost over a dozen lives and numerous injuries. It will also cost the company over a billion dollars. We believe GM has responded in a forthright manner and is doing the right – and smart – thing by being as transparent as possible. They have recalled over 10 million cars this year for a variety of safety issues. In spite of all this – and crucial to our investment thesis – car sales are continuing their strong rebound from the 2008

Grisanti Capital Management

crisis, and should do so for at least two more years. We believe a year from now, the recall news will be fading, and the stock should be significantly higher.

We would like focus on another investment in the HIEP that serves as a window into our investment philosophy, the much maligned technology behemoth, **IBM.** We often joke internally that we like potential investments that have the "gag factor." When you first consider the investment, the idea makes you shudder because news flow or current fundamentals are so poor. General Motors certainly had that quality when we bought it several months ago, as did the refiners and the financials when we first made those investments during the 2008-09 crisis. IBM is disliked by *every* major Wall Street firm – each one ranks it either neutral or even "sell." The analyst at each firm will be quick to tick off a list of negatives, ranging from a dying mainframe business to failure to capitalize on the cloud. We disagree. We think it will take a while, but IBM has shown the ability to defend market share, exit technology niches where margins are shrinking, and enter new areas (like the cloud) by organic growth or acquisition. Importantly, we believe almost all the bad news is in the stock. In the last two years, the market is up 50.2%, but IBM is down 3.6%. The stock now sells at 9.5 times next year's earnings, a 40% discount to the market. We join Warren Buffett in thinking that Big Blue has a lot more reward ahead than risk.

We will continue to focus foremost on preserving your capital in the HIEP. We are pleased that it is also appreciating well, but the premise of the HIEP is that things can get more difficult at any time, and the portfolio is ready for that eventuality. We hope you enjoy our Summary of Investments and we would welcome any questions you may have.

Very truly yours,

Christopher C. Grisanti