Grisanti Capital Management

January 2, 2015

Large Cap Value Portfolio Fourth Quarter 2014 Letter to Investors

	For the Period Ending December 31, 2014			
	4Q2014	2014	Since 9/30/2011	Since 12/31/99
Grisanti Capital Management LLC Large Cap Value Portfolio (net of fees) [1]	***+10.9%***	***+15.6%***	***+97.0%***	***+156.0%***
S&P 500	+4.9	+13.7	+95.1	+85.7
Average US Large Cap Mutual Fund	+3.6	+10.2	+85.6	+123.4

Dear Clients & Friends of Grisanti Capital Management,

When the Gods wish to punish us, they answer our prayers.

– Oscar Wilde

2014 was a strong year for your investments, and it ended with momentum. For the second time in three years, the Grisanti Capital Management Large Cap Value Portfolio ranked among the top 3% of U.S. value managers.[2] The portfolio was up 10.9% for the fourth quarter, more than twice as much as the S&P 500 Index. For all of 2014, the portfolio rose 15.6% (net of fees). Since forming Grisanti Capital Management in the fourth quarter of 2011, the portfolio is up 97.0%, or 23.2% per annum. And while we took less risk than the market, sometimes having cash positions over 20%, we managed over that period to beat a soaring S&P Index (which was up 95.1%, or 22.8% per annum including dividends). We can think of no better way of showing our gratitude to those clients who stayed with us during that transformative period.

[1] The GCM Large Cap Value Composite performance is in compliance with the Global Investment Performance Standards (GIPS) through 2013 (2014 pending). Performance for the Large Cap Value Composite is shown net of advisory fees and transaction costs, if any. GCM's advisory fees are described in Part II of its Form ADV. The Composite's benchmark, the S&P 500 Index, includes the reinvestment of income but does not include any transaction costs, management fees or other costs. The Large Cap Value Composite includes all accounts that are fully discretionary, managed in the large cap value strategy and over $1,000,000 in total assets. Prior to 2002, there was no minimum asset level. 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.

[2] The average U.S. large cap value mutual fund was up 10.2% in 2014, and the performance of the GCM large cap value composite this year (up 15.6% net of fees) would place us 29th (or top 3%) out of the 1,276 U.S. large capitalization value funds tracked by Morningstar. While we are not a mutual fund, we compare our net results (after fees) to those of publicly traded mutual funds with similar styles (U.S. large cap value equity) because we believe it is a fair comparison and the data is publicly available.

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Our strong performance in 2014 was driven, of course, by the investments we owned (like **American Airlines, Morgan Stanley** and **Covidien**), but it was also a result of what we *didn't* own. As you may recall from these letters, our research into the American Oil Renaissance led us to conclude that oil would be in greater supply, pushing its price lower. As a result over the past three years we have made no investments in the energy sector except in companies that *benefit* from falling oil prices, like refiners. The excess global oil supply reached a tipping point in the second half of 2014, and the price of oil is now down 49% from its high six months ago. *This is an unprecedented drop during a period of economic health in the U.S.*

Which brings us to Oscar Wilde. The great majority of Americans (as opposed to Saudis or Venezualans) view lower oil prices as an answer to prayer. Everything from gasoline and heating oil to groceries and airfares becomes less expensive. That's why, in mid-November, when oil prices were down "only" 20%, the market was ecstatic. But as oil continued to decline 30%, 40% and now 50%, one could almost hear the market pause, skip a beat and start to ask questions. In mid-December, as oil surpassed a 40% decline, the Dow dropped almost 1000 points in seven trading days. It has since rebounded, but there remains a sense of unease. Perhaps the Gods are punishing us by giving us what we always wanted. After all, we've never had such a drop in commodity prices without a recession. We believe further price drops will make the market more fearful – it will ask 'why are prices falling so much when the economy is healthy?' And finally the unspoken conclusion – maybe oil is trying to tell us something – maybe the economy isn't so healthy after all….

We disagree. Like Freud's cigar, sometimes oil prices are just oil prices, with no deeper meaning. From our work on the American Oil Renaissance, we're confident prices are dropping because there's just too much oil, and they don't portend a weaker U.S. economy ahead. Further, we think we are nearing an inflection point. The cure to low oil prices is low oil prices. With oil below $60, new drilling is certain to slow, with companies already announcing cutbacks. Supply will be curtailed, and as demand picks up in a growing global economy, prices will rebound. For that reason, we believe broad market turmoil caused by falling energy prices is an *opportunity* rather than a precursor of calamity, and we plan to take advantage of it. Many of our investments (especially our airlines, **General Motors** and retailers like **Bed Bath and Beyond**, **Autozone** and **Amazon**) should see a direct earnings benefit from the decline in fuel prices. In addition, for the first time in almost ten years we are evaluating investments in the energy patch that rely on the *higher* oil prices we think are coming down the road (don't ask us for a specific date). We believe we are early in the cycle but opportunities are now being created for meaningful capital appreciation over a three year period. Meanwhile, we have reduced our exposure to the refiners, and with the drop in oil prices, that thesis has played itself out nicely. As you know, we have made significant gains with those investments over three-plus years. We suspect we will be writing more as the year progresses about changes to the energy portfolio.

Our performance in 2014 was not reliant on any one investment or theme. While our investment in **American Airlines** (up 61% in 2014) and **United Continental** (formed by the merger of those two airlines, up 47%) were the best performers, we also benefited from two takeovers, **Covidien** (up 42%) and **Direct TV** (up 19%), as well as outsized performance from companies in financial, media and retail: **Morgan Stanley** (up 18%), **Liberty Global** (up 21%)

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and **Bed Bath and Beyond** (up 24%). We made our mistakes in 2014 as well, but we kept them manageable. **IBM** (down 6%) was a classic "value-trap," which we bought in hopes of a turn-around that never materialized. But the cheap valuation at time of purchase prevented the mistake from costing us a lot.

In the market downturn in early October, we initiated several new positions. The theme that merits the most discussion is the digital payment revolution. We love investments that have two (or more) things going for them. In this case, the trend to pay with a credit card (digitally) has two growth engines. The first is demographic. If you are over 70, you pay for things with your credit card 30% of the time. It does not occur to many septuagenarians to use a credit card for groceries or a taxi or a cup of coffee at Starbucks. A twenty-five year old does the exact opposite. She carries very little cash, and it wouldn't occur to her *not* to use a credit card. She never opens an envelope or licks a stamp to pay a bill. Instead, she links her credit card to automatically pay for her electricity, phone and student loan. The second way to win is international growth. The United States is *way* ahead of the rest of the developed world in using credit cards, whipping them out almost twice as much per capita as their German or French counterparts. We have invested in **Mastercard**, **American Express** and **Sychrony** (a private-label credit card issuer being spun out of General Electric) to exploit this multi-year trend. Because we were opportunistic and purchased these investments during the October decline, they are already up an average of 13%. We see further gains ahead over time.

As we look to 2015, we see a benign backdrop for U.S. equities due to a strengthening economy and low commodity prices. There are two main risks to our general outlook. First, with recent economic growth, we believe the Federal Reserve will probably raise interest rates sooner rather than later. This is not necessarily bad – after all, strong economic growth is a good thing for our investments and for the world at large – but it will add volatility. The other risk, which we think is less likely but more severe, is that the slowdowns in Europe and China become more pronounced and drag down the rest of the world. In this scenario, interest rates and commodity prices would continue to fall, and stock prices would eventually follow suit. Of course there is always the chance of an unforeseen event – Russia invades Ukraine, a debilitating disease, terrorist attack or storm, etc. However, while we will remain on guard for these events, we want to underscore that the most likely version of the future is a strong economy that produces earnings growth and some stock appreciation. With the stronger dollar, investors should continue to see the United States equity markets as the most attractive place for their money, especially on a risk-adjusted basis.

We enter 2015 with strong momentum. Our portfolio is considerably less expensive than the overall market, and is composed of out-of-favor, well-run companies. That was a recipe for success in 2014, and we think it should serve us well in the New Year. We wish you a healthy and prosperous 2015.

Very truly yours,

Christopher C. Grisanti