Grisanti Capital Management

Large Cap Value Portfolio First Quarter 2012 Letter to Investors

	For the Period Ending March 31, 2012	
	1Q12	1/1/00-3/31/12
Grisanti Capital Management LLC Large Cap Value Portfolio[1]	**16.6%**	**74.2%**
S&P 500	12.7	19.8

Dear Clients and Friends of Grisanti Capital Management LLC:

Our portfolio had its best quarterly performance in more than ten years, as investors sought out neglected shares of financial, energy and technology companies. For the quarter, our portfolio rose 16.6% net of fees, versus 12.7% for the S&P 500 Index. This performance bested all but 6 of the 1,254 funds listed by Morningstar in our style (Large Cap Value). The tone of the economy and the market has clearly changed since September. Whether that change is long-lasting remains to be seen, but early evidence is encouraging. Stronger employment and manufacturing statistics have propelled the market higher for the last six months. Since the market bottom on October 3rd, our portfolio has risen 39.8% (versus 29.7% for the S&P 500). Also encouraging, the strength was broad-based: our three biggest winners for the quarter were a bank, an oil refinery, and a computer maker.

While all but one portfolio company rose in the quarter, the largest contributors were our financial investments. As we mentioned in the 2011 year-end letter, the S&P Financial Sector had underperformed the broader market for 5 years in a row, an unprecedented circumstance. In the first quarter, the pendulum began to swing back. **JP Morgan** and **Goldman Sachs** were both up more than 30% in the first quarter. In addition, we added **Morgan Stanley** to the portfolio last September, and it is up 43%

---

[1] Performance for the Large Cap Value Composite is shown after deducting all advisory fees and transaction costs. GCM's advisory fees are described in Part II of its Form ADV. The Composite's benchmark, the S&P 500 Index, include the reinvestment of income but do not include any transaction costs, management fees or other costs. Your actual performance is attached, and may be higher or lower, depending on the specific investment objectives reflected in your portfolio.

The Large Cap Value Composite includes all accounts that are (1) fully discretionary, (2) managed in the large cap value strategy, (3) mandated to be fully invested in equities, (4) tax-exempt and (5) over $500,000 in total assets. Prior to 2002, the Composite also included certain taxable accounts that the firm had authority to manage without regard to tax consequences and there was no minimum asset level. The inception date for data in the Large Cap Value Composite is June 1999.

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.

Grisanti Capital Management

since. Sometimes, as with Morgan Stanley, you do your research, steel your nerve and make a contrarian investment that succeeds as exaggerated fears subside. On the other hand, sometimes you do your research, and come to the conclusion that a very popular company is still too cheap. Our purchase of **Apple** is an example of this latter process. We bought the stock in November after it had an uncharacteristically soft earnings report. Even though it is obviously a popular company, we estimated it sold at an attractive 9.8 times 2013 projected earnings. The stock is up 63% (or 232 points!) since our purchase,[2] yet the earnings growth has exceeded even our high estimates, so we still find the stock attractive for now. A quieter technology star was **Microsoft**. It also was up sharply (25% for the quarter), as fear of its obsolescence gave way to awe of its consistent and prodigious cash flows.

We purchased three new stocks in the quarter, **American Express**, **CIT** and **Google.** The first two are part of our continuing theme of financial recovery. Amex has a different business model than Visa or Mastercard. It makes a lot of money from merchant fees (~80% of income), but relatively little from interest on carried balances. Given its high-end customer base, merchants are willing to pay higher fees to get American Express customers in the door. Amex is benefitting from two distinct macro-economic tailwinds: the recovery of consumer spending and the continued move towards using credit cards instead of cash both in the US and internationally. CIT is a company we have owned in the past that declared bankruptcy in the 2008 financial crisis. (We didn't own it then.) Since emerging from bankruptcy in December 2009, the shares have been trading at a discount to tangible book value. The company, under the leadership of John Thain, is paying down debt and, we think, preparing itself for sale as the market improves. (CIT was taken over the last time we owned it, in 2001, and investors were quite pleased.) Google remains the dominant player in online search, where they make money from advertising. We expect the continued growth in searches executed on mobile devices (like iPhones) to reduce the average revenue per "click", but substantially raise the *volume* of clicks, creating a net positive. Once beloved by the street, shares of Google have trailed the market recently, prompting our purchase, but are starting to gain traction. This is a high quality company with a rock-solid balance sheet ($40 billion in net cash) that should grow both the top and bottom lines nearly 20% per year while delivering a return on equity (ROE) between 17 and 25%.

The only stock that hurt us in the quarter was **Hewlett Packard**. It reported disappointing earnings in February, and we exited the position, losing 8%. The sale was a tough call, because the company is just beginning its turn-around strategy. Yet the earnings report showed surprising deterioration in several business lines, and meanwhile Apple is taking share from practically everyone in the personal computing space. While HP might still be a good long-term investment, the increasing risk profile exceeded our comfort zone. On the plus side, several stocks hit our sale targets and were eliminated,

---

[2] And, lest you think our strong performance was overly-reliant on Apple's ascension, it was not our largest contributor to performance for the quarter. That honor goes to the considerably less sexy – but more undervalued – JP Morgan.

Grisanti Capital Management

including **International Paper** (up 24% since purchase) and **Valspar** (up 36%). We also sold **Mosaic Company**, which was a mediocre investment (up 7%), because we believe the frothy market leaves materials companies like Mosaic and International Paper vulnerable to sharp declines should the market euphoria subside. We have exited all material stocks profitably after having a meaningful 15% position as the quarter began. For this reason, the portfolio has over 10% cash. We are comfortable with that, and we'll take our time looking for attractive alternatives.

Besides the portfolio, there are other positive developments at our firm. We are in the process of taking concrete steps in three important areas: (1) grow our research team, (2) eliminate our long-term debt, and (3) take steps to remain an *independent*, *client-oriented* investment firm that relies on *our own, intensive research*. In a separate mailing later in April, we will lay out several steps we are taking to accomplish these goals. Two examples of our renewed research focus will accompany our April mailing. One will be a longer research piece about one of our largest investment themes: The crude oil renaissance in North America and the consequences that holds for the economy, geopolitics and your portfolio. In addition, we will include our semi-annual Summary of Investments, which includes a complete review of every portfolio company.

In closing, we are excited about the prospects of the portfolio from here. Certainly, part of that excitement comes from our recent strong performance. But looking past the short-term, there seems to be a secular transition occurring among asset classes. The S&P 500 Index has been up only 20% since January 1, 2000, less than 2% per annum. That is dramatically below the average return for the past 100 years. (That's not to say that active stock-picking can't deliver value, as our portfolio was up 74% net of fees during that same period.) At the same time, bonds have performed magnificently for the most part of a generation. We believe the 30-year bull market in bonds is ending. While the market had a strong run this quarter, stocks remain discredited and unwanted. Our financial models still show over 50% upside for the portfolio over the next 18 months (down from over 100% last September, but still an attractive return). Evidence of "equity aversion," quite reasonably caused by the 2008 financial crisis, is still pervasive. Broad market indices remain well below their highs of years past. Certain financial and industrial stocks continue to sell below book value, something not seen since the 1970s. Most tellingly, investors cling to fixed income instruments that yield little and carry significant risk if interest rates rise. The 'smart money' assures investors that inflation is not a problem and rates will stay low for many years. We are wary of consensus forecasts that lead to exceptionally crowded trades, and that's what the current preference for "safe" fixed income over "volatile and risky" equities seems to be.

We welcome any questions or comments you may have, and please look for an update from us in late April.

Very truly yours,

Christopher C. Grisanti