July 7, 2014

Large Cap Value Portfolio Second Quarter 2014 Letter to Investors

	For the Period Ending June 30, 2014		
	Year To Date	Since 9/30/2011	Since 1/1/2000
Grisanti Capital Management LLC Large Cap Value Portfolio [1]	***+6.0%***	***+84.1%***	***+160.8%***
S&P 500	+7.1	+83.8	+75.0

Dear Clients & Friends of Grisanti Capital Management:

We are pleased to report another profitable quarter for your investments, with the portfolio up about 2.5% for the quarter and over 6% for the year. While this was a respectable quarter, it should have been an exceptional one, and for the first 85 days, it was. We benefited from *two* takeovers as well as strong performance from our investments in industries as diverse as airlines, software and autos. But on June 25, the Wall Street Journal ran a negative story about oil refining, and our energy investments declined by 10 percent in the last three days of June. We have lived through a number of short-term setbacks since we initiated our otherwise successful refining investment four years ago (during which period our lead investment, Valero, has more than tripled). It comes with the territory, and over the long term the stocks bounce back. But, because of the vagaries of the calendar, the sudden drop in these stocks hurt our quarterly performance by more than 2%. Taking the long view, since we restructured our firm in the 4th quarter of 2011, the results have been strong: Your stock portfolio is up 96.1%, and the portfolio including the sometimes significant cash position is up 84.1%, both compared to the S&P 500 Index, which was up 83.8% in the same time period.

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.

Fortunately, while we report to you quarterly, we don't liquidate our investments every 90 days. We look forward to benefiting from a rebound in the stocks that declined last week (and in fact they are up about 3% in the first three days of the new quarter). We remain confident in our long-term oil refining thesis, stemming from the game-changing production of shale oil and natural gas. The American Oil Renaissance is a theme we have discussed in previous letters at greater length than anyone except a lonely petroleum

[1] Performance for the Large Cap Value 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 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.

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engineer would care to endure. (See particularly our note The American Oil Renaissance available on our website www.grisanti.com.) We believe this is one of the transformative investment themes of the beginning of the 21st century.

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 two takeovers this quarter, satellite television provider **Direct TV** and medical device company **Covidien.** Both received takeover offers nicely above their current prices. 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. We have sold the 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 we 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.

Our two airline investments continue to perform well, especially **American Airlines**, which is up 61% since its purchase last December. U.S. airlines continue to benefit from full flights, high prices, and extra charges on everything from baggage to wi-fi to meals. While we are pleased with their appreciation, we are also mindful that these are among the most volatile stocks in the portfolio. We are keeping a watchful eye on developments in this once despised group.

General Motors, a new investment in 2014, 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 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 are up over 5% on our average investment in GM, as we bought close to the maximum point of pessimism.

As mentioned at the start of this letter, with all this good news from takeovers, airlines and General Motors, we had offsetting bad news in the form of the July 25th Wall Street journal article affecting the refiners. Specifically, the article was reporting on a private ruling made by the Commerce Department about a volatile form of oil called "condensate." Condensate is oil,

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but it also contains features of natural gas, and can be more flammable and dangerous than regular crude oil. The new ruling allows this condensate to be exported with minimal processing. The market interpreted that as the first step towards a lifting of the ban on exporting *all* crude oil, which would hurt our refining investment by raising the price of oil. Such a wholesale change would require an act of congress, rather than a commerce department ruling, which we think is *highly* unlikely, given that it could lead to higher gasoline prices. If our analysis is right, there is a glut of crude oil that continues to build on the Gulf Coast, and as we head into 2015 the refiners should enjoy considerably higher profits. If that happens, share prices will be much higher, and the condensate issue will be a distant memory. Stay tuned.

Besides energy, financial stocks also lagged the market in the second quarter. We have reduced our exposure there, having sold over the last nine months our entire positions in **Wells Fargo** and **Citibank**, and half our position in **JP Morgan.** The world has normalized, and most banks are again trading above book value. Gone are the days – as recently as 2011 – where one could buy **Morgan Stanley** at a *60% discount* to book value. Still, we believe there remains value in Morgan Stanley, as it transforms itself into more of an asset manager and less of a trading house. We will continue the portfolio evolution in this sector, which has been so rewarding over the last four years.

We made only one new investment in the second quarter, 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 look for nuggets of value in a picked over marketplace, and we look forward to reporting back to you with an update in three months. We hope you enjoy our Summary of Investments and we would welcome any questions you may have.

Very truly yours,

Christopher C. Grisanti