ASHDON
Investment Management

Second Quarter 2015 Client Letter

Investors have had to sort through a series of incoming news in 2015 so far. During the second quarter, the European Union, Greeks and the ECB attempted to deal with the Greek debt load. Back and forth negotiations filled the headlines, with no resolution during the quarter. In Asia, the Chinese equity market continued its impressive rise early in the quarter, but broke down in a rather dramatic fashion beginning in late May. And finally, we cannot fail to note the ongoing deliberations of the Federal Open Market Committee (FOMC – the "Fed") on when to raise interest rates. The tug of war under this economic news showed up in both stock and bond markets: stock markets were nearly unchanged for the three month period and bonds returned all the gain the created in the first quarter. The net effect of this year's activities has been "sideways" markets. Our clients who are invested in our model portfolios fared well during this period, as our conservative portfolio positioning did a good job of dampening the ups and downs of the market without suffering opportunity cost.

There were two reasons to reposition client portfolios beginning in the fourth quarter of 2014. First, over the course of the last five years stock prices have, and continue to outpace their earnings growth and trade at valuations that are historically elevated. Additionally, we anticipated (and continue to anticipate) that a change in FOMC policy will cause increased market volatility in 2015. In the portfolio change, we maintained focus on quality companies, because they are more likely to perform stronger in down and sideways markets, while expected to only slightly underperform more risky investments when a "rising tide lifts all boats". We also chose to hold short term bonds and cash in a higher than normal proportion; dry powder to buy stocks in the event of a strong market downturn.

The quarterly performance, net of fees, for your equity portfolios was in line with the broad stock market. There was some divergence between our two favored international managers, so portfolios with the Dreyfus fund underperformed the index while portfolios with the Longleaf fund out-performed the index. Performance across the funds in the portfolio was mixed. Generally speaking, stocks in the Energy and Materials sectors performed poorly due to a continued story of oversupply in these basic commodity markets. Utilities and other high dividend-paying stocks also fell in price as many investors repositioned portfolios anticipating a rise in interest rates. Health Care and Technology sector stocks all rose with strength, primarily due to the market chasing any form of double digit growth – regardless of quality. The net result of this was that the overall market and our portfolios were little changed.

Bonds had a weak quarter with the broad index (Barclays Aggregate Index) down over 1.5%. Our bond portfolios, net of fees, were also down, but significantly less than the broad market. The short term price swings in the bond market are not particularly meaningful, though they can be unnerving. We are pleased with the way the fund managers are navigating this recent volatility, and bond portfolios continue to produce consistent income while muting stock volatility in balanced portfolios.

We do not anticipate changing portfolio positioning anytime soon. We anticipated a flat market as one possible response to the rapid climb since 2011. However, broad-based earnings growth has not moved upward sufficiently to make the markets a good value, and they are definitely not "cheap". If markets run higher from here, we are positioned to participate. If markets remain flat, our conservative position we help to stabilize value. However, if prices correct downward sharply, our cash and short term treasures will help preserve value and give us the opportunity to purchase companies at a discount.

214 EAST GRUNDY STREET • TULLAHOMA, TENNESSEE 37388
(931) 461-5733 PHONE • (931) 461-5735 FAX
INFO@ASHDON.COM