



A Choppy First Quarter

The equity markets ended the first quarter 2014 right about where they started. The S&P 500 rose 1.3%, the Dow Jones Industrials declined 0.72%, and the NASDAQ gained 0.50%. Given the outsized performance of U.S. stocks last year (S&P was up 30%) it is not surprising to see a period of consolidation and choppiness. Concerns over global growth, particularly the China slowdown, and the volatile situation in the Ukraine also weighed on the market. Our outlook, however, has not meaningfully changed from what it was three months ago. The fundamental backdrop for equities remains more positive today than it has for many years.

We still see an improving U.S. economy that may be nearing a point where growth can be self-sustaining. The economy is certainly not threatening to take off, but GDP growth should approach 3% this year, and interest rates can be expected to rise as confidence increases. New Chairwoman Janet Yellin and the Fed continue to pursue a highly accommodative monetary policy that is supportive not only of equities, but capital investment, housing and real estate, and risk assets in general. The leadership transition at the Fed created some uncertainty in financial markets, but Yellin recently made crystal clear the ongoing commitment to stimulative monetary policy:

"I think this extraordinary commitment is still needed and will be for some time, and I believe that view is widely held by my fellow policymakers at the Fed... recent steps by the Fed to reduce the rate of new securities purchases are not a lessening of this commitment, only a judgment that recent progress in the labor market means our aid for the recovery need not grow as quickly (March 31, 2014)

The Fed believes that deflation and low nominal growth remain a greater threat than inflation in the current environment. The Bank of Japan and ECB Chairman Mario Draghi have recently expressed a similar concern over persistent low growth and deflation. Draghi went on to call for a Euro version of quantitative easing to address its moribund economy. We believe monetary policy will remain supportive for longer than consensus, a continuing tailwind for equity markets. We are seeing the effects of five years of extraordinary Fed policy in a surge of liquidity that is now gaining velocity in both the economy and financial markets. ISI reports 101 deals (IPOs, M&A, JV agreements etc.) in the past two months. In the first week and a half of April alone there were 27 deals totaling \$144 billion.

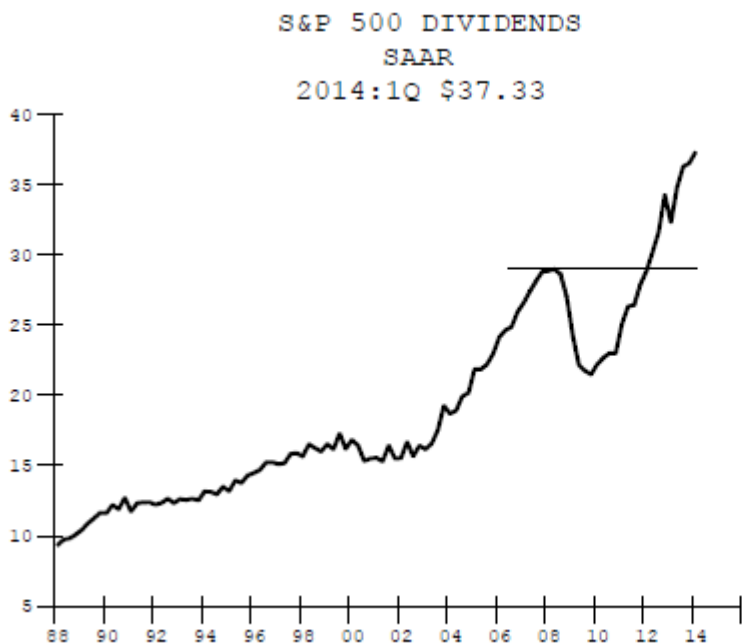
Market Crosscurrents

In our last couple of reports we have talked about the extended valuations building up in pockets of the market like biotechnology and "new tech" stocks - (social networking, cloud, and software-as-a-service). An echo of the tech bubble in the late 1990s, these stocks with speculative prospects had surged to wildly extended valuations. While by no means have all of the excesses been purged, in the last few months we have seen a healthy correction in these high flyers.

One result of the sudden but violent correction in the NASDAQ high flyers is a rediscovered appreciation for high quality dividend stocks. This plays to the strength of the Cypress portfolio. As we wrote in our recent January commentary:

The investment style at Cypress is one that favors larger, proven companies with significant global exposure, dominant market shares, high quality and growing earnings, and above average balance sheet liquidity. These companies produce more predictable cash flow and grow their businesses at reasonable rates over long, investable periods of time. Generally, the companies we invest in pay a healthy and growing dividend that becomes a meaningful part of the total return to long term investors. Our conservative oriented investment style produces investment results that should be significant, sustainable and consistent over cycles.

The stocks you own, and the S&P 500 as a whole, remain reasonably valued and supported by solid and growing dividends. Your portfolio and its equity holdings represent a valuable and productive asset in today's low growth, low interest rate environment. We expect dividend growth to outpace earnings growth in 2014 by a factor two to one (14-16% vs 6-8%); and even so, at a historically low 32% payout ratio there is still lots of room for further growth going forward. So at Cypress we hold a steady course, despite a choppy ride, confident we are well positioned to benefit from both the liquidity tailwind and a gradual rebalancing back towards higher quality yield producing equities.



S&P 500 DIVIDENDS	
Y/Y %	1Q
2007	+10
2008	+9
2009	-16
2010	-8
2011	+13
2012	+15
2013	+12
2014	+16

Source: ISI Group

Over the past four years, dividends have surged almost 70%, a very strong support for the +60% surge in the S&P over the same period. And yet, the payout ratio is still very low (32%).