C Y P R E S S

ASSET MANAGEMENT, INC.

MARKET COMMENTARY **April 2013**

Q1 2013: A Defensive Rotation into US Equities

The narrative for Q1 of 2013 was supposed to be how mandatory reductions in federal agency budgets (sequestration) and income tax increases would hamper the United States economic recovery and pose an early headwind for equities. Instead, the S&P 500 returned 10.6% in the first quarter led by investor demand for defensive sectors (Healthcare+15.2%; Consumer Staples +13.8%) and dividend income (Utilities +11.8%). MLPs, which as a group are not included in the S&P 500, outpaced the index producing a total return of 19.4% as measured by the Alerian MLP Index. Despite the much publicized risks to the economic recovery, the first quarter advance in equities demonstrates a lack of viable alternatives for investors seeking current income and some potential for appreciation. Fixed income no longer provides an attractive yield or a reasonable risk/reward profile in this ultra-low rate, Federal Reserve stimulated environment. Blackrock, the world's largest asset manager, spoke to this trend during their Q1 earnings call:

> "Aging populations are living longer worldwide at the same time that global monetary policies have reduced interest rates to historic lows. Now, long-dated fixed income instruments traditionally used to fund retirement obligations carry asymmetric risk for investors looking to match retirement assets and liabilities. This is having a significant impact on where we're seeing asset flows as investors seek other sources of yield, including equities, where we witnessed a record $34billion [Q1] in net new flows."
>
> *-Blackrock CEO Laurence Fink 4/16/13*

The preference for defensive sectors over cyclical equities was also evident in world market returns. Emerging market returns were negative for the quarter (MSCI EM-1.6%) as the oil, iron ore, and other commodity heavy markets in Brazil and Russia suffered and Chinese (Hang Seng -1.4%) equities continued to struggle amid concerns over an economic slowdown. The only market to match the US return was Japan (TOPIX +11.0%), where "Abenomics" and a historic monetary stimulus program by the BOJ has boosted equities and weakened the yen.

GDP Growth Forecasts versus S&P Earnings	2011	2012	2013e	2014e
Global GDP Growth (y/y rate)	4.0%	3.2%	3.3%*	4.0%
U.S.	1.8	2.2	2.0	3.0
Euro Area	1.4	-0.6	-0.8	1.0
Japan	-0.8	2.0	1.8	2.0
Developing Asia	8.1	6.6	7.0	7.3
China	9.3	7.8	8.0	8.2
Latin America	4.6	3.0	3.4	3.9
Emerging Market & Developing Economies	6.4	5.1	5.3	5.7
S&P 500 Aggregate EPS	98	103	109	118
Earnings (y/y rate)	15.0%	5.0%	5.8%	8.3%

* Global growth forecast to accelerate from under 3% in 1H to 4% in 2H 2013. Trend of stronger 2H applies in every region.

Sources: IMF, ISI Group, BAML

Consumer Stocks Remain in Favor

Over the past two years investors have favored consumer equities as best positioned to provide stable earnings growth in a slow global economy. Cypress portfolios remain significantly over weighted to the Consumer Staples sector which has been a standout performer (33% 2yr return) alongside Consumer Discretionary (36%) and Healthcare (39%). Consumer franchise stocks, with global brands and global reach, should continue to provide a solid portfolio foundation and an above average long term total return. Investors have perhaps anticipated a shift away from a rising commodity price environment and fear that reduced growth trajectories in the emerging BRIC economies will not be robust enough for industrial companies and infrastructure spending to flourish. Hence, the relative valuations in the consumer sectors continued to rise during the quarter, while Industrials (11% 2yr return), Energy (-1%), and Materials (-1%) continued to lag. Despite slower growth, consumer spending in emerging markets has remained relatively strong due to an increasing penetration of branded staples and rising demand for luxury "discretionary" products among the new class of uber-wealthy aspirational consumers.

Energy and Industrial Sector Positioning in a Slowing Macro Environment

Given the slowing macro-economic environment and uncertainty surrounding the threat posed by unprecedented debt levels constraining the developed world, we have positioned our portfolios conservatively over the past two years. We reduced our holdings in the energy and industrial sectors, paring back to the highest quality names best positioned to come through a slower growth period unscathed. Within energy and resources we have focused on MLPs, which offer both good current yields and attractive total returns. The dramatic growth in shale hydro-carbon production provides a clear path for further infrastructure development, higher volumes, and steady growth in distributable income. Energy midstream infrastructure (pipelines, storage, and processing systems) are prime beneficiaries of both the North American energy renaissance and the manufacturing resurgence it is fueling.

But before wondering why investors would want any exposure to businesses vulnerable to a slowing and uncertain global economy, remember the stock market is forward looking. We began positioning our portfolios for the current slow growth environment some time ago. The relative stability and security of the United States, the slowdown in emerging markets, a preference for defensive names, and avoidance of cyclical and commodity linked equities is now conventional wisdom and pretty fully discounted in the market. Our outlook is for global growth to pick up in the second half of 2013 and into 2014. We see undervalued earnings growth potential among our energy and industrial holdings and look to opportunistically increase our holdings in this area as we see evidence of better growth and gain confidence in a reacceleration in emerging markets. In the meantime we are very comfortable that our portfolios blend of defense and offence and of growth and income will continue to prove its value over time.

MARKET OUTLOOK

Positives

U.S. Economic Fundamentals Improving:

Housing has turned the corner and should enjoy a sustainable multi year recovery. Existing home sales and starts both trending higher; home prices finally turn up; mortgage rates at record lows. Housing price improvement may be even more important to overall economy than new house starts.

Strong Domestic Auto Market
Auto sales up 66% from 2008 recession low, reach recovery high of 15+ million units in Q1.

Energy & Manufacturing Renaissance in North America

- Increasing U.S. oil production and declining domestic oil consumption puts U.S. on the path to energy independence – essentially zero oil imports projected by decade end.
- Record low natural gas prices benefit both U.S. consumers and manufacturers: U.S. natural gas prices are rose to $4 in Q1 but still far below $12 world average. Cheap natural gas a competitive advantage for U.S. manufacturers.

America feeds the world: U.S. farmers and farmland should continue to be primary beneficiaries of ongoing global agricultural bull market.

Favorable demographics in the U.S. for growth versus the rest of the developed world.

Attractive Equity Fundamentals:

- Strong Corporate Fundamentals: Cash, Cash Flow, and Profits at record levels and still growing.
- Strong Dividend Growth: Dividends surge almost 20% in 1Q 2013 and are now well above prior peak. Even so, the payout ratio remains close to a record low, i.e. lots of room to grow.

Stimulative Monetary & Fiscal Policy Wave:

- Wave of Stimulative Policy initiatives underway around the world (ISI counts more than 370 stimulative policy initiatives by governments around the world over the past 20 months).
- Accommodative Fed, ECB & BOJ (Bernanke Fed continues "open ended" QE3; Draghi commits ECB to do "whatever it takes" to preserve Euro Zone; PM Abe moves forward boldly in Japan with historic reform and monetary stimulus program. BOJ announces QE on larger scale than US Fed: "Our stance is to take all the policy measures imaginable."

Commodity prices have cooled providing a boost to consumers and manufacturers, and obviously positive for inflation outlook (e.g. oil, gasoline, copper, corn all down better than 5%).

Stocks remain out of favor but flows pick up:
The Great Re-Allocation Trade: 2013 bond fund inflows have slowed but remain positive YTD 2013; concerns grow over what happens when "bond bubble" and artificial low rate environment comes to an end….have we reached a tipping point where investors re-allocate capital out of fixed income and into stock?

- Twelve consecutive weeks of equity inflows in 1Q 2013; $73B in equity mutual fund inflows in 1Q the most in 7 years.

Negatives

Global growth slowdown extends through 1H2013:

- Euro Zone Recession deepens well into 2nd year: (Southern European Countries: Greece, Spain, Portugal, Italy in historic downturns).
- China economic challenges: China struggles to transition to a more consumer demand and domestic driven economy.
- BRICs sputter: Emerging market growth slows in from China to India, Russia and Brazil but should start to pick up second half 2013.

Higher tax rates in the U.S.:

- Income tax rates return to 39.6% for income above 450K (joint filers).
- Capital Gains & Dividends: Permanently set rate at 15% for incomes below 450K, and 23.4% for incomes above 450K (joint filers).
- Deductions are limited for higher incomes.

U.S. federal debt crisis: How much longer can we postpone meaningful fiscal reform?

- Growing federal debt and entitlements, if not addressed, will ultimately cripple the U.S. economy and fundamentally weaken the U.S. and its global leadership – see Europe.

Macro Concerns:

European financial and banking crisis:

- Stabilized but still capable of flaring, as we saw with Cyprus Bank failures.

Middle Eastern turmoil & Iran nuclear crisis