CYPRESS
ASSET MANAGEMENT, INC.

MARKET COMMENTARY **January, 2015**

Economic and Market Outlook 2015

Despite a higher level of uncertainty surrounding global growth, the U.S. economy should remain the best performer among the major economies with GDP growth accelerating to 3% -3.5% in 2015. We expect the Fed to reduce its policy support only gradually and not to raise short-term interest rates until mid-year or even later. The Fed clearly wants to begin the process of normalizing policy and rates, but inflation expectations continue to diminish. Global growth concerns, a strong dollar, and the plunge in oil prices all raise the risk of deflation, while wage increases remain missing in action in this recovery. Downside risks involve the market reaction, both in the U.S. and abroad, to an increase in U.S. rates. It has certainly, however, been well communicated.

2014 Equity Market Returns*	%
United States S&P 500	**13.7**
Dow	10.0
Nasdaq	14.8
MSCI World Index**	**9.9**
MSCI Emerging Markets**	**5.6**
MSCI World Ex U.S.**	**6.5**
Bond & Currency Index Returns	**%**
U.S. Dollar Index (DXY)	**12.5**
Long Term Treasury	**26.3**
U.S. Corporate Investment Grade	**7.5**

*Index returns include dividend reinvestment

** Local Currency

Commodities	Units	12/31/2013	12/31/2014	% Change
NYMEX Crude	$/Bbl	98.42	53.17	-46.0%
Brent Crude	$/Bbl	110.82	55.73	-49.7%
Nat Gas	$/Mmbtu	4.34	2.99	-31.1%
Gold	$/troy oz	1206.6	1184.1	-1.9%
Copper	$/lb	339.45	282.4	-16.8%
Iron Ore Fines	$/net ton	134.2	69.3	-48.4%

GDP Growth Forecasts versus S&P Earnings	2012	2013	2014e	2015e
Global Real GDP Growth (y/y rate)	3.4%	3.3%	3.2%	3.5%
U.S.	2.3	2.2	2.4	3.1
Euro Area	-0.7	-0.4	0.8	1.2
Japan	1.5	1.5	0.2	1.4
Developing Asia	6.7	6.6	6.0	6.2
China	*7.7*	*7.7*	*7.3*	7.1
Latin America	1.4	2.5	0.8	1.7
Emerging Market & Developing Economies	5.0	4.7	4.4	5.0
S&P 500 Aggregate EPS*	96.8	107.3	116.8	125.0
Earnings (y/y rate)	0.4%	10.8%	8.8%	7.0%

Sources: IMF, ISI Group, BAML, Capital IQ

Reduced Growth Expectations Outside the U.S.

The most obvious uncertainty to the global outlook involves stagnation in Europe. The Eurozone should be supported by a weak currency, lower energy prices, and its own quantitative easing stimulus program. These forces should enable Europe to avoid recession and see better, albeit very modest, growth in 2015. As U.S. monetary policy is starting to gradually normalize, the ECB, Bank of Japan, and the central banks of China, India, and many emerging market countries are only in the early stages of easing campaigns. The ECB is expected to purchase hundreds of billions of dollars of government bonds and private debt to fight deflation.

The trend of slowing economic growth outside the U.S. has characterized the global economy over the past two years. Growth should begin to respond to monetary policy and unprecedented global stimuli and to the 50% drop in oil prices by the middle of the year and could even exceed expectations in the second half.

We look for slower headline GDP growth in China as it continues to transition away from fixed investment and export dependency to a more balanced consumer and service driven economy. China has the capital resources to manage its transition to a more sustainable level of growth (5% to 7%) over the next few years and avoid a hard landing.

Global Crosscurrents Create Winners and Losers

In the words of the recent IMF report, the world economy is contending with “strong and complex crosscurrents”: forces that are positive for some economies and markets but negative for others. The result is a more complicated and uncertain picture. Global growth will see a boost from lower oil prices, potentially even a significant boost - Good news for the U.S. economy and consumer (we still import 5+ million barrels of crude oil per day), China, India and Asia, and most of Europe; bad news for Russia, the Middle East, Texas, and North Dakota. Texas and North Dakota account for nearly half of total U.S. crude production (38% and 11 % respectively).

The strong dollar also creates winners and losers. A rising dollar is putting downward pressure on oil prices, further complicating the outlook for crude oil. It also attracts capital from around the world to the U.S. market and assets. It hurts the earnings of U.S. multi-nationals while helping competitiveness and corporate profits in Europe and Japan. For U.S. investors who venture abroad, however, currency depreciation could erode nominal gains in foreign markets. In the final analysis, we believe the U.S. gains from its status as a strong and safe haven currency, market, and economy.

U.S. Dollar Strength to Continue

The U.S. dollar index rose 12% in 2014 and is expected to remain strong. It poses a headwind to corporate earnings, but at the same time it lowers the outlook for inflation and future rate increases. Thus in theory, the negative impact to earnings should be offset by a higher multiple on those earnings based on lower inflation and rates. A strong dollar environment encourages investment from overseas, making U.S. assets (equities, bonds, real estate) more attractive given prospects for continued secular dollar currency appreciation. The U.S. is likely to remain a safe haven in an increasingly uncertain and dangerous world. The strong dollar reflects a number of relative economic and geopolitical strengths, and improving underlying fundamentals:

- The U.S. economic recovery and growth contrast with disappointing ROW growth
- A dramatically improved Federal Budget deficit, down to 2.5% of GDP at the end of 2014 from 10% in 2010
- US monetary policy is still accommodative but normalizing versus Central Banks in ROW only now following suit and implementing extraordinary monetary stimulus
- The renaissance in U.S. energy and shale oil production making it again an oil and gas super power and providing energy security if not independence

The Plunge in Crude Oil

Crude oil prices have dropped 50% in the past year, most of that occurring in the last three months. The collapse in price has surprised just about everyone in the market and the industry. It reflects a combination of weak global demand and production increases from U.S. shale. North American supply growth represents 70% of total global oil supply growth over the past five years (which raises the question of where prices would have been without the U.S. shale boom- perhaps much higher than we might like to think about).

The current oil market is over supplied, but not dramatically by historic measures. Excess supply is a relatively modest 1.5 million barrels per day out of a 94 million barrel global market or 1.65% of total. This compares to previous supply gluts that approached 5% or more of global production: the 2008 financial crisis, 2001 global recession, 1998 Asian Financial Crisis and OPEC supply growth, and 1986 when Saudi Arabia also refused to continue in its role of OPEC swing producer.

Is OPEC Broken

What caught the markets off guard was the unwillingness or inability of OPEC to act to stabilize prices. Instead, Saudi Arabia essentially launched a price war against the U.S. shale producers, Russia, Iran, and the rest of OPEC which have all benefited from the OPEC/Saudi price umbrella. This raises the question of whether we are witnessing the demise of OPEC and the dawn of a new era in energy markets in which it is no longer the dominant producer and price setter.

The U.S. is now poised to surpass Saudi Arabia as the world's top producer at more than 9 million barrels per day (and according to some industry insiders has already done so) with U.S. shale producers now in the role of global swing producer. As a result, for a period of time the North American market will determine energy prices, rather than the OPEC cartel price setting mechanism.

It is often said that the best cure for low oil prices is low prices. We agree. U.S. producers have already acted rapidly to curtail drilling plans and capital spending in 2015. The rig count could decline by 35-40% by later in 2015 and we could see year over year production declines by the end of the year. At the same time, lower oil prices will provide a boost to global growth and oil demand. Oil at $50 is already below levels that make sense fundamentally, so we expect a recovery in prices in the second half to a range of $65-$75. That said, lower oil prices could be with us for an extended period of time (2-3 years) in comparison to the $90 level that prevailed from 2010 through mid-2014. And as discussed above, the strong dollar will also continue to be a headwind even when supply and demand tighten.

Finally, OPEC remains a wild card, and still has the means to lower its production and raise prices. It does not have the power it once did not only because of the U.S. shale producers, but also because so many of its members are in bad financial condition and facing geopolitical instability. This makes it harder for them to act to cut production and temporarily lose revenue. But a surprise cut and OPEC response in 2015 is not out of the question.

From an investment perspective, strategically well positioned and well capitalized U.S. producers will emerge even stronger from the current downturn and represent attractive investments when viewed from longer than a short-term time frame.

Cypress Portfolio Strategy

Cypress results for the quarter lagged the S&P 500 for several reasons. First, we are generally invested in stocks with a significant dividend yield. Second, with good reward over the years, we have been long-term investors in the energy and energy infrastructure sectors, two areas that had particularly weak performance as the commodity price of oil and natural gas declined. During the fourth quarter of 2014, US equity outperformance was principally driven by two sectors, technology and health care (including biotech). Many companies in those sectors pay nominal dividends, if any dividends at all. Moreover, large numbers of companies in those sectors have what we consider shorter term, more ephemeral business models and do not represent solid long-term investments. Many of the stocks in these areas are inconsistent with our investment strategy. Yet their investment performance drove much of the return in this quarter. Simply put, if you invest long enough in the market and are long-term, low turnover investors, you are going to experience quarters and shorter periods of investing where you are out of synch with the shorter term movements of the market. Inevitably, there are going to be times when your investment strategy is going to lag the general indices because some of the sectors you invest in lag the general market. The fourth quarter of 2014 was such a period for Cypress.

We would argue that there is long-term opportunity created with our short-term underperformance. The energy and energy infrastructure sectors are now much cheaper absolute and relative holdings. Commodity prices have been decimated and, we would argue, are now closer to the bottom than to the top. As long-term investors, we recognize that there remain significant challenges in these sectors but we think that these groups represent good value to investors as well. And make no mistake, as you have seen with Cypress over the years, in the search for strong, consistent growth and income investments, we evolve. We have added many investments in areas such as consumer discretionary and health care that we feel represent significant long-term opportunities in a challenging economic backdrop. We will continue to seek out great long-term investment opportunities in areas that offer durable growth relative to domestic and international challenges. Likewise, we feel that some of the investment sectors that outperformed in late 2014 will have a hard time maintaining that outperformance given their heady valuations. The worm turns.