AUGUST 26, 2015

S/A

Dear Client,

Over the past several days, global stock market activity has been a lead story today in countless newspapers and media outlets. As much as we believe that having a long term perspective is the key to successful investing, the gyrations of the last week or so have been hard to ignore. The dramatic volatility stands in marked contrast to the stagnation of the second quarter and mid-summer. In the letter we sent you in mid-July, we wrote the following:

Investors will eventually regain conviction in a ***coherent****, though not necessarily accurate, view of the future. This period of market doldrums will come to an end, and a direction will be established. A stronger consensus will form on the following:*

- *the strength of the U.S. economy – we think signs point up*
- *whether Europe and Japan are finally emerging from their struggles – probably yes for Europe, no for Japan*
- *whether the Chinese government will be able to manage economic slowdown ("soft landing") and avoid a more serious accident ("hard landing") – in our view, the data coming out of China are so unreliable that we are reluctant to hazard a guess, though we are* ***innately skeptical about soft landings****.*
- *when, by how much, or if at all U.S. interest rates will rise – we believe that they will (Emphasis added)*

It seems that concern about China has been the proximate cause for the global swoon in stock prices. All of a sudden, the market has adopted the view that the "landing" will be more hard than soft. This in turn causes traders (more than investors) to worry about the implications for the other three factors we outlined in our letter. When combined with another drop in the price of oil (below $40 a barrel), it is possible to construct a tidy package of potential risks:

1. Slowdown in China prevents
2. Europe from emerging from its post financial crisis slump, which in turn
3. Damages the US recovery just when the Federal Reserve wants to raise interest rates

If you accept that a theory needs only to be logical and consistent to be coherent, this one does fit the definition. We do NOT believe this narrative will play out; however it does provide a useful measuring stick by which to evaluate future economic reports and the subsequent market reactions. Our long held skepticism about China has proven to be correct. We are not yet ready to adopt the fear that the Chinese economy will play the role of first domino. Until signs clearly point otherwise, we still believe that U.S. economic growth is reasonably on track and that Europe may at last show signs of re-emergence.

SPEARS/ABACUS

147 EAST 48TH STREET, NEW YORK, NY, 10017 SPEARSABACUS.COM
T 212-230-9855 F 212-230-9861

We have always maintained that the stock market is capable of dropping 10% at any time. In candor, we did not foresee such a sharp sell-off. Because market emotion is so difficult to predict, we stay hard to our core beliefs about equity investing. Your portfolio is comprised of companies with durable businesses, in fortress-like financial condition that we believe will continue to produce above average results even in difficult periods. We feel strongly that none of these companies present the risk of permanent loss of capital.

We will keep a close eye on unfolding global events and make whatever adjustments are necessary. Watching markets move in leaps rather than steps is never comfortable, but having a well-constructed portfolio should prove to be the best defense.

It is likely that there will continue to be broad media coverage of market volatility (though we can count on something more newsworthy or sensational pushing the story off the front page). If you have any questions or concerns about what you see, hear or read, please do not hesitate to call or email. All of us at Spears Abacus are reading and thinking about, discussing and forming views about these market events. We are more than happy to share our thoughts with you.

We hope you enjoy the rest of the summer.

Best regards,

Spears Abacus