FBB capital partners

July 1, 2015

Dear Clients and Friends:

The investment committee is excited to begin this quarterly letter by announcing our most recent addition to the FBB team, Michael D. Bailey. After a thorough search process that spanned four months and 60 applicants, we identified Mike as our first choice and we are pleased that he chose to join the FBB family.

Mike takes on the roles of Director of Research and Chair of the Investment Committee. Mike is a Chartered Financial Analyst (CFA), one of our industry's most esteemed designations. He brings more than 15 years of investment experience, having spent the majority of that time as an equity analyst and most of the past decade with Legg Mason Investment Counsel. Mike brings a wonderful balance to the team with expertise in bottoms-up equity research, paired with a talent for applying analytics and theory to portfolio construction, and macroeconomics. Please feel free to introduce yourself to Mike the next time you are in our office. Additional information about Mike is posted on our website, *www.fbbcapitalpartners.com*.

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In May, we reassessed the risk and return opportunities across FBB's existing portfolio companies and asset classes. This is a discipline that we practice every quarter at the tail-end of earnings season. Where the risk-return trade-off seemed less attractive than before, we sold or reduced positions (i.e. Walmart and Emerson Electric). Alternatively, we have been adding new ideas where the risk-reward proposition appears more attractive (i.e. UnitedHealth, Alexion, and Danaher). In anticipation of rising interest rates and an eventual turn in the market cycle, rebalancing activity will continue throughout the next quarter, though likely at a slower pace.

At current levels, equity prices still seem full but not grossly overvalued. We continue to look for companies that seek to drive long-term transformation within their respective businesses and industries. We also look for companies that exhibit an ability to outperform earnings estimates, despite the much anticipated rise in interest rates. Likewise, we plan to further reduce exposure to industries that could struggle as a result of interest rate hikes (i.e. utilities, telecom, and real estate investment trusts).

Over the years, we have often written about the role of dividend yield—While it remains an attractive part of a company's financial profile, it is not a mandatory metric for a company to possess before finding its way into our investment committee or even your portfolio. Within the aforementioned sectors, we believe a likely tradeoff will occur between dividend yield and total return prospects. Additionally, the absolute level of dividend is less important to us than the underlying growth opportunities for that dividend over time. Typically, an active dividend policy shows us that management:

1) Has the ability to internally generate cash flow to support a rising dividend, and

2) Understands the importance of (and has) a capital allocation plan.

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As the second quarter came to a close, the final read on first-quarter GDP was an unimpressive -0.3%. Early data for the second quarter points to a positive number, likely above the recovery's average, but still lower than expected. Increased consumer spending, which we expected to coincide with lower energy prices and increasing wages, has been spotty at best. While at times the data has shown potential positive trends, it has been offset by wage earners paying down debt and increasing their personal savings. Over the long-term, we see these as structurally positive activities. However, in the near-term, the sluggish consumer is sapping some of the “oomph” from the overall economy’s growth rate.

The U.S. employment situation has continued its steady march of improvement. The official headline figure hit its lowest level since before the financial crisis at 5.4%. More impressive is the fact that the four-week average of weekly unemployment claims recently hit several 14-year lows. These figures should support our theory of higher wages and a near-term rate increase by the Federal Reserve.

In mid-June the Federal Reserve announced that it would not be raising rates just yet, but that the first rate hike would likely occur “later this year.” The bond market seems to be signaling a “*We are ready*” sentiment to the Fed, as the selloff in bonds pushed rates notably higher toward 2.5%, thus reminding us that the market’s rates may have adjusted ahead of the central bank. For now, it seems the markets are settling in on a 2 to 2.5% range for the 10-year note vs. the 1.65 to 2% range in the first quarter. This could be a positive development as we continue to look for opportunities to put cash to work within the fixed-income asset class.

A couple of MACRO developments as we go to print:

First, the Greece situation appears to finally be coming to a head. The government implemented capital controls ahead of an expiration of the European Central Bank bailout extension. Today, ownership of Greek debt is much more tilted toward other governments and their central banks versus the private sector. Current estimates are in the 80% government / 20% private sector range—much more reasonable than 2012 levels. This leads us to believe that systemic risks or shock to the financial system from a Greek exit would likely be contained. However, long-term implications remain to be seen, and, once again, we find ourselves in a credit-driven market correction where investors are left wondering—*Where might the counterparty risk lie?*

Second, after a meteoric rise for the first five months of the year, the Chinese stock market has been hurling back toward earth over the past two weeks, officially reaching bear market territory at the end of June (defined as a correction of 20% or greater). We continue to tactically minimize direct portfolio exposure, preferring to own multinationals with some sales in China.

Near-term, these two macroeconomic events will likely lead to some equity market volatility and a rise in bond prices as investors jockey for safety and quality within portfolios. As you know, FBB’s investment posture generally favors quality and safety, and, as you should expect, we are currently re-evaluating areas where the risk and reward merits of some lower quality assets may be called into question.

With kind regards and wishes for safe summer travels,

FBB Capital Partners’ Investment Committee