CARMICHAEL CAPITAL INC.

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2014 Year End Review
"A Tale of Two Markets"

Volatility returned to the stock market in spades during the fourth quarter. With the flurry of more recent events taking precedence, it may be surprising to remember that just a few months ago we and the markets were trying to digest the possible impact of an Ebola outbreak in the U.S. and a takeover in Iraq by ISIS, as all the while the markets tanked. Neither danger was by any means trivial, but noticing the rapidity with which such threats emerge and recede from investors' awareness can give us some insight into the nature of the markets in which we are investing. After two substantial sell-offs in the fourth quarter, the markets recovered with the Dow Jones Industrial Average closing the year up 7.5%. Smaller stocks generally didn't do as well, as the Russell 2000 index small company stocks rose 3.5%. Contrary to popular expectations, bonds in general rallied as inflation stayed in check and the Federal Reserve Board pledged to "be patient" in raising interest rates. The actions and comments of the world's central bankers appear to continue to have an outsized effect on the direction of equity prices.

In the depth of the severest decline in the fourth quarter, which we actually hoped might continue in order to give us the opportunity to deploy more cash at better prices, it was the comments by a Federal Reserve member offering the possibility of providing still more emergency liquidity that seemed to turn the rout into a head-snapping rally. Contrary to its mandate and stated mission, the Federal Reserve has become the arbiter of prices in a supposedly freely operating capital market. They now decide if a 10% decline in stocks warrants massive government intervention. What is disturbing is the underlying fragility in the financial system which this kind of intervention may indicate.

Our core holdings of large, dividend-paying stocks in our larger portfolios continued to perform reasonably well. One bright spot in particular has recently been Bristol-Myers which just announced some encouraging results from their treatment for lung cancer. The telecom company stocks remained flat while paying good dividends showing prospects for improved earnings. Corning continued to do well after a mid-year swoon, with new products for TVs, cell phones, and for industrial applications. One of our more recent additions, Oaktree Capital Group, began to recover from a dip earlier in the year. Elsewhere, however, there were a number of problem areas.

In the interest of being conservative, we often keep cash reserves when markets have risen and leave us with fewer investment options that meet our criteria for value. Because money markets now pay so little interest on their credit balances, those cash reserves become a drag on performance in a rising market. That is one reason we are doubly frustrated by the central banks "jawboning" stocks higher just when the declines are beginning to reveal some real value. We also expected that the unprecedented and massive "printing" of money by the world's large central banks would eventually translate into a logical increase in precious metals prices, especially since gold is a store of value that can't be created by government fiat. On the contrary, prices for precious metals fell again this year, taking precious metal stocks down with them.

We had a few special situations that held their own disappointments. We invested alongside the legendary value investor Seth Klarman of the Boston-based Blaupost Group in the apparently undervalued stock of one of the largest mortgage services in the country, Ocwen Financial. However, an adverse reaction to a settlement with New York State regulators took the stock down substantially and the settlement may have delayed the ability to realize the value of the company. We were only thankful that we didn't hold Klarman's 7 million share position. We also took a small position in Monitise, a small London-based company that is a favorite of another legendary investor, Leon Cooperman who is chairman and CEO of Omega Advisors. Its mobile banking platform is a potential huge winner in the proliferation of mobile payments in retail. However, the stock was rocked when Visa recently decided to sell its 5% stake in the company. Fortunately, Mastercard along with other major international players like Telefonica and Santander expressed their support of the technology and the company by later buying a still-larger portion of the company's stock. This could represent a great opportunity for Monitise as Santander has 107 million checking accounts and Telefonica has 252 million mobile subscribers. Even with the recent set-back, there is still substantial upside to this one.

The biggest story of them all, however, is oil. The price of the black stuff has fallen by 50% in the space of a year. This is a somewhat complicated situation as lower gasoline prices are a boon for the consumer, but prices may have fallen so far and so fast that the fallout may be more damaging to the general economy than would at first be obvious. Lower oil prices like higher bond prices, may indicate that global economic growth is slow and in danger of stalling. The 5% GDP growth number posted for the 3rd quarter in the U.S. would put us near the top of the world's growth rates, but the rest of the world is not faring nearly as well. Even our good growth number could be due to an "adjustment" from the "Obamacare" accounting that, according to some, raised a tepid 2.7% rate to the much higher number. Even if the drop in oil prices is only due to overproduction, the ability to cut back production to stabilize prices is beyond the reach of many of the small companies that have financed their fracking operations with bank loans and the promise of $80 oil. Many of them can't cut back because they have interest payments and bonds due. Any investor who has been around long enough to remember the failure of Continental Illinois Bank in 1984 will realize the potential for problems in the banking system from oil loans gone bad. Once again, small oil company stocks were hit harder than the larger, integrated oil companies we hold in our larger accounts.

While we are frustrated by the recent setbacks, we have a core of good investments and enough flexibility to react and regroup in this new year. There will surely be more sell-offs and more opportunities to put capital to work at better prices. Frustration and patience are not easy companions, but actions based on frustration are often less rewarding than those taken with an awareness of the long-run nature of the value investment proposition.

Enclosed you will find your quarterly reports and statements for 2014. Please feel free to give us a call to discuss the contents of these reports and/or to suggest any adjustments that you would prefer to make in the management of your portfolio. We consider it a privilege to help you with your investments and we are grateful for the opportunity to have done so during 2014.

Sincerely,

Claude R. Carmichael CFA