CARMICHAEL CAPITAL INC.

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2015 Second Quarter Review
"Greece is the word, but China may be the problem"

It has been a long time since the world has paid so much attention to developments in Greece. Inhabitants of the Peloponnesian Peninsula have contributed enormously to western culture, but now they may be relegated to the role of Achilles' heel of the Eurozone. Economic markets have reacted violently to many of the developments that should come as no surprise. This particular can has been kicked down the road so many times that, until recently, investors had become inured to the danger. However, this kind of angst we are now seeing on the part of the public is what we've been preparing for as investors wake up to the risks they have often ignored in the past. We have sweated it out with ample cash reserves while the market continued to ignore the rising risks of a correction. Now, we are beginning to see the possibilities for using some of that cash to make purchases at lower prices if/when the equities markets decline some more.

The mantra for investors has quickly begun to shift from "TINA" (There Is No Alternative to stocks, that is) to "There's no place to hide." Stock indexes have fallen only 3% to 4% from their recent highs, but long term Treasury Bonds have gotten hammered, falling about 15% in price from their late January highs. With stock and bond markets becoming weaker, cash reserves are beginning to look like a better idea after all. We have been waiting for that.

By the end of the first quarter the S&P 500 was basically flat for the year while the Dow Jones Industrial Average had declined by 1.14%. That still looked good compared to the hit that bonds took with the Barclays iShares ETF down 6.7% year-to-date.

Only two stock market sectors have shown positive performance for the year so far; Healthcare and Consumer Discretionary. Our pharmaceutical stocks have held in well and provide one of the few bright spots lately. Utilities have fared the worst as fears of the long awaited rise in interest rates intensifies. Happily, we are very much underweighted in that sector. However, we do own some energy stocks that have been laggards. They stabilized during the first quarter but have started to show weakness again, becoming the second weakest sector in the market so far this year. Precious metals have behaved similarly to energy in that they stabilized earlier in the quarter only to sell off again near the end. We have sold off some of our weakest performers and have raised cash in anticipation of possible further declines.

The weakness in bonds, in utilities, and to some extent in the general stock market has partial been attributable to the seemingly inevitable (someday) rise in short term interest rates. However, the Fed still seems terrified to bump rates up the tiniest bit, fearing they will be blamed for any market sell-off or economic slowdown that might ensue. One of the beneficiaries of higher interest rates should be banks, particularly regional banks. That is why we are beginning to nibble in that sector for some stocks that may perform well when rates finally do start to rise. It still remains to be seen whether we will get a rate hike this year from The Fed. If we don't, it may be because the markets are acting so poorly that Yellen and Co. may become too afraid to pull that trigger.

The turmoil surrounding a Greek bailout or a possible "Grexit" from the Eurozone has grabbed the headlines, but more serious dangers may be developing in China. There has been a real estate boom in China that seems to dwarf our own housing bubble. There has developed a "shadow banking" system in China that might rival our own derivatives market of 2007 for lack of transparency. That particular bubble has started to show signs of deflating. The Hang Seng Index has dropped over 17% from its recent high, while the Shanghai Composite Index has fallen 26% since June 5th. The smaller Shenzhen Composite Index has fallen over 35% since May. If you think about it, it may just be China's turn to have an economic bubble burst. It happened here first in 2007-2008, then in Europe, and now perhaps China is next in line as the excesses are purged around the globe. If China does experience a recession it could have meaningful impact on world markets for everything from copper to Treasury Bonds. Greece is in the spotlight now, but we are keeping an eye on China for potentially more serious trouble down the road. We should not be surprised to see a "relief rally" if the problems with Greece are kicked down the road again in what many analysts call "extend and pretend." That kind of rally might be tempting but short-lived; especially if the problems in China continue to grow.

At any given time, there is a price at which almost any marketable asset represents a bargain. As one of my favorite analysts likes to say, "Price is what you pay. Value is what you get." We haven't seen many prices that represent compelling values recently and that's why our buying has been subdued. The pendulum may have started a swing back to more "fear" than "greed," however, in which case we will want to have our cash reserves available to buy some stocks during any "fire sale" sell-off. The natural tendency, of course, is to want to buy stocks when things look great and they all seem to be going up, and to sell stocks when fear peaks and prices are down. To the extent that we can overcome those emotional tendencies to buy high and sell low, we will be able to increase the long term returns on your investments.

Enclosed you will find your quarterly reports and statements. Please review them at your leisure and give us a call with any questions or suggestions you may have. As always, if you want to change your investment position to become more or less aggressive, please just give me a call and we can discuss the details of your portfolio and your participation level in the markets.

As is our annual duty, we hereby inform you that no personal information of yours of any kind is shared with anyone without your express consent. (You don't even have to "opt out!"). Also, you should have received an updated copy of our informational brochure (ADV form) during the first quarter. You can always request another or view the form by visiting our website at www.carmichaelcapital.net.

I hope you enjoy the rest of the summer as we see how this drama of "life on Earth in 2015" plays out.

Best regards,

Claude R. Carmichael CFA