Steinberg Asset Management, LLC

First Quarter 2015 Commentary and Outlook

Major equity markets ended the quarter little changed from year end as the combination of a strong dollar and weak oil prices dampened outcomes for the large multinational companies that feature prominently in both the Dow Jones Industrial Average and S&P 500 Index. Small and mid cap stocks fared better for the period as their profitability tends to reflect less exposure to the dollar and oil.

Dollar's Strength Dominates

Over the past nine months the dollar has surged 20% against a basket of currencies of our principal trading partners. The dollar's rise has been propelled largely by the greater return investors can earn on U.S. fixed income investments compared to similar investments outside the U.S. This growing spread differential reflects a U.S. monetary policy that has been on hold compared to a policy of aggressive accommodation pursued by central banks around the world. In lowering the interest rates borrowers pay, monetary authorities from Asia to Europe have also lowered the yield – in some cases to zero – that investors receive from fixed income investments. This growing difference in yield between the U.S. and most of the rest of the world has acted as a magnet for capital from abroad, fueling demand for U.S. dollar denominated fixed income assets and driving the dollar's rise.

Further bolstering the dollar has been anxiety in the currency markets that the interest rate differential between U.S. and other currencies will widen further when the Fed makes good on its policy statement to begin raising interest rates later this year.

Path of Interest Rates Key to Dollar

Recently the dollar rally has stalled, reflecting a more tempered near-term outlook for U.S. economic growth. The recent slower pace of U.S. economic activity is thought to make it less likely the Fed will begin to tighten monetary policy in the near-term. At the same time, there are signs of improving growth abroad, which suggests the decline in foreign interest rates could be halted. Such developments could serve to promote stability and would be most welcome. As long as the dollar trades in a narrow range investor concerns about growth and profits should be assuaged.

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If recent economic weakness is nothing more than a blip, reflecting temporary factors including another harsh winter in parts of the U.S., and if the economy bounces back as policy makers deem likely, then the Fed can be expected to gradually start raising interest rates. Should data suggest an acceleration in the pace of economic activity pointing to lower unemployment and a core rate of inflation more consistent with the Fed's 2% target, then the dollar would likely resume its strong advance accompanied by a resurfacing of investor concerns about the impact on the profits of multinationals and the durability of economic growth in the face of slowing export growth. In addition, a strong dollar raises the possibility of major disruptive credit events for such debtors as sovereign nations and corporations that carry the financial burden of servicing dollar-denominated loans whose payments have increased 20% in local currency terms in less than a year. These concerns can be expected to become a focal point of investor wariness if, as and when the dollar resumes its advance in earnest.

Domestic Companies in Preferred Long-Term Position

All else being equal a robust, secular rise in the dollar will often present challenges for multinational companies and businesses that are heavily dependent on exports. Therefore, more recently we have preferred to seek additions for the portfolio in businesses that have a domestic orientation because they should be in a relatively preferred position. Moreover, these domestically focused businesses would be the prime beneficiaries of a reduction in the federal tax rate on corporate profits if it were to occur in the coming years.

Recently we have begun to build a position in a company we believe offers an exceptional risk-reward profile. The company is a leader in food and facilities management, a highly fragmented, $900 billion global industry, where the two largest competitors combine for only about 3% of market share. The company has demonstrated steady growth, excellent free cash flow generation, a healthy balance sheet and is led by an accomplished management team. Management has instituted broad-based cost reduction initiatives and a capital investment program that should produce materially higher margins and enhance the company’s competitive position. Further, management has pledged to return the company’s large and growing free cash flow to investors, with the largest proportion expected to come in the form of share repurchases. If this business develops along the lines we anticipate, then over the next three years earnings should more than double. We expect this will be reflected in a rising market value of the business, which should result in excellent long-term returns.

Portfolio Positioning

We are pleased with the first quarter operating performances of a number of the businesses in the portfolio and highlight a few examples below.

A point of care diagnostic company moved forward effectively with its announced cost reduction and deleveraging program while disposing of non-core assets and focusing capital investments on more fully developing core competencies. The potential embedded in the company’s diagnostic product pipeline has become more clearly defined and looks promising. On balance, company developments support the prospect for rapid earnings gains in years ahead. These advances, coupled with a much improved financial posture, suggest these shares are well positioned to demonstrate attractive long-term returns.

The outstanding management team at a major North American retailer continues to advance a long-range plan to unlock the substantial value of the company's real estate portfolio with specific actions to highlight the appraised value of some of its holdings as well as continuing to develop its retail brands. We believe the company's shares sell at a material discount to the value of its real estate and the developing earning power of its retail operations. This creates a compelling risk-reward profile.

The share price of our holding in the LNG mid-stream and shipping space has been pressured by an unfavorable turn in investor sentiment toward businesses with even derivative exposure to recent declines in oil prices. We believe these sentiments will prove misguided. Meanwhile, management continues to deliver progress on strategic objectives of developing the leading mid-stream company in the LNG industry. We expect management to report significant progress this year. While this company's shares have weighed on recent portfolio results, our conviction level in the investment continues to grow, and we believe that it represents our most compelling risk-reward.

Our holding in an automotive parts company continues to move towards the last phase of value creation for this investment. By year end, we expect management to return substantial capital to shareholders from the divestment of one of its businesses and continue to grow its remaining business rapidly. We believe this will translate into well above average returns and an exceptional risk-reward profile.

In addition to the investments discussed, the portfolio has other attractive holdings across a variety of industries. Each of these companies is run by a management team with a demonstrated record of operational and capital allocation excellence coupled with strategic vision and an alignment with shareholders that should lead to superior value creation for long-term investors.

Firm Developments

We are happy to announce that Nick Daniello, a senior member of our trading team, and his wife Jolene welcomed their first child, Samantha. We want to congratulate them and wish them all the best.

As always, if you have any questions please don't hesitate to reach out to us.

Sincerely,

Michael A. Steinberg
Managing Partner

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