Shikiar

July 19, 2018

Dear Client:

Enclosed please find your investment performance and portfolio report for the second quarter of 2018. In it you will find second quarter performance for 2018, as well as annualized return and cumulative investment performance since inception. Additionally, the report provides the market value of the portfolio as of June 30, 2018, asset allocation, a complete listing of security positions, cost basis, and a year-to-date capital gain/loss report.

We have officially reached the halfway point of 2018. Unlike last year's lower than typical market volatility, the first half of 2018 has thus far been quite the opposite. After becoming accustomed to the unusual calm in the stock market in 2017, investors have shown a higher degree of skittishness year-to-date. While the U.S. equity market eked out gains in the second quarter, bouts of volatility have become more the norm than the exception this year, due primarily to concerns of rising U.S. interest rates, trade tensions, political uncertainty in the Eurozone and slowing momentum in the global economy. Thus far this year, the Standard and Poor’s (S&P 500) Index has had a total of 36 trading sessions in which it closed up or down 1 percent or more versus only 7 days in all of 2017. Although the S&P 500 Index and the Dow Jones Industrial Average (DJIA) each advanced slightly during the second quarter, both remain below their January 2018 record highs. In contrast, the technology-heavy NASDAQ Composite extended its push to record levels, registering its eighth consecutive quarterly advance, driven by strength among numerous bellwether technology stocks (many of which we own at SAM Inc.). Bulls and bears alike have plenty of data points that they could marshal in their favor during the first six months of the year. Optimists point to continued accelerating growth in corporate earnings, the benefits of recently enacted tax reform, a strong labor market, etc. Conversely, pessimists cite a potential trade war and its adverse impact on global economic growth as well as central banks becoming less accommodative with regard to monetary policy. We believe a key question for the market for the foreseeable future is whether these factors ultimately engender concrete changes to what has been a stable macroeconomic environment and a long bull market.

On balance, the global economy is experiencing a steady expansion, underpinned by strong activity in the export and manufacturing sectors, with nearly 90% of country Purchasing Managers Indexes signaling export growth. Economic growth remains relatively strong in the U.S. and around the world, as the International Monetary Fund (IMF) forecasts 2018 and 2019 global GDP of up to 3.9%, driven by strength in China, India and emerging markets as well as a boost from tax cuts in the U.S. In addition, the Conference Board Index of Leading Economic Indicators has been positive since the middle of 2016. This Index is widely regarded as a reliable barometer of future growth. Despite these positives, inflation is lurking, having accelerated to its fastest pace in more than six years, reinforcing the Federal Reserve's outlook for continued gradual interest-rate hikes. The consumer price index (CPI) rose 0.1 percent month-over-month in June and 2.9 percent year-over-year, representing the largest annual gain since February 2012. While the pickup in headline inflation in large part reflects gains in fuel prices, it is important to note that elevated inflation can dampen future economic growth. Consequently, central banks seek to create a balance between growth and inflation. When the latter becomes a concern, they generally respond by raising interest rates, which is precisely where we are today (more on this below).

Outside of the U.S., the Chinese economy appears to be decelerating somewhat (yet growing at an estimated 6-7 percent), as policy-makers slightly tighten financial conditions to address excess leverage and overcapacity in the industrial sector. However, housing activity and external conditions are more favorable and may be providing an offset. While a rebound in industrial output has been a bright spot, the outlook for Chinese exporters is uncertain due to trade tensions with the United States. In the Eurozone, growth has slowed since the beginning of the year, as exports have contracted for the first time since the fourth quarter of 2012, reflecting decreased government spending and fixed investment growth.[1] Concomitantly, European Central Bank (ECB) president Mario Draghi announced the beginning of the end of its bond-buying program totaling approximately 30 billion euros (~$35 billion) per month, which is scheduled to conclude in December 2018. While the U.S. Federal Reserve has been shrinking its balance sheet for quite some time, the ECB's quantitative easing has been a key source of liquidity. This comes at a delicate moment, as trade tensions between Europe and the U.S. have increased and regional growth has decelerated. Britain is due to leave the European Union in less than nine months, and the ultimate political outcome of "Brexit" and its economic ramifications have further tempered growth expectations. Additionally, a new Italian government was sworn in after months of political turmoil that unnerved investors and sparked worries that the eurozone's third largest economy might exit the EU.

During the second quarter of 2018, the U.S. Federal Reserve raised the benchmark federal-funds rate by a quarter-percentage point to a range between 1.75% and 2%, representing the second year-to-date increase, while upping its projection of total rate hikes in 2018 from three to four. Additionally, our central bank suggested that it will likely continue the pace of interest rate increases next year in order to keep our expanding economy on an even keel. While the U.S. Federal Reserve updated its economic forecasts, projecting modestly stronger growth and inflation this year and lower unemployment than previously expected, it did not alter its forecasts regarding longer-term GDP growth, unemployment, and/or inflation. Given the present unemployment rate of 4 percent, coupled with elevating inflation, we expect continued interest rate hikes albeit on a data-dependent basis. With the 10-year U.S. Treasury Bond yield still historically low (approximately 2.85 percent), we believe that future rate increases will not be interruptive of the U.S. economic expansion for the foreseeable future. Although early, we remain confident in Jerome (Jay) Powell and

[1] Wall Street Journal. June 30, 2018.

his colleagues and appreciate that they have been transparent in terms of how and when they will be reducing the central bank's balance sheet.

It is our view that U.S. equities as an asset class are properly valued in the context of continued historically low interest rates. Additionally, unemployment is at levels not seen since the 1960's, inflation seems range bound, the U.S. dollar is steady, and corporate earnings are on pace to grow by more than 20 percent this year. Yet, after nearly six years of expansion, Price Earnings (P/E) multiples have contracted somewhat of late, reflecting concerns over the increasing global trade tensions as well as a more hawkish U.S. Federal Reserve. Nevertheless, as we have communicated in the past, bull markets do not "die of old age," and high valuations alone do not cause bear markets. To the contrary, they are generally caused by economic recessions, and we believe that the likelihood of that anytime soon is very low, as they are typically caused by rising inflation, rapidly increasing wages, and a decline in corporate earnings, none of which exists at the present time. While we have no doubt that the current bull market will eventually end, we continue to sense that the near-term investment landscape remains bright. Corporations are likely this year to inject more than $2.5 trillion into the U.S. economy through a combination of share buybacks, dividends, and mergers and acquisitions activity.[2] This comes as companies find themselves awash in cash, due primarily to years of stashing away profits coupled with the benefits of a $1.5 trillion tax break this year that slashed corporate rates and encouraged firms to bring back money to the U.S. for deployment.

S&P 500 companies are on track to repurchase as much as $800 billion in stock this year, eclipsing the previous record which took place eleven years ago.[3] 2018 has also set a record as the most active year thus far for initial public offerings (IPOs) since 2014, with 120 companies coming to market and generating gross proceeds of approximately $35 billion. Lastly and importantly, the number of publicly traded companies has declined quite considerably. In our opinion, this and increased global liquidity has helped to further propel the market.

Despite the encouraging economic backdrop, we are cognizant of the numerous potential risk factors, and we do expect, as we regularly communicate, that there will be periodic market corrections in the future which at times will no doubt appear to be unnerving. One salient risk factor has been the escalation of geopolitical stresses. Whereas last year tensions with North Korea were a concern for the market, this has been usurped by the potential threat of a trade war between the U.S. and China – the world's two biggest economies. Additionally, signs of slowing growth in some countries outside the U.S. have added to anxieties. We believe that it is important to be mindful of the fact that while the

[2] CNBC. June 4, 2018.

[3] Wall Street Journal. July 8, 2018.

Trump administration has been regularly “bashing heads” with the Chinese government over proposed tariffs, President Trump has a longstanding track record of being an “extreme negotiator” in business in order to maximize negotiating leverage with his counterparts. Additionally, China's announced tariffs to-date affect an extremely small portion of U.S. exports. That being said, however, it is the present uncertainty that is somewhat of an overhang on the equity market, which may persist in the near term as the upcoming midterm elections will soon take the spotlight. To wit, this is by no means the first time we have been down this road, and we do not recall any midterm election ending or starting a bull market.

We at SAM, Inc. have achieved solid investment results thus far in 2018. Our investment style, asset allocation, risk disciplines and stock selection have been and continue to be well matched for the present market environment. We maintain an emphasis on proprietary research and are dedicated to strict investment criteria which remain fully intact. As we have stated in the past, our portfolios are thoughtfully constructed with growth and dividend paying stocks, higher yielding common and preferred equities as well as corporate and municipal bonds, where appropriate. Our portfolio companies manifest attractive, sustainable long-term fundamentals. Strong balance sheets, free cash flow, earnings growth, cash dividends, and share repurchases heavily factor into our investment decisions. We remain steadfastly focused on achieving our overarching objective – preservation of capital coupled with a performance goal of comfortably exceeding the risk-free rate of return plus inflation, and we remain confident in realizing this investment goal in 2018 as well as over a complete market cycle.

As always, the experienced team at SAM, Inc. welcomes your questions and greatly appreciates your confidence in our organization.

Very truly yours,

Stuart A. Shikiar
President