Miller CAPITAL

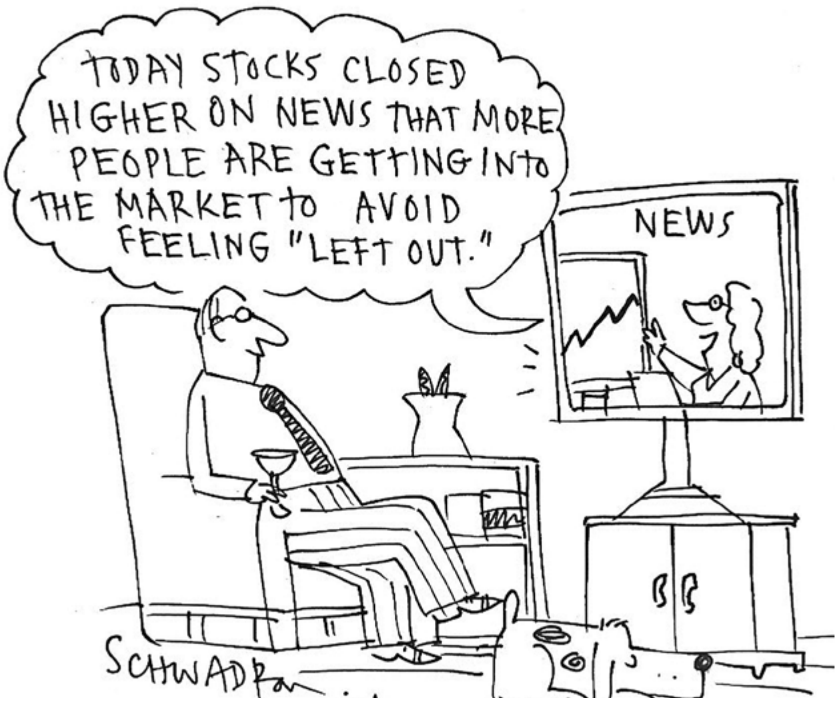
Investment Advisor

CONVERSATIONS ON INVESTMENT MANAGEMENT

FOURTH QUARTER 2014

CONTENTS

Mark A. Miller, CFA
President



Making investment decisions based solely on emotion is rarely a good idea. In fact, research supported logic is often the best medicine for the fear and stress that can result from an investment-focused decision.

This issue of *Investment Advisor* is not designed to give answers. Its purpose is to identify relevant investment issues and the process of reaching research supported logic. As we all know, asking good questions is often the first step in reaching sound conclusions.

If you would like more information about the topics in this issue of *Investment Advisor,* or about our investment services, please feel welcome to call or e-mail us at info@millercapital.com.

Best regards,

Mark

November 20, 2014

Have You Listened to the Latest from Miller Capital?

If you haven't heard the latest webcast from Miller Capital, we welcome you to tune in at millercapital.com. Each of the topics below can be separately streamed or downloaded.

- **2014 – A Prove it Year:** Our view on the stock and bond markets [as of October 1, 2014].
- **Buffett Unveils an Investment Classic:** A discussion of Warren Buffett's most recent shareholder letter, which contains a wonderful summary on investing "The Buffett Way".
- **To Index or Not to Index:** Buffett is an advocate of stock index investing for some investors. We've unpacked some of Buffett's thoughts on this topic along with some of our caveats.
- **Trust Investing - The Buffett Way:** In his most recent shareholder letter, Buffett mentioned his personal views for the preferred investment strategy of his wife's trust. It is a noteworthy viewpoint that must be carefully examined.
- **Trust Investments – Respect and Inspect.** The trust world is changing due to longer beneficiary life expectancies, lower interest rates, and higher tax rates. As a result, trusts are often under more financial stress and facing greater demands from beneficiaries. In this complex world of trusts and investing, we focus on some basic fundamentals that should be complied with, by trustees and investment advisors.

If you would like to receive an email notification when our next webcast is available, use the "Contact" section of our website to provide us with your email.

What Important Issues are Being Debated by Investment Advisors and Economists?

Debating economics is a fool's game, for the most part. However, there are a few economic issues and investment forecasts of significant importance. If we are on the verge of a major shift in interest rates, inflation or long-term economic growth rates, these factors matter. These issues, along with the most important issue of valuation of assets, are the key determinate factors to future investment class returns.

Here are a few key issues being discussed by investment advisors and economists:

1. There are clear deflationary trends in Europe and Japan. Now the questions is, will those trends reverse, due to the massive amount of government stimulus and monetary expansion being implemented?
2. Is low inflation in the U.S. about to change to a higher level, due to potential wage inflation?
3. Are lower interest rates in the U.S. [compared to a year ago] signaling an economic weakening in Europe, Japan and China?
4. What impact will the strong U.S. Dollar have on the global economy and stock prices?

Perhaps the most important question for investors is: Does this really matter?

HERE AT MILLER CAPITAL, WE BELIEVE IT DOES MATTER. As we have discussed many times in previous newsletters and webcasts, a critical issue for an investment strategy is whether interest rates will remain low. Since 2009, most investment advisors and clients have held the strong view that interest rates will move much higher.

WE TOOK THE OPPOSITE PERSPECTIVE. Such a view has a tremendous impact on investment strategy, including what type of bonds to invest in and at what maturities.

Consider the following insights and opinions that have an impact on the issue of inflation vs. deflation, higher interest rates vs. lower interest rates and other related issues:

- Beginning in 2016/2017, it is estimated that there will be 300,000 or so eligible Social Security retirees per month. This will substantially dampen potential GDP growth to about 1.5% per year, absent a ramp-up in immigration and HB-1 visa issuance [Source: Economist John Herrmann, Mitsubishi UFJ Securities, on Bloomberg Surveillance, June 6, 2014].

  MILLER CAPITAL VIEW: Because of the large decrease in the U.S. labor force from retiring workers, the unemployment rate can decrease substantially without a large increase in new jobs. For this reason, a declining unemployment rate is no longer a clear sign of strong economic growth.

- The percentage of Americans with full-time jobs in 2014 is 37% compared to 42% in 2004. This is a 25-year low [Source: Lawrence McDonald, Forbes, November 6, 2014, citing Department of Labor statistics].
- The percentage of the population above 65 years old is growing rapidly, but the impact is much greater in Europe and Japan than in the United States.

Percentage of the Population above 65 Years Old

	2005	2014
Japan	19.7%	25.8%
Europe	18.5%	21.1%
United States	12.2%	14.2%

  MILLER CAPITAL VIEW: An aging population tends to be deflationary, as older residents spend less during retirement or semi-retirement. More important, if the labor force is also growing less due to a slowing population growth and older average age, this has an even larger impact on economic growth, and tends to result in lower inflation and lower interest rates.

- Europe and Japan are in a deflationary environment. In Europe, every single "goods" sector has a negative year over year change in inflation [Source: Economist Charles Gave, GaveKal Research, October 28, 2014].
- As the United States imports less oil and actually exports diesel and gasoline, the amount of U.S. Dollars sent overseas could decrease substantially. Less importing of goods due to greater manufacturing in the United States could have a similar impact on fewer dollars being sent overseas. The combined impact of fewer oil imports and fewer goods imports could equal nearly $500 Billion per year, creating an even stronger U.S. Dollar. Remember, a majority of international trade is in U.S. Dollars.

  MILLER CAPITAL VIEW: We may already be in the early stages of a U.S. Dollar bull market. As Europe weakens its euro and Japan weakens its yen, massive amounts of wealth could move into the U.S. markets; including stocks, bonds and real estate.

CONCLUSION:

We have some strong views on the impact of all of these issues on various stocks and bonds, but our specific advice is reserved for our clients. Despite the growing concern of deflation, deflation or even very low inflation is not always a negative. The strong consensus has been for higher interest rates once the Federal Reserve lessens its degree of bond buying. A key question is whether central banks, including the Federal Reserve, are causing rates to stay low, or simply fighting against an overwhelming trend that is pushing interest rates and inflation lower.

All in all, we see great potential to prepare for and take advantage of changes in the global economy, even as volatility is likely to increase.

What Some Leading Executives are Saying about the Economy and Their Industry.

OLD DOMINION FREIGHT LINE [TRUCKING COMPANY], CFO WES FRYE, OCTOBER 30, 2014:

"Clearly, there has been an increase in demand for trucking services…across all sectors of transportation. [There are clearly] a lot of constraints on growing capacity. The capital side of it is very intense. The driver shortage is real. The cost of doing business, the taxes, our regulation, all of that is putting a damper on growth and capacity."

> MILLER CAPITAL VIEW: While long-haul trucking costs more per mile than long-haul rail transportation, the rails are being overwhelmed by greater oil, sand, gravel and agriculture shipments. Trucking is picking up some of the extra demand but the truckers have limited expansion capabilities. For both truckers and railroads, transport prices will move much higher. Certain companies will benefit much more than others.
>
> What's the bottom line? The rail and trucking networks in the U.S. are becoming overloaded.

CSX RAIL [EASTERN U.S. RAILROAD COMPANY], CFO FREDRIK ELIASSON, OCTOBER 15, 2014:

"The underlying macro-economy remains strong and the data and our experience suggest a positive outlook for growth. Many of the customers we serve grew at a robust pace and most of the key indicators we track point to continued expansion.

In excess of 50% of our contracts that we have to renew for 2015 have been re-priced. It's looking very good. That is why I made the statement earlier that prices were going up for 2015. I felt very positive about what 2015's pricing is looking like, it will be much more robust than you've seen probably in the last three to four years for CSX."

> MILLER CAPITAL VIEW: While economic statistics can change quickly, we note the positive view on rail pricing. This pricing outlook has been noted by numerous transportation companies, not just the companies that we invest in.

PIONEER NATURAL RESOURCES [TEXAS BASED OIL COMPANY], CEO SCOTT SHEFFIELD, NOVEMBER 5, 2014:

"I believe [we] could easily be in a $70 to $80 oil price environment over the next two years. As you all know, the price of oil has dropped about $30 a barrel. It is $1 Trillion in stimulus per year to the world economy. It's going to take a while to get the demand side up in the world today. At the same time, we're in a battle with Saudi Arabia in regard to market share versus U.S. shale oil.

There's been articles written about whether or not they're [Saudi Arabia] trying to hurt the Russians or the Iranians, but you have to realize, OPEC is down to just Saudi Arabia, maybe Kuwait and maybe UAE. But when you're trying to negotiate with the bankrupt Venezuelans or trying to negotiate with the Shia in Iraq and Iran, that's going to be a lot tougher for OPEC to come to an agreement to cut production. So the U.S. is still growing [oil production] over one million barrels a day. Most people have the world [demand] growing only 600,000 barrels a day this year because of the European economy, and what China is doing. And so the stimulus, I think, will help long-term [along with] the $1 Trillion stimulus. And so prices should recover within the next two years. But it's going to be really hard for OPEC to come to some type of agreement just because of the status of these various OPEC countries. I didn't add Libya. Who do you negotiate with in Libya to cut production? So it's a lot tougher than it has been in the past. So it's down to Saudi to cut production. They just don't want to do it. So it's putting pressure on the U.S. shale oil revolution."

> MILLER CAPITAL VIEW: It pays to own stronger oil companies in the U.S. that can survive the near-term uncertainty and exploit the long-term potential. Balance sheets are important.

WYNN RESORTS [OPERATES CASINO RESORTS IN LAS VEGAS AND MACAU, CHINA], CEO STEVE WYNN, OCTOBER 28, 2014:

"The central government [China] is being very, very aggressive about what appeared to be misconduct in corruption of the government has put a lot of the wealthy businessmen in the fox holes. Everybody is being very conservative at this point over there. I think [they are] taking the cue from the president [of China] who is a very conservative man, and it's had an impact on Macau in October."

LAS VEGAS SANDS [OPERATES CASINO RESORTS IN UNITED STATES, CHINA, AND SINGAPORE], CEO SHELDON ADELSON, OCTOBER 16, 2014:

"Everyone is talking about China reducing its growth from 7.5% to 7.4%. That's a reduction in growth of one-tenth of 1%, which continues to be a rounding error or a meaningless move. I don't think anyone can perceive an economic slowdown by GDP changing one-tenth of 1%. The important point is that growth in China continues."

MARATHON PETROLEUM [LARGEST GAS STATION OWNER AND OIL REFINER IN EASTERN U.S.], CFO DONALD TEMPLIN, OCTOBER 30, 2014:

"[With lower gasoline prices] what we're seeing in October is that we are up lightly over 1% in same-store gasoline demand."

> MILLER CAPITAL VIEW: Gas prices have dramatically increased these past few years. However, if oil and gas prices were to decrease, this would provide additional money for spending on other goods and services, along with additional demand for energy, around the world.

STARBUCKS, CEO HOWARD SCHULTZ, OCTOBER 31, 2014:

"[There is a] massive cultural shift in consumer behavior underway. The shift in consumer behavior has people spending less time shopping in bricks-and-mortar stores and more time online….consuming more and more food and beverage away from home, and tremendous growth of online activity from mobile devices allowing consumers to conveniently conduct their lives including commerce from wherever they happen to be. What's actually occurring is the cultural shift in time allocation, away from retail experiences people have felt forced to undertake and towards retail experiences that people want to enjoy with convenience as the key enabler.

Please consider this metric. In 2013, payment for purchases by use of all mobile devices in the U.S. totaled $1.3 billion…that was the entire market. Now listen to this. Bricks-and-mortar commerce in 2013 totaled more than $4.2 trillion. Now what you're going to see in the years ahead will be a rapid acceleration in mobile device purchases and a continued significant migration away from bricks-and-mortar commerce.

But a year ago today, we began talking about the macro shift in the amount of traffic that was going through malls and main streets in America….that is less people shopping with bricks and mortar stores and much more people shopping online [and with] their mobile devices."

> MILLER CAPITAL VIEW: This is merely a confirmation that online spending and mobile payments are going to grow stronger- at the expense of traditional retailers that do not adapt. When a company, such as Starbucks, is staking their future on a better in-store, online and mobile payment system, it pays to take notice.

Please note, when we refer to a specific company, we are not recommending securities issued by these companies or implying that we own them for our clients. We simply find these company comments and insights to be of interest.

Why Purchasing an Actively Managed Stock Mutual Fund in a Taxable Portfolio Requires Caution – Especially in the 4th Quarter.

Over the past five years, the U.S. stock market has produced strong returns. In turn, unrealized capital gains have also been large [unrealized capital gains are securities with a profit, but not yet sold].

Here are a few key points to consider in the 4th Quarter when it comes to actively managed stock mutual funds owned in taxable accounts:

KEY POINTS:

- In mid-to-late November, most mutual funds provide an estimated capital gain amount and record/payable date for year-end distributions.
- Actively managed stock mutual funds typically pay capital gain distributions in mid-to-late December, but some can come as early as November.

- A few of the largest actively managed U.S. stock mutual funds have already provided estimates of year-end 2014 capital gains. These distributions range from 5% to 12% of the fund value for long-term gains. These preliminary estimates do not include possible short-term capital gain distributions. Many funds will pay capital gains at a much higher percentage.

SAMPLE OF THREE LARGE ACTIVELY MANAGED STOCK MUTUAL FUNDS	ESTIMATED LONG-TERM CAPITAL GAIN DISTRIBUTIONS FOR TAX YEAR 2014
American Funds Growth	9% to 12%
American Funds Fundamental	5% to 8%
T Rowe Price Growth	7%

- If you own the fund as of the record date and receive the capital gain distribution, you must report the capital gain distribution - even if you owned the fund for a short period of time and have no gain on your investment in the fund.
- Purchasing an actively managed mutual fund in the 4th Quarter, just prior to the distribution, can result in an unexpected taxable gain.
- Before purchasing any actively managed mutual fund, it is wise to consider how much unrealized gain is in the fund. Eventually, this amount may become realized gain.

IMPLICATIONS:

- Most of our clients have taxable accounts, so taxes are always a key consideration in our investment management and consulting processes. For clients that have an IRA or other tax-deferred accounts, these mutual fund tax issues are not relevant.
- For our clients, we tend to use a mix of individual stocks, passive index funds, and some actively managed stock funds.
- We tend to defer purchases of actively managed stock mutual funds until capital gain estimates are known for the year. As a result, when implementing an investment plan for a new client, it is not usual for us to use individual stocks and index funds before we begin using actively managed stock mutual funds.

CONCLUSION:

Imagine a client that just sold his business, with a very large capital gain. Portions of the proceeds are then reinvested into an actively managed U.S. stock mutual fund in the 4th Quarter. Before year-end, a large capital distribution occurs. Now, this produces another large capital gain and additional tax, even if the mutual fund has not increased in value. For taxable portfolios, actively managed stock mutual funds can play a role, but they must be used with caution. This is also the reason index funds and individual securities offer tremendous tax planning advantages for clients with taxable portfolios.

What Clients Should Expect their Investment Advisor to Tell Them, Without Asking.

Technology has vastly increased the amount of information available to investment advisors, providing the ability to clearly categorize and summarize data for clients. As a result of this technological advancement, investment advisors have never been better positioned to provide useful investment information to their clients. Because investment advisors work for their clients, we believe they should provide relevant information to their clients without the need for a client request.

In this case, "The Golden Rule" should apply: Give your client the information you would want, if you were the client. Put yourself in the client's shoes.

Here's a brief list that you should expect to receive from your investment advisor on a regular basis. If you are not currently receiving this information, ask for it until you receive it in a clear, understandable format. You shouldn't never feel guilty about asking for this information.

- Total fees charged on the portfolio and/or on each account, separated for fees charged by the investment advisor and those charged by others, as a percentage of the account value.
- A description of how the fees are calculated, when they are paid and where they are paid from.
- Performance for each account or portfolio, along with performance for each asset class [equities, bonds, alternatives, other types] and for each outside manager, all in an easy to understand format.
- An explanation of whether performance is:
  - Before or after all investment fees.
  - Before or after taxes, and the amount of capital gains that impact returns each year.
- Whether and to what extent tax planning is performed by the advisor prior to year-end.
- An update, at least annually and preferably in writing, describing your current investment strategy, whether changes are appropriate and a clear description of the major holdings in your account and why you own them.

This isn't too much to ask. Excellent client service means providing relevant information before being asked, or at least providing it promptly and clearly upon request. After all, that is what investment advisors get paid to do.

ABOUT MILLER CAPITAL

- Miller Capital was established in 1999 and is independently owned and operated.
- We are a Registered Investment Advisor.
- We offer both investment management and investment consulting services.
- We represent individuals, corporations, investment partnerships, and private trusts (serving individual and corporate trustees).