May 6, 2014

First Long Island Investors, LLC

March 31, 2014

"Discipline is the bridge between goals and accomplishment." -- Jim Rohn, American entrepreneur, author, and motivational speaker

The first quarter of 2014 resulted in equity markets, on average, being about flat and the market for long-term Treasuries rallying with yields declining. We expected to give something back temporarily in equities. At the same time, to our surprise, bond yields actually declined in the first quarter, with the 10-year Treasury falling to 2.7% from 3.0%. This reflected an economic slowdown resulting in part from the adverse weather impacting parts of the U.S. At the same time, growth in China appeared to slow, there remain concerns about China's shadow banking system and modest economic gains were made in Europe. Other international factors affecting investor sentiment included the Russian annexation of Crimea and Russian troop movements on the Ukrainian border. Cold war-type feelings are rising, although this has not impacted the U.S. economy, nor has it roiled the equity markets yet. Further acts of aggression by Russian President Vladimir Putin could impact markets, depending on U.S. and NATO responses. This situation must be watched carefully both from an economic and market sentiment standpoint. A cold war environment may not be good for market multiples that expanded last year.

Also, volatility increased in the first several months of the year. More significant swings in the equity markets occurred because of the transition to Janet Yellen (from Ben Bernanke) as Chairperson of the Federal Reserve, as well as concerns about domestic and global corporate earnings and GDP growth. These factors are making investors a bit nervous about stock market valuations. The proverbial stock market correction (typically at least a 10% drop) is anticipated, but yet to happen. Add to this mix the upcoming midterm elections, and you have the potential for a jittery market. History (since World War II for midterm election years), which is an imprecise guide but worth noting, suggests that the equity markets are volatile for at least two quarters of the year, followed by appreciation towards the end of the year. Meanwhile, the bond market suggests that the economy, although modestly improving, remains somewhat fragile.

Our view at FLI has not changed. We believe GDP will grow in the 2% to 3% range this year. This in turn should help employment improve, but not quite at the level of improvement that would turn heads. Interest rates and inflation should remain low for the foreseeable future reflecting this modest growth. Fed Chairperson Yellen made it clear that she supports rates remaining low despite the tapering of bond purchases by the Fed. We expect rates might be increased starting in mid-2015. We believe this accommodative stance is helpful to businesses and real estate owners, but it continues the financial repression that altered consumer spending and reduced wealth for retirees.

Meanwhile, corporate earnings continue to increase and profit margins remain high. We believe that this increase in earnings will support current valuations. However, the equity markets are no longer cheap, although we believe they are reasonably valued. From here, we believe prospective gains will mostly come from astute stock picking. In other words, we think the tide will not lift all stocks as in 2013 (appreciation resulted from an earnings increase and meaningful multiple expansion). In some cases, there might be pockets of overvaluation. We view this as an opportunity for us as our concentrated approach to investing relies on selecting those companies that have the most attractive growth or value characteristics. This is the case with our directly managed strategies and the strategies that use among best-of-breed managers. In addition, the companies making up our Dividend Growth strategy continue to increase dividends in the 7% to 10% range on average annually. On balance, the equity market environment of a 10-year Treasury at 2.7% and price earnings multiple of approximately 16 for the S&P 500 is not expensive, but it is not as cheap as it was before last year's excellent performance (our forward looking view uses a 3.5% to 4% range for the 10-year Treasury bond).

Certain events could negatively impact our outlook, including an economy growing slower than outlined, an unexpected pickup in inflation, an outbreak of greater hostility in the Ukraine and/or the Middle East (perhaps relating to Iran), or something completely unforeseen. One factor that could boost chances for a better investment outcome would be a faster growing economy without rising inflation. This would have the tendency to see an even better stock market because corporate earnings would grow faster than we anticipate and would help make valuations more attractive. On the other hand, this would trigger rising longer-term interest rates that could foster even greater interest in buying quality stocks as bond portfolios would suffer even greater losses. We believe, based on our research and experience, that the stock market would not be negatively impacted (except for short-term blips) by gradual interest rates increases until the 10-year Treasury exceeds 5% (this seems like a long way from today's rate of 2.6%).

Our advice is to stay the course, continuing to underweight fixed income. The long-term bias, in our opinion, is to higher rates. At current levels, bonds (i.e., 5-year AAA municipal bonds at approximately 1.2% and 10-year Treasuries at approximately 2.6%) are not attractive in our opinion, and higher rates will cause paper losses for longer-term maturities. Also, high-yield fixed income seems very expensive as spreads between high quality and junk are tight. In light of this, we continue to overweight our defensive basket. Dividend Growth, thus far, continues to perform well with dividends expected to rise in the 7% to 10% range on average for 2014. We believe that our recommended defensive strategies appear poised to deliver a reasonable risk-adjusted return while reducing volatility. Additionally, we would continue to have some exposure, or an average weighting, to our traditional equity strategies. We see potential appreciation through our primarily concentrated portfolios where we still see ample opportunity to own fine growth and value companies at attractive valuations. However, these strategies could be more prone to the increased volatility we expect to see this year. For these reasons, we continue to overweight our defensive basket, especially given the significant gains made by the equity markets last year.

Asset allocations are unique to each individual investor and should encompass all of your investable assets. We always remain available to engage in a discussion about your current asset allocation. Please keep in mind, our investment committee reviews your individual asset allocation on a quarterly basis (based on available information). We make recommendations to you for change where necessary.

Finally, we have several important announcements. First, please join us at our next Thought Leadership Breakfast on June 3 at The Garden City Hotel. We will be discussing the future development of the Nassau Coliseum site with the 2015 departure of the New York Islanders. Visiting with us will be Ed Blumenfeld of Blumenfeld Development Group, a partner in the new development, and Bobby Nystrom, the Islander legend. We look forward to seeing you. Second, please be advised that First Long Island Investors is now a part of the LinkedIn Network, and we urge you to visit us on our site to keep abreast of our events, news, and thoughts.

We are also pleased to announce two new hires. Karen Weiskopf joined our company as Director of Marketing. Karen will lead our efforts to better service our clients, liaise with our centers of influence, and help us advance our social media platform. Matthew Cohen joined FLI as Assistant General Counsel. Matt will reinforce our legal and compliance areas, as well as assist with our wealth management, estate planning, and real estate advisory services. With Karen and Matt as great additions to the FLI team, we are growing to better serve our existing clients. Hopefully, you will get to meet them both in the near future.

Best regards,

Robert D. Rosenthal
Chairman, Chief Executive Officer
and Chief Investment Officer

*The forecast provided above is based on the reasonable beliefs of First Long Island Investors, LLC and is not a guarantee of future performance. Actual results may differ materially. Past performance statistics may not be indicative of future results.

Disclaimer: The views expressed are the views of Robert D. Rosenthal through the period ending March 31, 2014, and are subject to change at any time based on market and other conditions. This is not an offer or solicitation for the purchase or sale of any security and should not be construed as such. References to specific securities and issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.