CAIRN INVESTMENT GROUP

Newsletter and Quarterly Update

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- Annual Privacy Notice Enclosed
- NYSE Closed for Labor Day

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Greetings from the Northwest.

I'll admit it up front: We're a bit tardy this quarter in getting our reports and summaries out to our investors. Now that I have admitted the bad part, I'll just blame it on being busy and busy is good. Busy is the pace we would like to be and like to stay.

Recently, some of the topics that have been keeping us busy are a plethora of news from around the globe. As I think about the globe, my mind drifts to sailing, and sailing around the globe reminds me of a wonderful opportunity I had a few years ago to go sailing with my daughter Lindsey. She knows I enjoy sailing a lot and she knows that it's always a challenge of current, wind and skill. We had one of the world's best sailing days here in Portland on the Willamette River in a very fast 18' open cockpit sail boat. And why is Jim talking about sailing? Well, Lindsey commemorated our sailing adventure with a coffee cup. The printed words varied a little bit from the historic saying, but it says "Keep Calm and Sail On." The world of investing is a stormy place and it's a good time to remember to "Keep Calm and Sail On." As I envision that round globe mostly covered with water, I think about the things that are happening all over our blue planet. It's not just Greece, it's not just the FBI making a mistake and not stopping the Charleston suspect from buying a firearm, it's not just the ticker-tape parade celebrating the Women's World Cup Soccer Champions, and it's not just Duff Beer. Duff Beer! Well, right now I can assume some Simpsons fans are smiling, but yes, the famed beer of the Simpsons has made it to the WSJ front page because the real Duff Beer can now be purchased. Don't go running to the stores just yet; the first Duff Beer will be rolled out in Chile with plans to expand in South America and Europe early next year. But Homer, we're waiting and we're ready for you to bring it on. DUFF BEER FOR ALL!

This quarter's report will be rather brief; we need to get it wrapped up so that we can get prepared for the next quarter; and my golly, these quarters are improving. I think that we're probably going to be on track for a 3% growth rate throughout 2015. That's quite a challenge because the first quarter turned out to be such a blooper. One of the main factors that helped us bloop the first quarter into a blooper were soft retail sales; they declined by about 4% in the first quarter, but now it looks as if they're on track to hit a number closer to 7% for the year. This is the type of improvement that should provide a strong tailwind for future sales. Along with improved economic growth, the first signs of inflation have begun to emerge. This is the sort of information that Janet Yellen and the team of Fed

Icefields Parkway, Alberta Canada *Photo by: Darin P.*

governors have been looking for. Something that would cause them to trigger an interest rate increase. The interest rates that the Fed controls--the short rates--are still as low as they've been, but longer rates--maturing in a longer period of time and controlled by market trading pressures--are beginning to increase now. I believe that barring any unforeseen drastic economic reversal there is a fairly strong chance that the Fed would increase short rates before the end of 2015. Increasing interest rates by the Fed isn't anything to worry about; if they didn't increase, it would concern me. I want to see that the Fed is confident that our economy is moving along at a healthy clip and can tolerate a little less stimulus and a little higher interest rate. We've been positioning ourselves anticipating an interest rate rise by keeping our fixed income maturities fairly short, not the shortest, but with fairly short maturity dates. This is one of those special times in history when those kinds of investments that you might historically characterize as "safe" can turn out to have a lot of volatility and surprise on the downside as interest rates increase. So we're keeping our maturities short and we're keeping our credit quality pretty darn healthy. I've had a couple of phone calls from investors who are concerned about rising interest rates and what that might do to slow down the bull market. The Fed raising of rates shouldn't end this economic expansion; we should see quite a few quarters of opportunity for companies to easily absorb slightly higher interest rates and continue economic growth.

The joke around the office is that if I delay the quarterly reports long enough, there will be a resolution to the Greek debt crisis. We could then write a quick synopsis and be done with it. Well, that just hasn't happened; the story continues to unfold day by day, hour by hour, one last minute critical meeting after another. Greece has continued to negotiate and continued to frustrate not only their local population, but the populations of many of the EU countries. I don't know, but it looks as if it may be coming to a conclusion where there will be an extended debt program for Greece. Many eyes have been focused, not just on Duff Beer and the World Cup Women's Championship, but also on Greece.

Away from Greece, there are several other topics that are important; these developments should reflect well in our investment portfolios going forward. First, an increase in overall manufacturing activity in Europe. Second is how noisy the Chinese stock market has been lately, and by noisy I mean extreme volatility. Behind that volatility there has been a period of recovering home prices in China. Moving on to our own shores, a significant report released last week pointed out that the oil rig count is up. When oil was at $120.00 barrel, there were hundreds and hundreds of rigs across the country exploring for oil and pumping oil. As oil prices fell, that pumping and exploration came to a quick halt. We have seen several of our companies negatively impacted by that rapid curtailment of production and exploration. We are now seeing, for the first time in months, an increase in the number of oil rigs. It's only a small number, less than a dozen, but it is a positive sign that we may see more growth in the rig counts. One of the other subjects that's intriguing to watch is inflation or deflation in countries outside of our borders. One of the easiest to watch is Britain. Why? I think it's our common language. Britain's deflation has apparently stopped and they are now in a rebounding or inflationary mode, which is good for them and certainly gives their Fed equivalent confidence for the future.

As I believe that we are still in a post great-recession recovery mode, it is delightful for me to see other analysts support some of the companies of which we have long been champions. I suppose we could refer to these as mid-cycle cyclical companies, not early-recovery commodity companies, but the mid-recovery and ongoing expansion companies mostly related to industry. Some of those names that many of you would recognize would be companies like Emerson Electric, Precision Castparts and Ford Motor. All of these are seeing a distinct change in positive growth of their businesses. In the category of abstract, hard to get your mind around ideas, the concept of "the power of losing less" comes to mind. And this is always the foremost question in our minds: What are we going to do as markets rebound? What are we going to do if markets decline? Protecting clients' portfolios during periods of market volatility is really an important component of compounding wealth. Lately, we seem to have struggled with avoiding some of the market volatility that I think is just part of the natural cycle of an ongoing expansion. Though I rarely speak about it, among the important components of our business are the dollars that we choose to allocate to a mutual fund or two. I was reminded when reviewing Forbes Magazine last week that very few funds beat their peers in both up and down markets. On this short list are two funds that we think are regular champions. So congratulations to the First Eagle Global and the American Funds Capital Income Builder; it's a nice group of funds to be associated with.

Switching to a couple of office keeping items, I've been delighted to get responses from many of you regarding your interactions with Brie. She has been here a few months now and has gotten to know many of you, over the phone, by email, and in person at the office. Please don't hesitate to call, Brie is happy to help. She has been wonderful and we have enjoyed getting to know her and her young daughter Mia. Always fun, always interesting.

This year we've seen several examples of companies that have not been able to keep customers' personal information private. With this copy of your quarterly report we have inserted the annual update to the Privacy Notice for our investors. This is something that we continue to take seriously; it is important for our investors to have confidence that we are working at this vigorously. I really do treat this in the same way that I would want to be treated by someone else. I'm cautious and very calculated when it comes to protecting your private personal information. As always, please stop in to see us. We look forward to an opportunity to catch up with you. If there is anything changing in your world financially, please let us know.

Happy Trails,

Jim

Jim Parr, Principal

Cairn Investment Group, Inc.