NEPSIS
CAPITAL MANAGEMENT

4TH QUARTER 2014 UPDATE

VOLATILITY IS IN THE AIR… AND WE LOVE IT!

As I say many times in our Quarterly Updates, investors must maintain a realistic perspective regarding their investments and expectations, both in performance and in investment timeline. This perspective will become increasingly important in the near future as we believe investment returns will be muted. Patience will be critical.

As we suggested in the last Quarterly Update, we should see more volatility in the stock market in 2015, and, as I am writing this Update, there is no question volatility has increased and continues to do so. ***Remember, it is volatility that creates the opportunities to take advantage of buying into great businesses over time.*** It is a critical component to the success of a long term investor whose portfolio has the **Flexibility** to take advantage of buying more into a great company when available.

There are many reasons why an individual stock, or the stock market can experience volatility over short periods of time. The volatility we are experiencing today should have been expected and should be expected to continue for a quite a while. However, as statistics show, the longer you own a company, the less volatile the stock becomes.

SO, BE PREPARED FOR MORE VOLATILITY!

cont. next page

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Investors should always expect and be prepared for a 20% stock market correction. History certainly shows this to be the case.

ADDITIONALLY, REALIZING THAT THE U.S. STOCK MARKET HAS BEEN PERFORMING QUITE WELL SINCE THE END OF THE FINANCIAL CRISIS IN 2009, IT IS IMPORTANT TO NOTE THAT VALUATIONS OF MANY COMPANIES ARE NOT AS COMPELLING TODAY AS THEY WERE TWO OR THREE YEARS AGO.

STOCK PRICES AND STOCK MARKETS DO NOT GO STRAIGHT UP!

Therefore, as investors, it's important to remember that investing is a process over time.

Because valuations are quite a bit higher than they were a few years ago, it will be important for investors to have patience with their investments. We will need to continue to see the economy improve as we look to Strategic Cost Average™ (SCA) into the companies we own and want to own over time.

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SYNOPSIS OF PORTFOLIO PERFORMANCE FOR 2014

We are quite happy with the total return of all five portfolio models for 2014. Obviously, returns were not as we saw in 2013 on a relative basis, however, relative to our metrics, we are quite pleased with the results, the companies we own and allocations.

There are several reasons for why we felt returns would be muted in 2014 (as discussed in earlier updates). As a foundational component, please remember, we invest in companies, not the "Stock Market." We look to own many of our companies long-term and continue to invest in them when appropriate, over time.

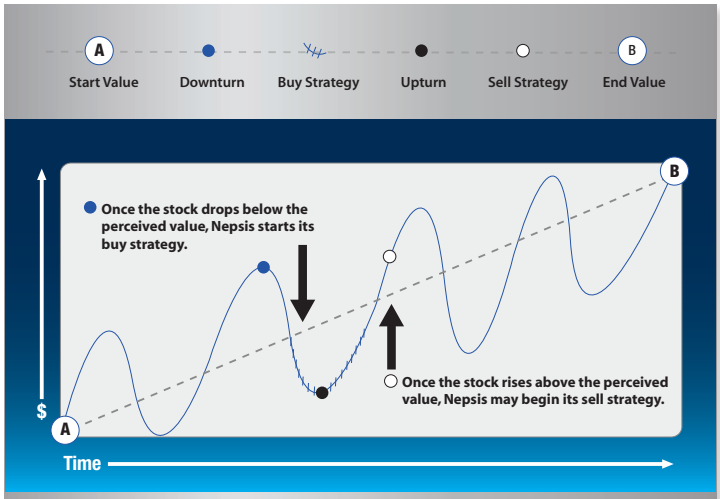
As performance in 2013 relative to the allocation and risks was extremely strong, 2014 should have been a muted year for our equity performance relative to our internal metrics. However, once again, performance relative to our internal metrics was very good, leaving us quite pleased with our allocations and performance. This means of course, many of the companies we have owned for a long time continued to perform well in 2014 (companies such as, Visa, Boston Beer, Bidu, Under Armour, etc.).

Remember, we believe in diversification into a Global allocation. Therefore, we own companies in Europe and in the Emerging markets. Both of which continued to struggle in 2014.

Now that 2015 is well under way, the investment climate has become far more volatile and cautious (as we expected and have forewarned). In our opinion, we believe this is extremely positive and important for the success of long-term investing.

We need a 20% correction in the markets and more importantly, in the businesses we own.

Of course, you may be asking yourself why I would say such a thing! The answer is easy. It is always better to invest in companies when they are on sale! By being able to buy more of a company at a lower price, it provides us with opportunities longer term to increase the positions we own. We call this approach Strategic Cost Averaging™.



The chart above outlines the fundamental reasoning behind our Strategic Cost Averaging™ approach.

Later in the Update, I will provide information on the current allocations and what we see for 2015.

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STATE OF THE "MARKETS"

As mentioned earlier, the markets have become far more volatile in the last 3-4 months. I believe that we are in a period where investors will need to stay focused and "stick to the knitting". Valuations are stretched here in the U.S., while we have seen several years where the economy and valuations of businesses have expanded nicely.

Now… patience will be the virtue. We expect 2015 to be very unexciting from an investment standpoint and will not be surprised if we finally get that 20% correction we have been waiting for.

However, remember, we are not in the business of trying to time the market or more importantly trying to time when it is a good time to invest in a strong business. We believe success happens over time and that corrections create the opportunities to adjust portfolios, including selling "weaker" companies to purchase stronger companies that have gone on sale.

Therefore, it's possible we may not see a 20% correction for many years. But, we will continue to monitor the valuations of the companies we own and continue to always be prepared to take advantage of an opportunity presented to us for investment.

Continue to expect the elusive 20% market correction! I realize that over the last year, I have continued to tell clients to always expect a correction of 20%. Obviously, we have not experienced that in the last year. It has been since 2011 when we last saw a correction of almost 20% when the S&P 500 was down over 19%.

In September of 2014 we saw the S&P 500 go down almost 10%. Frankly, there are too many variables in the world today that have short-term impact on markets. If you spend your time watching things daily or weekly, I am sure you will have found the last 4-6 months to be quite active!

There will eventually come a time when we will see another 10%, 20% or greater correction. However, it is the corrections that create the opportunity to reposition our portfolios to take advantage of the next leg of growth in an economy and equity valuations.

Magnitude of Market Decline	Frequency of Occurrence
>5%	Every Year
>10%	Every Two Years
>20%	Every Five Years
>30%	Every Ten Years
>40%	Every Twenty-five Years
>50%	Every Fifty Years

In last quarter's Update, we provided the chart above. It is featured again because I believe it is a powerful testament to the impact and frequency of corrections. We continue to remind our investors that corrections happen and that these corrections are healthy for our long-term investing. As we can clearly see today, markets not only have frequent corrections, but they also have recoveries, as we are once again sitting near all time highs in the U.S. markets.

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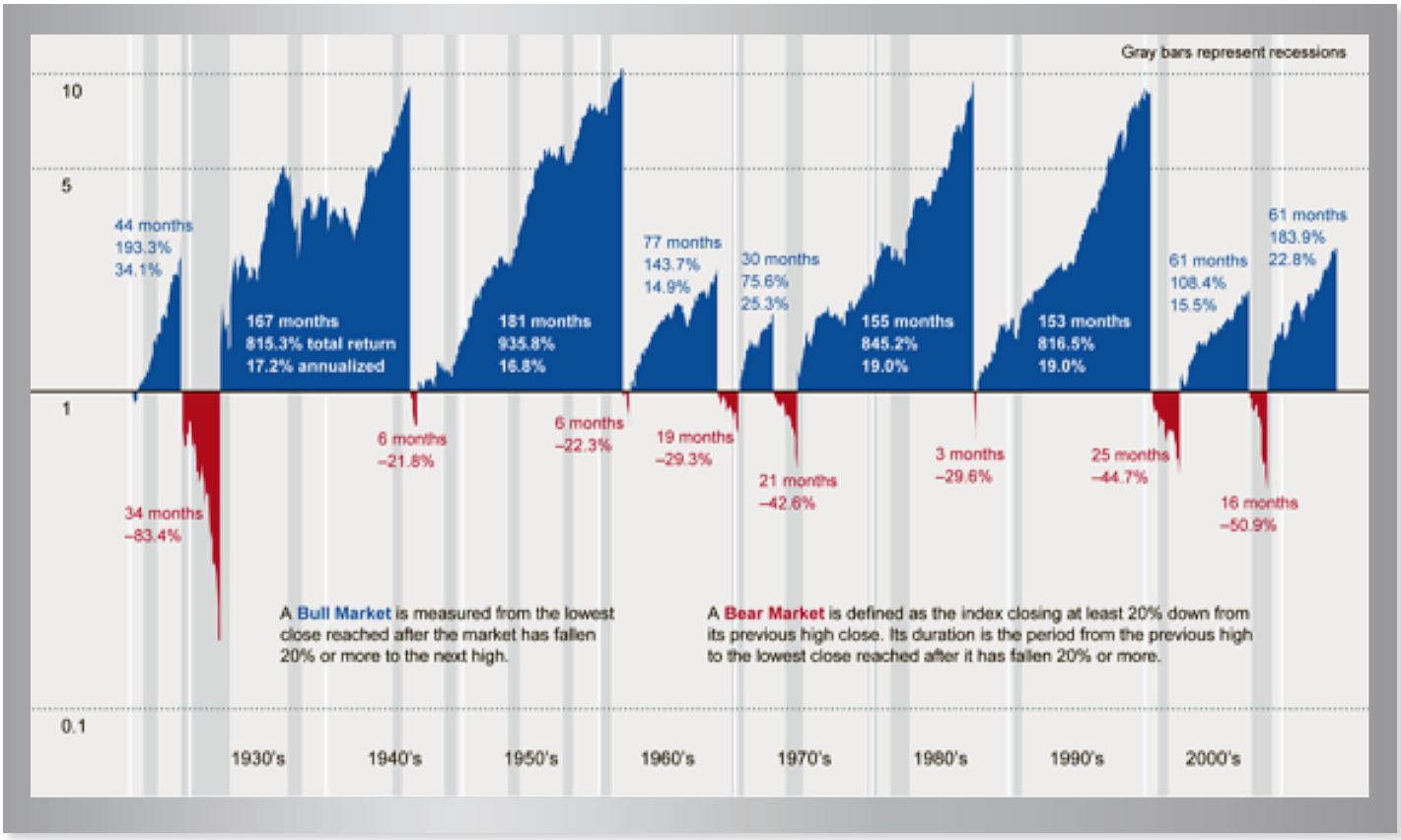
STATE OF THE "MARKETS"

While many investors focus on the short-term pain of a correction, few investors think about the long-term gain and potential to buy more of a company or companies they want to own. Because the Nepsis investment process believes Flexibility is one of the four paramount factors to the success of investing over time, we remain poised to capitalize on corrections with Strategic Cost Averaging™ (SCA)… it's one of the many reasons we embrace SCA!

As the chart below clearly shows, sizable corrections have occurred in the past and there were recoveries after. This chart was also in last quarter's Update, I believe it is important and telling. As history has clearly shown, many investors sell their investments at market bottoms after purchasing them at market tops. Obviously, while many people will always get nervous during big corrections, we believe it is Investment Clarity that allows investors to "Stick to the Knitting". Continue to expect and even look forward to the elusive 20% market correction!



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2014 KEY PERFORMANCE

December 31, 2014

Key ETF Performance (%)

Source: Bespoke

US Related ETF	Description	Last 2 Days	QTD	YTD
SPY	S&P 500	4.48	4.95	11.96
DIA	Dow 30	4.06	4.54	7.45
QQQ	Nasdaq 100	4.27	5.53	19.01
IJH	S&P Midcap 400	4.06	5.81	8.13
IJR	S&P Smallcap 600	4.23	8.09	3.31
IWB	Russell 1000	4.42	4.80	11.60
IWM	Russell 2000	4.62	8.49	2.83
IWV	Russell 3000	4.46	5.08	10.91
IVW	S&P 500 Growth	4.51	5.35	13.96
IJK	Midcap 400 Growth	4.10	5.61	6.50
IJT	Smallcap 600 Growth	4.29	7.49	2.01
IVE	S&P 500 Value	4.52	4.42	10.05
IJJ	Midcap 400 Value	4.04	6.02	9.74
IJS	Smallcap 600 Value	4.03	8.57	4.70
DVY	DJ Dividend	3.93	7.88	11.67
RSP	S&P 500 Equalweight	4.30	5.82	12.56
FXB	British Pound	-0.39	-3.40	-5.74
FXE	Euro	-1.82	-2.80	-11.02
FXY	Yen	-1.86	-7.77	-11.71
XLY	Cons Disc	3.59	6.42	6.19
XLP	Cons Stap	3.40	8.67	14.05
XLE	Energy	6.15	-13.31	-11.24
XLF	Financials	4.64	6.99	13.40
XLV	Health Care	4.66	10.31	27.16
XLI	Industrials	3.47	6.47	8.29
XLB	Materials	5.07	-2.14	5.00
XLK	Technology	4.80	4.61	16.79
IYZ	Telecom	4.30	-2.00	-1.28
XLU	Utilities	3.78	12.14	24.31

Global ETF	Description	Last 2 Days	QTD	YTD
EWA	Australia	-1.04	-8.69	-10.30
EWZ	Brazil	5.41	-17.95	-20.21
EWC	Canada	2.50	-7.98	-3.16
FXI	China	2.97	5.88	5.63
EWQ	France	3.15	-5.16	-11.49
EWG	Germany	2.63	1.48	-11.49
EWH	Hong Kong	-0.25	-0.49	-1.80
INP	India	5.38	-0.98	22.03
EWI	Italy	1.68	-11.03	-10.46
EWJ	Japan	2.69	-2.72	-5.68
EWW	Mexico	5.77	-14.07	-13.15
EWP	Spain	0.39	-7.46	-6.66
RSX	Russia	3.76	-33.30	-48.32
EWU	UK	1.62	-6.35	-13.07
EFA	EAFE	2.00	-3.91	-8.17
EEM	Emerging Mkts	2.23	-7.19	-7.72
IOO	Global 100	3.80	0.06	0.36
EEB	BRIC	5.16	-13.82	-15.27
DBC	Commodities	0.26	-18.43	-26.19
USO	Oil	-2.63	-39.73	-41.28
UNG	Nat. Gas	1.13	-15.24	-9.42
GLD	Gold	0.17	-0.91	-0.84
SLV	Silver	1.13	-6.73	-18.49
SHY	1-3 Yr Treasuries	-0.15	0.01	0.17
IEF	7-10 Yr Treasuries	-1.25	2.12	6.63
TLT	20+ Yr Treasuries	-2.66	6.82	21.93
AGG	Aggregate Bond	-0.39	0.99	3.53
BND	Total Bond Market	-0.40	0.83	3.21
TIP	T.I.P.S.	-1.10	-0.24	1.73

Listed above are portfolio returns of many of the popular ETF's in the market which track indexes as of December 31, 2014. ***As the chart indicates, performance of different investments/ markets has varied considerably in 2014. Of course, these numbers are going to look quite a bit worse right now since the markets have moved deeper into correction territory.***

By looking at the chart, you can understand why we believe it is more important to be an investor in businesses as opposed to "stock markets" over time as indexes provide no level of clarity and understanding as to how they operate in the first place.

Despite the poor performance of International Markets and the Emerging Markets, for long-term investors, we believe investors should be diversified around the world. Therefore, we continue to be invested between 20% and 30% in International and Emerging Market companies and relative to what is happening in those parts of the world, continue to be very pleased with the companies we own.

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BOND MARKET UPDATE 2015

- From the desk of Chuck Etzweiler, MBA, CIMA®, CMT | Director of Global Research

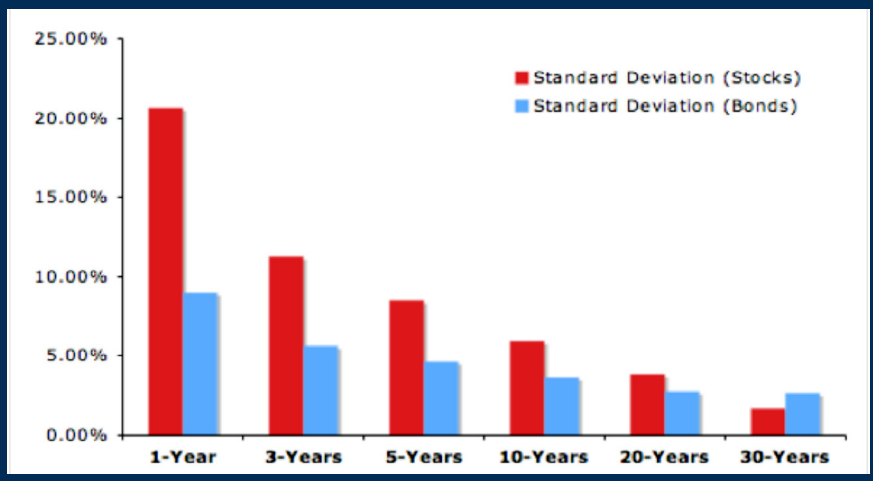
SUMMARY

1. It is adding Stocks to Bonds that lowers Volatility and not vice versa and the longer the time frame, the more appealing.
2. Stocks vs. Bonds on a Yield comparison basis, are much more compelling with a Yield spread of 400 basis points.
3. Based on Historical average returns at these valuations, stocks have a much more appealing upside than bonds.
4. Despite what the press may infer, the downside potential for bonds could be fairly significant.

Despite what investors are frequently told, stocks after only five years have a better risk/reward profile than bonds. From that point onward stocks continue that characteristic and beginning at year 20 actually have lower risk as measured by standard deviation than that of bonds.

Source: "Stocks for the Long Run," by Jeremy Siegel (fifth edition; McGraw-Hill, 2014)

Despite what we are told about the supposed overvaluation of the stock market, it is really bonds that are rich in price as the following chart shows where the Earnings Yield on stocks (inverse of P/E Ratio) is more attractive. Moreover as the next chart shows, the equity dividend yield is also lower than its historic average thus giving the edge to stocks.



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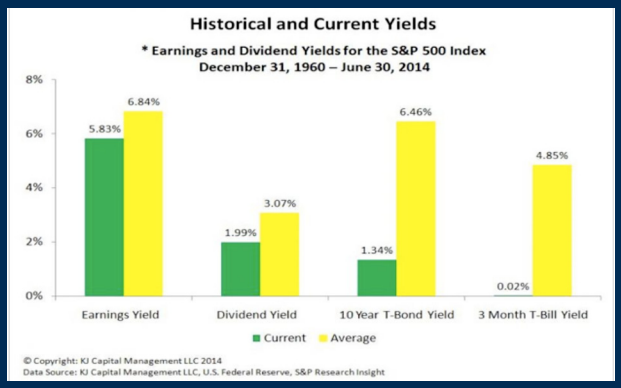
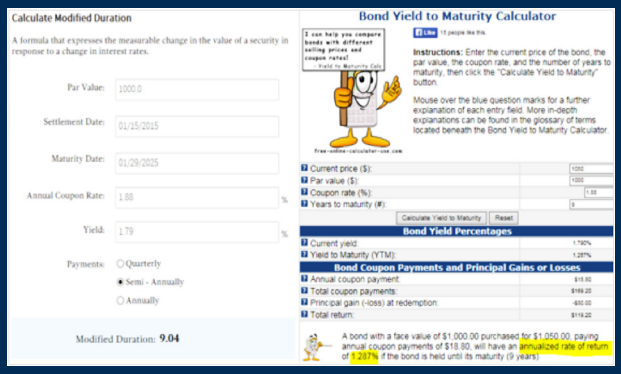
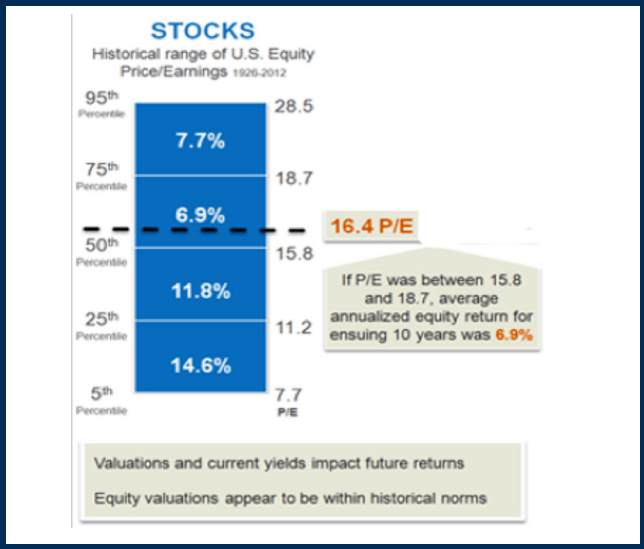
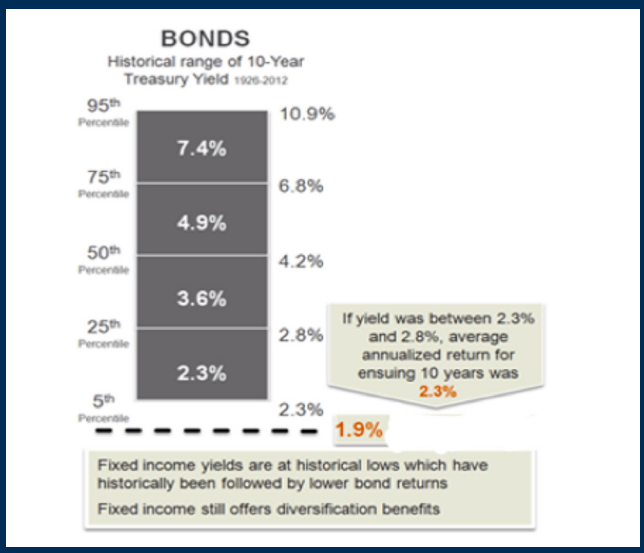
BOND MARKET UPDATE 2015 *(cont.)*

Based on the historical returns when stock and bonds have been at this particular point of reference, stocks have outperformed bonds by more than 2x or 6.9% vs. 2.3% over the ensuing ten years. Obviously no one can predict future results but we can use history as a guide for our decision making.









Let's take the Bond Bull side and suggest that rates will stay low for long. If that happens, the total annual return on a recent bond purchase would net an investor +1.29% per annum assuming one purchased a 10 year US Treasury with nine years left until maturity. On the other hand, if rates simply rise 1% that same 10-year US Treasury would have a loss of -9.04%. In our opinion, bonds poise a much greater risk than stocks all around.

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2015 STOCK MARKET PREDICTIONS

Welcome to 2015! I am sure that many of you who read this will have already heard the countless predictions from Economists, Money Managers and Financial Advisors as to what they think will happen in 2015. Therefore, like years past, we have once again come up with our **Top 10 Predictions for 2015!**

Of course, some may ask, "Why do you provide predictions because frankly, most people don't take the time to look back and see whether they were accurate or not?" Well, that's a legitimate point! However, as we have written for many years, we believe many investors have what we refer to as "Addiction To Predictions".

Understand, we believe predictions really are meaningless when you make investment decisions based on a long-term flawless **Investment Philosophy & Strategy.** Additionally, by adding **Flexibility & Transparency** to the investment process, an investor has much greater Clarity in their investments and decisions making futile predictions meaningless.

For those investors who have missed out on great opportunities in 2014, there is great news for you!

First, companies' stock prices historically have, and will continue to go up and down on a regular basis. Of course, a stock market correction of 10% to 20% right now would be ideal for long-term investors as it would potentially provide the opportunities to buy into great businesses at lower prices!

Second, although stock prices go up and down during short periods of time, well run companies continue to invest and execute on their business plans, potentially providing patient investors the opportunity to participate in their success over time.

We fundamentally believe investors should invest like a business owner… long-term and with patience! So, without further delay, below are our 2015 stock market predictions!

1. **Once again as in years past, most predictions on where the S&P 500 will end 2015 will be wrong with another year leaving long-term investors with the potential consequence of missing out on great opportunities.**
2. **The stock market and more importantly, individual companies' stock prices will continue to move up and down irrationally, causing many investors to be fearful and not take advantage of long-term opportunities — As usual!**
3. **There will be tremendous opportunities in 2015 to buy into great companies for the long-term at lower prices for those who think like a business owner and not a stock market trader — Thank goodness!**
4. **Timing the stock market and stock prices will continue to be very difficult — That's nothing new.**
5. **Investors' continued desire to focus on short-term portfolio performance will distract them from making intelligent long-term investment decisions — Too bad, hindsight is always 20/20.**
6. **Some investors will make investment decisions based on emotions and not a structured Investment Philosophy and Strategy — Thank goodness! Smart investors call that, Investment Opportunity!**
7. **Investors will buy stocks or sectors that were considered "top picks" for 2015 and sell too soon once again focusing on short-term returns.**
8. **Investors will attempt to compare their portfolios' returns to other investments or benchmark returns, not realizing they have no idea what they are comparing or how to compare — The usual lack of Investment Clarity!**
9. **Investors will continue to view "investing" as participating in the "Stock Market" and not view their investments as investing in businesses.**
10. **Once again, many investors will focus on predictions, be frustrated by predictions and be frustrated that they were wrong!**

As you can see by our predictions, once again, we did not go out on a limb! This is because we believe that while many people love hearing predictions, it is not the predictions that make up a successful portfolio. It is the principles applied to investing that assist in managing a successful portfolio.

As we enter 2015, investors need to be ready for the unexpected. Why? Because the unexpected happens every year. Yet, it is the unexpected along with the fear investors show during these unexpected periods that create the great opportunities for long-term, business owning investors. **Invest With Clarity™!**

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PORTFOLIO STRUCTURE AND OUTLOOK

In light of the tremendous performance of client portfolios in 2013 and 2014 (on a risk adjusted basis), we have and will continue to make adjustments to positions in 2015 in an effort to maintain the appropriate balance of companies and percentage owned in portfolios.

While the last five years have certainly had very volatile times with strong disconnects between "market" performance and actual company performance, investing in well run companies has always been very beneficial for long-term investors.

When writing our last Quarterly Update, we informed our clients that we felt the "Stock Market" as a whole was "fairly" valued. Meaning, we didn't think the overall market was inexpensive, but we didn't believe it to be overly expensive either. This is still the case today. Because of these thoughts, there are several adjustments we have done in portfolios throughout the course of the last quarter and year. Some of the decisions made include (but are not limited to):

1. **Take profits in companies we want to continue to own. We have had several companies we own provide tremendous performance over the last couple of years. However, we would still like to continue to own those companies. So, selling some to lock in profits is prudent. A few of the names include, CTRP, BIDU, UA, SAM, AAL and CELG to name a few.**
2. **Because of the overall valuations of the market and while raising cash to lock in gains in 2014. We also added a couple companies this quarter including PNR and BABA. BABA was the largest IPO in the U.S. recently and with the potential for the consumer in China, we believe the future is bright for BABA. PNR is in the water business and as the economy continues to improve we should see nice growth along with a discounted valuation and a nice 2% as well.**
3. **We have also continued to do some "Tax Loss Harvesting" as well as selling weaker companies to raise cash while looking for other opportunities during a correction. A few of these names include NOV, HAL, COP, EJ and EDU.**
4. **For the fixed income portion of portfolios, we continue to look for bonds to own. Unfortunately, finding decent yields these days is very tough in the fixed income area. Bonds continue to be very expensive and do not warrant the return potential for the risk taken. I believe Chuck's research above provides great insight into fixed income investing!**

Obviously, one of the major drags, on portfolio performance in 2014 was our energy positions. Remember, we diversify into great businesses around the world in many quality sectors.

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PORTFOLIO STRUCTURE AND OUTLOOK *(cont.)*

The bad news is a couple of our long-term core holdings got hurt (COP and HAL). The good news is, we sold out of a couple of our other energy holdings (NOV and ESV) at much higher prices.

Many investors are asking what we think will happen with the price of oil. Of course, as you know, we are not in the business of predicting! However, I do remember when oil was around $75 or so, telling investors not to be surprised if it hit $50. At that time, many people thought there was no way that was going to happen. But, it did. In fact, it got to almost $40 before rebounding.

So, can it go lower? Sure. Will it? No one really knows. It's a guess. However, one thing I do know; We will monitor it closely and realize that at some point, the price will stabilize and move higher on a sustained basis. When it does, we will assess if we want to add to our energy positions. However, at this point, we continue to look at strong businesses that will do well regardless of what oil prices do.

However, every position is owned for a specific reason. As we continue to watch the markets and valuations, we continue to look at our current companies and new opportunities available to ensure our portfolios perform well, long-term.

Remember, we will not start buying a company at its bottom. We do not own a crystal ball and are not in the guessing game. We are less interested in timing a correction and more interested in making sure it is a company we could hold on to for years!

We continue to assess opportunities we would like our clients to own long-term.

Lastly, it is important for investors to remember, there are many moving parts in our portfolios. We are believers in Diversification, not Over-Diversification. Therefore, as you may assess the structure of what you own in your portfolio, please understand that there may be other reasons we own a company besides the fact that it is a "good company."

Today, our portfolios continue (and will more than likely continue this way for a long time) to be overweight in financials and other Large Cap companies. We continue to believe that many of the U.S. banks and other financial companies continue to be tremendous long-term investments despite mediocre performance in 2014.

Although the Emerging and International Markets as a whole continue to be underperforming, we continue to look for opportunities to add to current holdings in the portfolio from that part of the world as valuations have gotten very attractive.

As we move through the first quarter of 2015, the volatility will continue. The correction may or may not end for a while. However, our investment time horizon is not the next 3 months, 1 year of even 3 years!

As the stewards of your financial resources, we will continue to adhere to the Nepsis Philosophy & Strategy, Strategically Cost Average and provide a level of Transparency in your portfolio we don't believe is any where else.

As Nepsis Capital continues to grow, we appreciate your continued confidence and support. We believe successful investing requires Investing With Clarity™ in your portfolio. We look forward to continually providing you with the Clarity needed to be a successful long-term investor.

Respectfully,

Mark Pearson

President & CIO
Nepsis Capital Management, Inc.

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