NEPSIS
CAPITAL MANAGEMENT

3RD QUARTER 2013 UPDATE

Dear Clients:

Just about every quarter I begin our updates advising clients to always be prepared for a sizable correction in the stock market and in the individual stocks we own.

Why do I do this? After all, last quarter was another great quarter for the overall stock market and many of the companies we own!

The answer is simple: Long-term investors must understand that the stock market and stock prices do not go straight up or straight down. It is the volatility that creates the opportunity to continually invest in great companies over time.

For the first time in quite a few years, the U.S. stock market and many of the companies we own have not experienced much volatility in 2013. However, make no mistake, volatility and a correction will once again hit the overall stock market and our companies' prices.

There will always be investors who spend time worrying about corrections and when they are going to happen. My question would be, why? After all, regardless of what happens in the markets or to individual stock prices over a short period of time, it is the quality of the company and the ***Flexibility*** to buy more of a great company on sale that can potentially enhance an investor's ability to be successful **OVER TIME!**

As investors, we know that a company's success over time is never guaranteed. This is why we diversify our portfolios while simultaneously relying on a proven investment ***Philosophy*** and ***Strategy*** when making our investment decisions!

Lastly, it is not only important for investors to know what companies they own in their portfolio, but it is equally important to know what the sell discipline is when it comes time to selling a portion of a company owned or exiting a company completely.

AT NEPSIS, WE HAVE FOUR KEY COMPONENTS OF OUR SELL DISCIPLINE.

They include:

1. Selling if the fundamentals of a company have completely changed.
2. Selling a portion of a position to lock in gains and use the cash for other opportunities.
3. Selling a weaker company to purchase a stronger company - This discipline is used very often during corrections. This is one reason why we love corrections as we are long-term investors and when corrections come, it often provides the opportunity to buy a potentially stronger company on sale.
4. Tax loss harvesting – This sell discipline is used for non IRA accounts. It allows us to harvest losses against future gains in an effort to minimize tax implications.

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VOLATILITY
IS YOUR FRIEND

At Nepsis, we fundamentally believe that stock market volatility is our friend because it creates opportunities to purchase great companies on sale!

It is important to understand that many of the companies owned in portfolios are companies we plan on owning for a very long time. Therefore, although we may sell a portion of the position after a big move in a company's stock price to lock in gains or rebalance the portfolio, the company's stock price may be stagnant for an extended period of time.

We have seen several of the companies we own remain flat for an extended period of time, many with great volatility, giving us the opportunity to continually buy more shares. It wasn't until 2013 that their prices flourished. This is why investors must be patient, like a business owner when it comes to investing in a business or businesses!

Patience has been the key to success in 2013 as portfolios have had significant performance relative to risk taken ***(Risk Adjusted Return)*****.** I will address the "relative" performance later in the update.

I continuously stress that if you are going to invest in equities, you must have at least a five-year time horizon. Unfortunately, many investors are not patient enough and end up chasing historical returns or hoping they can get better results somewhere else. These investors do not understand how the historical returns were accomplished including the "risk" associated with achieving such returns.

When you look at the financial crisis, it has now been almost five years since U.S. markets hit a bottom. In the meantime, the U.S. stock market and many of the companies we own are now hitting all-time highs! Yet, many investors do not believe in the rally in equities and continue to be fearful of what **MAY** happen!

Additionally, many investors do not understand that volatility is their friend and they do not have an ***Investment Philosophy, Strategy, Flexibility or Transparency*** that enables them to be investing for the long-term.

How fearful are investors? According to an article published on Reuters on October 23, 2013, there is over $2.6T sitting in money market funds. Additionally, according to the Milken Institutes website on April 30, 2013, it is estimated at least $30T is sitting on the sidelines in money market instruments globally earning less than 1%!

The **"Four Key Components to Successful Investing"** (Philosophy, Strategy, Flexibility and Transparency) are what grant us the ability to be confident in investing in great companies and using volatility as a critical component to long-term success.

At Nepsis, we call this process, "Investing With Clarity™."

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AROUND the World

Although we saw a promising rebound last quarter, many of the Emerging Markets continue to have negative returns in 2013 and many of the International Markets continue to significantly underperform the U.S. markets (shown in the adjacent chart).

Emerging Markets and many International Markets have continued to underperform the U.S. markets again in 2013. However, it is important to remember that we invest in companies, not the "stock market."

For example, when you look at the performance of the China and Russia markets compared to companies we own in portfolios, we have seen tremendous performance in the companies while the indexes have performed poorly.

A few examples of companies we own would include: CTRP, BIDU and VIP to name a few.

It is the performance of the individual companies we own in the portfolio that has provided extremely strong returns this year and more importantly, extremely strong portfolio returns on a ***Risk Adjusted Basis.***

Please remember, stock prices do not go straight up and we will not see our companies perform at this level every year. However, it is the ability to utilize the ***Philosophy, Strategy, Flexibility*** and ***Transparency*** that allow us to be extremely confident in sticking to our investment process!

Ticker	Name	Price	% From 50-DMA	YTD % Chg
EWA	Australia	26.79	4.72	6.56
EWZ	Brazil	48.59	1.18	-13.14
EWC	Canada	29.24	2.71	2.96
ECH	Chile	50.14	-1.19	-20.71
FXI	China	37.28	-0.76	-7.85
GXG	Columbia	20.11	-1.99	-9.58
EWQ	France	27.41	1.81	16.19
EWG	Germany	29.06	4.18	17.65
EWH	Hong Kong	20.18	0.74	3.91
PIN	India	17.15	4.48	-6.59
IDX	Indonesia	23.42	-2.03	-18.23
EWI	Italy	15.35	5.41	14.13
EWJ	Japan	11.69	-0.36	19.91
EWM	Malaysia	15.77	2.29	4.23
EWW	Mexico	63.81	-1.78	-9.53
EWN	Netherlands	24.77	3.12	20.77
EPHE	Phillipines	34.78	2.35	0.67
RSX	Russia	29.03	1.69	-2.93
EWS	Singapore	13.76	3.23	0.51
EZA	South Africa	64.05	-0.15	-10.52
EWY	South Korea	63.34	1.76	-0.02
EWP	Spain	37.03	5.65	22.37
EWD	Sweden	33.64	-1.55	11.39
EWL	Switzerland	31.65	1.80	18.10
EWT	Taiwan	14.19	-0.05	4.19
THD	Thailand	76.82	0.06	-6.87
TUR	Turkey	54.66	-2.12	-18.15
EWU	UK	20.36	3.41	13.49
SPY	US	176.27	3.59	23.78
VNM	Vietnam	19.01	3.56	5.61

Source: www.bespokeinvest.com

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ADDICTION TO PREDICTION

"Investment success does not come from following the right predictions, it comes from following the right principles."

The desire investors have for predictions can lead to costly mistakes and can hurt their ability to be successful over time.

The adjacent questions are part of a post I wrote about investor's "Addiction to Prediction" on our blog site, **www.investingwithclarity.com**

Unfortunately, many investors in today's market have unknowingly become addicted to predictions. The irony is, no one knows who, if anyone, is keeping track of these predictions. And, who does the research to find out how often the predictors are correct?

People will often ask for my opinions on various aspects of investing or the markets. However, I learned a long time ago that making predictions is a losing game – so why do it? Of course, some may argue that the reason I don't make predictions is because I am afraid of being wrong or don't want to appear ill informed. If one should have that opinion, I am okay with that. ***After all, it's an opinion!***

We live in a world where many people thrive on opinions and predictions. After all, if the investment community did not make predictions, what would they spend their time talking about? But why is it that investors place so much emphasis on predictions? **I think the answer is simple! Lack of INVESTMENT CLARITY!**

Like many business owners, I fundamentally believe that the more you understand about the business or businesses you own, the more clarity you have in making investment decisions. If you have investment clarity, than predictions are irrelevant. If you have investment clarity, you focus on the ***Philosophy, Strategy, Flexibility*** and ***Transparency*** of how a business owner runs their business, not predictions!

Below are a few common questions regarding investment predictions and the reason why I believe they are irrelevant.

Q: What is the year-end target of the S&P 500?

Answer: It really doesn't matter. If you are investing in a great business, the business should do well over time. If for some reason the company's stock price should go down in a given year, it will more than likely be a great opportunity to continue to invest in the company when the share price is "on sale."

Q: Will the Federal Reserve raise or lower interest rates at their next policy meeting?

Answer: Whether the Federal Reserve raises or lowers interest rates in any given month, it really shouldn't significantly impact great companies longer term. After all, well-run companies will adjust to economic conditions on an ongoing basis.

Q: What about the, "I have a hot stock tip for you!" theory?

Answer: I know of very few investors who have successfully employed this approach. Have you ever taken advantage of a "hot stock tip"? Frankly, I have only heard about poor results from "hot tips", which tells me that is generally the outcome!

Q: When will we see the next stock market correction and how big will it be?

Answer: The reality is, no one knows. But, smart investors do know that corrections create excellent opportunities to take advantage of buying more of a great company "on sale!"

I realize that we will continue to live with predictions in the investment world as long as there is an audience out there willing to listen to them. However, I believe predictions become irrelevant when investors approach investing from the perspective of a business owner.

When investors obtain ***Investment Clarity,*** they have the ***Philosophy, Strategy, Flexibility and Transparency*** needed to take advantage of opportunities to continue investing in the great companies they want to own long-term.

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PORTFOLIO STRUCTURE AND OUTLOOK

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At Nepsis, we are always prepared and looking for a stock market correction and we are not in the business of trying to guess which way the "stock market" is going to move. Instead, we look at the fundamentals of the companies we own and base our investment decisions on the information we review with a long-term objective.

It is important to note that we may occasionally hedge positions and/or the portfolio as a whole by using individual companies or other hedging instruments. But always remember, ***it is not any one position in a portfolio that "makes or breaks" a portfolio.*** It is the allocation as a whole that is most important.

Client portfolios continue (and will more than likely continue this way for a long time) to be overweight in financials. We believe that many of the U.S. banks and other financial companies continue to be tremendous long-term investments.

Although we still to believe in the financials, they have not performed to the level of many other positions this year. This is OKAY! It is why we diversify portfolios in the first place! More than likely, at some point many of our "winners" of today will be laggards and the laggards today will be future winners.

The bottom line: Continue to invest in great businesses over time while diversifying the portfolio to reduce portfolio risk.

PORTFOLIO DECISIONS:

In the third quarter, we made quite a few portfolio decisions. For disclosure purposes, please remember that all portfolios are separate and therefore results and positions may vary. This is particularly important to remember for new clients of Nepsis in 2013.

While we are extremely happy with many of the companies we own right now, we have made several changes that we believe will enhance the portfolio longer term. We have taken profits in many of the companies we own (even though we love them) to raise cash for other opportunities. While I currently believe many stocks are currently expensive, we continue to look and find value in companies we want to own long-term.

As we enter the fourth quarter of 2013, we continue to believe that buying companies is the best long-term strategy for investors. Of course, if you are in retirement or close to retirement, having a diversified portfolio of equities and fixed income is prudent. However, please remember, we do not believe fixed income investments will provide much value and opportunity for investors, as I think interest rates have already begun their long-term move higher.

Remember, ***Transparency*** of an investor's portfolio enables them to "stick to the knitting" during difficult periods in the economy and in their investments.

Although we continue to be very bullish on the U.S. economy and the stock market as a whole, there will be bumps in the road (i.e. corrections). While this does not mean we won't make changes as opportunities present themselves, we will continue to remain very diligent in assessing the companies we own and new opportunities for future investment.

We appreciate your continued confidence and support in the ***Nepsis Investment Philosophy and Strategy*** and look forward to a great rest of 2013!

Respectfully,

Mark Pearson
President & CIO

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