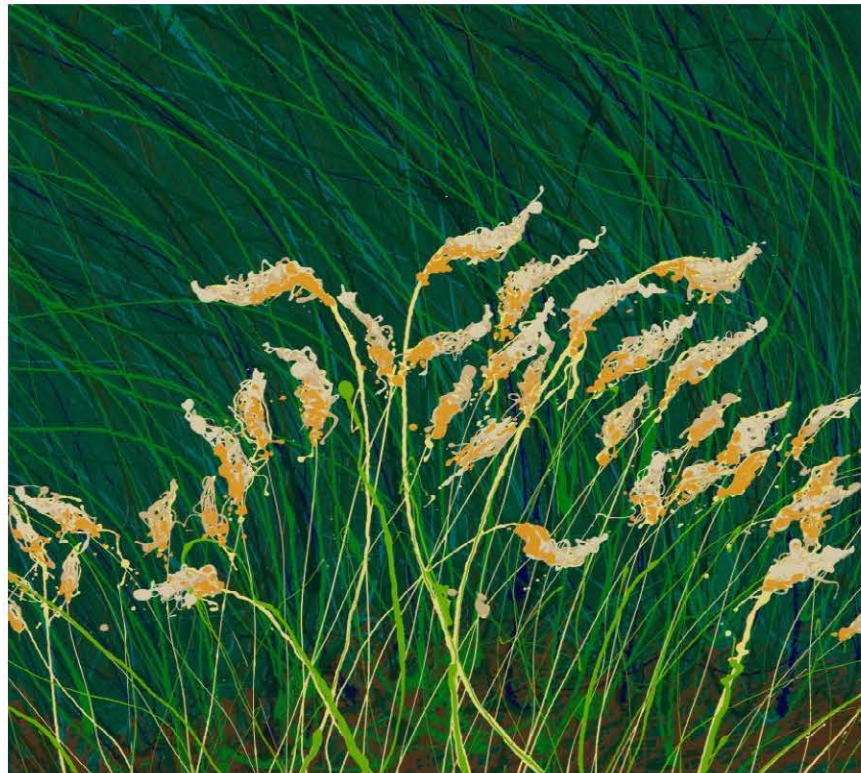


U.S. SMALL-CAP MARKET TRENDS & OPPORTUNITIES



PML.CA

PEMBROKE
PRIVATE WEALTH MANAGEMENT

Painting: *Uncultivated III*
Catherine Adamson



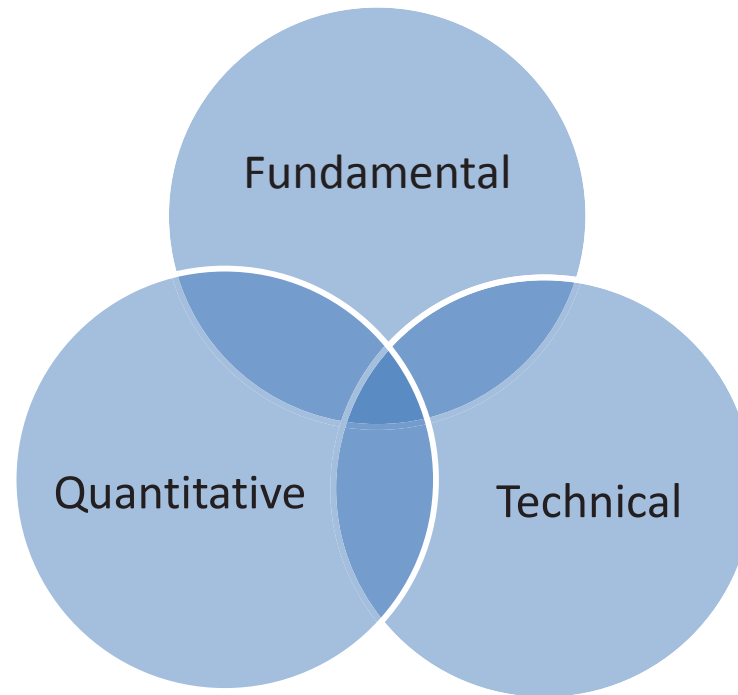
JIM FUREY, CFA, MBA



- Jim Furey is the Managing Partner & Chief Investment Strategist of Furey Research Partners, the premier source for U.S. small-cap strategy and idea generation.
- Mr. Furey previously worked at Lehman Brothers, JP Morgan, Atlantic Capital Management, Amerindo Investment Advisors, Morgan Stanley and Bankers Trust.
- Mr. Furey is a graduate from Princeton University with a BA in History. He also received an MBA from Dartmouth's Amos Tuck School of Business Administration.

Furey Research Partners

Integrated Small-Cap Strategy



Strategy & Outlook

March 2015

Summary of Today's Investment Conclusions

- Bullish on equities – **R2000 Target of 1388** and **S&P 500 of 2400**. **Bearish on bonds**
- **US economy's growth stronger** than expected
- The purposefully lagging **Fed doesn't hike in '15** due to fear of driving the dollar higher and hurting overseas economies pegged to the dollar. The US economy is strong enough to take hiking. Investors should root for the Fed to be able to raise rates
- Despite the Fed not hiking, **US interest rates rise** and lead the Fed making the '16 Fed hiking easier
- Rising rates and a steepening yield curve are bullish for stocks and small-caps, which outperform
- Higher rates **hurt REITs** but not **Biotechnology**, which moves higher on the strength of successful Public Venture capital outcomes and Healthcare M&A
- **Technology and Healthcare lead** the US small-cap market higher
- **Energy puts in a second bottom in 1H15** and then leads a mighty 2H15 rally just as investors again give up on Energy. The crude contango causes the last flush in prices and then disappears as the bottom is made, alleviating storage pressure.
- **EU and Japanese rates begin to move higher** on successful QE in each region. The dollar stabilizes in the 2H15
- **US Asset prices continue to move higher**. Inflation dormant due to still low Energy costs creating a Fed dilemma which contributes to '16 decision to raise rates

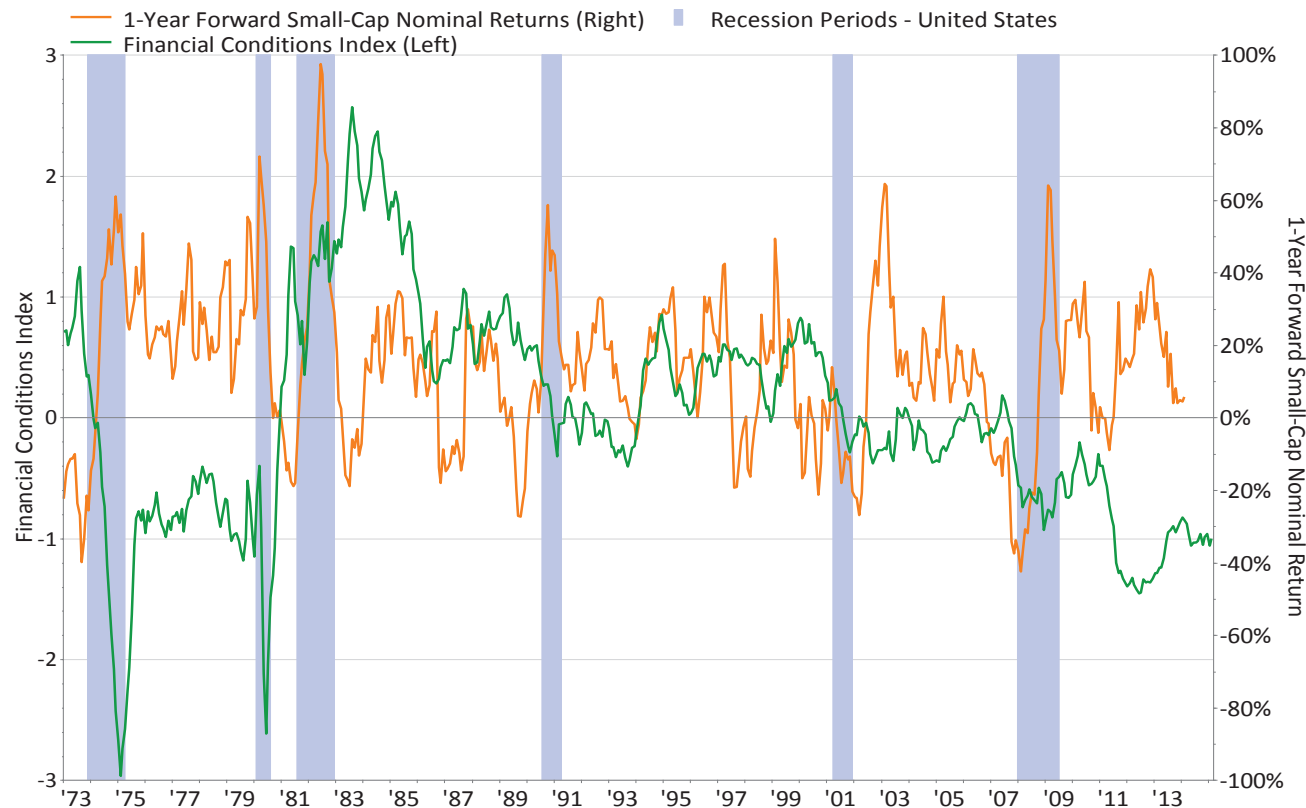
What Moves Financial Asset Prices Up & Down?



The Fed Keeps Financial Conditions Highly Stimulative

Even if the Fed hikes, rates will remain highly stimulative. Governments require low rates & future inflation to solve their balance sheet problems.

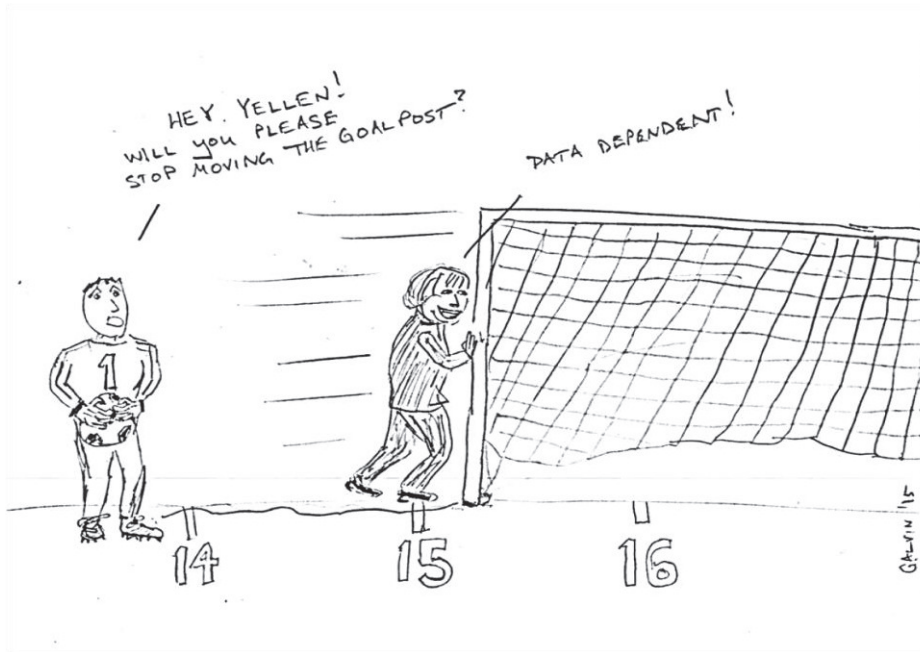
A rising dollar tightens financial conditions but the current rise has been more than offset by the decline in energy prices.



If rates rise it doesn't mean the Fed is tightening if nominal and real growth is growing faster than rates rise.

Source: Furey Research Partners and FactSet

Yellen is a Dove – The Goal Posts Keep Moving Back



Source: Furey Research, John Galvin

Fed targeting lagging indicators (employment & wages), means it will create inflation & keep rates low. It's the solution to balance sheet woes. Foreign worries. Energy cushion.



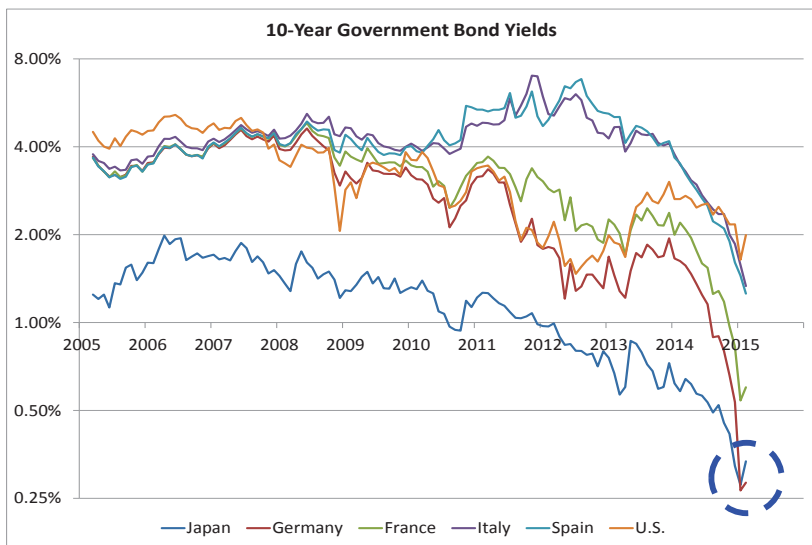
Source: NPR.ORG

Conditions & Policy are Producing

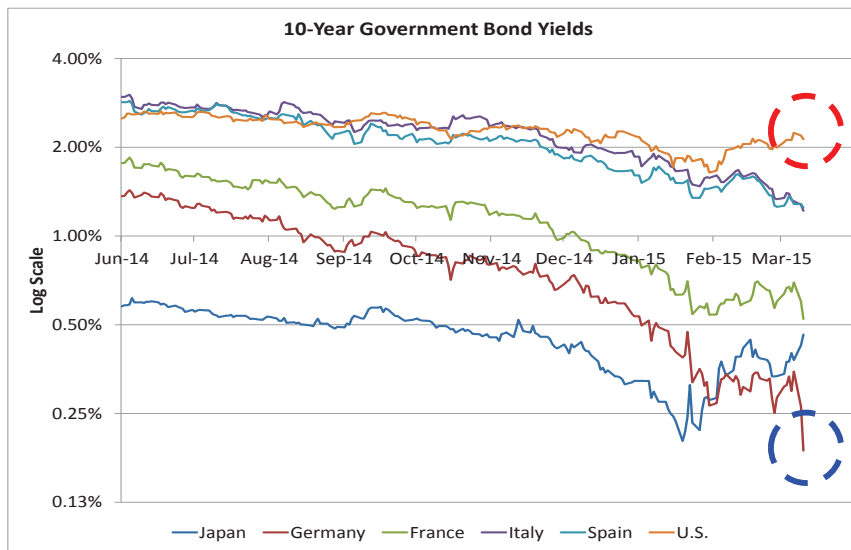
- Anemic growth globally
- Superior US growth vs foreign nations
- Rapid disintermediation of existing goods and services
- Globalization
- Low inflation and in some case deflation
- Commodity pressure
- Reliance on monetary policy
- Political and social pressure
- Military conflict

Monetary Policy is Forcing Investors to Buy Stocks

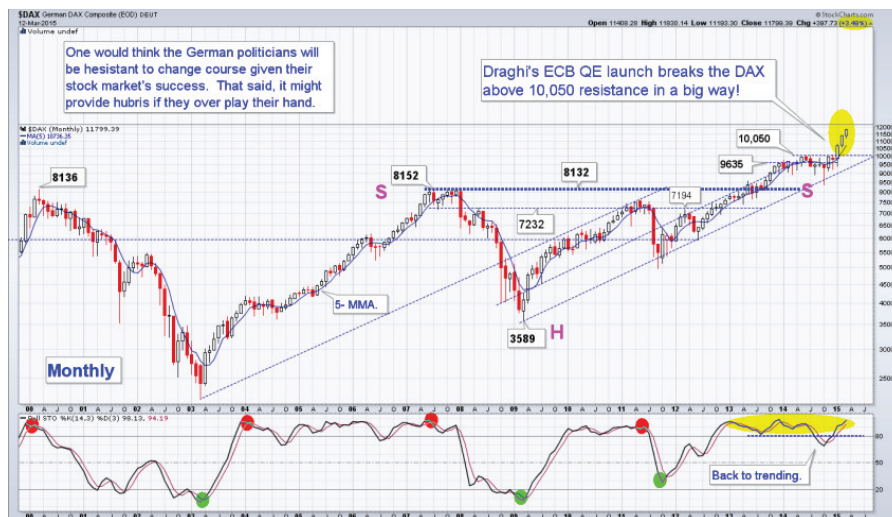
Europe's new QE is only the latest example.



Source: Furey Research Partners & FactSet . Data as of Mar 10th, 2015



Source: Furey Research Partners & FactSet . Data as of Mar 10th, 2015



Source: Furey Research Partners, StockCharts.com. Data as of Mar 12th, 2015

Germany's sharp gains show the power of QE and the current policies.

US Best of Any Major Nation with Structural Challenges

US & global policy makers are interdependent.

- Fiscal
 - US corporate **taxes** are the **highest** in the world
 - In the US, but especially overseas, politicians don't have to face fiscal reality because of ultra-low rates, which are now negative in some EU nations
- Monetary
 - Ultra low rates
 - **Currency wars** are heating up
 - US QE **ending**, Japan's QE **surging**, and Europe **starting** QE
 - **Currency manipulation** to improve growth is pushing the **dollar higher** and tightening financial conditions for all dollar pegged nations and will likely **push out Fed rates hikes out further** than most expect

In Sum, Bullish Trends & Conditions Persist , Vigilant for Change

Danger lurks in structural challenges. This bull market will end, just not now.



With existing pre-conditions and likely forward policy maker actions,

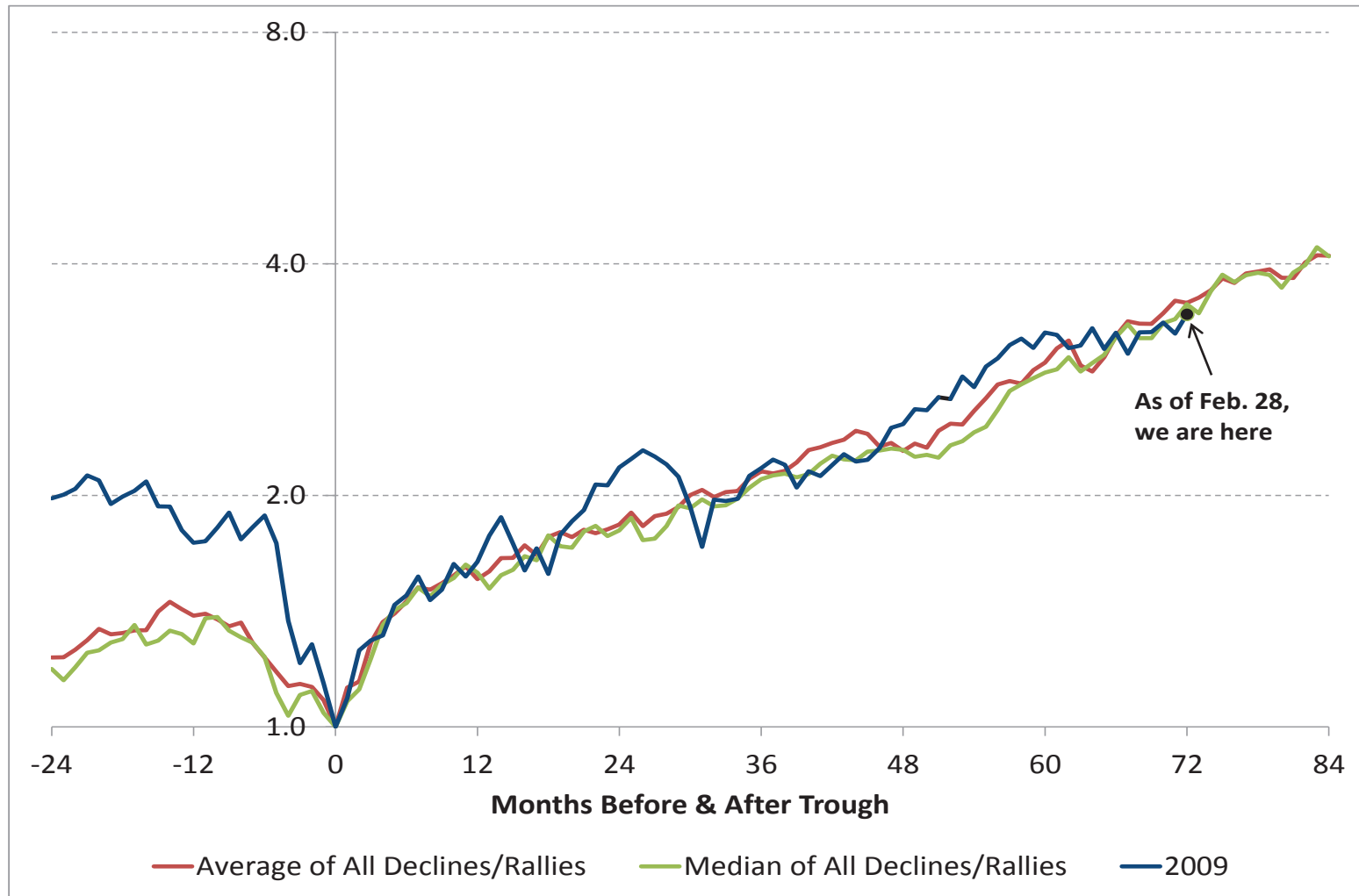
OUR 2015 FORECAST

Bullish – Russell 2000 1388 and S&P 500 2400



No Different From Past Major Bear Market Recoveries

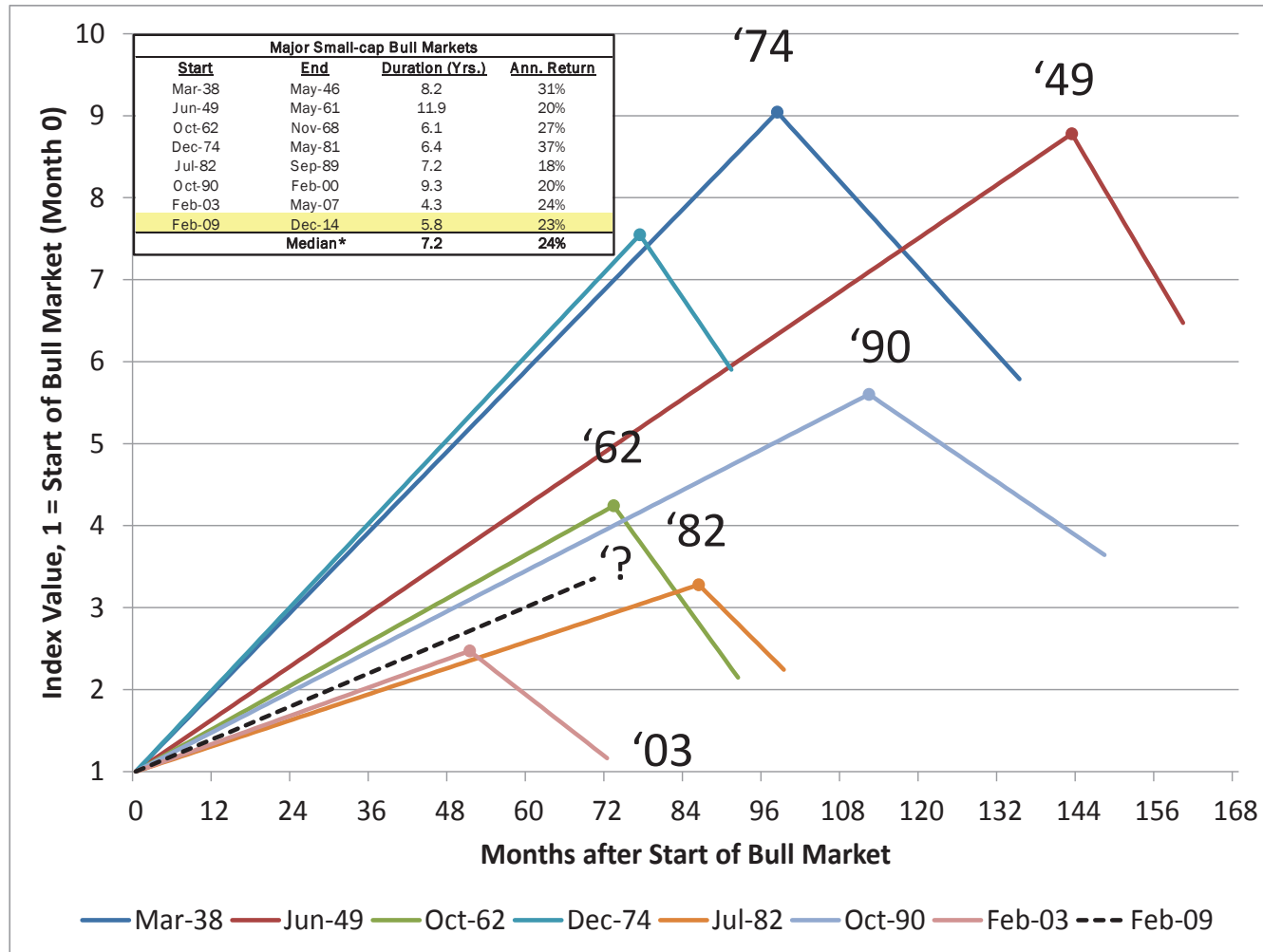
Back to trend. Seen this script before with worse outlooks than the current one.



Source: Furey Research Partners and FactSet

Major Bull Markets Tend to Last Seven Years

While the current advance seems rapid, it lags many of the past.



We are often asked what happens after 84 months in the above chart. The answer is that bull markets start to end.

We examine 7 small-cap bull markets going back to 1938. We find the median bull market lasts just over seven years. With the current bull market approaching six years, we would not be surprised to see another 12-18 more good months.

Source: Furey Research Partners and FactSet

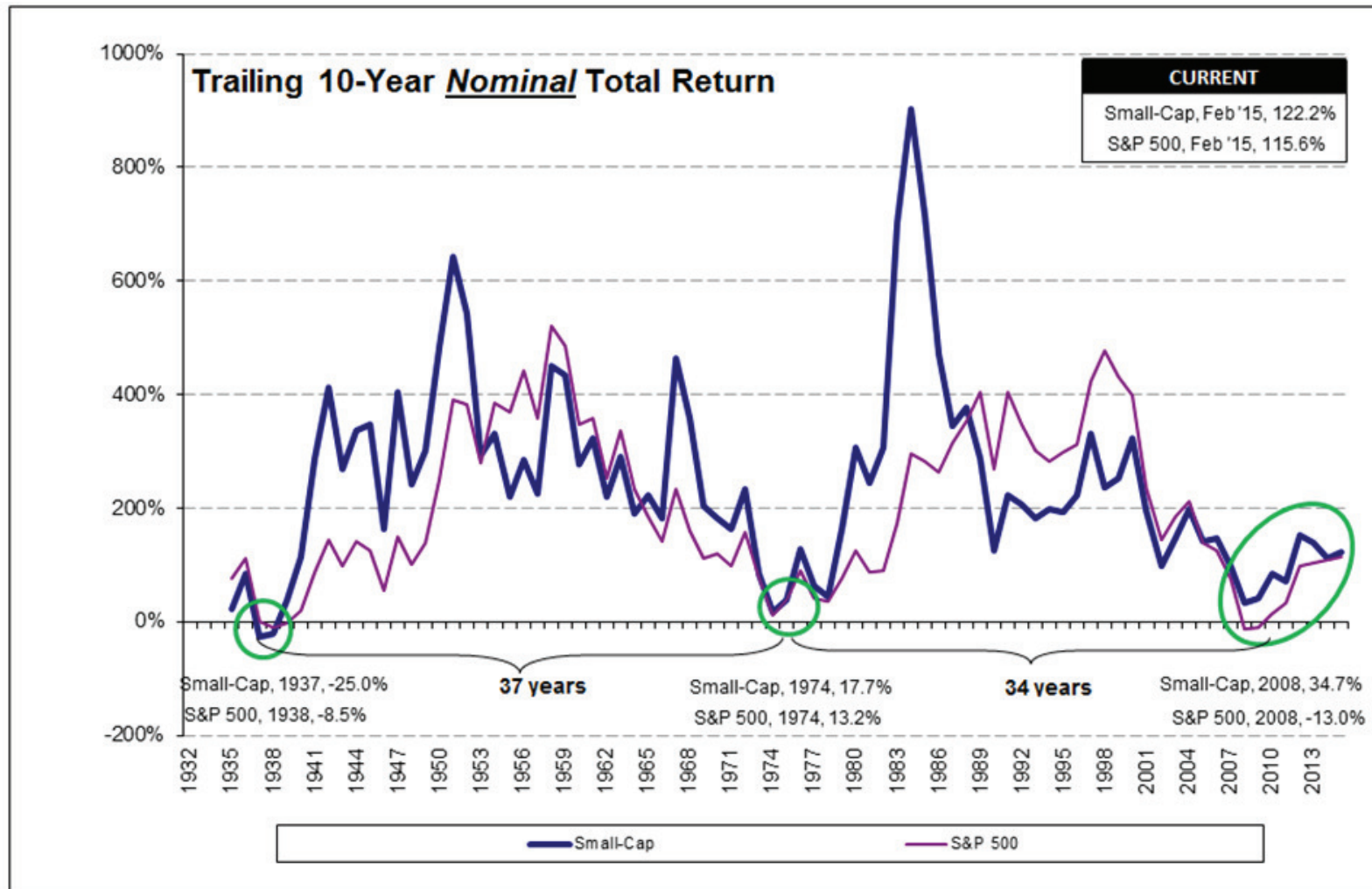
Why Bullish? Growth Fine, Fed & Policy Makers Consistent

Great Recession challenges are a 20-year battle. Investors remain fearful of stocks.

- The existing pre-conditions and secular drivers are not changing rapidly, especially overseas, and policy makers won't alter their behavior
- Real interest rates are negative and below nominal GDP
- The US central bank will severely lag traditional response times for tightening
- Weak foreign economies and the strong dollar will reinforce the Fed's caution and desire to lag policy behind growth
- Energy price decline has provided a surprise excuse for the Fed not to raise rates
- Stocks are cheap vs. bonds

The Bull Market is Not Over

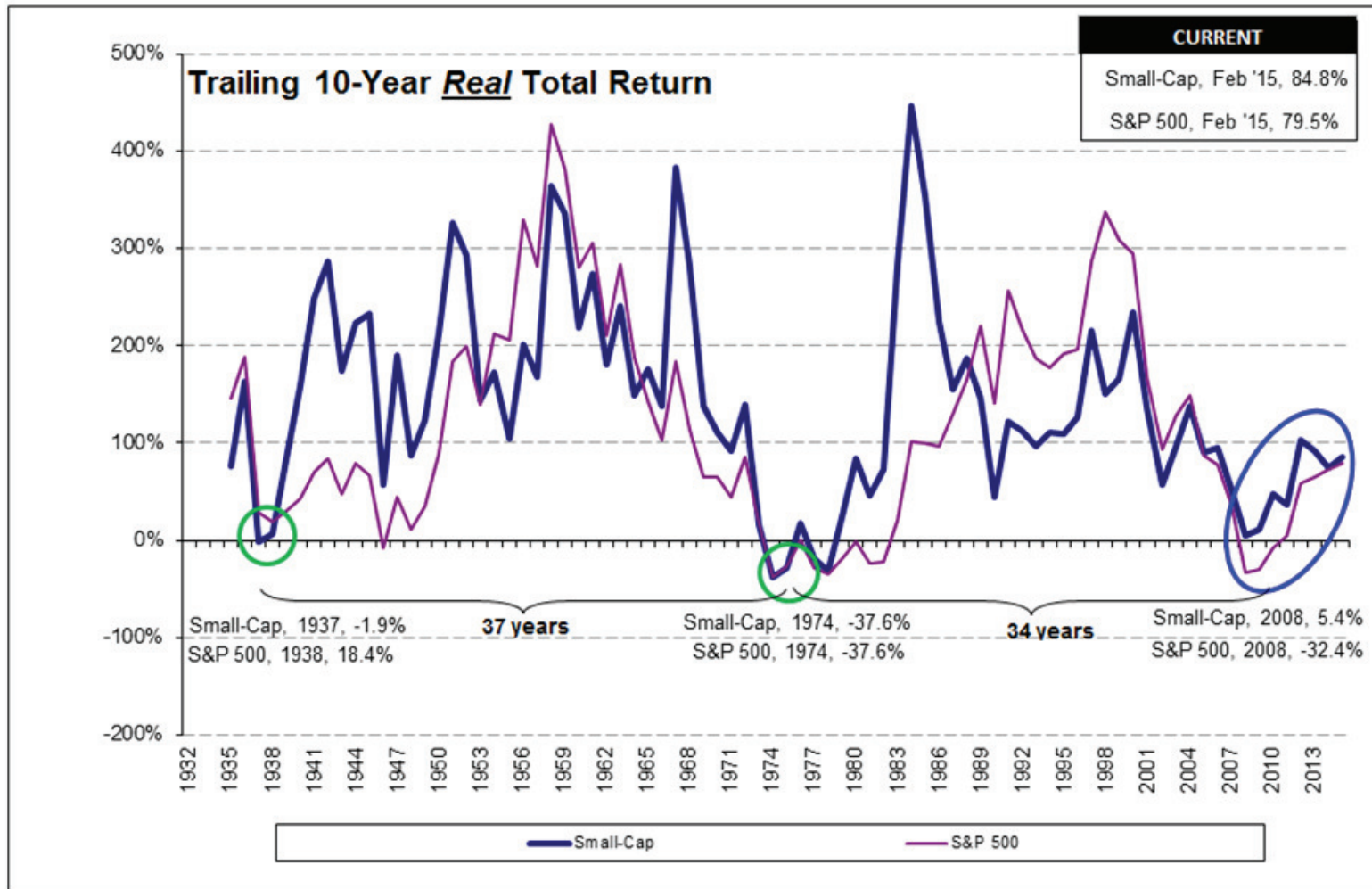
We expect a small-cap trailing **NOMINAL** 10-year return to reach 400%.



Source: Furey Research Partners, FactSet and Ibbotson & Associates. Data as of Feb 28th, 2015

The Bull Market is Not Over

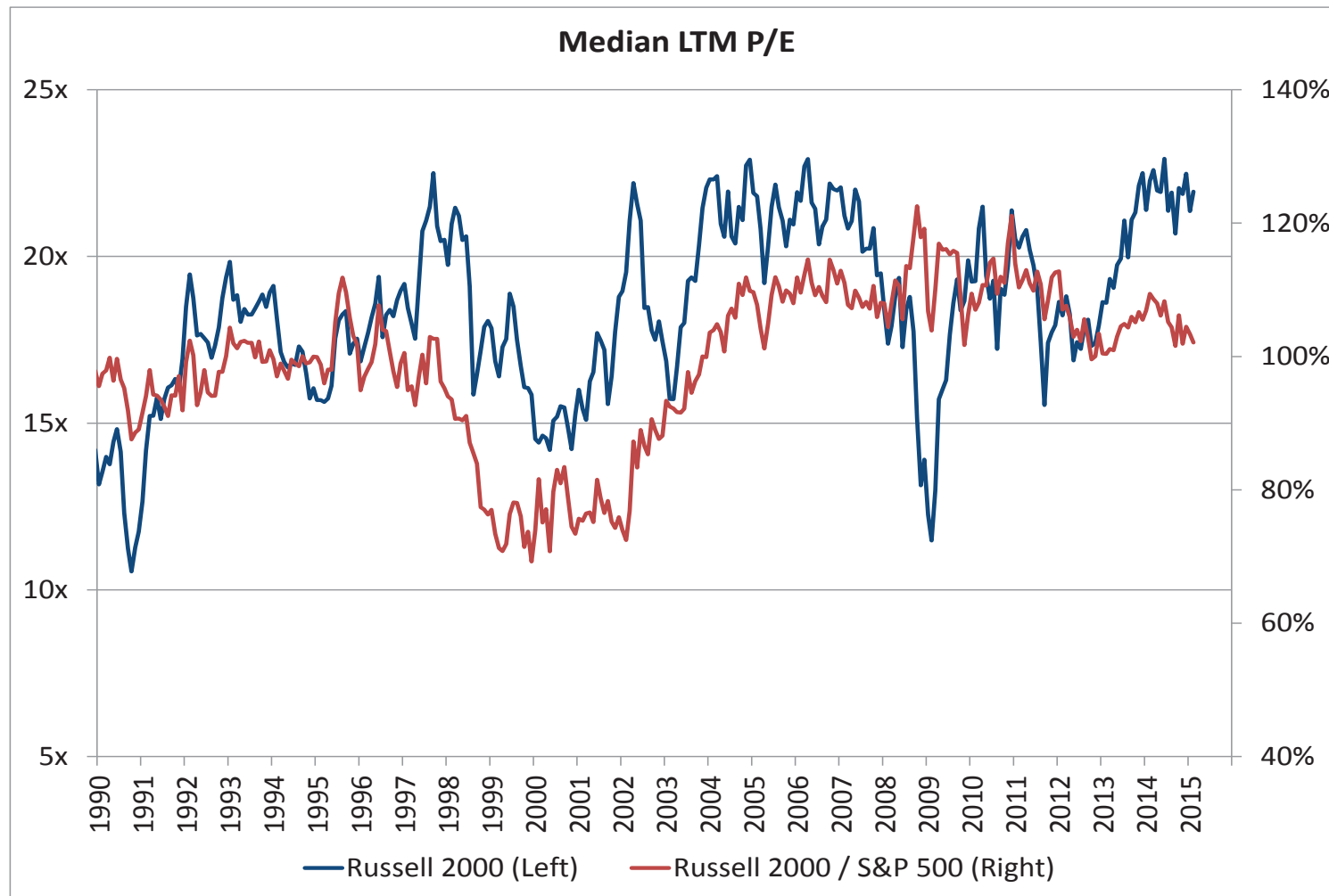
We expect a small-cap trailing REAL 10-year return to reach 200%.



Source: Furey Research Partners, FactSet and Ibbotson & Associates. Data as of Feb 28th, 2015

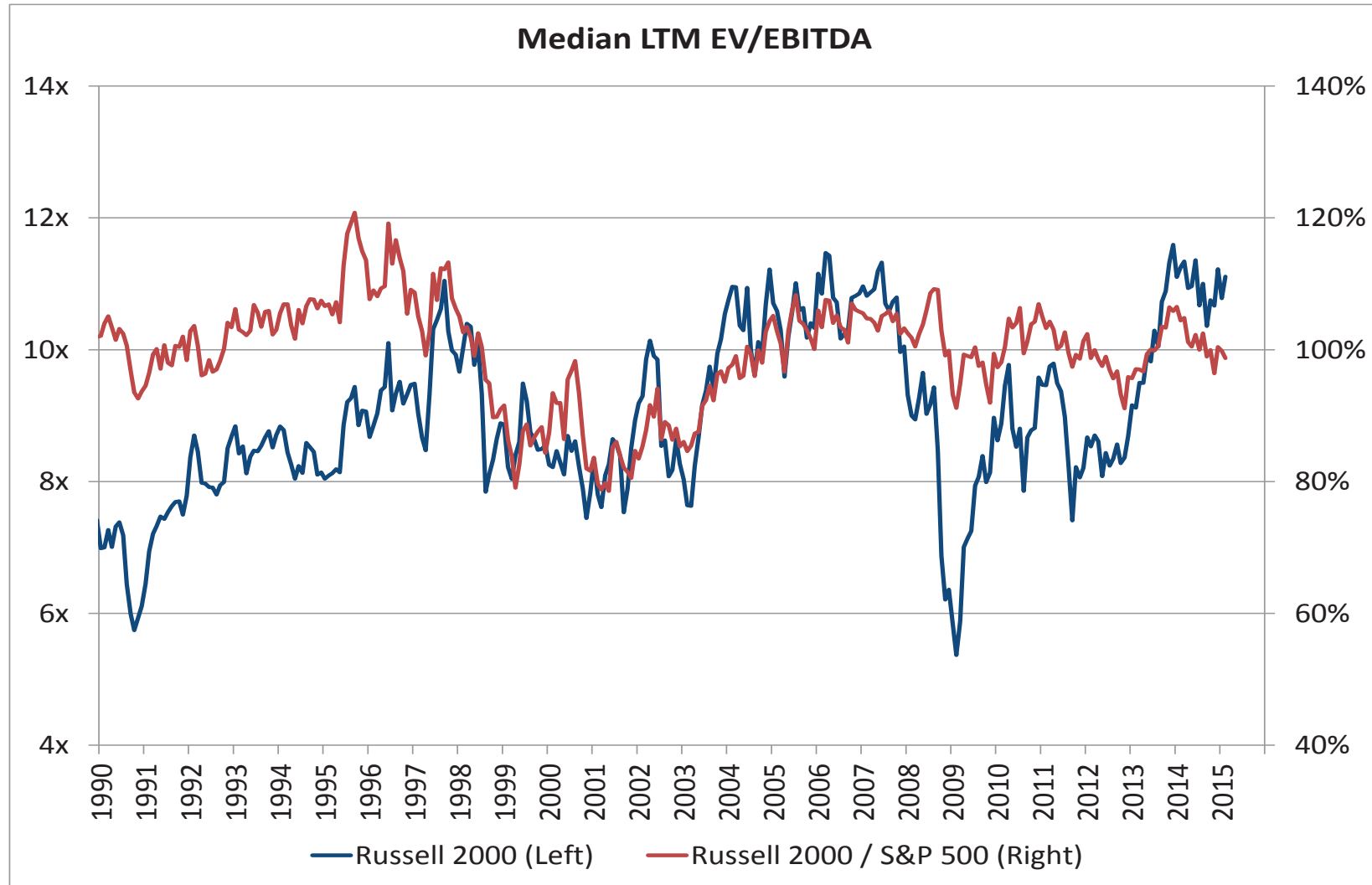
It is True that Valuation is Elevated on a PE Basis

Multiples are declining as earnings grow. Relative PE at recent lows.



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

Valuation is Elevated On an EV/EBITDA Basis too

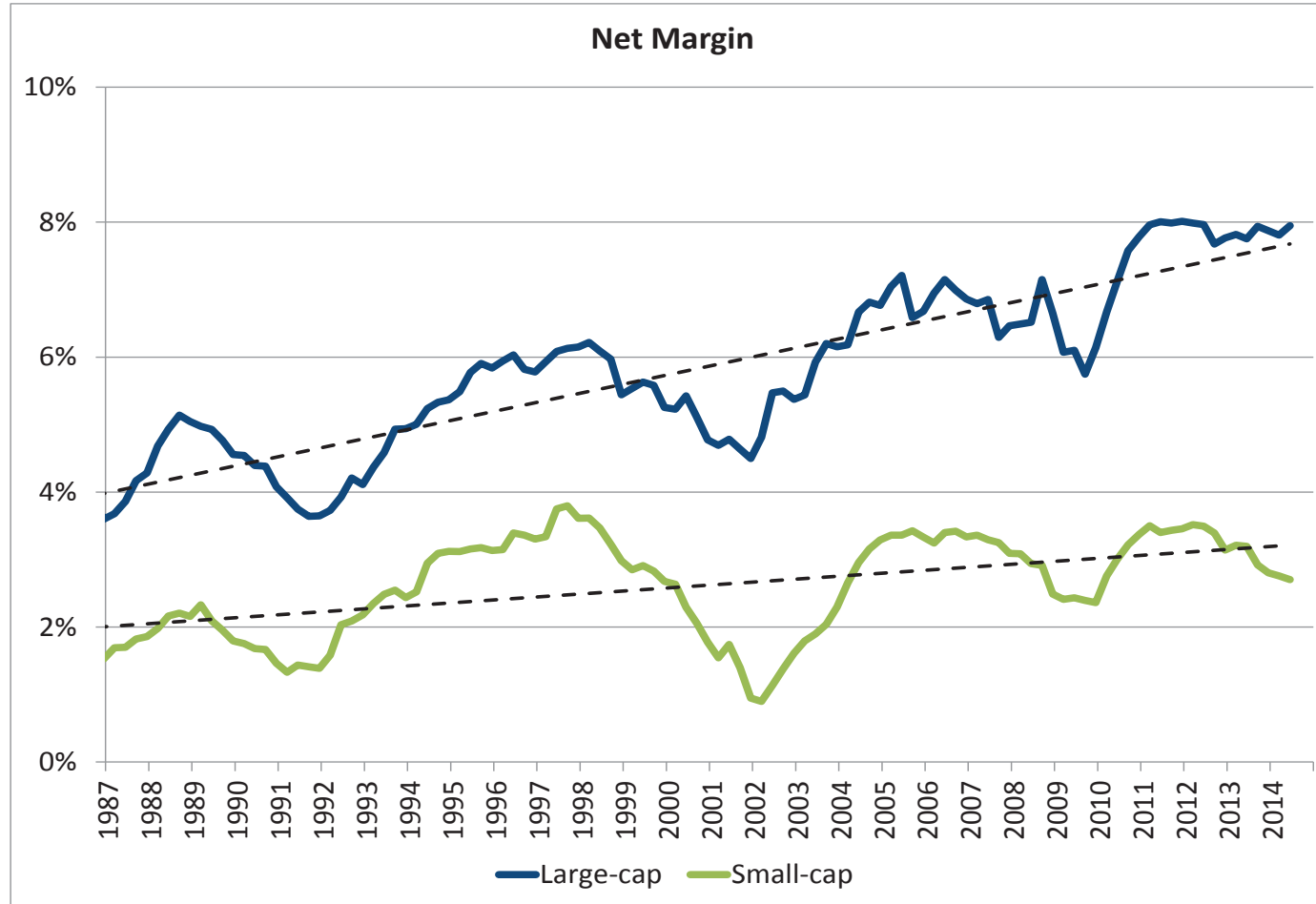


Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

Margins Complicate Valuation Discussions

Small-cap margins peaked two years ago. Large-caps are near their peak.

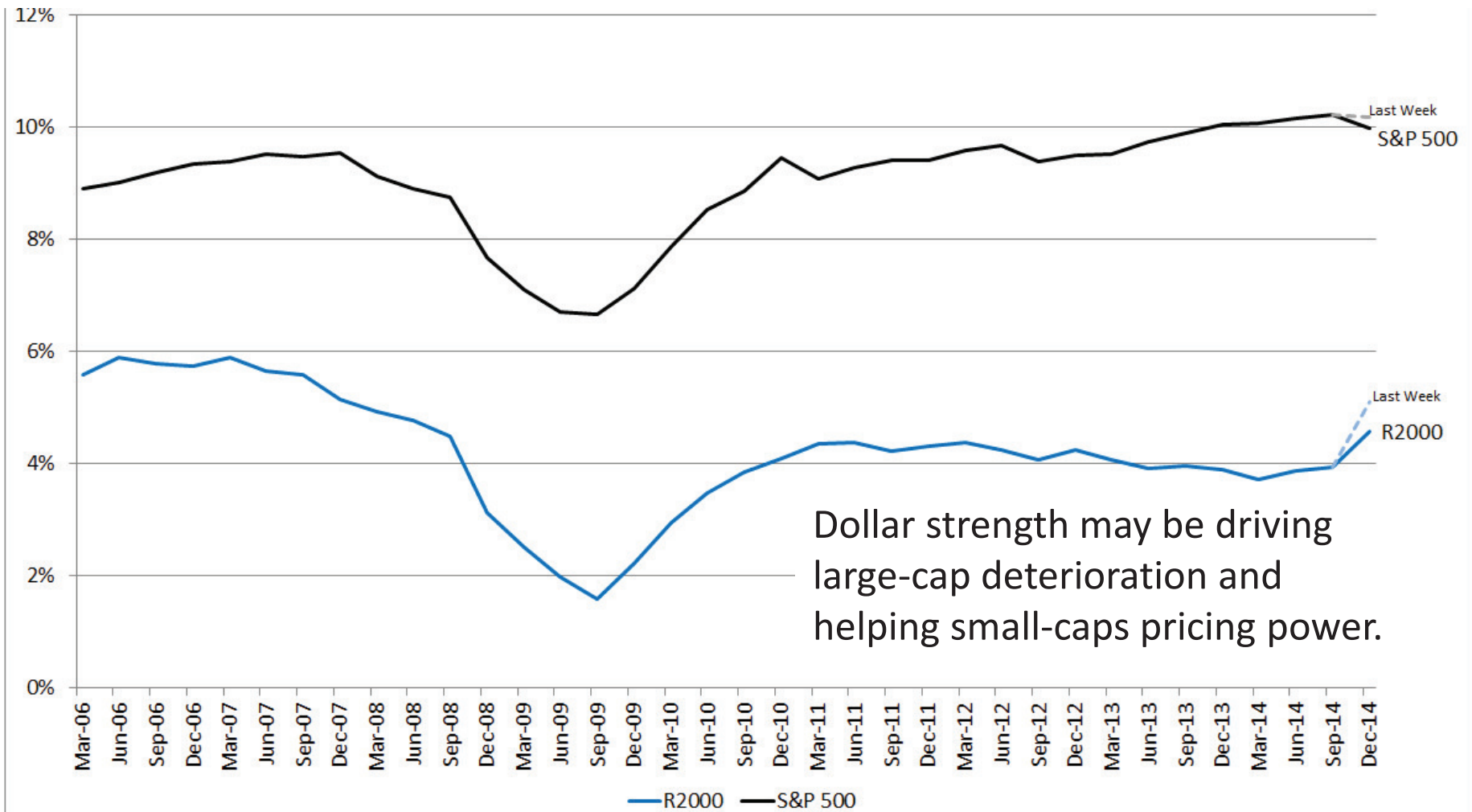
We believe capital will continue to be well treated versus labor and margins will remain high.



Source: Furey Research Partners and FactSet. Data as of Sept. 2014

S&P 500 Margins May be Rolling Over & the R2000's Improving

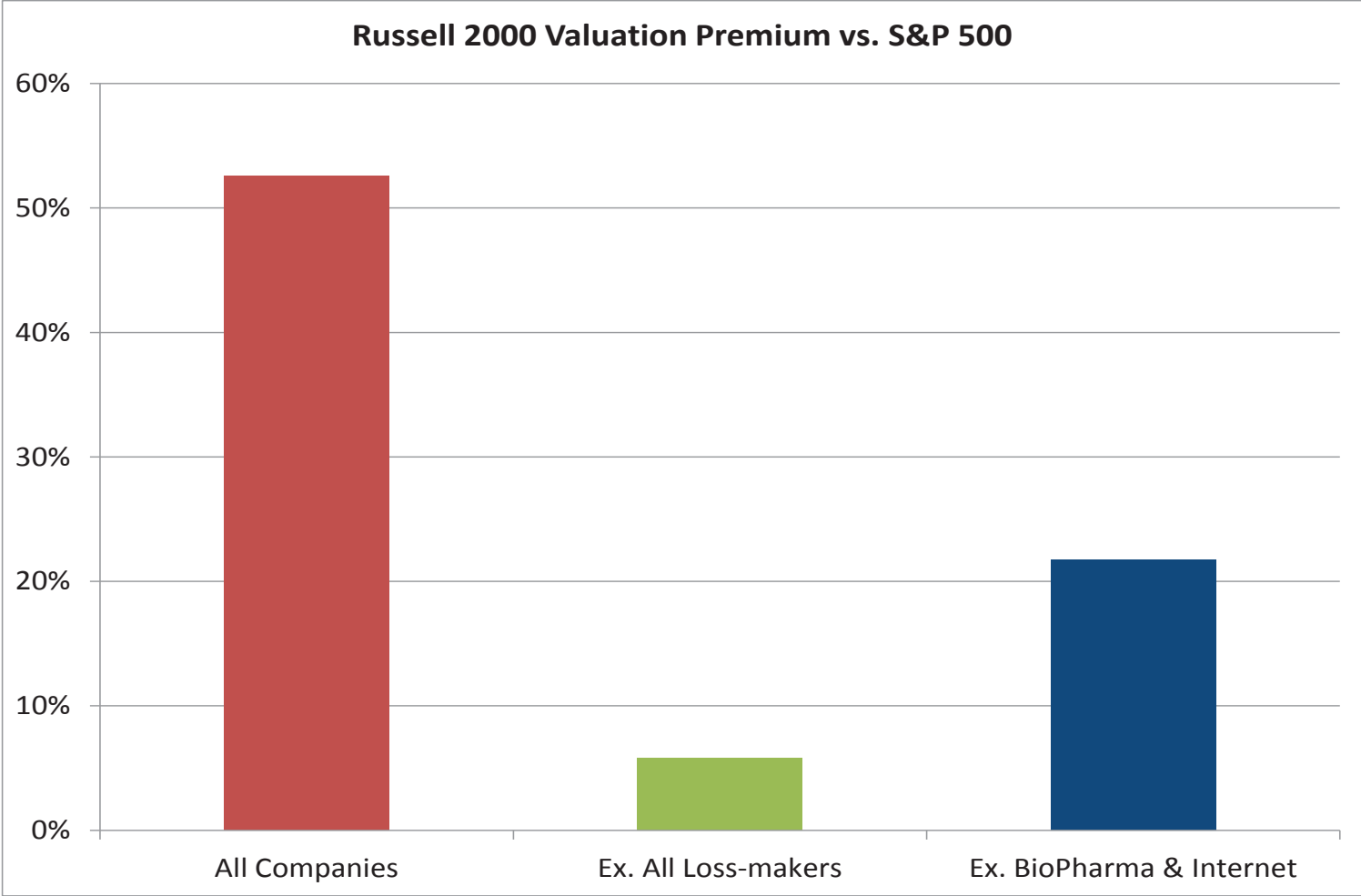
This exhibit is current constituents for each index, not what existed in the index back in time.



Source: Furey Research Partners and FactSet. Data as of March 4th, 2015

But it's also True that Valuation is Misunderstood

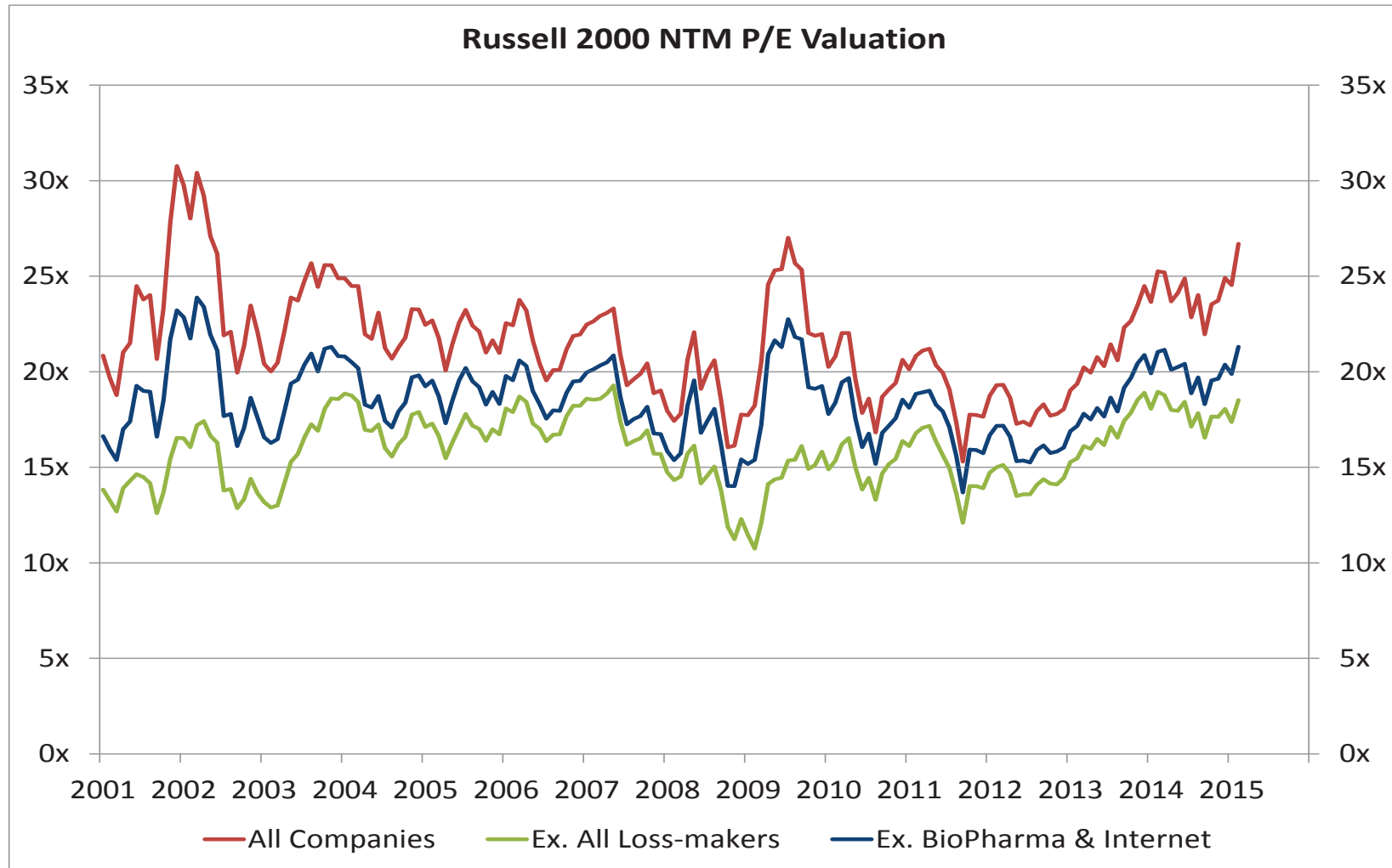
Large-cap bulls don't want to take a nuanced small-cap valuation view.



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

While High, Valuation is Not Unprecedented

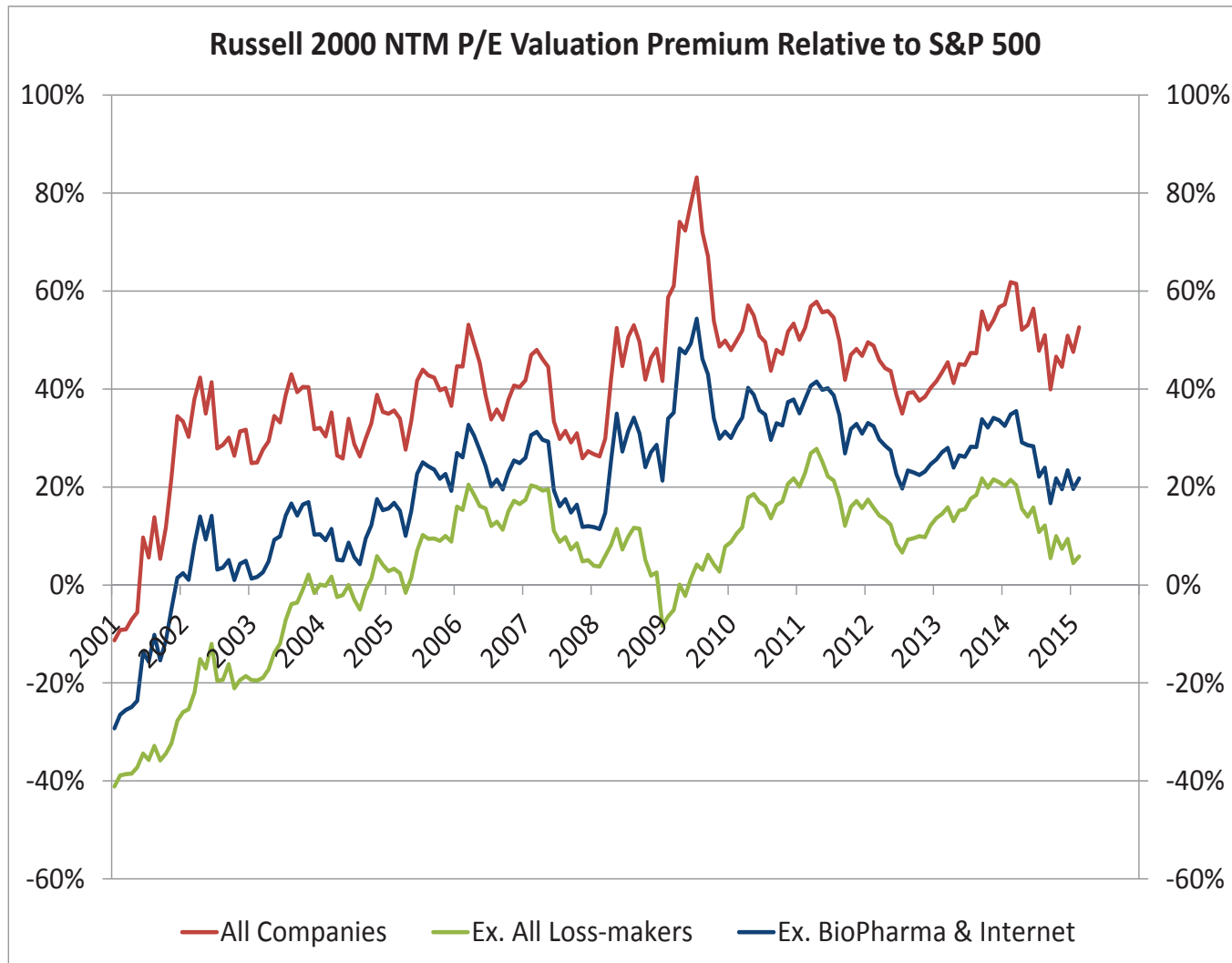
Ex-loss makers, the R2000's PE is only modestly above its average since '01.



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

Large-Cap Outperformance Reduces Small-Caps' Premium

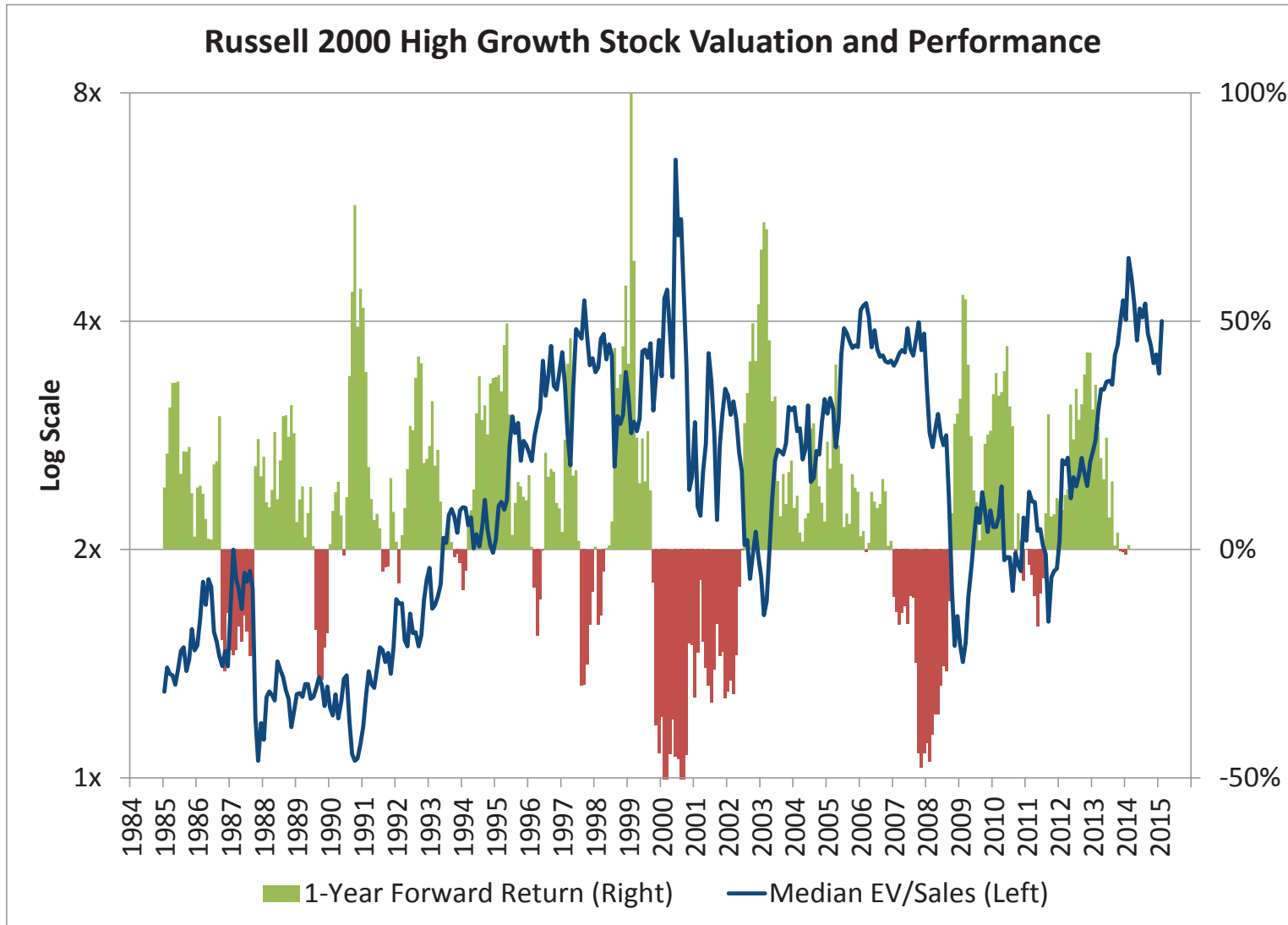
Relative earnings strength and price both contribute to this phenomenon.



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

Valuation Risk Exists in the Highest Growth Cohort

The highest growth stocks '14 struggles compressed valuation modestly



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

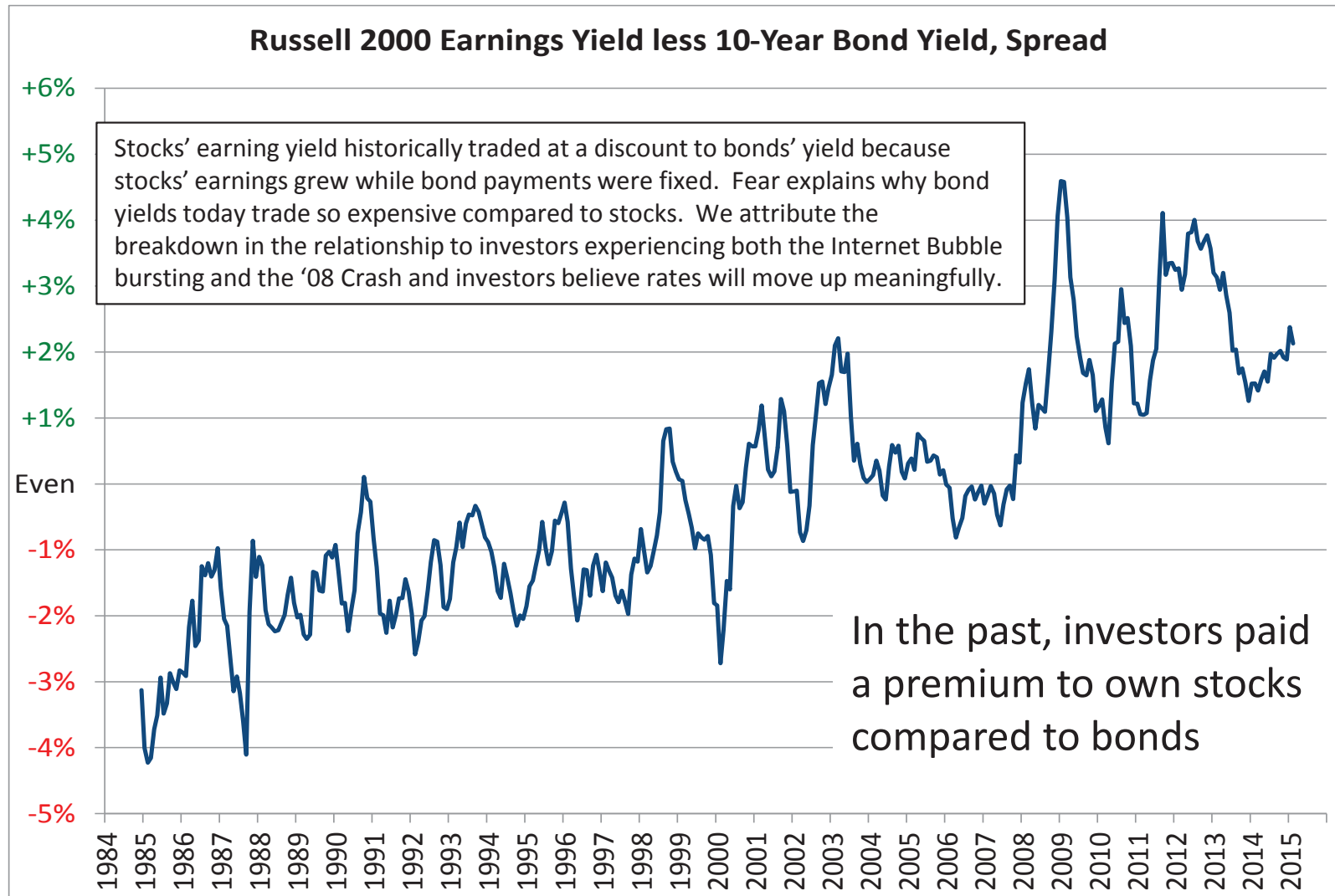
The Most Important Reason Stocks Will Advance...

...Investors will seek relative attractiveness among assets while fear subsides.



Small-Caps Remain Inexpensive vs Bonds (US Gov't)

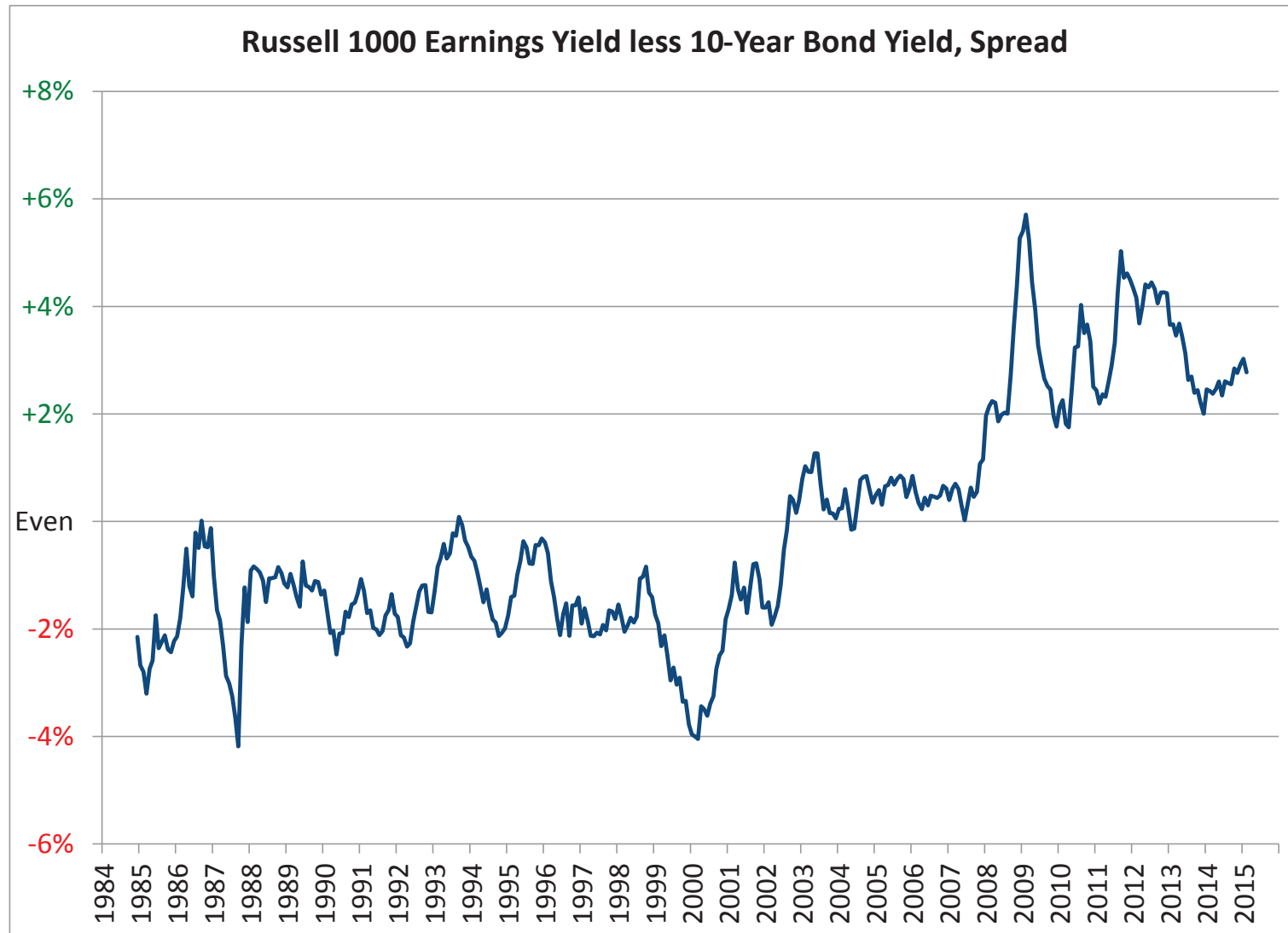
R2 earnings yield looks stellar vs. 10-year yields.



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

Large-Caps Even More Compelling on a Fed Model Basis

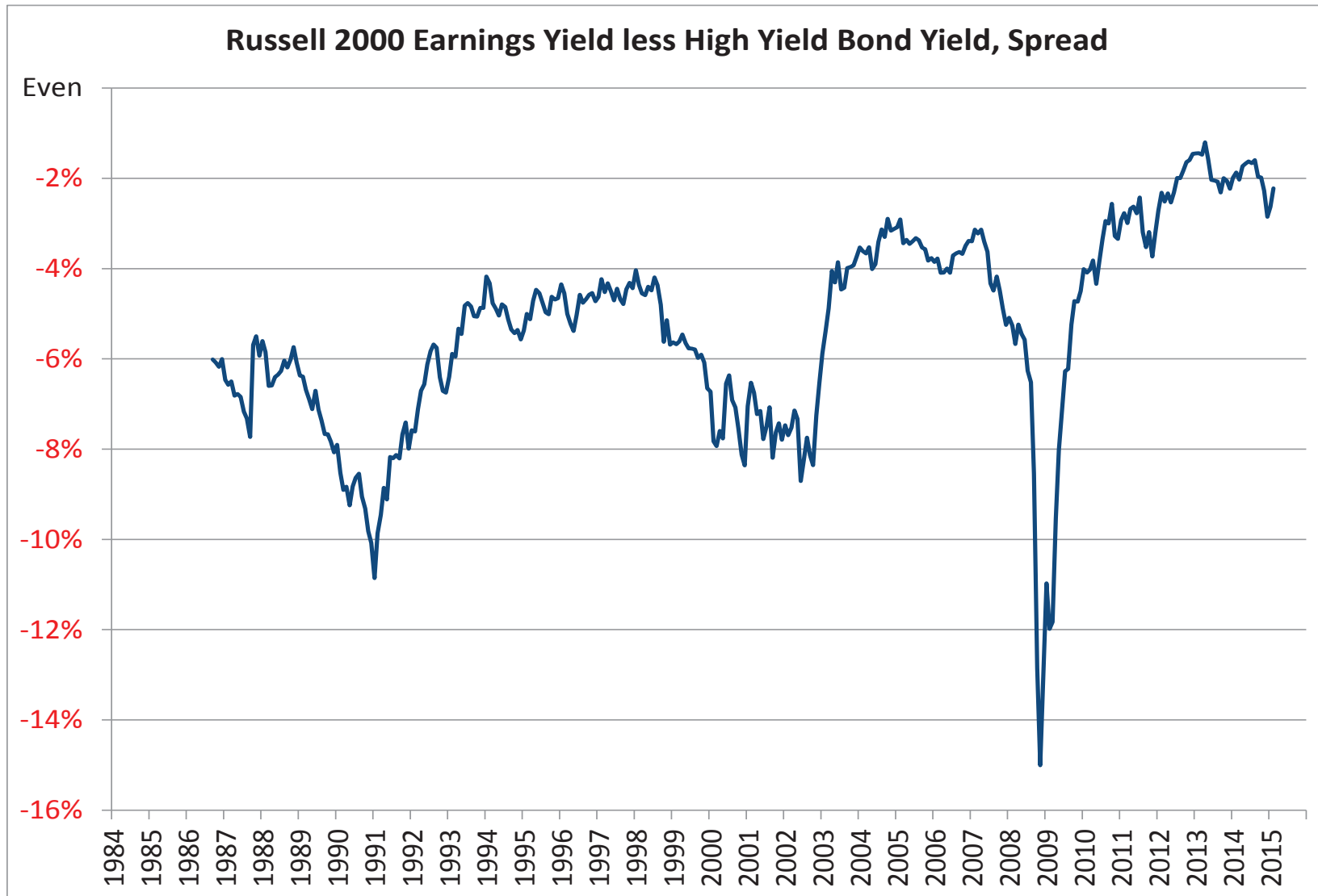
Investors are valuing stocks on mistaken normalized earnings?



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

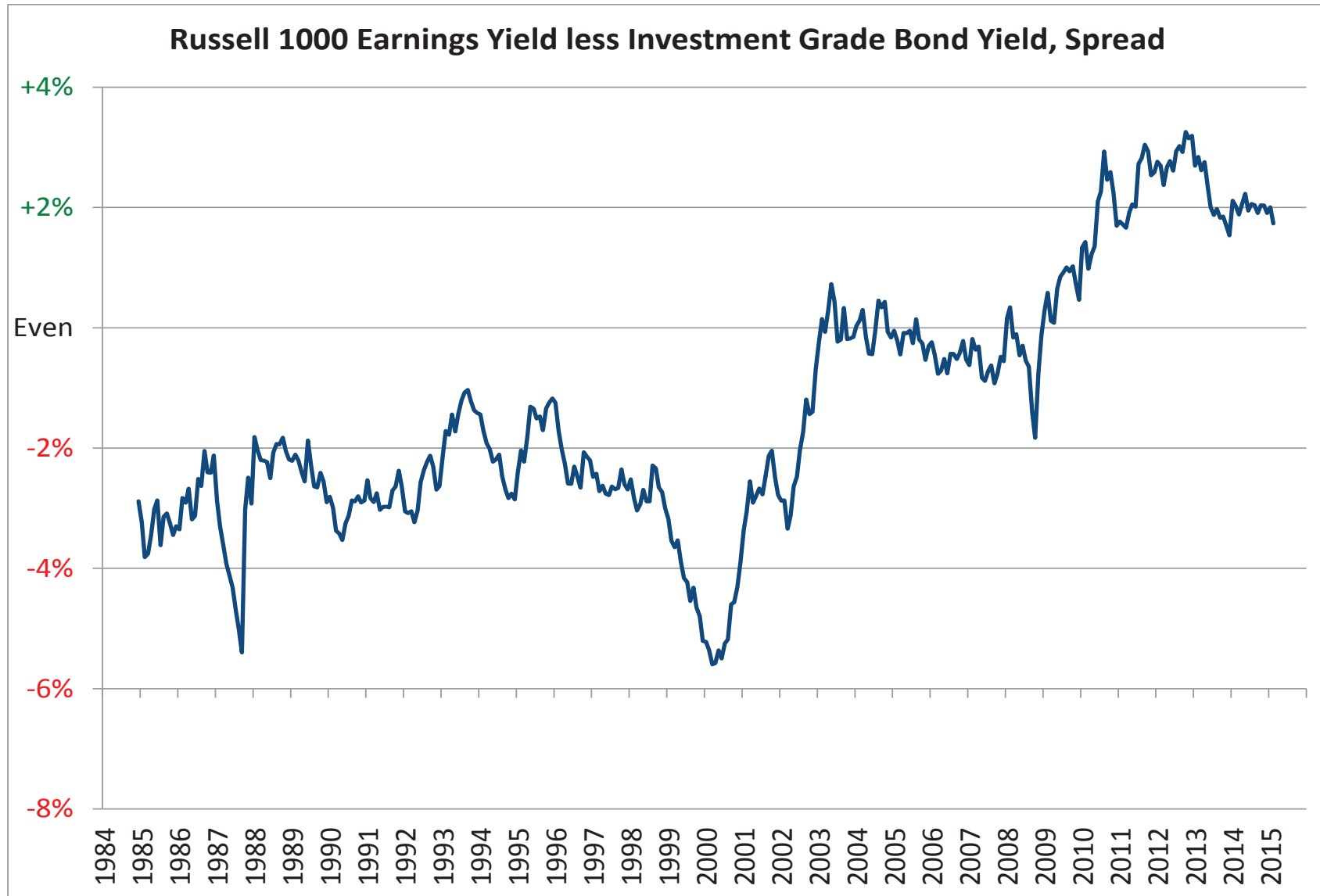
Small-Caps Remain Cheap vs High Yield

If the Fed Funds "Neutral" rate is less than 2% where should high yield trade?



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

Large-Caps Even More Compelling vs. High Yield



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

A Hiking Fed and Higher Rates are NOT Bearish

The early correction was driven by Fed rate hike fears.

R2000		
Performance for:	AVERAGE	
	Nominal	Relative
3 Mos Prior to 1st Hike	9.1%	5.1%
3 Mos After 1st Hike	-1.3%	0.3%
During Hiking Period	10.7%	0.5%
1 Mo Prior to Last Hike	3.0%	0.9%
1 Mo After Last Hike	1.2%	-0.1%
3 Mos After Last Hike	5.4%	-1.8%
6 Mos After Last Hike	10.9%	-2.0%
1 Year After Last Hike	12.9%	-3.4%

Note: Average returns exclude the 1986-1987 hiking period.

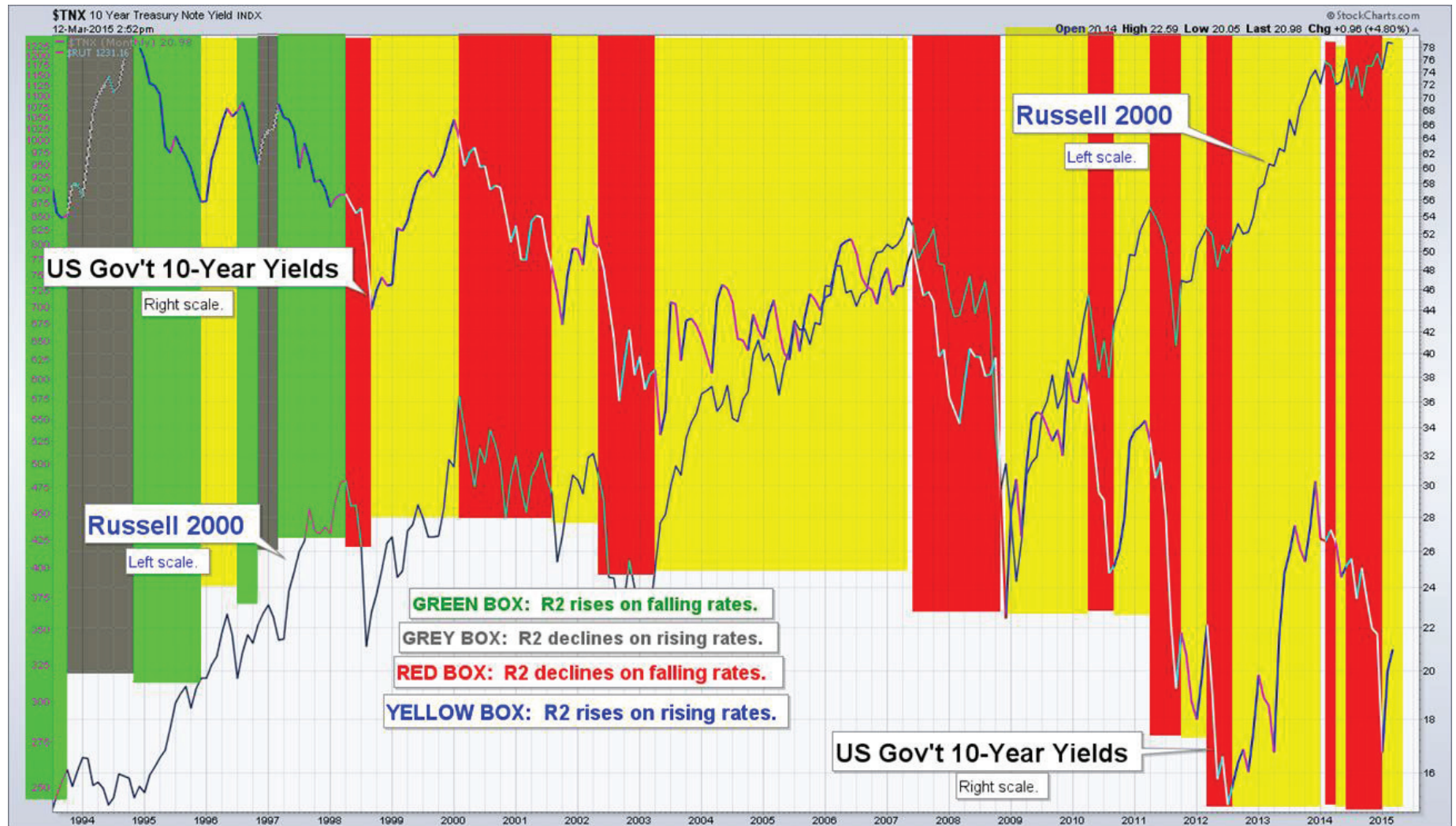
Charts are indexed to 100 as of the date of the first hike.

Relative returns are relative to the S&P 500

Source: Furey Research Partners and FactSet Research

Yields Rise, Stocks Rise. Bulls Should Root for Higher Yields

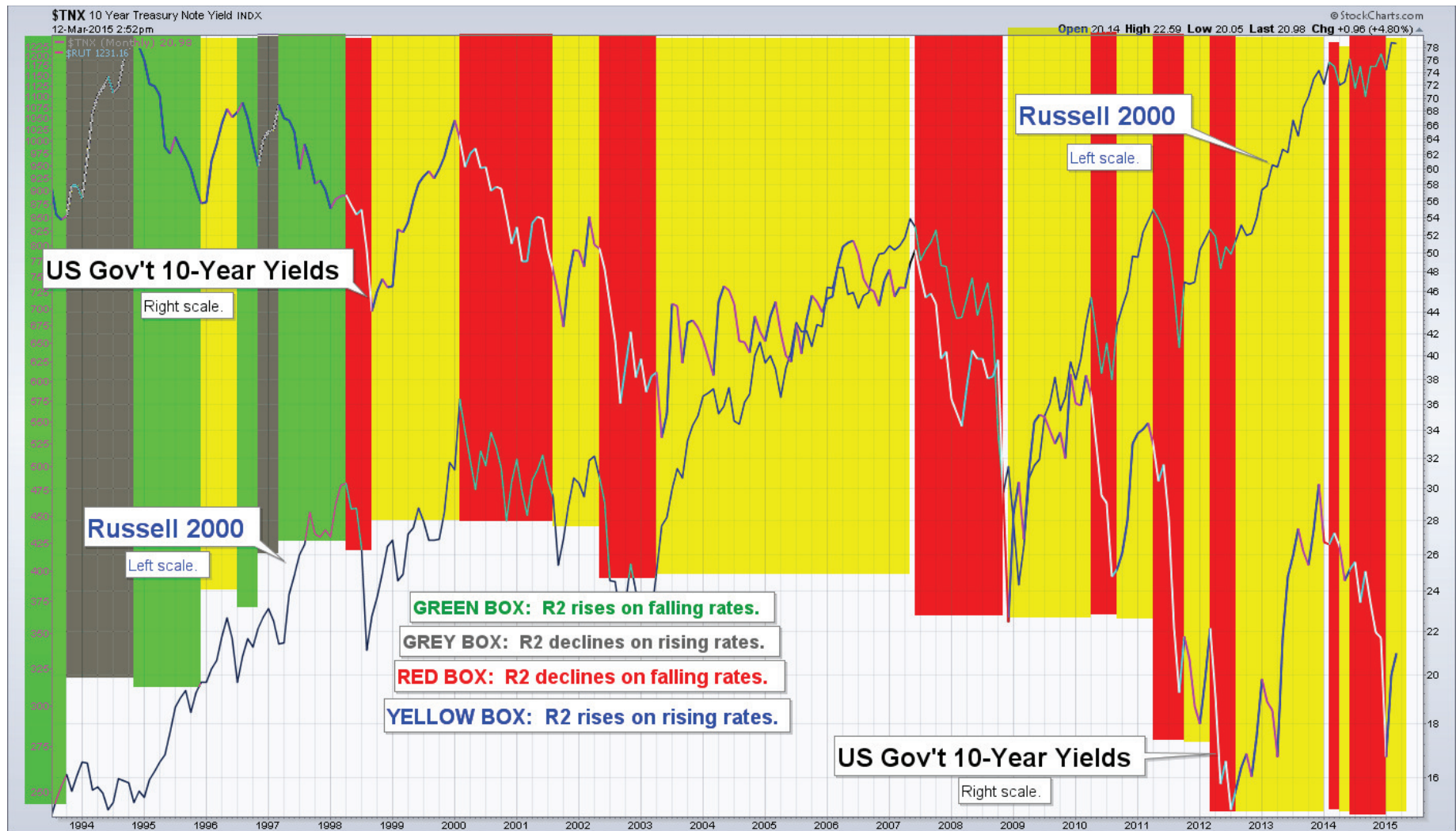
Draghi & the ECB are complicating yield's profit forecasting signal.



Source: Furey Research Partners and StockCharts.com. Data as of Mar 12th, 2015

Small-caps Outperform Large-caps when US 10-Yr Rates Rise

Since rates began rising in Oct, small-caps have outperformed large-caps.



Source: Furey Research Partners and StockCharts.com. Data as of Mar 12th, 2015

It's outside the US where risks are the greatest.

RISKS TO OUR 2015 BULLISH OUTLOOK

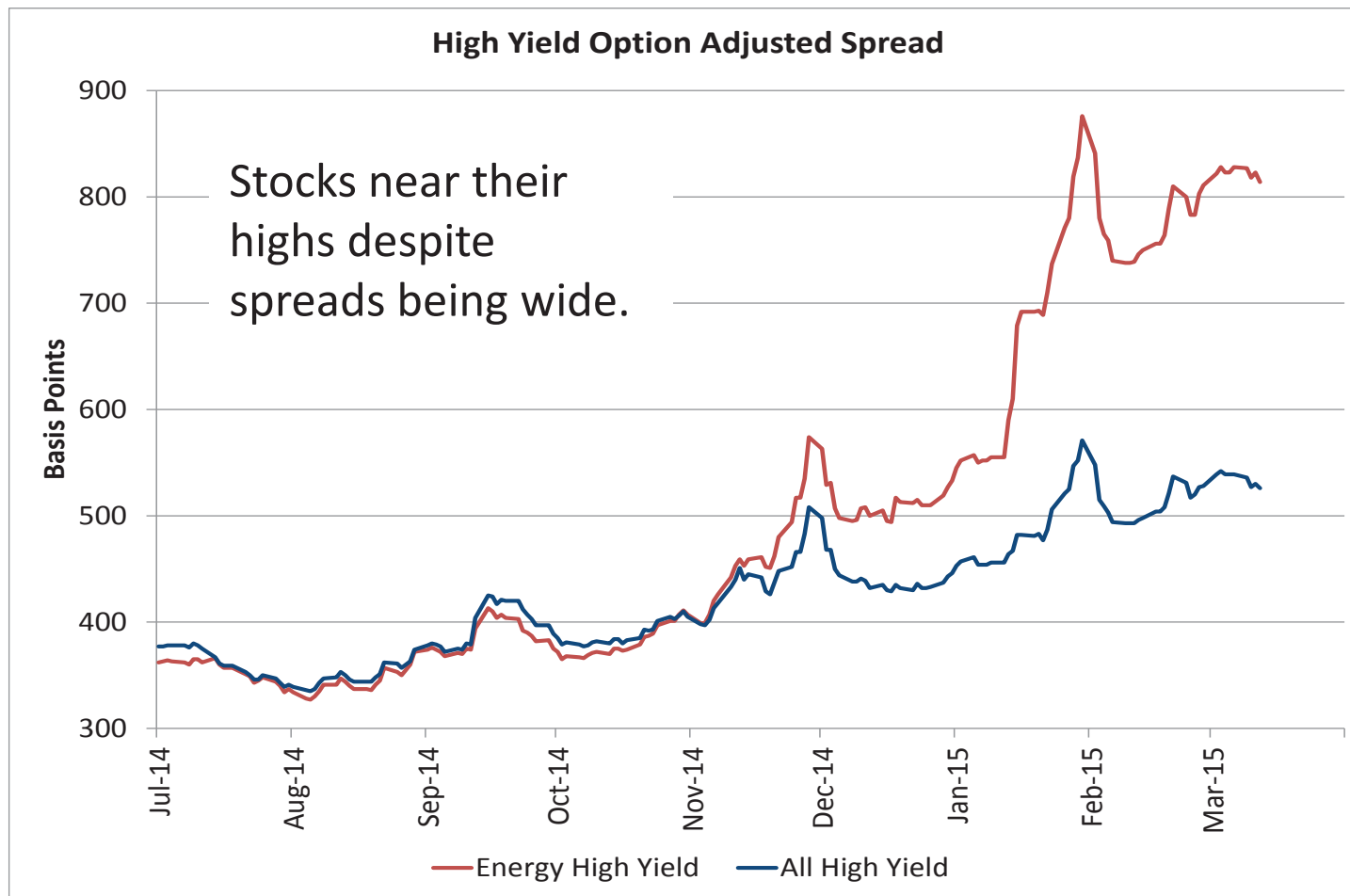
Asset Price Break Leads our List of Worries

The largest recession risk comes from a break in asset prices.

- **Super Mario & the EU** – The Euro is in free fall and the currency wars heating up.
- **Rapidly Rising Dollar** – in a world where 40 nations have dollar pegged currencies a rising dollar tightens financial conditions in those 40 nations. China is the biggest pegging nation.
- We misjudge the **Fed's future actions and they tighten too aggressively**
- **Asset prices fall** and produce fear that lead to recession
- Paradox of **Thrift**. The velocity of money is slowing particularly in Europe and Japan and is driving the need for QE in those markets
- **Deflation**
- **Crude** weakness reflects important demand weakness, not supply strength
- The **yield curve** flattens or inverts due to global growth worries and/or Fed tightening and scares investors even if US growth continues, compressing multiples
- **Market structure**. Flash disruptions. Lack of market makers
- **China's real estate** market
- **Putin** responds to economic weakness and political discontent with even more military action
- **Our Fed Model** assumptions are misplaced and stocks aren't attractive vs bonds
- **Euro breakup**, which no one will anticipate

Spiking High Yield Spreads Reflect Fear

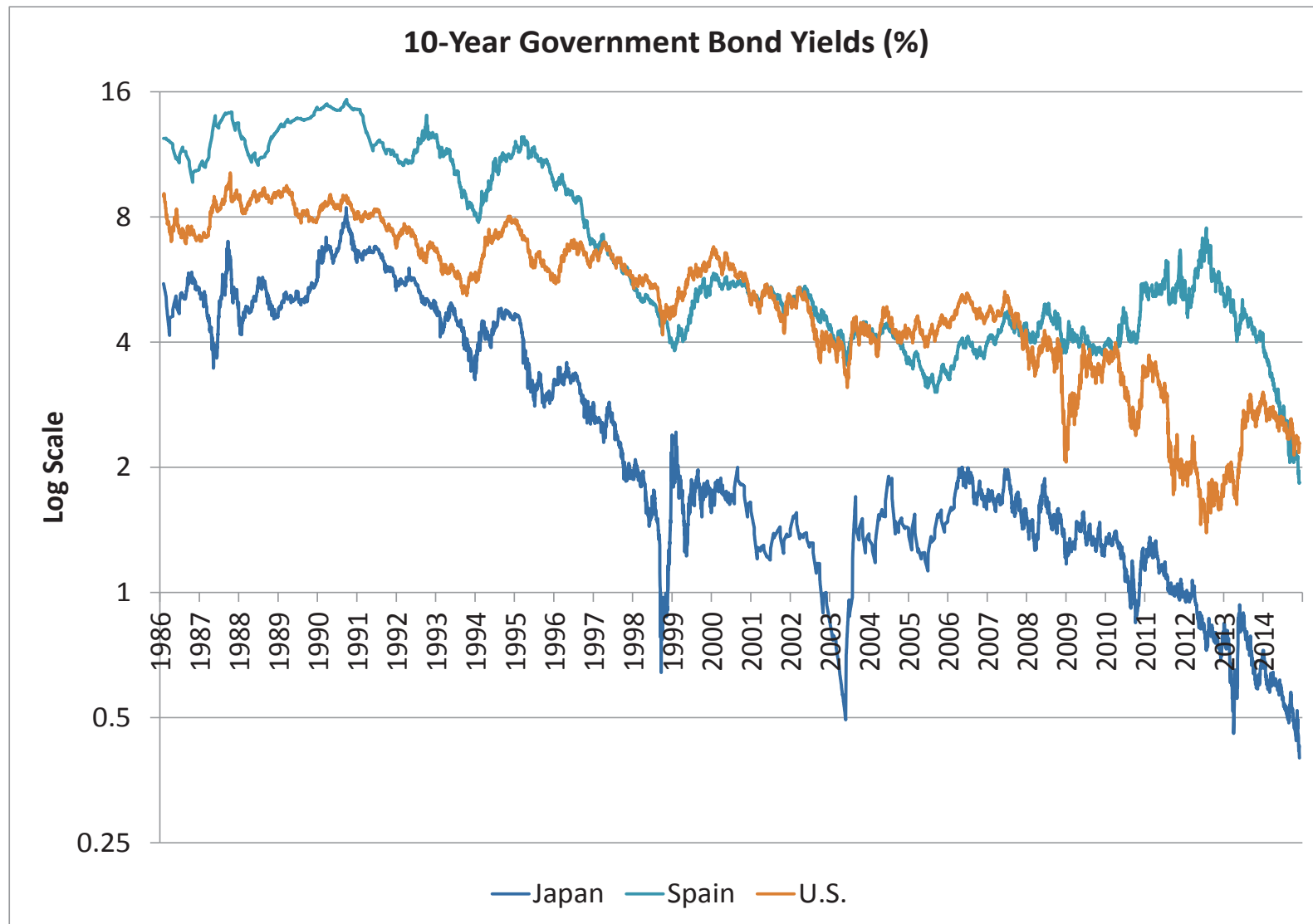
Should growth remain strong, spreads might compress & stocks rise. Energy is much worse than the average and influencing the overall level.



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

Where Can Investors Make Money if Armageddon Doesn't Come

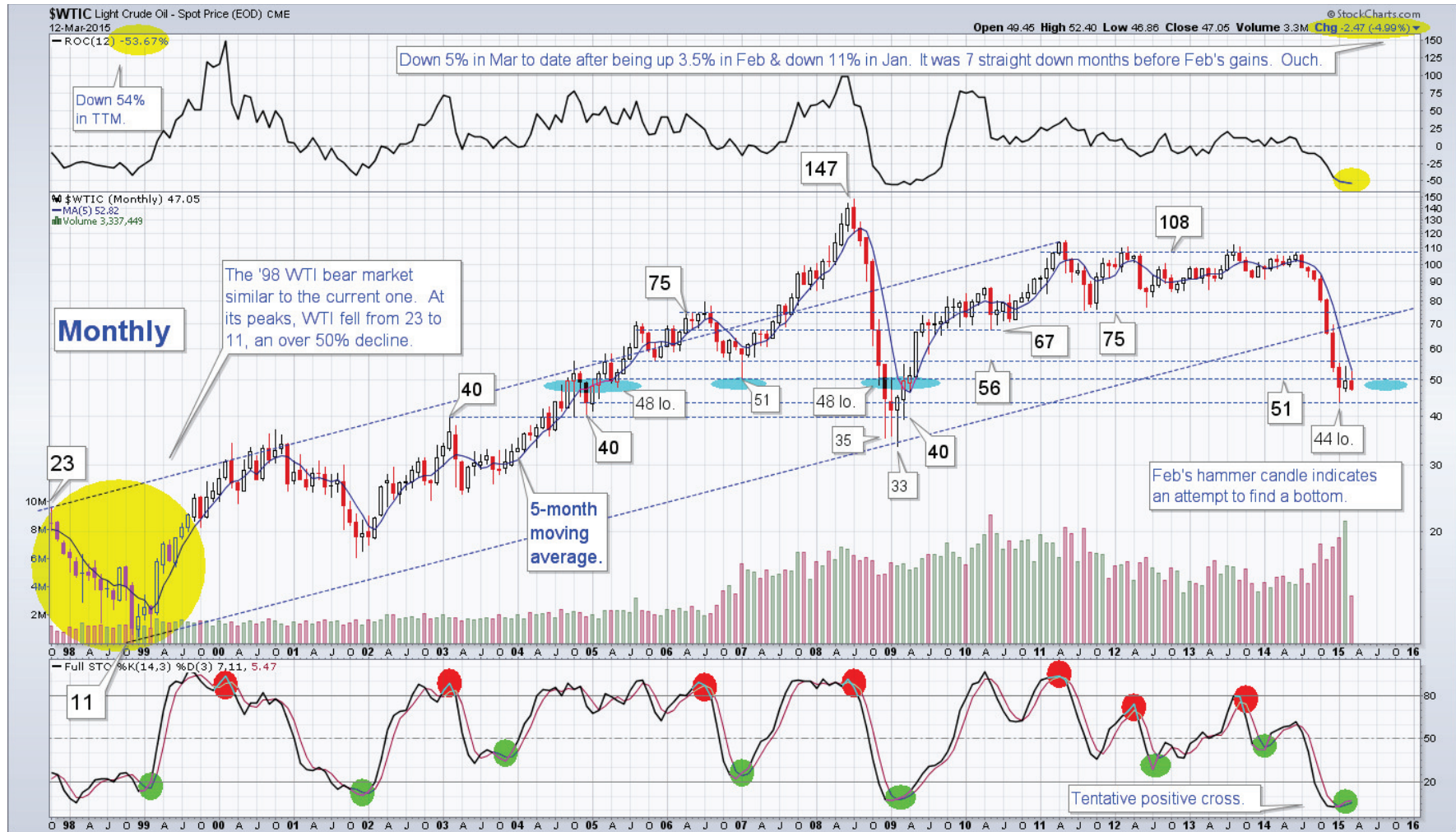
Draghi's skewering the market. The dollar is very attractive.



Source: Furey Research Partners and StockCharts.com. Data as of Mar 8th, 2015

Falling Crude Not a Risk, A Significant US Stimulus

The strong dollar cheapening oil for US buyers. Will it also keep the Fed on Hold?



Source: Furey Research Partners and StockCharts.com. Data as of March 12th, 2015

Markets have embraced public venture capital.

THE CHALLENGES PRESENTED BY PUBLIC VENTURE CAPITAL

Public Venture Capital is Thriving in Healthcare & Tech

It's not just ultra-low rates. Public VC began with Netscape. Driven by innovation.

Ex-Tech/Telecom, the R2000's weight in loss-making companies is at a non-recession high...

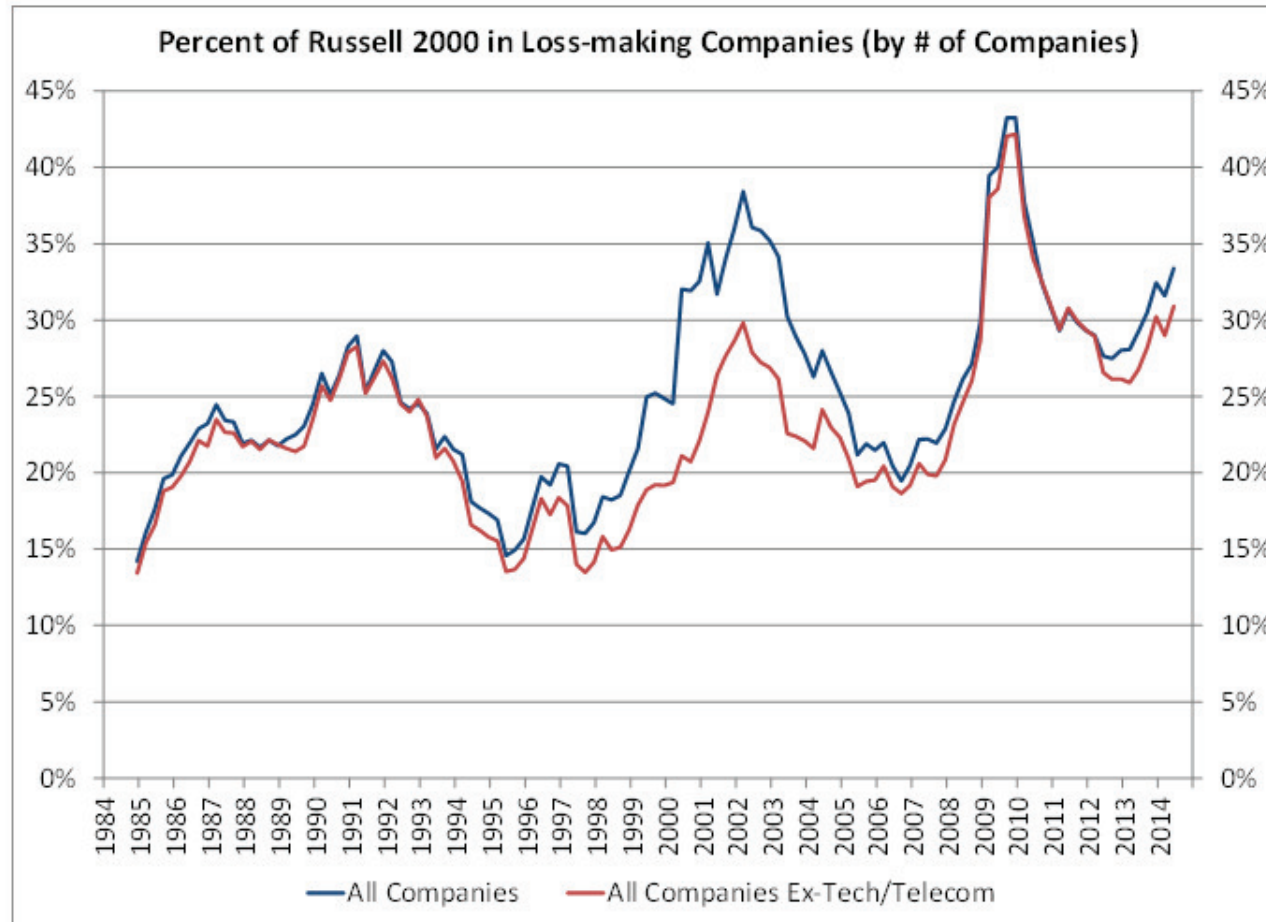


Source: FRP and FactSet

A Bear Sees Speculation. A Bull Sees Innovation

It's true money losers are a higher percentage of firms than at any non-recession time.

...as is the R2000's composition based on number of companies.

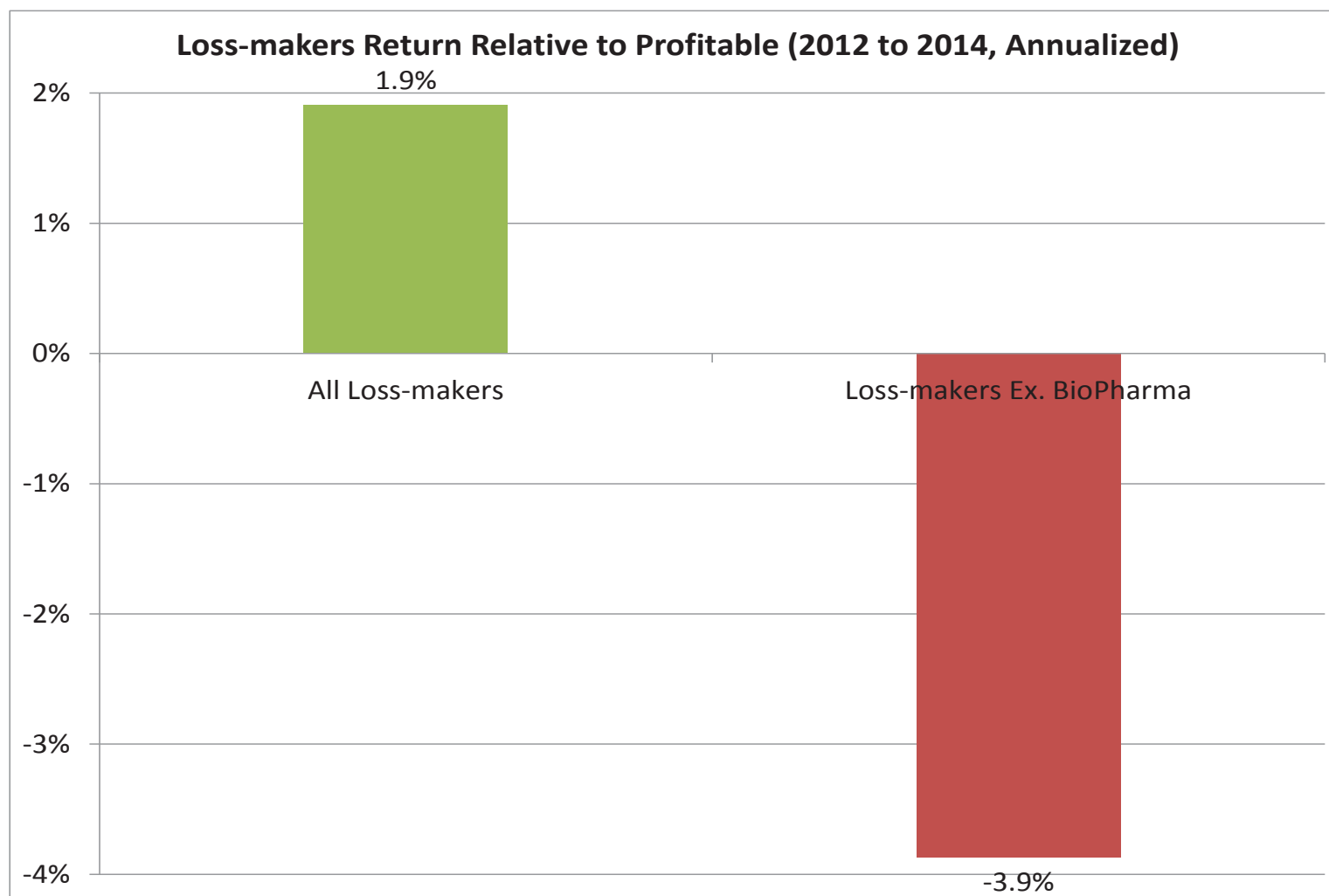


Source: FRP and FactSet

Data as of Sept. 30th 2014

BioPharma are Driving Loss-Makers Strong Performance

Public VC Tech companies are rarely profitable.



Source: Furey Research Partners and FactSet Research. Data as of Dec 31st, 2014

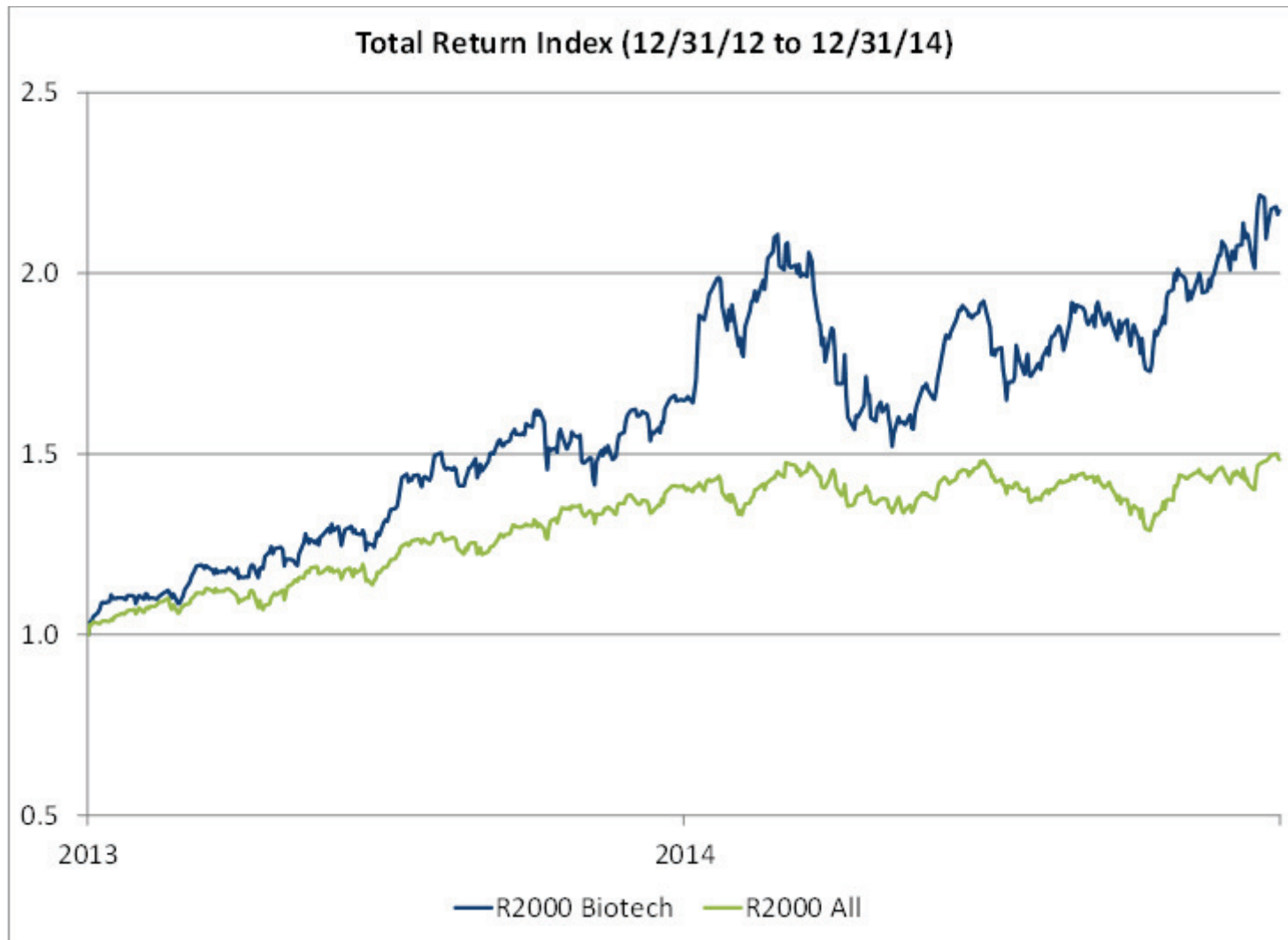
Biotechnology – The Struggle to Value Binary Outcomes

If you only own profitable firms it restricts you & ignores public VC.



Biotech - 11% of the Small-Cap Growth Investor's Benchmark

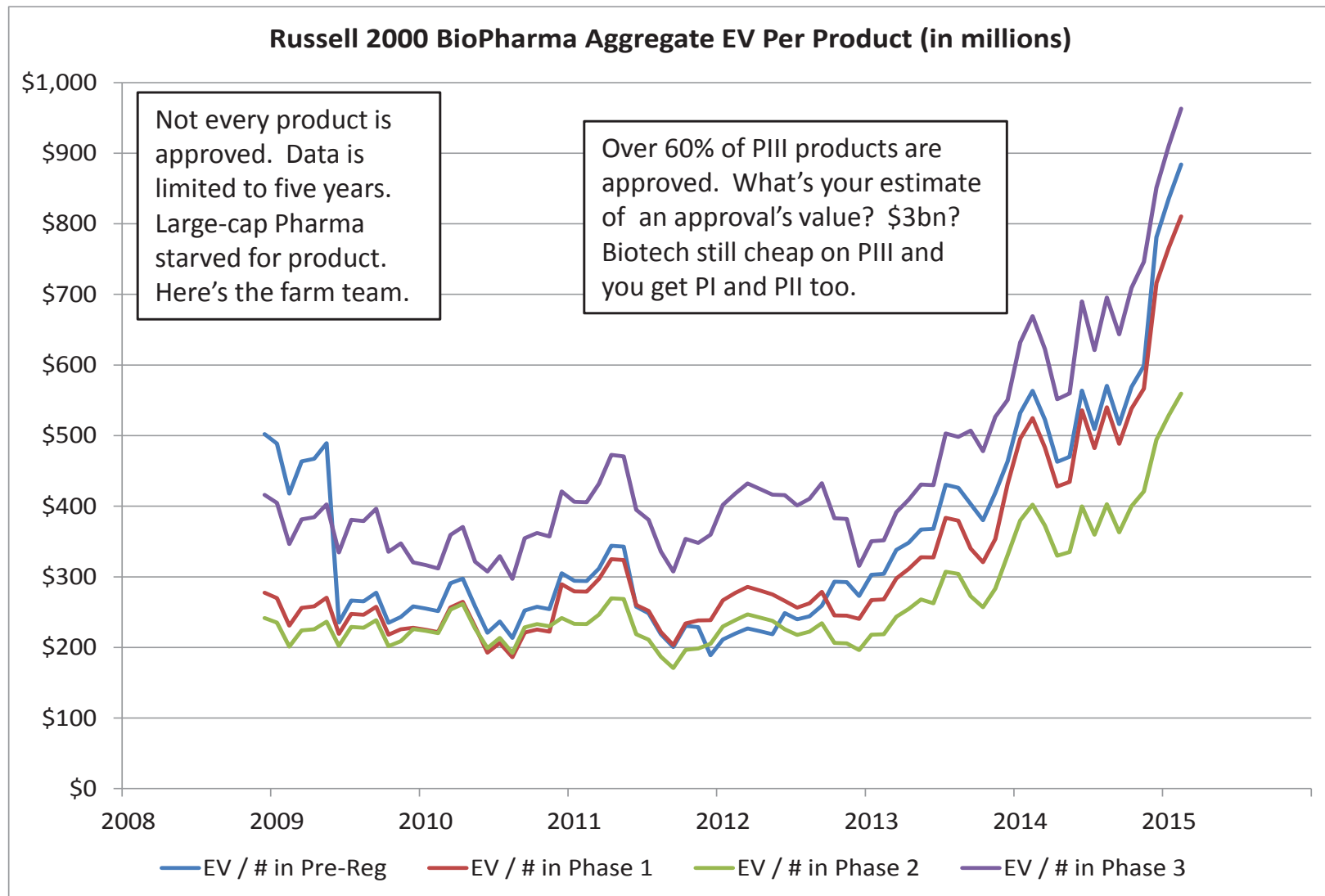
Biotechnology is up over 220% in two years versus a market up 150%.



Source: Furey Research Partners and FactSet. Data as of Dec 31st, 2014

FDA Approvals Easier - Probabilities & New Drug Value

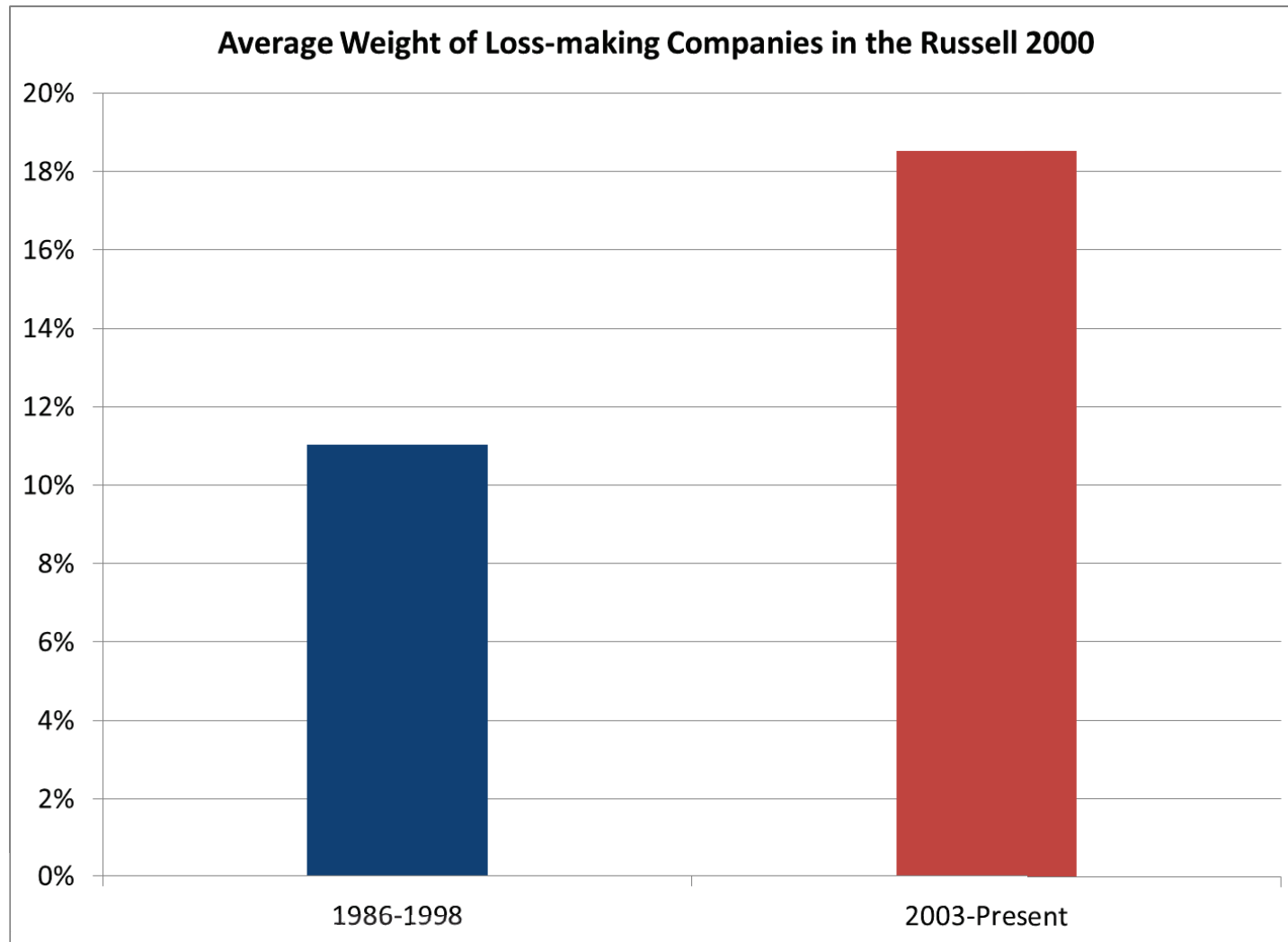
'90s "hope", '00s "science", & '14 "cures" as the science improves.



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

Loss Making Companies are Over 18% of the R2000

Not only are loss makers not the “easy beat”, they’re more important.



Relative performance – relative earnings growth and valuation are keys.

SMALL-CAPS VS. LARGE-CAPS

Small-Caps Have Started to Outperform Large-Caps

The Oct '14 market bottom was small-caps' relative bottom too & correlated with small-caps' forward earnings strength improving due to the dollar

Since '12 →



Since '95 →



Other than being long the dollar, there was no more popular trade in '14 than to be long large-caps and short small-caps. That is now reversing.

Source: Furey Research Partners and StockCharts.com. Data as of Mar 12th, 2105

A Rising Dollar Favors Small-caps

Small-caps have lower foreign exposure. A strong dollar means US earnings are running higher than foreign ones. A strong dollar also hurts foreign earnings translation.

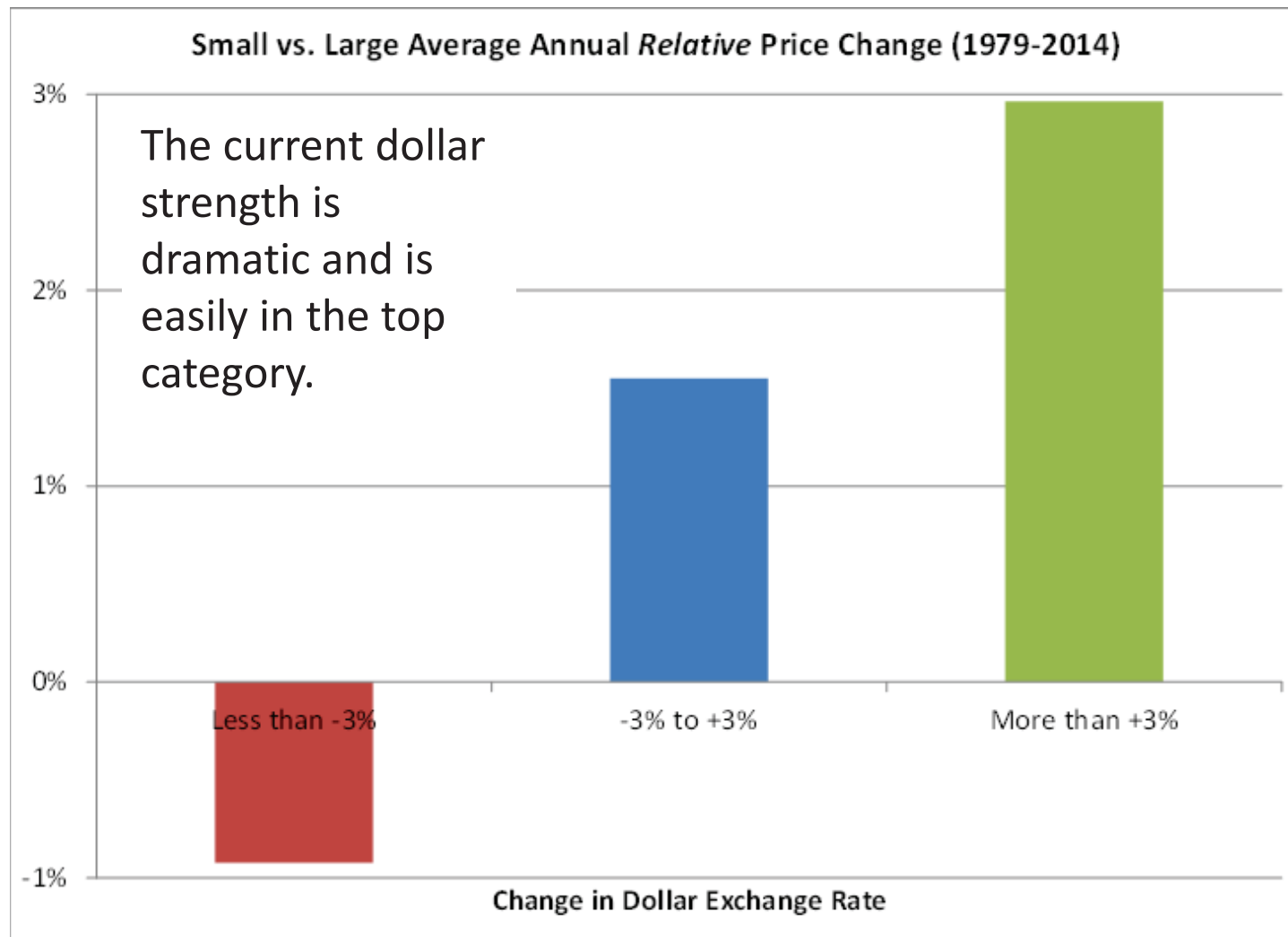
Average Annual Relative Return (Small less Large), 1974-2014

		GDP Growth		
		< 3%	> 3%	All
Dollar Change	Falling	-1.4%	-1.3%	-1.4%
	Rising	8.3%	2.6%	5.4%
	All	3.7%	0.8%	2.3%

Source: Furey Research Partners and FactSet. Data through Dec 31st, 2014

The Stronger the Dollar, the Stronger Smalls' Relative Perf.

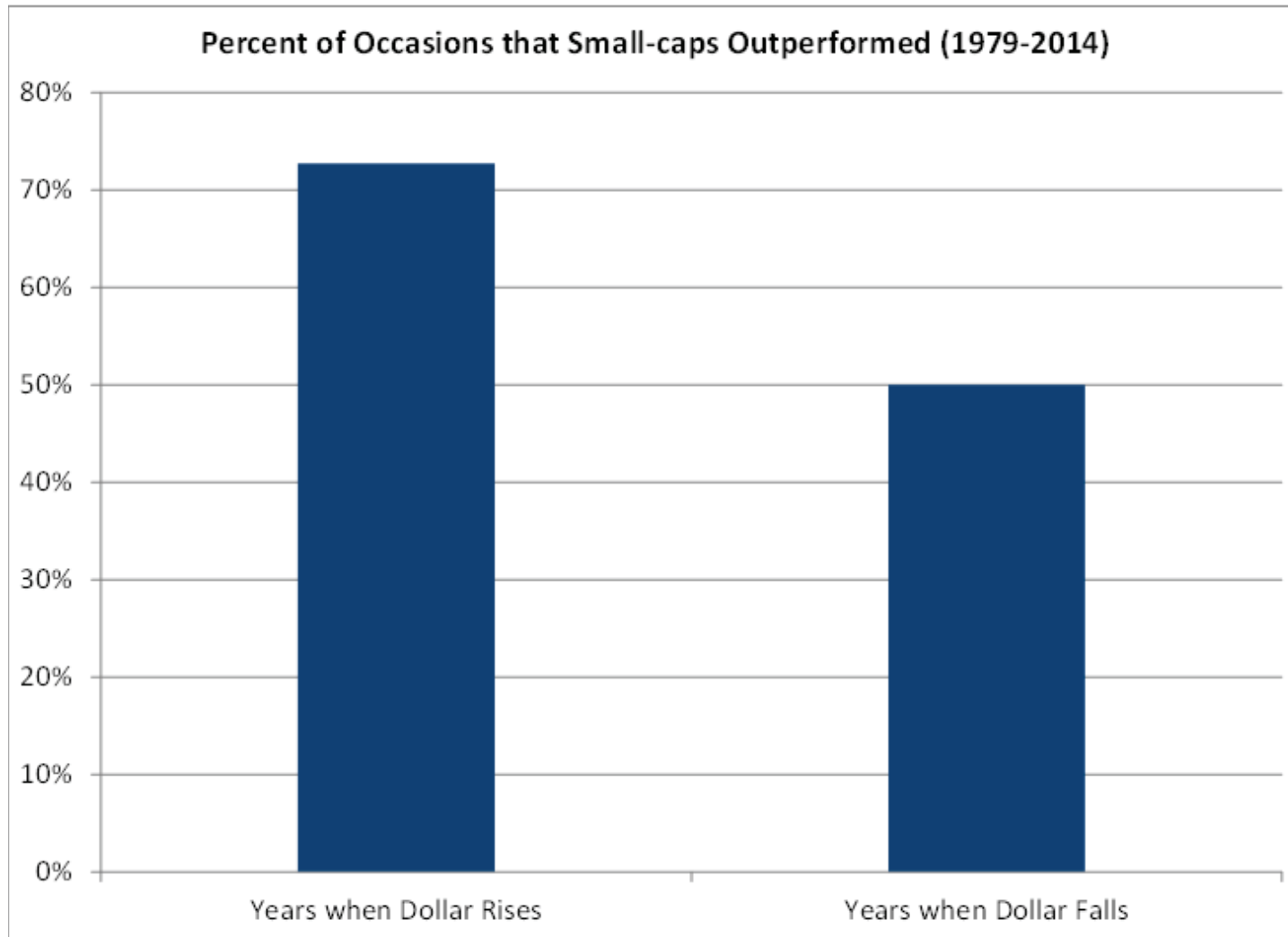
It makes intuitive sense that small-caps have stronger relative earnings strength.



Source: Furey Research Partners and FactSet. Data through Dec 31st, 2014

A Rising Dollar Favors Small-caps

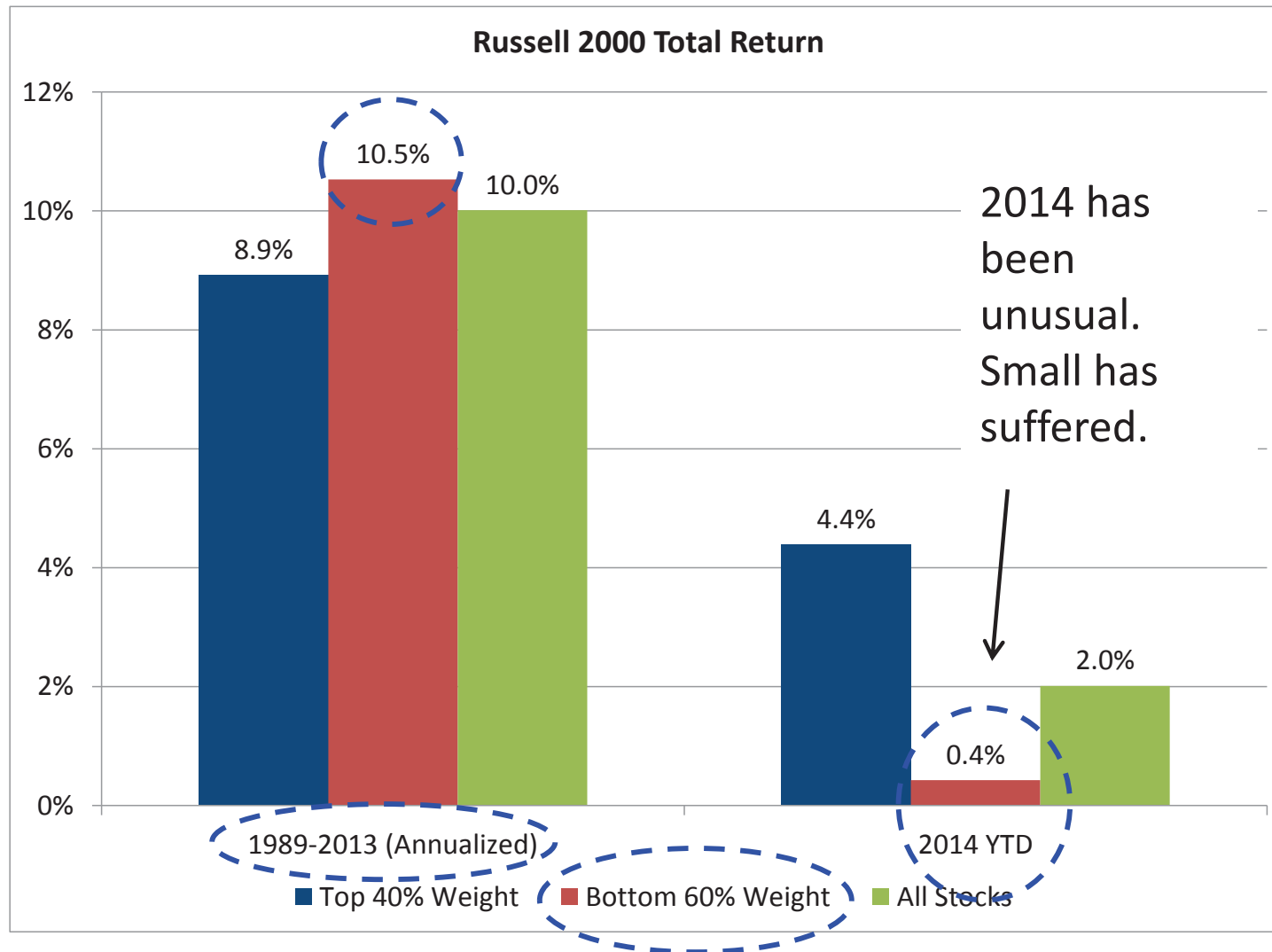
Small-caps outperform over 70% of the years when the dollar rises.



Source: Furey Research Partners and FactSet. Data through Dec 31st, 2014

Could the Smallest Small-Caps Surge in 2015?

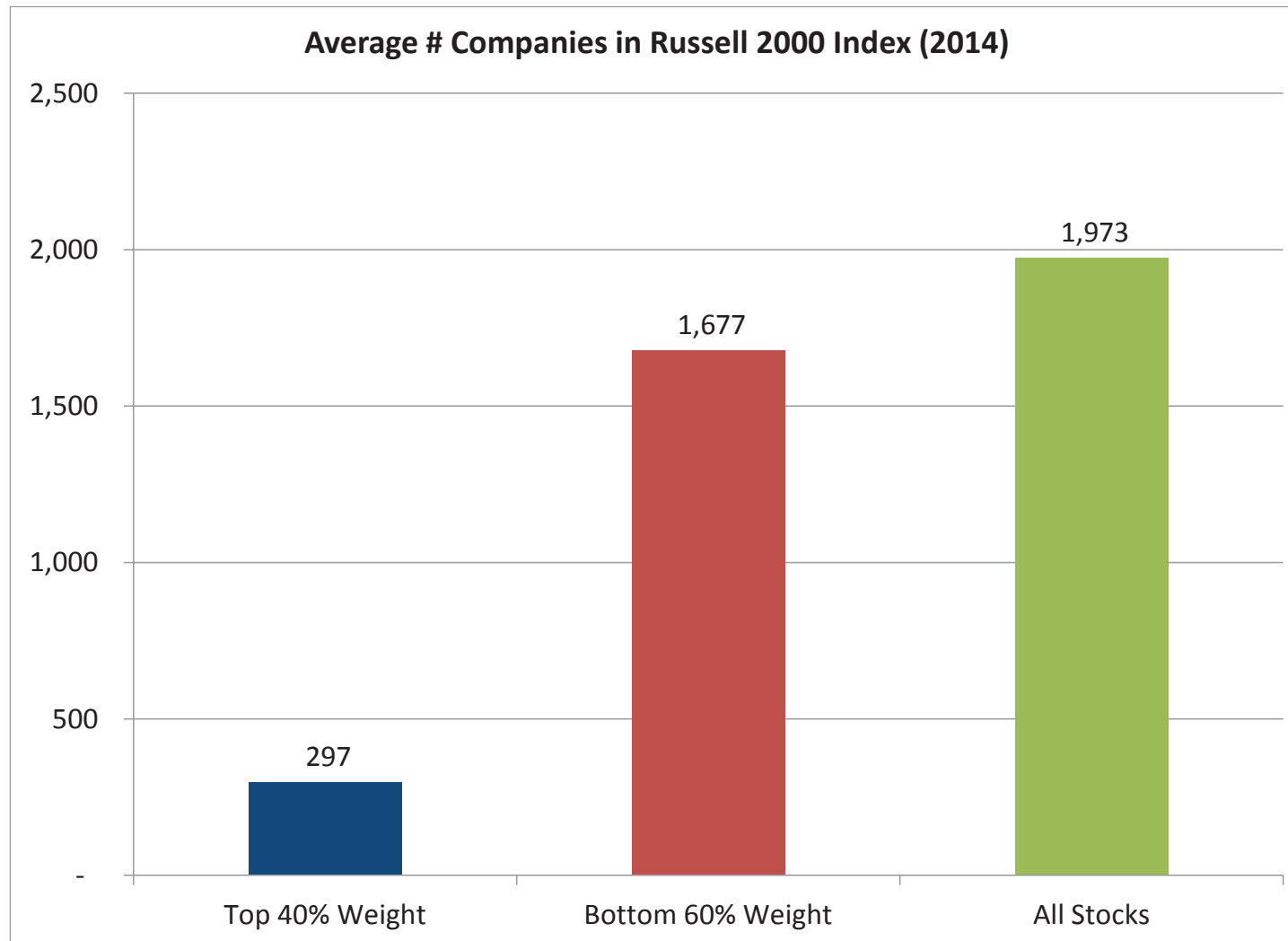
2014's best performers have been the largest small-caps.



Source: Furey Research Partners and FactSet. Data through Dec 9th 2014

297 Firms in the R2000 Drove 2014 Performance?

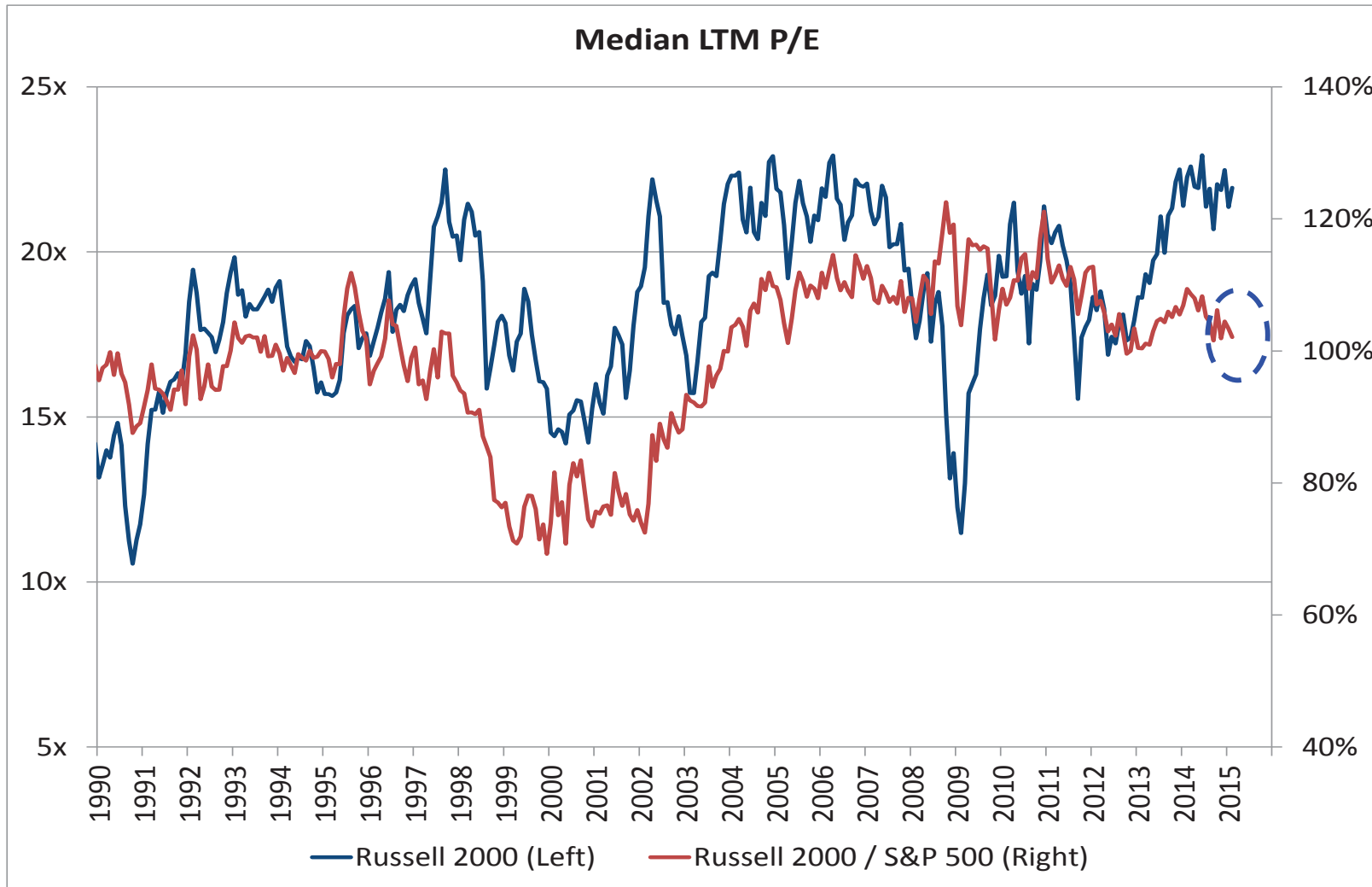
Relative performance is difficult when few companies lead.



Source: Furey Research Partners and FactSet.

Small-Caps Relative Valuation Compressing Setting the Stage

Strong relative large-cap returns are making small increasingly attractive.

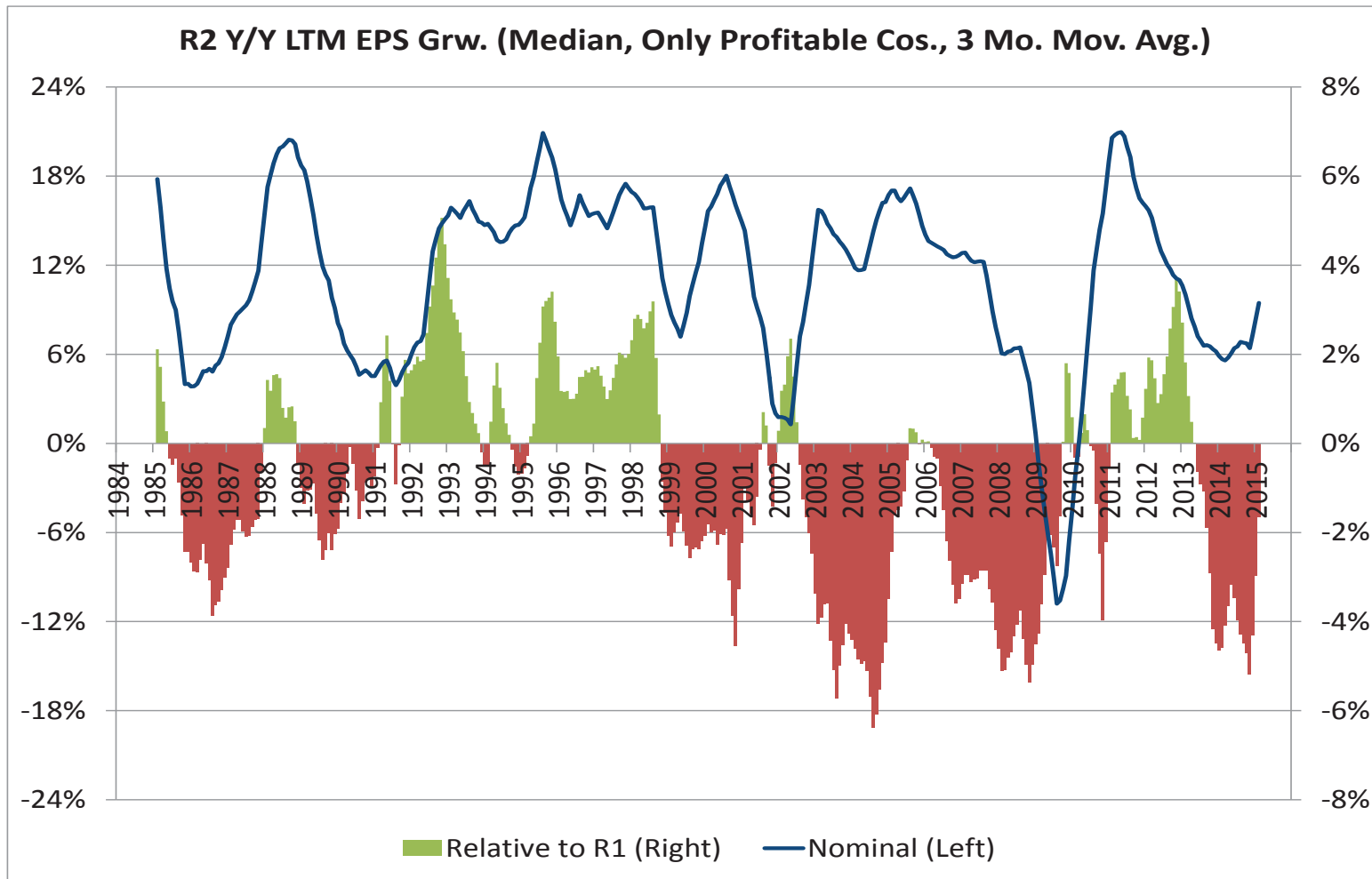


Relative valuation is back to the lowest levels since '05 ex-early '13.

Source: Furey Research Partners and FactSet. Data through Feb 28th, 2015

But... Poor Relative Earnings Were Hurting Small-Caps

The rising dollar and an improving US economy can change this and produce positive small-cap relative earnings re-acceleration?



Source: Furey Research Partners and FactSet. Data as of Feb 28th, 2015

As always, small-cap forward margin assumptions are too high. But more important revenue estimates are modest and could be exceeded if the Fed remains “patient” and on hold due to weakness overseas, a strong dollar and stimulative energy prices

EARNINGS AND REVENUES

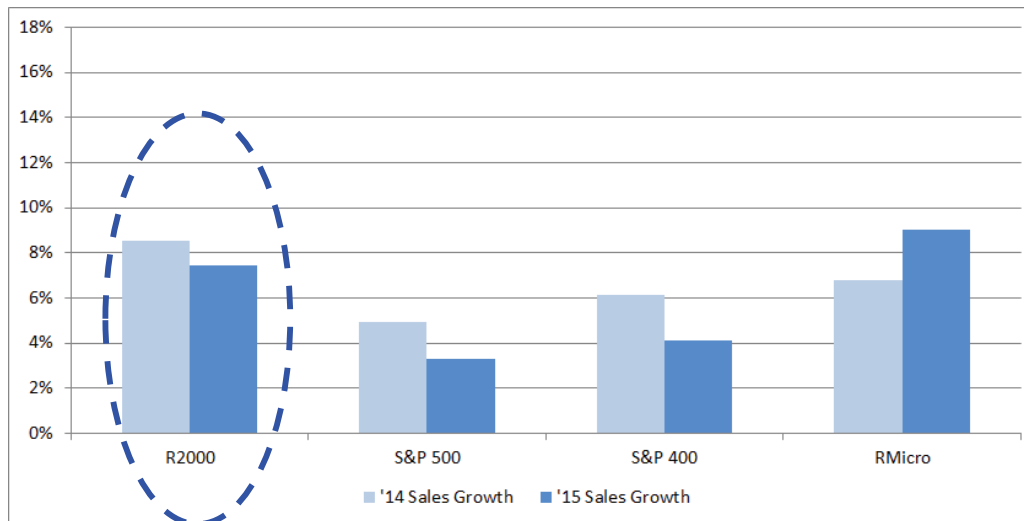
Small-Caps the Only Index Forecast to See Higher '15 Earnings

The more reliable revenue forecast also calls for a substantial small-cap advantage.



The R2000 currently expects 13.2% '15 earnings growth followed by 7.8% for the S&P 400 and 6.6% for the S&P 500.

The Russell Microcap notable earnings acceleration in '15 though these numbers are often overly optimistic at this point in the year.



Decelerating sales growth is the current expectation trend for all but micro-caps.

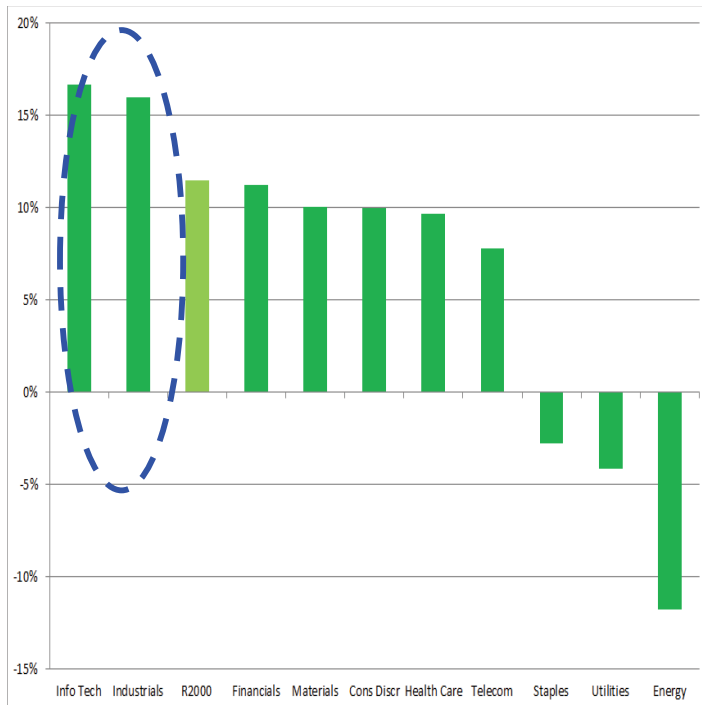
R2000 '15 sales growth is expected to decelerate by -13% in '15 versus -33% for the S&P 500 and S&P 400 indexes.

Source: Furey Research Partners and FactSet. Data through Mar 4th, 2015

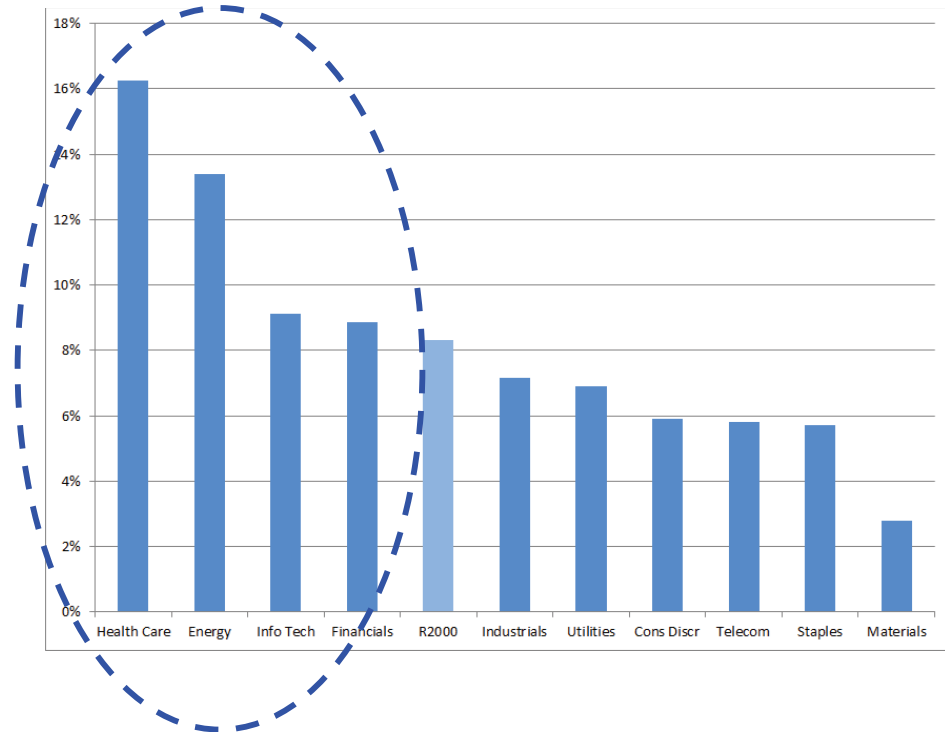
Small-Cap Relative (to R2) is concentrated in Tech & Industrials

The more reliable revenue forecast also calls for a substantial small-cap advantage.

R2000 4Q14 Earnings Growth



R2000 4Q14 Sales Growth

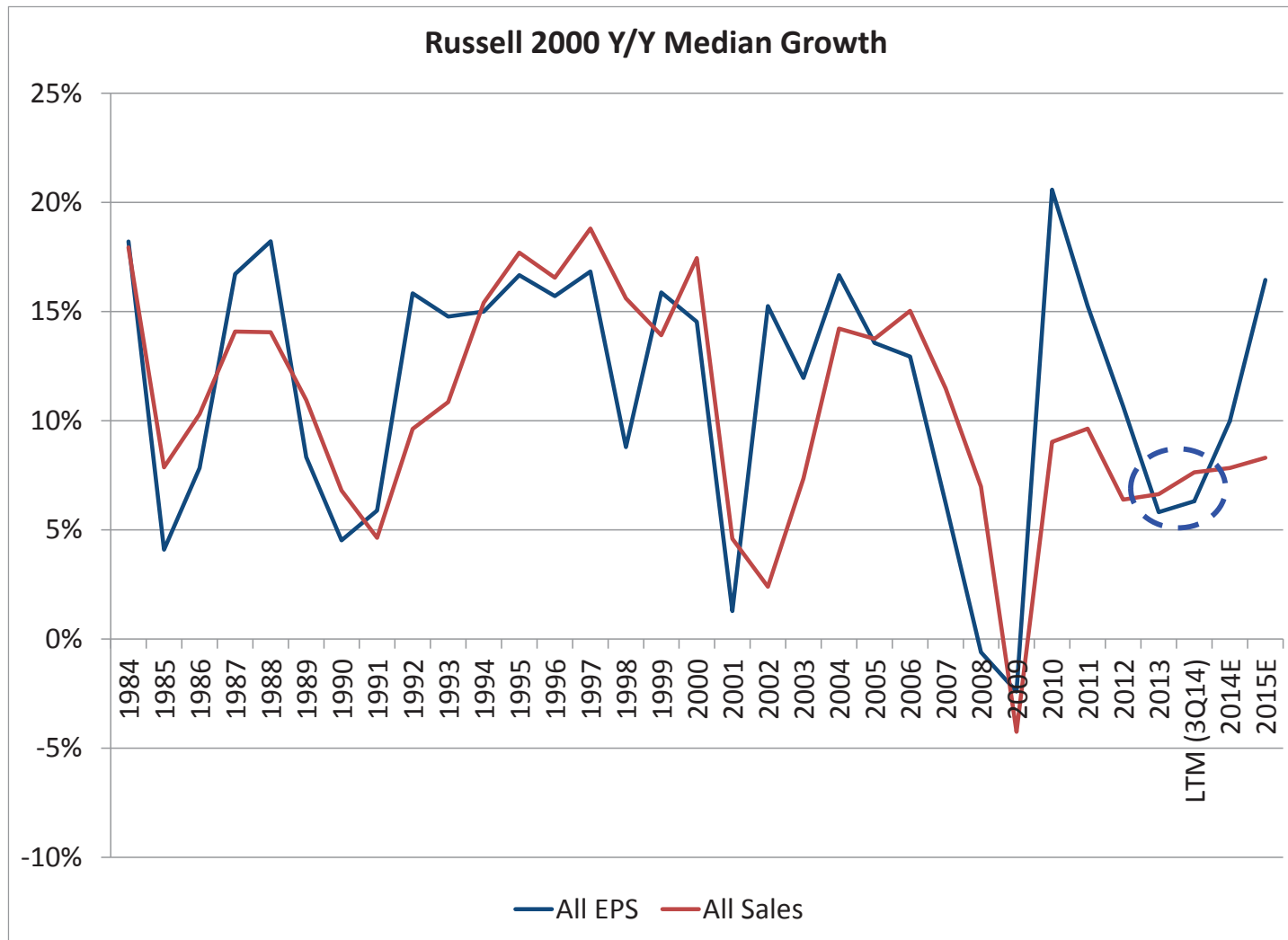


Only two sectors posted above R2000 earnings growth. Energy is still posting high revenue growth.

Source: Furey Research Partners and FactSet. Data through Mar 4th, 2015

2015 Revenue Expectations are Realistic

The dollar's rise & its impact on US growth will determine if estimates can beat expectations.



'14 negative operating leverage could reverse in '15.

Source: Furey Research Partners and FactSet. Data through Dec 11th 2014

A return to normal growth and financial conditions will spell equity market risk and danger.

**WHAT THE END OF THIS BULL MARKET
LOOK LIKE. NOT THERE YET**

It's Risky if the Fed, Policy Makers & Citizens Feel Comfortable
Normalcy will bring policy changes to the current bullish brew.



What the Bull Market End will Look Like

Five years into a bull market some present today. Majority not here.

- The R2000 and S&P 500 will be expensive versus bonds on a Fed Model basis using for High Yield. The Fed Model compares an equity index's earnings yield to a fixed income yield
- The PE Rule of 20 (PE minus inflation equals the justified P/E) will be sending a dramatic warning signal
- Breadth will have deteriorated and performance will have been driven by fewer and fewer stocks
- Small-caps will be lagging large-caps
- Small-caps will not be making new all-time highs in the recent past
- High yield bonds prices will be rolling over
- Retail investors will be enthusiastically embracing stocks, and small-caps in particular
- There is a significant sustained rise in the number of IPOs and a deterioration in their quality
- The US economy will be growing in excess of 3.5% and justifying the Fed to begin to tighten

What the Bull Market End will Look Like

Six years into a bull market that is not ready to end just yet.

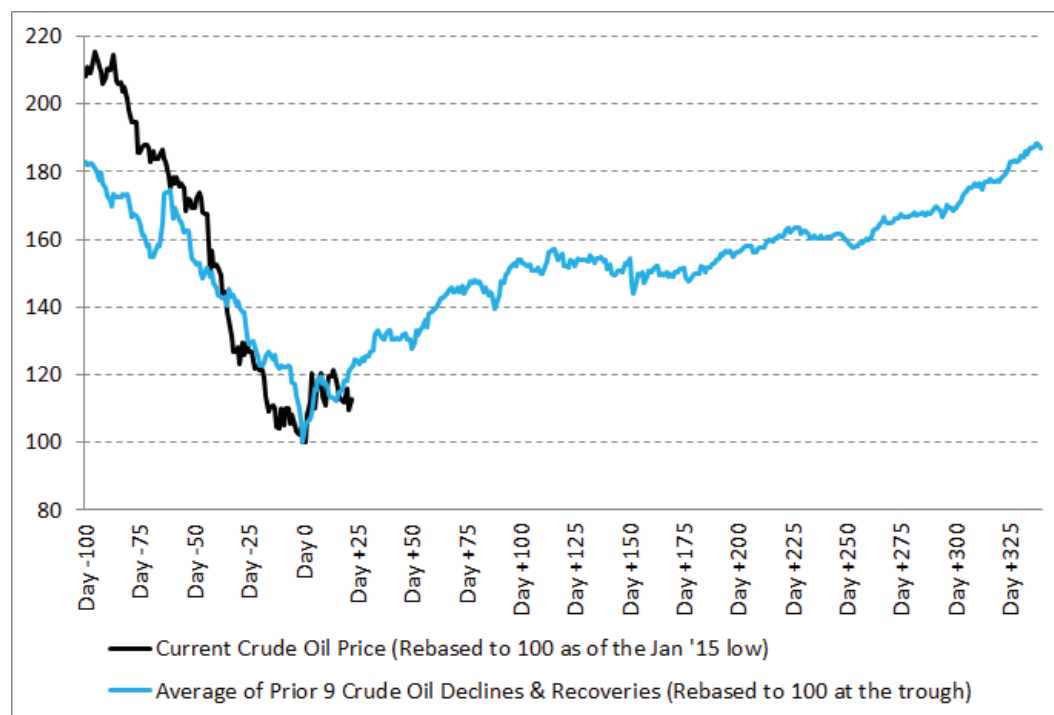
- The Fed and central bankers globally will be transitioning Financial Conditions from highly accommodative to neutral to restrictive,
- Inflation will be running above 3%,
- Accretive M&A and financial engineering would accompany speculative corporate activity, including spin-offs
- There will be many start up equity money management firms that can raise money easily
- The Russell 2000 will have reached our 1388 price target, the measuring implications of the massive inverted bullish head and shoulders that began in 2007 and likely have exceeded it
- The popular press will be glamorizing stocks, portfolio managers, and the fortunes earned

Sector, industry and stock accumulation and distribution.

WHERE'S THE ACTION?

Energy is Not Yet Under Accumulation

Crude bear markets.



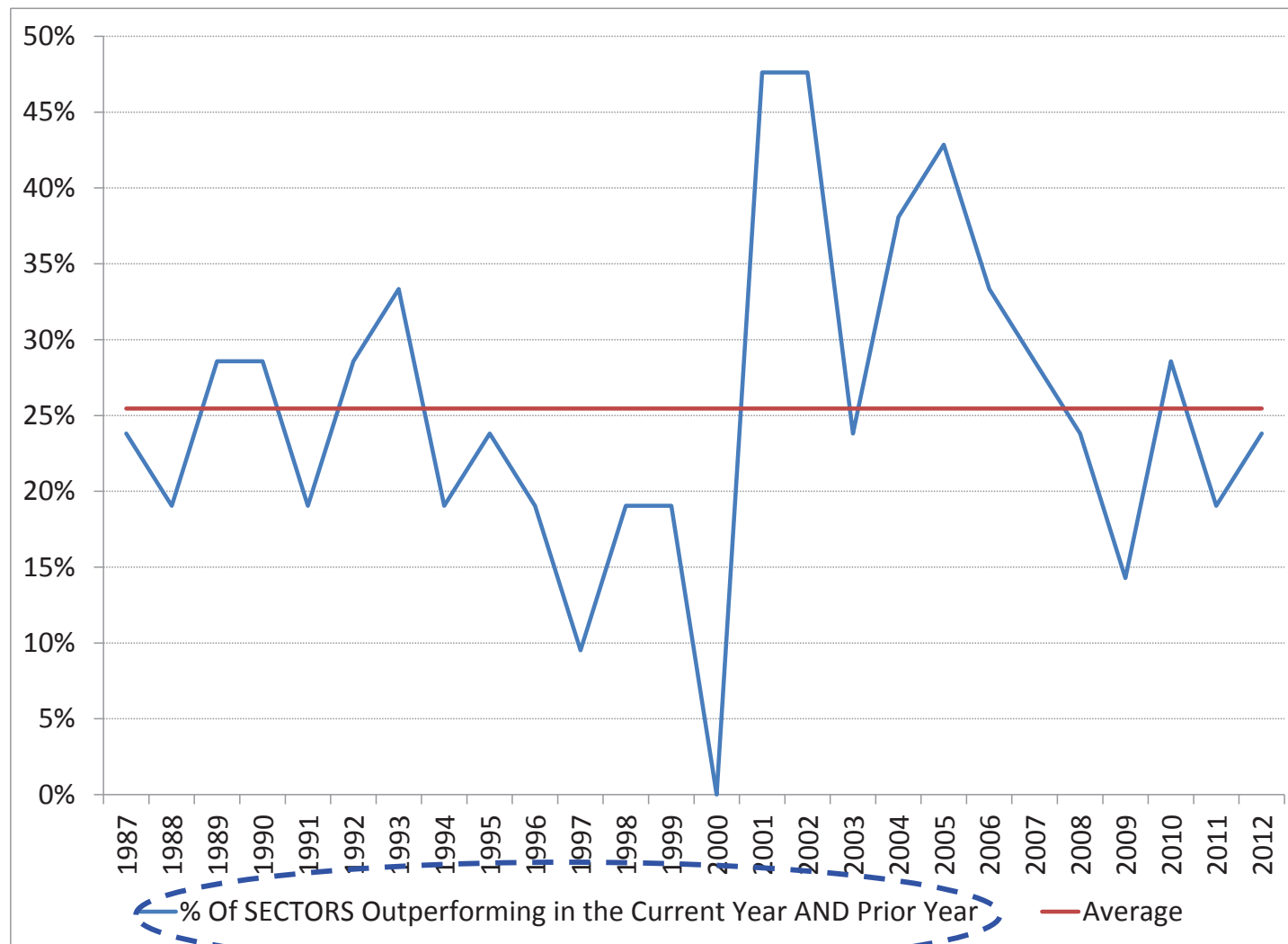
Source: Furey Research Partners and FactSet. Declines and recoveries must exceed +/-35% in order to qualify.

Source: Furey Research Partners and FactSet. Data through Mar 3rd, 2015

Crude Oil	Date	% Chg	Duration - Days	
			P to T	T to P
1 Trough	3/31/86	-60.8%	84	--
Peak	5/26/86	68.3%	--	56
2 Trough	7/9/86	-38.6%	44	--
Peak	7/17/87	108.4%	--	373
3 Trough	10/5/88	-43.7%	446	--
Peak	4/20/89	95.6%	--	197
4 Trough	6/20/90	-37.9%	426	--
Peak	10/11/90	164.1%	--	113
5 Trough	2/22/91	-55.8%	134	--
Peak	10/18/91	35.3%	--	238
6 Trough	2/16/94	-42.4%	852	--
Peak	1/8/97	91.4%	--	1,057
7 Trough	6/16/98	-56.4%	524	--
Peak	9/21/00	219.0%	--	828
8 Trough	11/15/01	-52.8%	420	--
Peak	7/11/08	733.3%	--	2,430
9 Trough	12/22/08	-78.8%	164	--
Peak	4/29/11	269.8%	--	858
10 Trough	1/28/15	-61.3%	1,370	--
Averages		% Chg	Avg Days	
Trough to Peak		198.3%	--	683
Peak to Trough		-52.0%	446	--

Will 2014 Winners Repeat? Not if History is a Guide

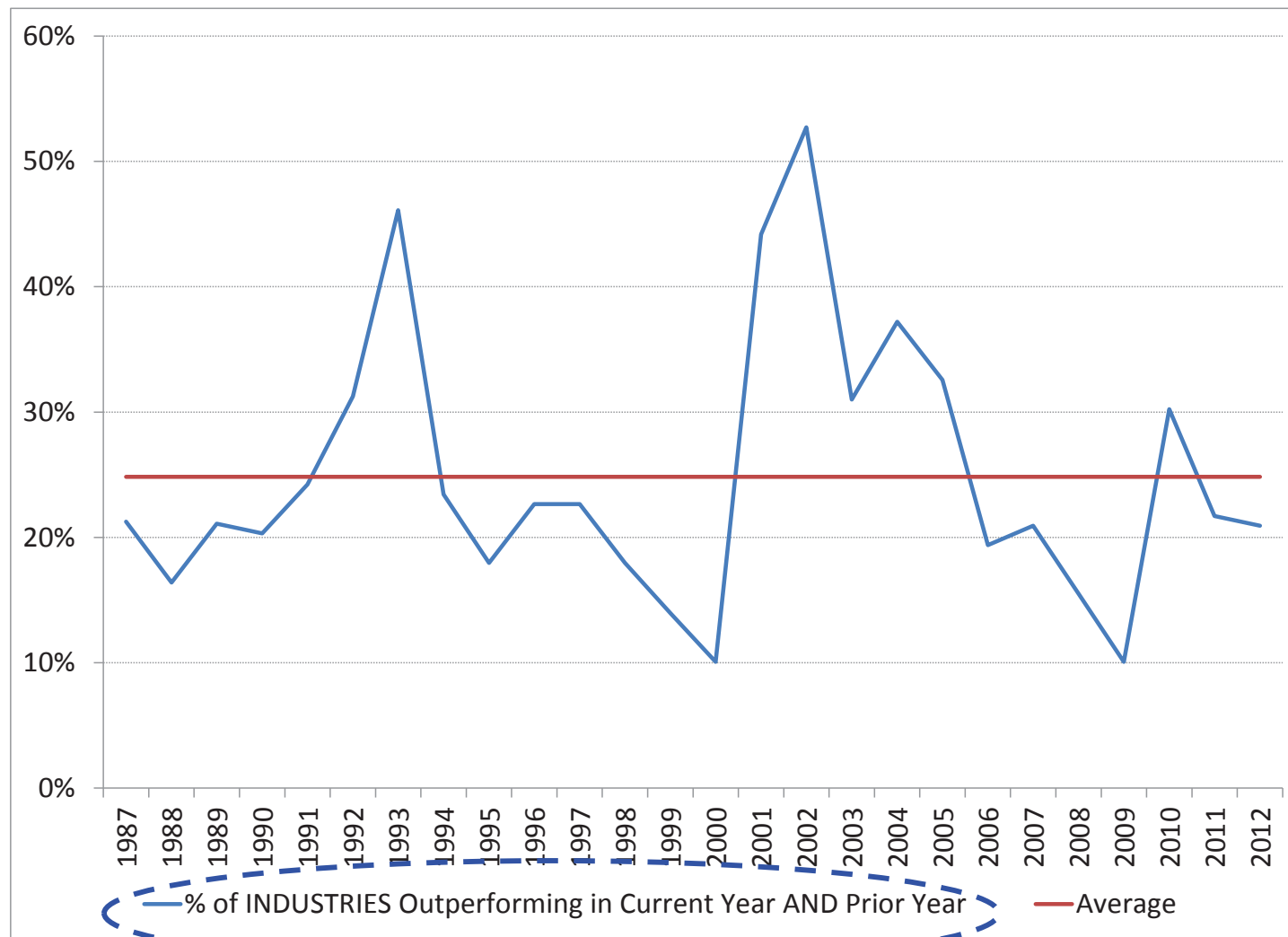
Mean reversion continues to be finance's most enduring force.



Source: Furey Research Partners and FactSet. Data through Dec 2012

Will 2014 Winners Repeat? Not if History is a Guide

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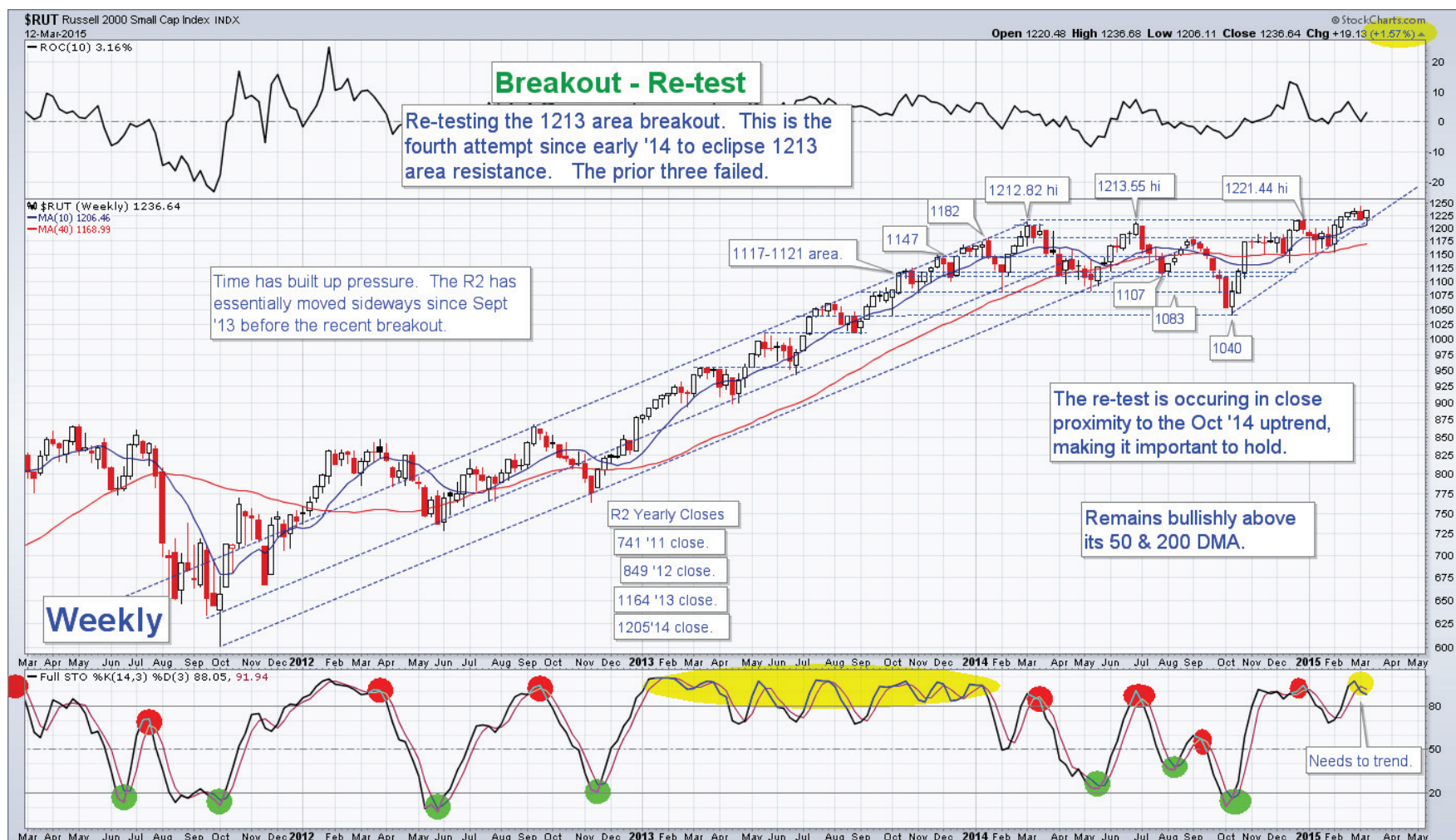
Source: Furey Research Partners and FactSet. Data through Dec 2012

Improving growth but not convincingly beating large-caps.

KEY ADDITIONAL CHARTS

Russell 2000

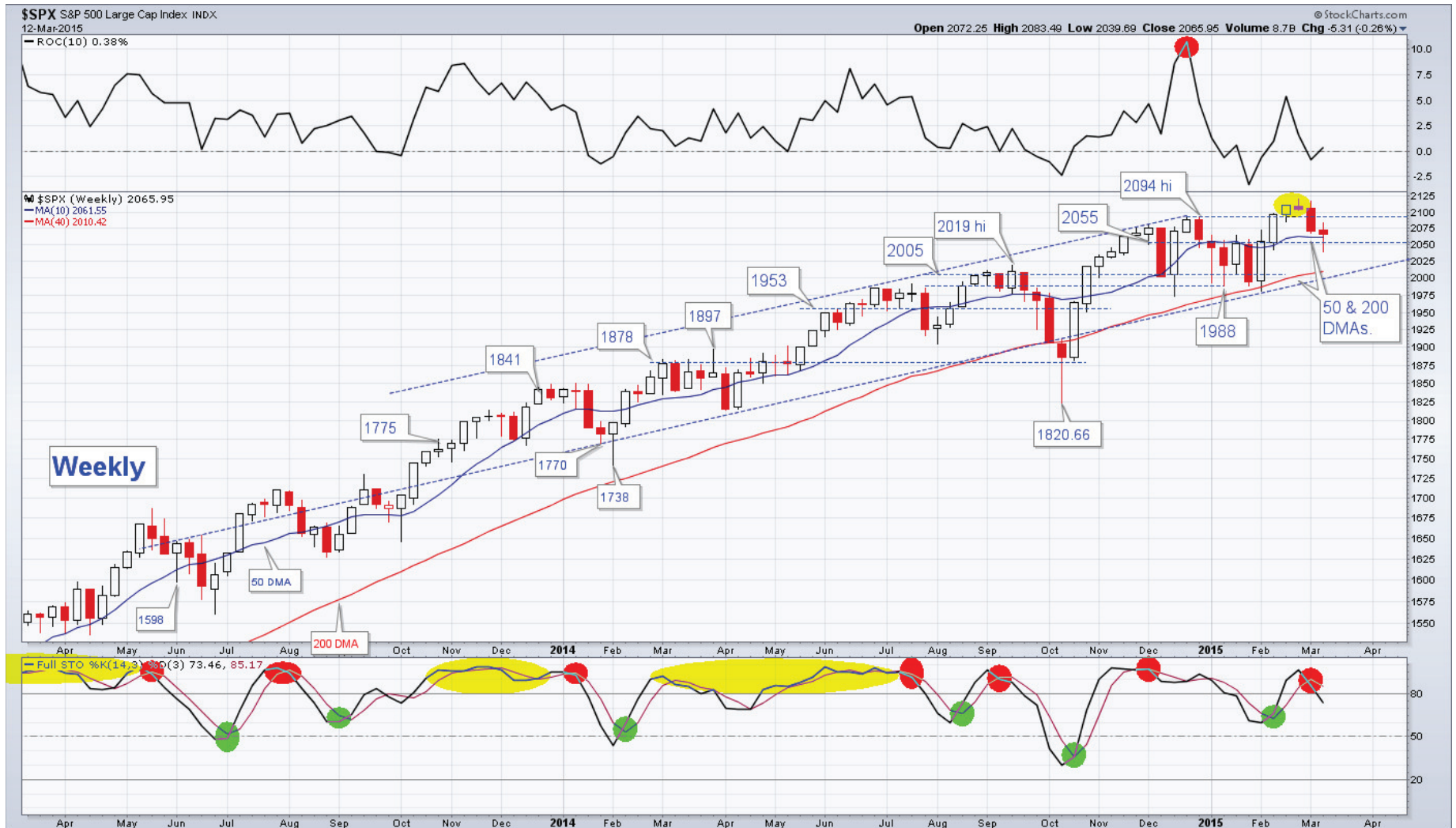
Battling to maintain the bullish 1213 area eclipse that's taken 16 months to break.



Source: Furey Research Partners and StockCharts.com. Data as of Mar 12th, 2015

S&P 500

Making new all-time highs and strongly trending.



Source: Furey Research Partners and StockCharts.com. Data as of Dec 17th 2014

Natural Gas – Working to Put in a Bottom

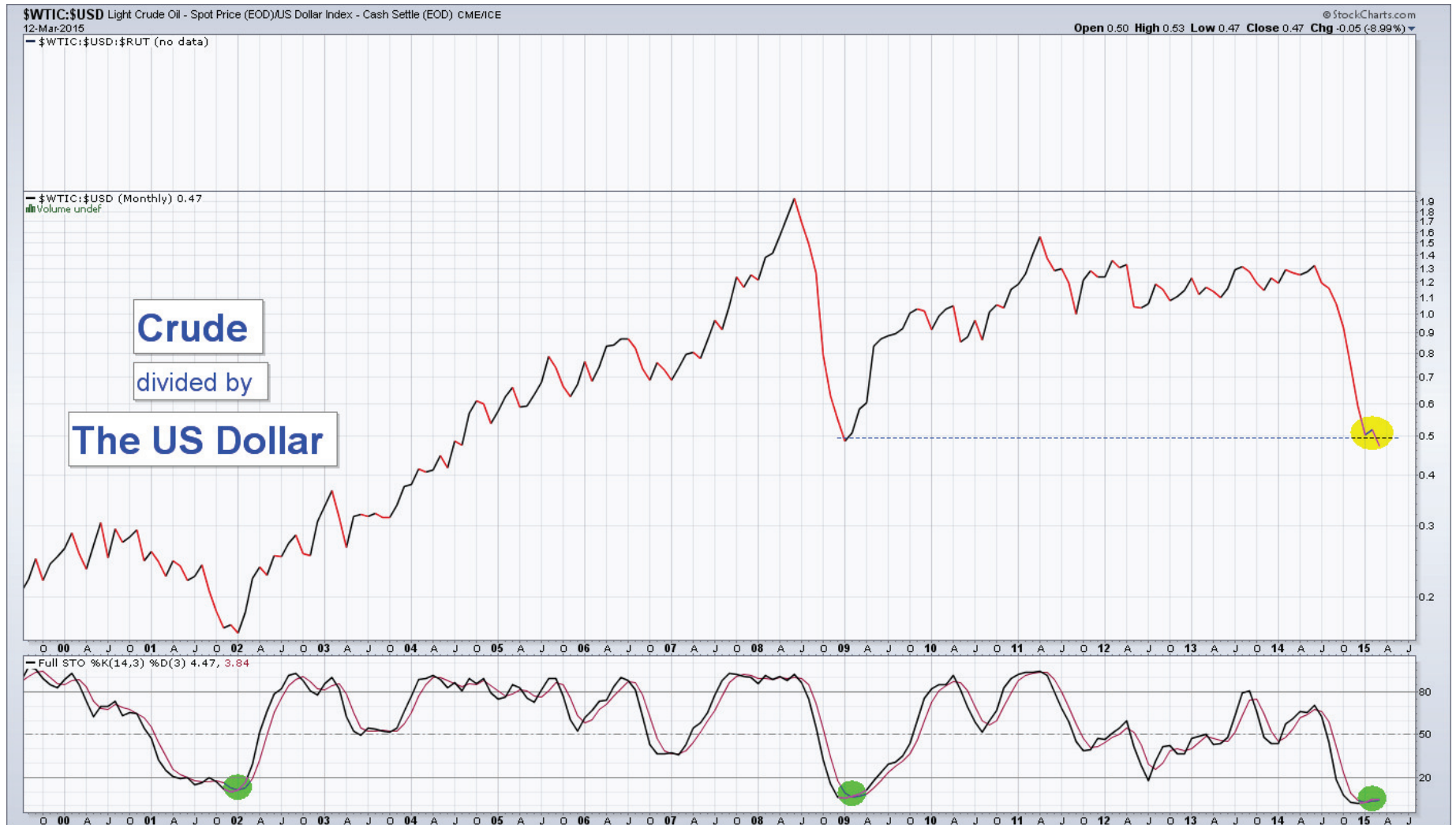
Entering the seasonally weak period. The '02 low was much lower.



Source: Furey Research Partners and StockCharts.com. Data as of Dec 17th 2014

Crude divided by the US Dollar

A collapsing ratio that is making new lows.



Source: Furey Research Partners and StockCharts.com. Data as of March 12th 2015

Stocks Have Been Crushing Crude

Known. Trending. Can go further. Commodities not yet optimally positioned.



Source: Furey Research Partners and StockCharts.com. Data as of March 12th 2015

Crude divided by Natural Gas

Maybe its time for crude to outperform crude?



Source: Furey Research Partners and StockCharts.com. Data as of March 12th, 2015

10-Year US Government Yields

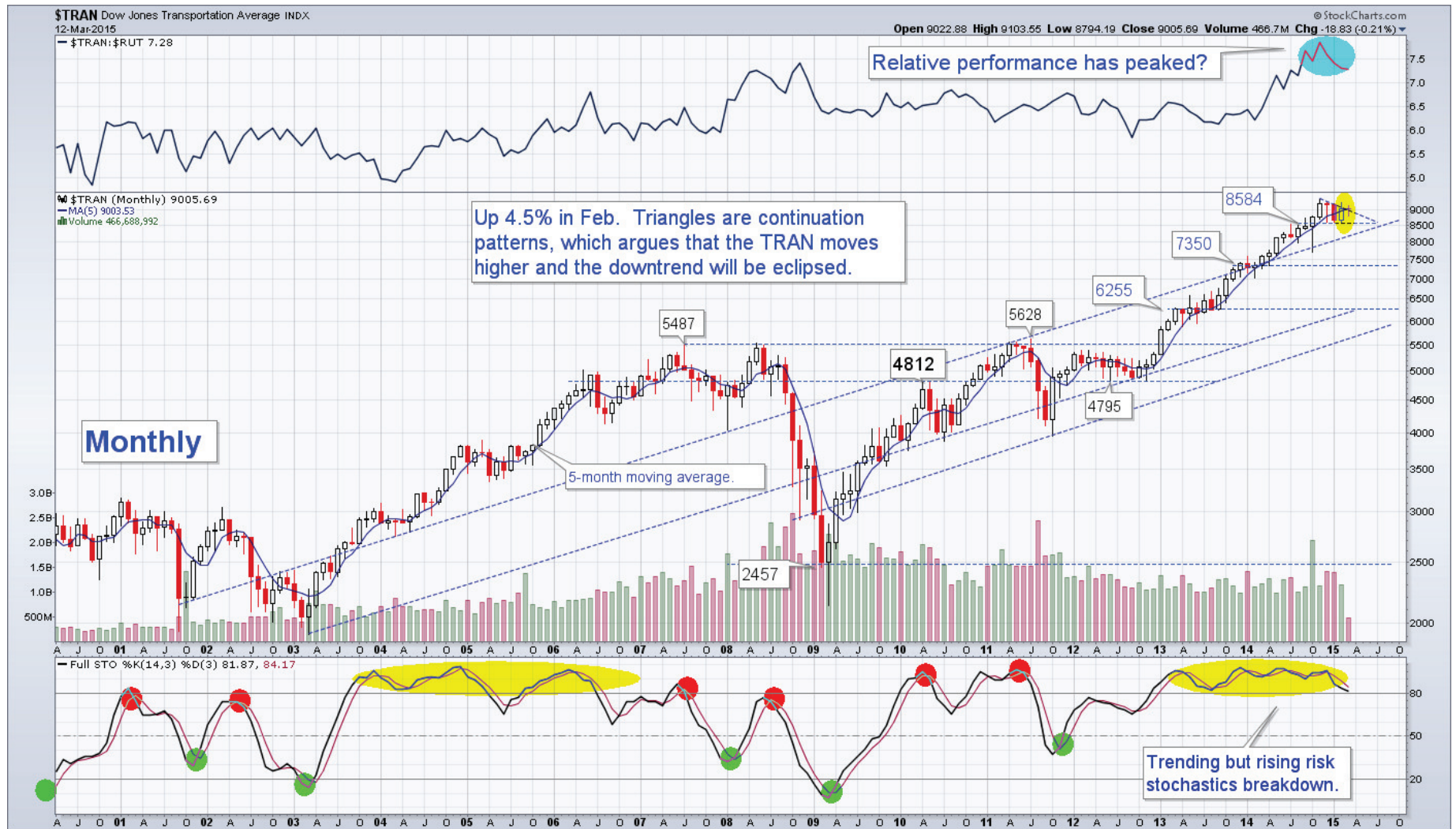
We believe the Fed won't raise rates in '15 but rates will move higher on better growth and lead the Fed, who start hiking in '16.



Source: Furey Research Partners and StockCharts.com. Data as of Mar 12th, 2015

No More Popular Industry/Sector than the Transports

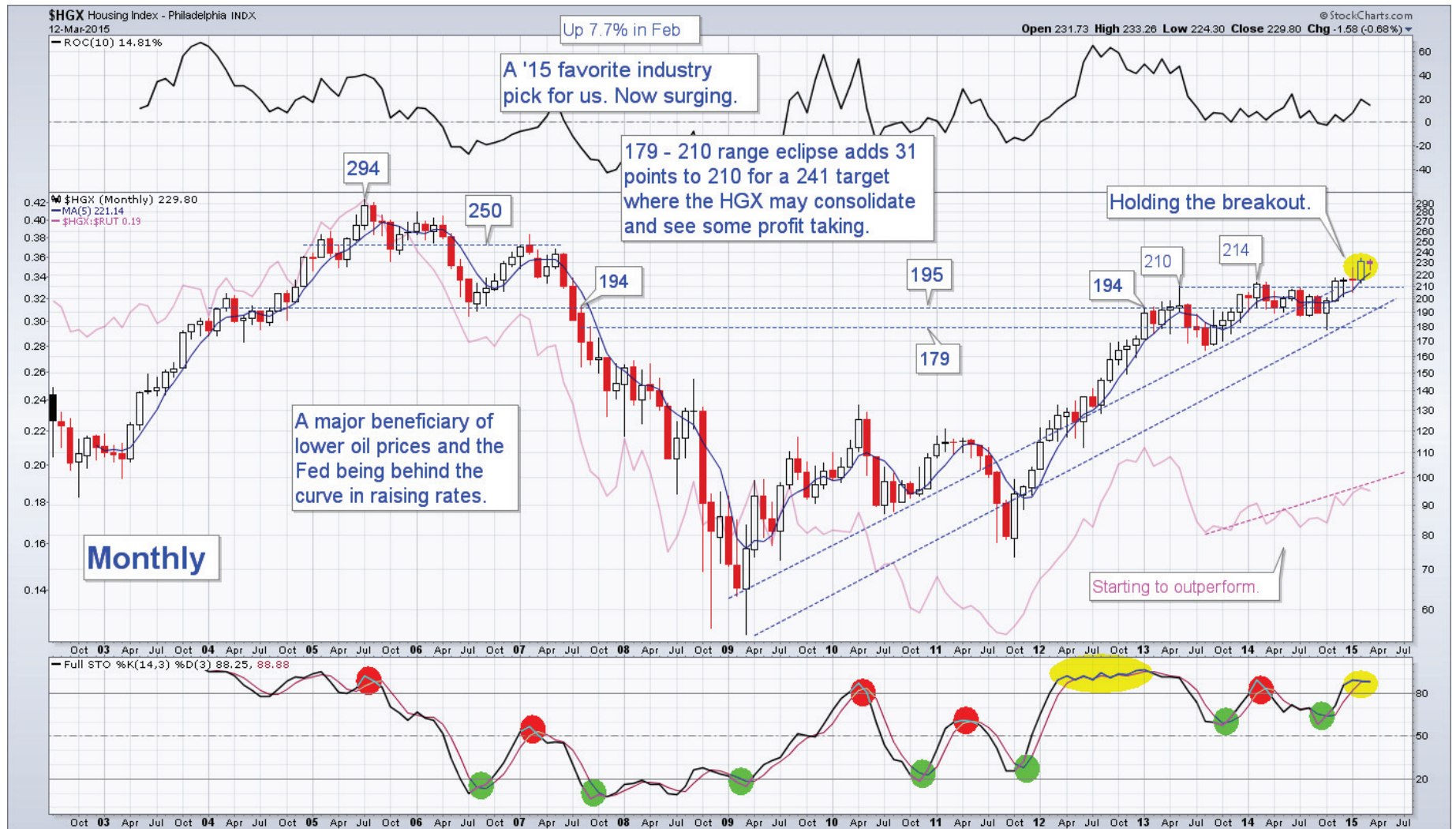
If energy prices rise, Transports may face “relative” profit-taking, not nominal losses.



Source: Furey Research Partners and StockCharts.com. Data as of Mar 12th, 2015

Lower Energy Prices & A Lagging Fed Helps Housing

Foreign buying of US bonds is a tailwind to US housing stocks.



Source: Furey Research Partners and StockCharts.com. Data as of Mar 12th, 2015

Bullish Factors Out Weigh Bearish Ones

Volatility Will Present Opportunities.



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Buy	Expected rate of return on investment at current prices levels is above that rate required, in CRT's view, to undertake the attendant risks perceived- positive risk/reward investment balance.		
Fair Value	Expected rate of return on investment at current prices levels is in line with that rate required, in CRT's view, to undertake the attendant risks perceived- equitable/reward investment balance.		
Sell	Expected rate of return on investment at current prices levels is below that rate required, in CRT's view, to undertake the attendant risks perceived- negative risk/reward investment balance.		
Ratings Percentages As of March 17, 2015		Percentage of Banking Clients Within Each Rating Category As of March 17, 2015	
Buy 71.20%		4.49%	
Fair Value 28.80%		0.00%	
Sell 0.00%		NaN%	

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