February 2016

Dear Client,

Enclosed are the return calculations for your account(s). Where applicable, three, five, ten year and returns since inception are included as well. The S&P 500 returned 1.38% including dividends in 2015. Our composite returned -3.20% in 2015 (individual results may vary). Since inception on 01/01/2000, our composite has returned 220.30% vs. 88.97% for the S&P 500 with dividends. That represents a compound annual return of 7.55% for the composite vs. 4.05% for the S&P 500 with dividends.

The S&P 500 index itself finished in negative territory in 2015. The small positive overall return was the result of the inclusion of dividends. Within the index, only a handful of stocks made positive contributions to the return, among the primary ones were Facebook, Amazon, Netflix, Google /Alphabet. Other industries, particularly energy and commodities, fared quite poorly. The shares of energy companies were down on average more than 23% for the year. The new-year has begun with a sharp sell-off that has continued into February. Those in our industry who make a living forecasting the unknowable – stock market pundits- are busily explaining to anxious investors that the sell-off is either a run-of-the-mill correction after a long period of rising prices or the beginning of a severe decline. Take your pick. Unfortunately, very few of us have been blessed with the ability to peer into the future and ascertain the short-term direction of stock prices. As such, we are left to utilize our more primitive toolkits which include analyzing corporate balance sheets, income statements, cash-flow statements, capital allocation decisions and transaction prices in the mergers & acquisitions arena. In short, what matters and what is knowable.

Based the above-mentioned criteria, we are optimistic that collectively, the securities positions in our managed portfolios are priced to deliver attractive future returns. Within this group of securities is a well-capitalized mortgage insurer, with a high-quality book of insured business, trading a mid-single digit multiple to earnings. We also own a REIT that owns more than 30,000 single family homes throughout the country with attractive rental streams and good appreciation potential. It is doubtful that either business could be purchased at their prevailing prices in the private market, but the current malaise surrounding these industries in the publicly traded markets allow for purchase prices at what are likely substantial discounts to their private market values. What is important for the investor to note is the current malaise is almost certainly transitory, while ability of the aforementioned businesses to earn and distribute meaningful cash-flow to owners is not. This ability to distribute meaningful cash to owners is what will ultimately determine value.

In last year's letter we noted our increased cash positions that were a by-product of sales of fully-priced securities and a lack of compelling investment opportunities. One area we did discuss as compelling was the dramatic sell-off in the high-yield bonds of well-positioned oil & gas exploration companies. While we continue to view the fundamentals as favorable, we were clearly too early in our purchases as prices continued to decline and the carnage within the industry spread to include not only the exploration companies, but the major transport/pipeline companies as well. The economics of the pipeline companies are completely different than the exploration companies and we feel quite comfortable with our recent purchases given the double-digit yields available. With respect to oil & gas prices and the asset values of select E&P companies, it is hard to imagine that the enormous reduction in capital spending over the past two years- variously estimated at over $200 billion- coupled with the decline in production of mature fields won't have a meaningful impact on supply, and thus prices, in the not-to-distant future.

Other 2015 purchases include Flowserve Inc. and Valmont Industries. Flowserve is a leading manufacturer and marketer of fluid-handling equipment and Valmont has a dominant position in the production of mechanized agricultural equipment and engineered metal structures. Both companies share prices dropped sharply last year in response lowered earnings expectations (short-term) and guidance. We view the long-term business prospects and earnings pictures as very favorable for both companies and given their depressed share prices, expect to earn an attractive return on our investment(s).

Building an investment portfolio is an exercise in assembling a collection of businesses with favorable prospects at reasonable prices. It requires some discipline and importantly, an ability to not to be overly influenced by short-term price movements or the sometimes near obsessive focus by the financial news media on a single data point. Successful investing is not a popularity contest where the objective is to buy the most discussed, active, or highly-praised stocks. These issues generally command premium valuations which in turn limit future appreciation potential. Many of our most successful investments over the past thirty years have been in comparatively mundane industries such as industrial gases, automobile finance, fast-food and waste management to name just a few. They were purchased at reasonable prices, managed by shareholder friendly and competent executives and often held for years. The investment process should be straight-forward and prudent, it need not be overly complicated.

Please feel free to contact us with any questions or comments. As always, we appreciate your trust and patience.

Very truly yours,

Eckart A. Weeck
Senior Managing Director.