February 2017

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 11.96% including dividends in 2016. Our composite returned 13.55% in 2016 (individual results may vary). Since inception on 01/01/2000, our composite has returned 263.70% vs. 111.57% for the S&P 500 with dividends. That represents a compound annual return of 7.89% for the composite vs. 4.51% for the S&P 500 with dividends.

The dominant theme in 2016 was to expect the unexpected. This refers not only to the U.S. presidential election but also to the Brexit vote which took place in June 2016. The actual outcomes were viewed by most polls as highly improbable and very negative for the stock markets if they occurred. Well, the polls were wrong and so were the predictions about the effects on the stock markets. While there was an immediate post-Brexit sell-off of approximately five percent, markets were higher in the aggregate within a month. With respect to the U.S. presidential election, the overnight futures markets were down sharply following the announcement of the Trump victory only to rally sharply the following morning and throughout the balance of the year. As a firm, we received more than a handful of phone calls questioning whether a dramatic asset allocation shift was in order in response (or preemptively) to these important macro events. Our answer is that we make no attempt to position portfolios in response to macro events; either preemptively or subsequent to. To do so would be an attempt to divine the unknowable and thus a waste of our time and research efforts.

Significant contributions to last year's returns came from a variety of securities. Our investments in the distressed debt of oil & gas exploration companies and gas transport pipeline companies performed exceptionally well; some returning in excess of 50%. Other important contributors referenced in last year's letter include Valmont Inc. (+33%), Colony Starwood Homes (+29%), Flowserve Inc. (+16%) and MGIC Investment Corp. (+15%). We also continue to hold and own well-managed and valuable franchise companies such as Berkshire Hathaway and the Bank of New York. While not deeply undervalued, our conviction in the durability of their respective franchises and their capital allocation decision making gives us confidence that at current prices, future returns should be satisfactory.

In 2016 we established or substantially increased several positions. Specifically, Calgon Carbon was increased and two manufactures of generic drugs- Teva Pharmaceuticals and Mylan N.V.- were added/increased. Calgon is primarily engaged in applying activated carbon technologies to protect people from contaminants in air, food and water. They also have a division- Hyde Marine- which provides ballast water treatment services to marine vessels of all types and sizes. Last year saw the ratification of a worldwide treaty designed to halt the spread of invasive species through the treatment of ballast water. We believe this market may develop into a very large commercial opportunity over the next several years with the potential to deliver meaningful sales and profits to Calgon. With respect to the generic drug manufacturers, share prices were negatively impacted by a host of company-specific negative headlines; Mylan’s EpiPen pricing controversy and Teva’s problems with the integration of Allergan’s generic business purchased for $40.5 billion. The EpiPen issue led to congressional hearings, allegations of pricing collusion and negative industry headlines relating to drug prices in general. By the end of 2016 their share prices were down -30% and -45% respectively. At current levels, they trade at single-digit multiples to earnings implying little or no growth in the years ahead. The generic business is a scale business. While there are current issues with respect to pricing, we think good growth opportunities exist as drugs and biosimilar drugs come off patent. These opportunities do not appear to be reflected in their current share prices.

The change in administrations in Washington has brought about a flurry of activity and new legislative actions and proposals. As alluded to earlier, we have no special insights regarding what proposals will actually be implemented and what their economic effect might be. To the extent that these actions result in increased volatility and irrational securities prices, we are prepared with ample cash and a long list of well-researched ideas.

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

Very truly yours,

Eckart A. Weeck
Senior Managing Director