April 13, 2017

"A goal without a plan is just a wish"
-Antoine de Saint-Exupery

The stock market continued to advance in the first quarter driven by strengthening economic conditions while President Trump's young administration encountered an early stumble when it failed to win Congressional support to replace and repeal the Affordable Care Act. In this note we'll share some observations regarding the new administration, but our investment focus remains on the economic backdrop in which our investment companies are operating.

Former Defense Secretary Robert Gates summed up our opinion of the new administration in a discussion we attended recently when he said every Presidential administration in which he has worked struggled moving from campaign to governing mode. Following some early blunders, the administration seems to be finding its footing. Specifically, the distracting Presidential tweets are moderating, NAFTA is now seen as acceptable, NATO is a worthy partnership, and China is not a currency manipulator, to name a few. Moderate members of the administration such as Gary Cohn, Chief Economic Advisor, are gaining influence at the expense of more extreme members like Stephen Bannon.

While the political environment in Washington has been finding its direction the economy has continued to chug along. The purchasing manager's index, a leading indicator of economic activity, continues to point toward expansion. In the most recent Federal Reserve Meeting participants noted that the labor market continues to improve, real private expenditures for business equipment is rising, and that personal consumption expenditures continue to increase, albeit at a slightly slower pace. Therefore, the economic data suggests that the long, slow economic recovery of the last eight years remains.

Companies owned in client portfolios continue to demonstrate shareholder friendly behavior. Reported earnings growth in the fourth quarter of 2016 by client owned companies was up 11% versus 2% for the S&P index companies. Projected earnings growth for client companies in 2017 is +18% versus +10% for the S&P 500 index companies. In addition, over the last twelve months 24 of 36 companies owned in client portfolios have raised dividends by an average of 10.8%, and 28 client owned companies reduced the number of shares outstanding through stock repurchases.

We are watching some issues which we perceive as risks to be managed. First, the overall valuation of the stock market is near the high end of historic levels. We believe that low returns in alternative investment opportunities, expectations of stronger economic growth, and the expectation that corporate tax reform will be enacted are contributing to current valuations. If any of these factors fail to occur then it is likely stock valuations could

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contract. While this causes short term risk, the key to long term value creation is owning companies that are able to grow earnings and deploy free cash flow in shareholder friendly activities. We'll continue to seek out investment opportunities with these characteristics on your behalf.

During the quarter we purchased shares of Del Taco Restaurants and FMC Corporation in client portfolios. Del Taco operates over 500 restaurants located primarily in the western United States. It is expanding into the southeastern part of the country while also revamping its menu to offer more fresh choices to its customers. FMC Corporation is a diversified chemical company that is making some interesting strategic steps by purchasing the agricultural chemical business of DuPont. We think this transaction is strongly accretive to earnings and provides opportunities for synergies. We reduced our position in Amazon where it had become overweight in client portfolios. This is the second time we have trimmed our holding in this position.

The year has begun with many surprises. We expect the new administration to continue to operate unconventionally, but hope that the recent trend toward moderation continues. In the meantime, as stewards of your money, we'll continue to follow our disciplined approach in stock selection with an eye on long term results. Thank you for entrusting us with the management of your money and we look forward to speaking with you in the coming months.

Sincerely,

JM Sam Nevin, Jr.
Managing Partner