LOUNTZIS® ASSET MANAGEMENT, LLC

March 1, 2019

RE: 2018 YEAR-END REVIEW

After one of the calmest markets ever in 2017, volatility returned in 2018. The stock market began 2018 with a solid January and rose to historic highs in September and October before closing with substantial declines in December. On September 20th, the S&P 500 reached its highest level ever and was followed on October 3rd by the Dow Jones Industrial Average rising to an all-time high. However, in December the S&P 500 declined 9% while the Dow Jones Industrial Average declined 8.7% making it the worst December performance since 1931. As a result, both the S&P 500 and DJIA posted declines of 4.8% and 3.5% for 2018, following solid returns in 2017 and 2016 as illustrated below:

Stock Market Index-a	2018	2017	2016
S&P 500	- 4.8%	21.8%	12.0%
Dow Jones Industrial Average	- 3.5	28.1	16.5

a-with dividends reinvested

PERFORMANCE OF LARGEST HOLDINGS

A breakout of the performance of our largest holdings for 2018, which followed strong performances in the full years 2016 and 2017 are given below.

Company	% Change 2018	Company	% Change for 2017	Company	% Change for 2016
Zoetis	18.7	Progressive Corp.	58.7	Martin Marietta Mat'l.	62.2
UnitedHealth Group	13.0	Mohawk Industries	38.2	Brown & Brown	39.7
Progressive Corp.	7.1	UnitedHealth Group	37.8	UnitedHealth Group	36.0
Brown & Brown	7.1	Zoetis	34.6	BB&T	24.4
Berkshire Hathaway B	3.0	Lowe's Companies	30.7	Berkshire Hathaway B	23.4
Lowe's Companies	-0.6	Lab Corp	24.3	US Bancorp	20.4
PepsiCo. Inc.	-7.9	Berkshire Hathaway B	21.6	World Fuel Services	19.4
Bank of New York	-12.6	Brown & Brown	14.7	Loews Corp.	17.6
BB&T Corp.	-12.9	PepsiCo. Inc.	14.6	Bank of New York	14.9
US Bancorp.	-14.7	Bank of New York	13.7	Zoetis Inc.	11.7
Martin Marietta Mat'l	-22.2	Wells Fargo	10.1	Progressive	11.6
Wells Fargo	-24.0	BB&T Corp.	5.7	Mohawk Industries	5.4
		US Bancorp	4.3	PepsiCo Inc.	4.7
		Martin Marietta Mat'l.	-0.2	Lab Corp.	3.8
		World Fuel Services	-38.7	Wells Fargo	1.4
				Lowe's Companies	-6.5

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A WORLD AWASH IN LIQUIDITY-CAPITAL IS A COMMODITY–GREAT IDEAS REMAIN RARE

An explosion of capital flows into the financial markets continues from a broad range of sources, including: sovereign wealth funds, family offices, private equity firms, life insurance companies, endowments, pension funds, hedge funds, venture capital firms, corporation venture firms and others. As **capital continues to pour into public markets, private markets and venture capital markets, valuation levels continue to rise.** This phenomenon has many implications that we will discuss later in the letter, but I wanted to point out just how important the massive current flows of capital is having throughout the global financial markets.

In the pages that follow we will discuss several topics of interest, several of which have been brought up by our clients over the past year or so.

We begin by emphasizing **our firm's founding principles** as well as **a driving force and focus at our firm,** which is **building long-term relationships with our clients, vendors, companies and colleagues.** Today, building long-term relationships is often rare and has been replaced to an extent with the ephemeral nature of social media, smart phones and the internet. We **cherish building deep relationships with our clients,** which enables us to create customized portfolios for their unique needs, goals and objectives.

We will provide a **perspective** with several charts on **historical stock market valuation levels** over various time frames, the **S&P 500's operating earnings per share and profit margins** and **stock buybacks.**

The **current 10-year bull market is discussed** along with our views on **future stock market returns** given the robust gains over the past decade. In fact, **since the S&P 500 low on March 6, 2009, the S&P 500 has risen 17.6% on annualized basis including reinvested dividends through December 31, 2018.**

It is also prudent to **remember bear markets of the past**. We have had a couple during the decade 2000-2010, including the **Technology, Media and Telecom bubble in 2000-2002**, and the **Great Financial Crisis in 2008-2009.**

The **commoditization of businesses** is occurring across industries and on a global scale. Almost **every business model today is under assault** from a broad range of challenges, including technology, globalization, and changing consumer preferences to name a few.

Executive leadership in this **rapidly changing landscape** is **more important than ever.** Those firms whose **leaders have vision, courage and sound judgment, combined with an ability to build great teams will be the future winners in a rapidly changing world.**

We include a lengthy section on **managing risk** utilizing **our investment process,** which is the foundation upon which our firm has been built. As the late **Benjamin Graham, the father of value investing, and Warren Buffett's mentor stated, "The essence of investment management is the management of risks, not the management of returns. The investor's chief problem, and even his worst enemy, is likely to be himself."**

The **valuation of businesses is an art form**, utilizing both **quantitative** and **qualitative factors.** Interestingly, the **quantitative factors,** while very important, **tell you about the past.** However, investing is all about the future and in a rapidly changing world the **qualitative factors matter more than ever.**

There are a few **macro areas of concern** that we briefly discuss in the current financial environment, including a large increase in **corporate debt, leveraged loans, IPO's with no profits, unregulated non-banks (shadow banking), very little fixed-income inventory held by investment banks creating liquidity issues,** and **global debt levels.**

Public Equity Markets are being driven by index funds and ETF's, where information is irrelevant and large money inflows are driving markets higher. **Money flows are becoming far more important than fundamentals.** The **investment business is also converging** as firms historically focused on mutual funds, private equity, and venture capital are all coming together and offering a broad range of services. Traditional private equity firms were in the leveraged buyout business but today many offer hedge funds, distressed debt funds, real estate funds, infrastructure funds, and many other products while continuing to raise enormous amounts of capital. We discuss the **Golden Age of Private Equity and the Golden Age of Venture Capital as well as the impact on public securities.**

Given our large holdings in banks, both as stocks and as fixed-income securities, we provide a **section** on the **overall banking industry in the United States** as well as a separate section detailing our **team's view on Wells Fargo and the challenges that it has faced and continues to deal with.**

Finally, we discuss our **2018 portfolio activity** for our both our **stocks and fixed-income securities.**

Before we begin the main body of our letter, our team wanted to share a couple of broad observations in the current investment world. First, our team has a combined 75 years of experience in the investment business and we **have never seen the amounts of capital available for investment as there is today.** Money is everywhere from sovereign wealth funds, endowments, pension funds, life insurance companies, public and private companies with their own investment funds, private equity firms, venture capital firms, family offices, mutual fund companies and on and on. The **enormous amounts of capital currently available are seeking fewer and fewer attractive investment opportunities in both the public and private sectors.** This **abundance of capital** has **fueled ever rising prices for both public and private businesses, venture capital startups, real estate and other asset classes.**

Second, as we discussed last year, the **investment landscape is far different than in the past few decades.** There are **fewer public equities to choose from, fewer bigger winners and many more losers,** as it is becoming a **winner take all world. Globalization and technology are creating enormous barriers to competition** and long runways for growth, with fewer and fewer companies to dominate, as **consolidation continues to rise in many industries.** On the one hand, there will be **fewer companies with higher profit margins, stronger competitive barriers and dominant market shares,** while on the other hand there will be many **companies with lower profit margins, weaker competitive barriers and declining market shares.** Therefore, **to be a successful investor now and in the future** will **require even more thoughtful research and analysis to truly generate unique differential insights for our client portfolios.** While **capital is currently in enormous abundance, great ideas remain scarce and are more valuable than ever.**

LOUNTZIS ASSET MANAGEMENT, LLC - FOUNDING PRINCIPLES

We strive daily to implement the following founding principles for our firm:

1. **TEAMWORK IS HIGHLY PRIZED AND RECOGNIZED BECAUSE IT MAXIMIZES MANY INDIVIDUAL CONTRIBUTIONS.**

2. **AN OPEN CULTURE THAT IS A TRUE MERITOCRACY IS OUR ULTIMATE ORGANIZATIONAL GOAL.**

3. **ENCOURAGING DISSENT LEADS TO AN OPEN CULTURE. RESPECTFUL COMMUNICATION IS THE FOUNDATION FOR A SUCCESSFUL WORK ATMOSPHERE AND CULTURE.**

4. **RESPONSIBLE FREEDOM PROVIDES THE OPPORTUNITY FOR INDIVIDUALS TO ACHIEVE SUCCESS ACCORDING TO THEIR INITIATIVE AND MATURITY. (PREMISE OF INHERENT TRUST)**

5. **HIERARCHY SHOULD BE DE-EMPHASIZED TO SPAWN CREATIVITY.**

6. **THE CLIENT COMES FIRST IN ALL WE DO AND IS THE FOCUS IN ALL WE DO- RESEARCH, PERFORMANCE, AND SERVICE.**

7. **PEOPLE NEED THE OPPORTUNITY TO FAIL. THE ABILITY TO FAIL IS ONE OF THE GREATEST GIFTS AVAILABLE TO US ALL-LEARN FROM IT AND MOVE ON.**

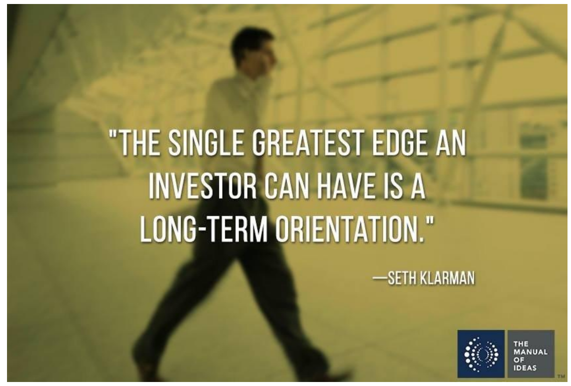
LONG-TERM RELATIONSHIPS – CLIENTS, VENDORS, COMPANIES, COLLEAGUES

In a very short-term oriented world, our firm seeks long-term relationships with clients, vendors, companies and colleagues. With the Internet and smart phones providing instantaneous feedback, personal interactions continue to decline, as have long-term relationships. We believe that **integrity, trust, investment discipline** and always **ferociously striving to do what is in the best interest of our clients,** is **a priceless currency that we cherish as the foundation of our firm's principles.**

LONG-TERM RELATIONSHIPS - CLIENTS

We have found that building relationships with each of our clients by focusing upon their specific needs, goals and objectives requires a long-term focus on both sides. **All companies are defined by the customers they choose to attract and keep; those customers play an enormous role in the type of firm we have created.**

We believe in **total transparency, openness** and **honesty in all our dealings,** which has resulted in an **extraordinary client base** for which we are most grateful. As Seth Klarman of the Baupost Group, a leading global investment firm, has stated on the following page.



In our view, Warren Buffett's investment success is the result of a confluence of factors: his extraordinary analytical skills, people skills, raw intelligence, emotional make up, discipline, patience and many other qualities, and one of his biggest additional advantages is having quasi-permanent capital in the form of insurance float. **This patient capital allows him to act ONLY when the risk/reward parameters are clearly and fully in his favor. Too often, short-term oriented clients place enormous pressure on managers for short-term results while ignoring risk levels**. We are grateful to our clients for their patience in helping our firm grow and prosper throughout the worst decade (2000-2009) of stock market returns since the Great Depression.

Leo Tolstoy's quote is most appropriate for **successful long-term investment, "The strongest of all warriors are these two: Time and Patience."**

One of the greatest attributes of all great investors is their ability to remain patient and disciplined when most investors lack both of those qualities. Following is a quote from **Warren Buffett**.

"You do things when the opportunities come along. I have had periods in my life when I had a bundle of ideas come along, and I have had long dry spells. If I get an idea next week, I'll do something, if not, I won't do a damn thing."

Charlie Munger on **patience, "If you took our top 15 decisions out, we'd have a pretty average record. It wasn't hyperactivity, but a hell of a lot of patience. You stuck to your principles and when opportunities came along you pounced on them with vigor."**

While remaining patient is difficult, over time we believe we will be rewarded. I have found that **the preponderance of our outstanding investments, have been made in only about 10– 20% of the investing period**. That is, we expect to make the great proportion of our money over time during periods when we can purchase outstanding securities at attractive prices and that only occurs 10-20% of the timeframe in which we are investing. Truly outstanding businesses rarely sell for attractive prices unless there is something we can see that others cannot, and those opportunities simply do not occur that often. Ironically, it is quite counter intuitive, but the fact remains **successful investing often means doing nothing for long periods of time and then pouncing when the right opportunities present themselves**.

Berkshire Hathaway, which has **continuously been our largest holding since we founded the firm 19 years ago,** provides an **excellent illustration of remaining patient and disciplined during inevitable market declines.** In fact, Berkshire Hathaway has had **four major stock price declines over the past 53 years ranging from 37.1% in October 1987 to 59.1% from 1973-1975. Selling during any of these declines would have been a terrible mistake.**

I read an outstanding article a few years ago from Jeremy Grantham, co-Founder and Chief Investment Strategist of Grantham, Mayo, Van Otterloo & Co., LLC a leading investment firm, where Grantham described his long-term focus. "**Grantham has illustrated the value of a long-term focus in how he invests his sister's pension fund, a subject he has covered in past quarterly letters. He considers his sister's assets to be permanent capital, because he has no career risk, since his sister will not fire him as the manager. He has managed it since 1968 and over the last 10 years his returns have exceeded those of Harvard's and Yale's endowments. Grantham said that the advantage he has with his sister's account is that he doesn't over manage it. Sometimes he makes adjustments twice a year, but once a year is more normal. Everyone in the audience and everyone in the institutional world over manages money for very good career risk reasons. They want to be seen as busy and earning their keep.**"

We seek to continue building and strengthening our relationships with our clients who understand our firm's philosophy, long-term approach to investing, and our field-based research process to first, help preserve, and then grow their capital. We are grateful and thankful for each of our clients as we could not achieve our success without outstanding clients that enable us to maintain our patience in a very short-term oriented world.

LONG - TERM RELATIONSHIPS – VENDORS

In addition to our long-term client relationships, we have also built similar relationships with several vendors over the past 19 years, two of which we highlight below. Lynx Computer Technologies, Inc., our technology partner, and MarketCounsel, our securities law partner, have both played key roles in our firm's success.

Lynx Computer Technologies, Inc., a leading regional technology solutions provider, will be installing our fourth computer network this year and we have worked closely with them for over 19 years. Our new network technology will continue to enhance our firm's broad range of capabilities to service our client base from various geographic regions while also providing business continuity and business interruption services with our data stored and available in several locations around the country. We will be working closely with Pete Mullenberg, Matt Heffner and several other members of their team to develop and implement the best systems for our firm's needs.

Our relationship with Lynx, a strategic partner, began when our firm was founded in 2000. Their integrity, technical expertise, customer service, reliability and overall excellence has enabled our firm to grow and prosper. We thank them and we look forward to working with them for the next several decades to provide the best technical capabilities for our firm to better serve all our clients.

MarketCounsel, founded by Brian Hamburger, has been our securities legal counsel since our founding. Brian is a terrific securities attorney and is also a first-rate human being who has built an outstanding firm that has guided our regulatory requirements. Working together with Brian and several attorneys on his team, including Dan Bernstein and Zachary Furnauld, we have successfully implemented our regulatory requirements at the Federal and State levels.

Brian's counsel has often included far more than just regulatory and compliance matters, as his business acumen and friendship have provided significant additional benefits to our firm to better serve our clients. We also look forward to continuing to work with Brian and his firm at MarketCounsel for the next several decades.

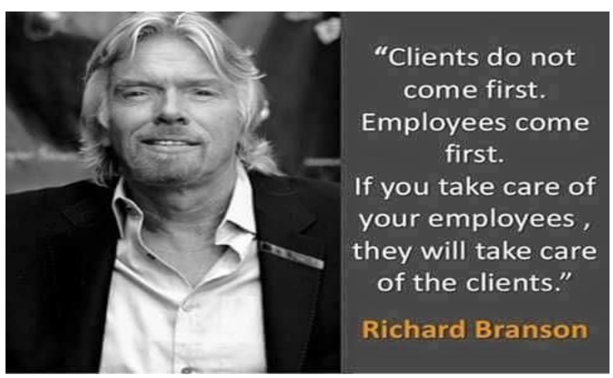
LONG-TERM RELATIONSHIPS – COMPANIES

Finally, we also seek to invest in companies in which we can remain invested for many years. We diligently search for companies with solid business models, strong balance sheets, honest and capable management teams, both as operators and capital allocators, available at attractive prices. Our **field-based, due-diligence research process augments our financial analysis to bring the numbers to life.** We hope our field-based research enables us to, first, preserve our clients' capital by **avoiding permanent capital loss** and second, to enhance our understanding of the businesses in which we invest to **gain greater confidence in making meaningful investments.** We are evaluators of risk as Howard Marks has stated below:

Our objective remains to maximize the long-term after-tax returns for our clients in various economic and market conditions while emphasizing the preservation of capital.

LONG-TERM RELATIONSHIPS - COLLEAGUES

Our firm strives to work with outstanding colleagues, as **working together as a team** provides the foundation and continuity paramount to building a great organization. We strongly believe in entrepreneur Richard Branson's quote on serving your employees as the key to building a great business.



I would like to highlight two of our key employees, Tina Schaeffer and Michael Auman.

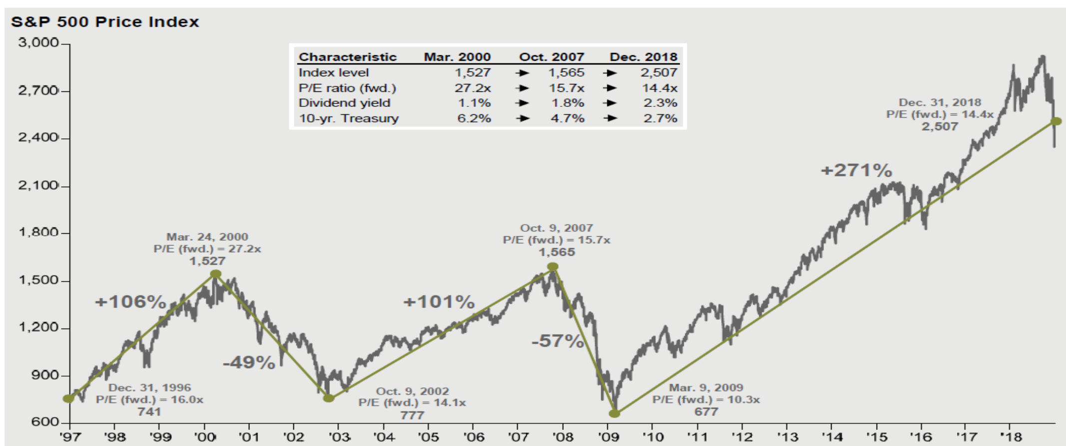
Tina joined our firm shortly after it was founded and has been with us for 18 years. Tina leads our client relations team, providing a broad array of capabilities serving our clients and their various needs.

I have known Mike for over two decades and he has played a key role in our firm's trading, portfolio management of both equities and various fixed-income securities as well as compliance.

It is a pleasure and privilege to work with both Tina and Mike, as well as all our colleagues, and I look forward to continuing to do so for many years to come.

HISTORICAL TO CURRENT STOCK MARKET VALUATION LEVELS 1997-2018

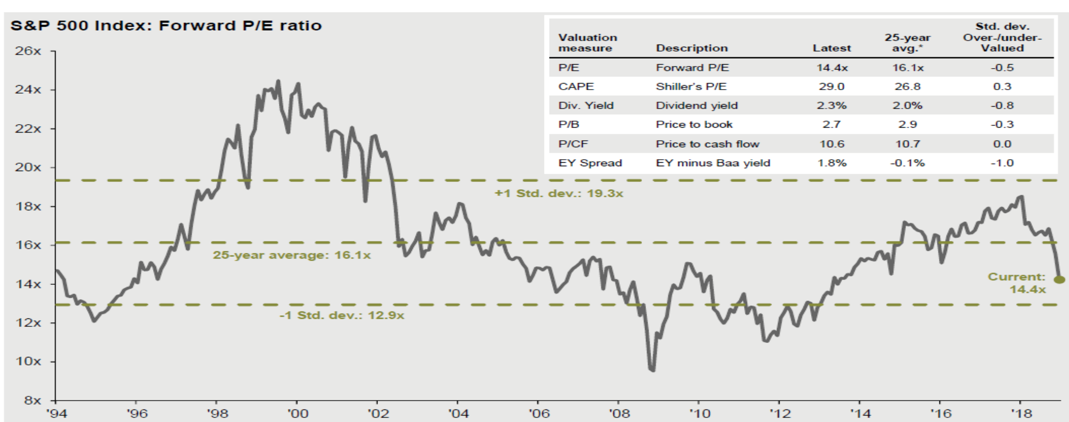
We find it helpful to review historic stock market levels to provide a perspective on the current stock market. The stock market, as measured by the S&P 500, has fluctuated with several increases and decreases over the past 21 years. Each several-year increase has been followed by meaningful declines of varying duration. After a very calm stock market in 2017, volatility returned in 2018 as both the S&P 500 and Dow Jones Industrial Average rose to all-time highs in September and October, before large declines in December that resulted in both averages generating negative returns in 2018. A breakout of the S&P 500 Index's performance since 1997 is illustrated below:



Source: Compustat, FactSet, Federal Reserve, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price to earnings ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of December 31, 2018.

J.P.Morgan

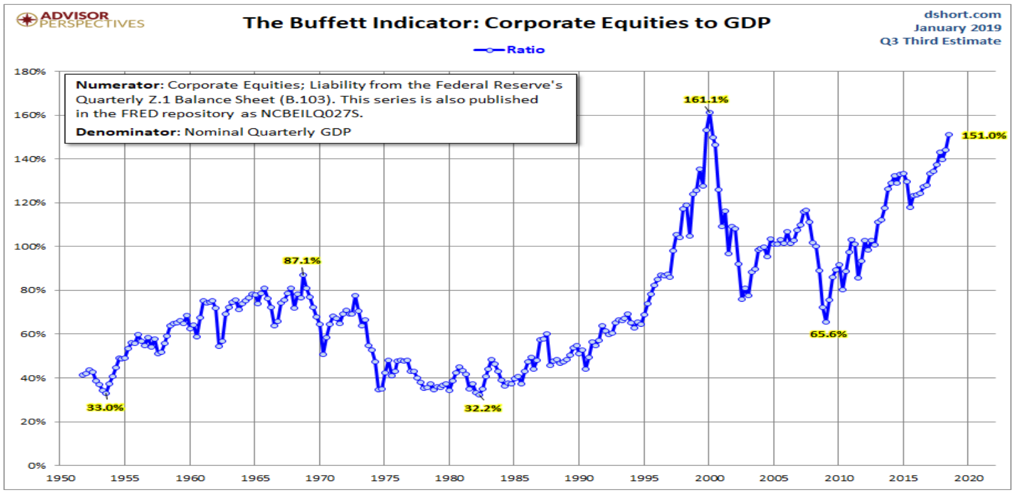
The stock market's valuation level, as measured using the S&P 500 Index on a forward price/earnings ratio, was 14.4x on December 31, 2018, and the 25-year historical average of 16.1x, is illustrated below.

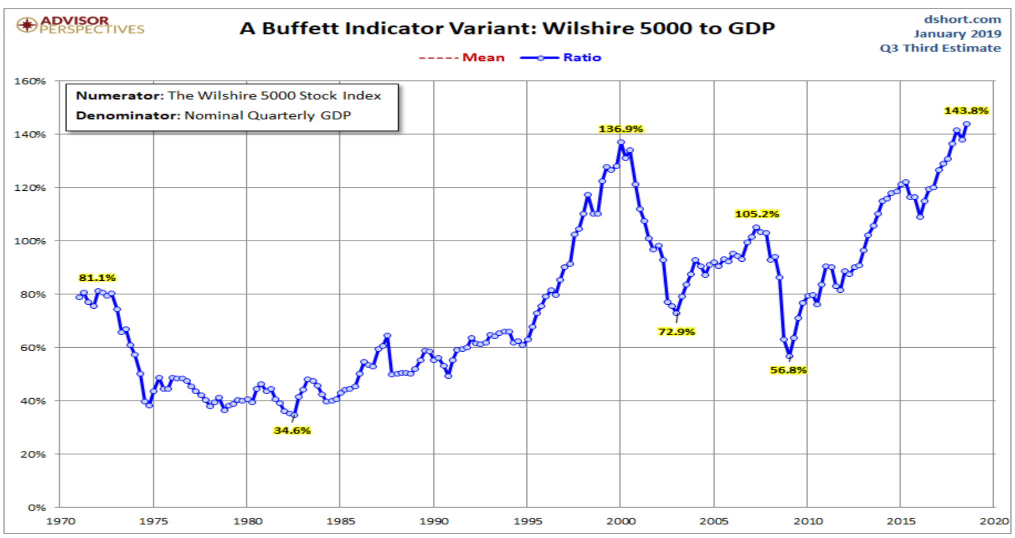


Source: FactSet, FRB, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Price to earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since December 1993, and FactSet for December 31, 2018. Average P/E and standard deviations are calculated using 25 years of IBES history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-month consensus dividend divided by most recent price. Price to book ratio is the price divided by book value per share. Price to cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 25 years for each measure.
*P/CF is a 20-year average due to cash flow data availability.
Guide to the Markets – U.S. Data are as of December 31, 2018.

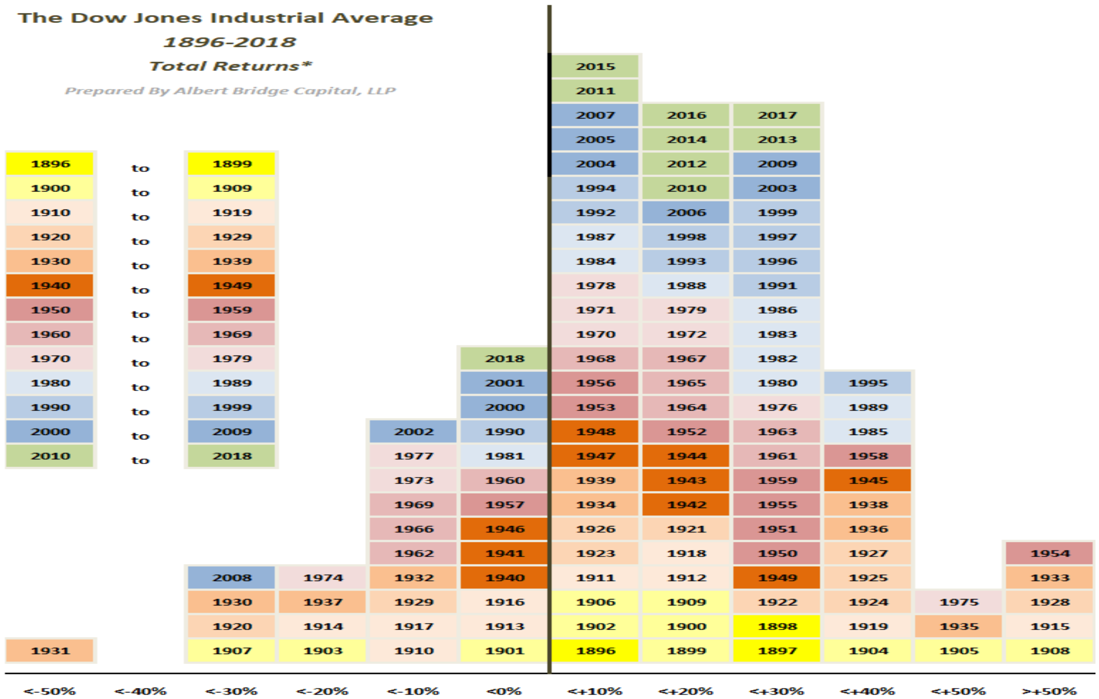
J.P.Morgan Asset Management

One of Warren Buffett's favorite stock market valuation measures is the value of corporate equities to GDP. Another measure we also review is the Wilshire 5000 Index to GDP. Both measures provide a historical perspective on the stock market's relative valuation to our country's productive output as measured by GDP. The charts below are as of January 2019 and the current elevated levels are only exceeded by the 1999-2000 technology, media and telecommunications bubble.

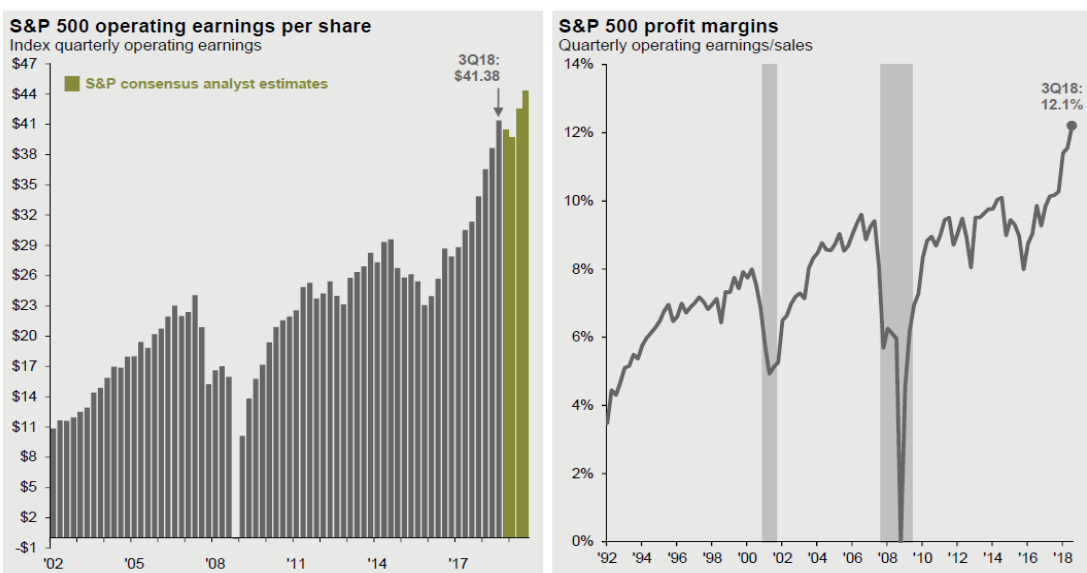




The table on the following page illustrates the total returns by year with various colors indicating the specific decade as well. The great majority of years had solid returns, or very small declines of 0-10%, with very few substantial declines exceeding 20%, which defines a bear market.



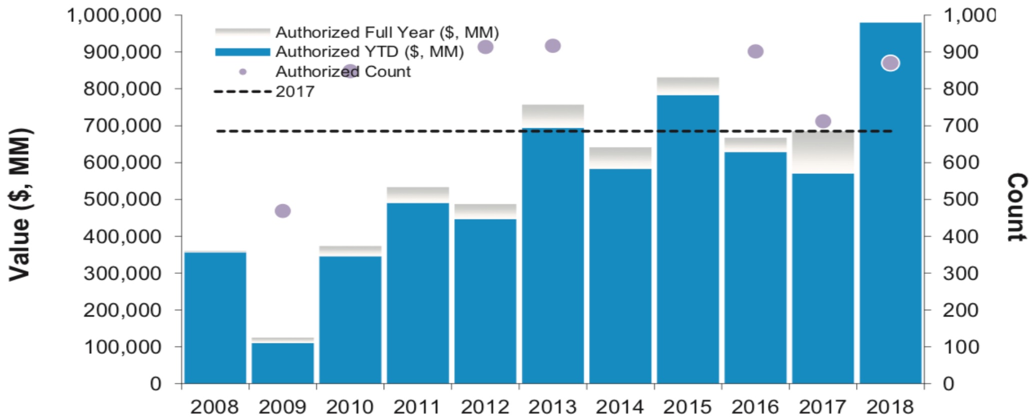
As illustrated below, the S&P 500's operating earnings per share and profit margins have risen over the past several years fueled by a strong economy, low interest rates, stock buybacks and most recently the Tax Cuts and Jobs Act signed by President Donald Trump on December 22, 2017. Rising stock prices are a direct beneficiary of rising earnings per share and the mutliple applied to those rising earnings. Low interest rates also justify paying higher multiples for solid, sustainable growth. Finally, corporate profit margins have more than tripled over the past 26 years, providing additional firepower to corporate earnings. An important question is are these profit margins sustainable?



Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Right) Federal Reserve.
EPS levels are based on operating earnings per share. Earnings estimates are Standard & Poor's consensus analyst expectations. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of December 31, 2018.

There are only five things a company can do with free cash flow: 1) invest in existing operations, 2) make acquisitions, 3) pay down debt, 4) pay dividends and 5) repurchase their stock. Stock buybacks have continued to rise, approaching $1 trillion in buyback authorizations in 2018 as shown in the graph below.

Buyback Authorizations: 2008 to Present



Note that during the most attractive period in 2008-2009, when stock prices were the lowest, companies spent the least amount on buybacks, yet as stock prices continued to rise, buybacks rose, raising the question as to whether most buybacks were a prudent allocation of capital.

While individual sector valuations remain reasonable relative to historical 20-year averages of both forward and trailing earnings, one must consider that S&P 500 profit margins are the highest ever, aided by a strong economy, low interest rates, stock buybacks and the recent corporate tax cut reduction from 35% to 21%. Going forward, sales and earnings growth will be more challenged than over the past few years. The table below illustrates various sectors and their respective valuations and returns since the market peak of October 2007 and market low of March 2009.

	Financials	Materials	Industrials	Real Estate	Cons. Discr.	Energy	Technology	Comm. Services*	Health Care	Cons. Staples	Utilities	S&P 500 Index	
S&P weight	13.3%	2.7%	9.2%	3.0%	9.9%	5.3%	20.1%	10.1%	15.5%	7.4%	3.3%	100.0%	Weight
Russell Growth weight	4.4%	1.8%	11.8%	2.3%	15.1%	0.8%	31.5%	11.9%	14.3%	6.0%	0.0%	100.0%	
Russell Value weight	22.5%	4.1%	7.4%	4.9%	5.2%	9.3%	9.3%	7.3%	15.7%	7.8%	6.5%	100.0%	
4Q 2018	-13.1	-12.3	-17.3	-3.8	-16.4	-23.8	-17.3	-13.2	-8.7	-5.2	1.4	-13.5	Return (%)
2018	-13.0	-14.7	-13.3	-2.2	0.8	-18.1	-0.3	-12.5	6.5	-8.4	4.1	-4.4	
Since market peak (October 2007)	3.3	50.7	85.3	63.7	212.4	-4.8	198.2	35.1	195.7	147.9	98.8	103.7	
Since market low (March 2009)	463.7	259.0	409.3	506.9	623.1	74.4	524.7	158.0	376.7	247.7	248.0	355.2	
Beta to S&P 500	1.41	1.27	1.25	1.12	1.12	1.07	1.02	0.91*	0.78	0.60	0.34	1.00	β
Correl. to Treas. yields	0.49	0.21	0.29	-0.20	0.29	0.49	0.17	0.22	0.25	0.15	-0.21	0.33	ρ
Foreign % of sales	31.2	52.7	44.6	-	34.1	54.1	56.9	-	38.2	32.5	41.3	43.6	%
NTM Earnings Growth	9.3%	5.9%	10.7%	3.6%	9.7%	7.2%	7.0%	6.0%*	7.3%	4.9%	5.2%	7.6%	EPS
20-yr avg.	22.6%	20.4%	11.0%	7.6%**	15.8%	13.4%	15.4%	10.7%*	9.9%	8.8%	5.0%	12.0%	
Forward P/E ratio	10.4x	13.5x	13.6x	16.5x	18.3x	13.7x	15.1x	15.7x	14.9x	16.8x	16.2x	14.4x	P/E
20-yr avg.	12.7x	14.0x	16.2x	15.3x	18.0x	17.5x	20.6x	18.2x*	16.9x	16.9x	14.2x	15.8x	
Trailing P/E ratio	11.4x	14.3x	15.0x	17.1x	20.1x	14.7x	16.1x	16.6x	16.0x	17.6x	17.1x	15.5x	
20-yr avg.	15.4x	16.7x	17.9x	16.3x	20.5x	21.6x	24.0x	20.2x*	18.5x	18.2x	14.8x	17.6x	
Dividend yield	2.6%	2.5%	2.3%	3.8%	1.5%	3.9%	1.9%	1.7%	1.9%	3.4%	3.7%	2.3%	Div
20-yr avg.	2.3%	2.6%	2.1%	4.4%	1.4%	2.3%	1.0%	1.7%*	1.8%	2.7%	4.0%	2.0%	

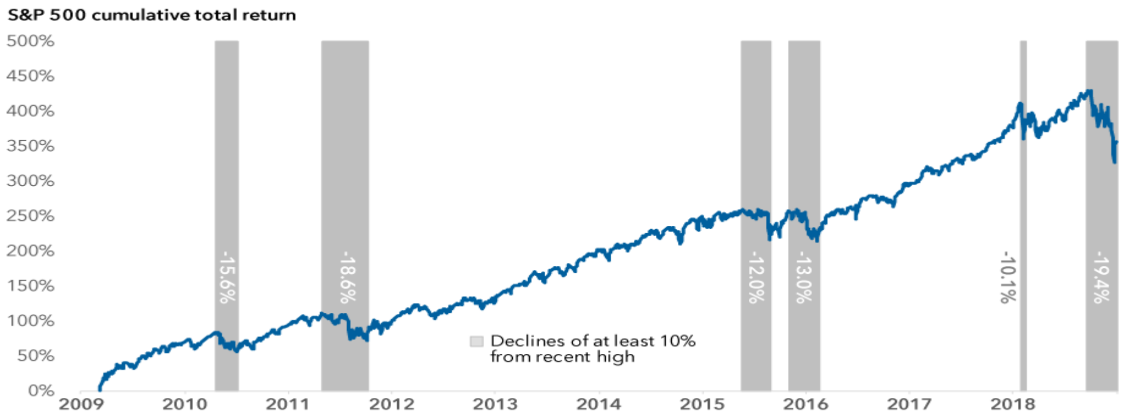
Source: FactSet, Russell Investment Group, Standard & Poor's, J.P. Morgan Asset Management. All calculations are cumulative total return, not annualized, including dividends for the stated period. Since market peak represents period 10/9/07 – 12/31/18. Since market low represents period 3/9/09 – 12/31/18. Correlation to Treasury yields are trailing 2-year monthly correlations between S&P 500 sector price returns and 10-year Treasury yield movements. Foreign percent of sales is from Standard & Poor's, S&P 500 2017: Global Sales report as of June 2018. Real Estate and Comm. Services foreign sales are not included due to lack of availability. NTM earnings growth is the percent change in next 12 months earnings estimates compared to last 12 months earnings provided by brokers. Forward P/E ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Trailing P/E ratios are bottom-up values defined as month-end price divided by the last 12 months of available reported earnings from brokers. Dividend yield is calculated as the next 12-month consensus dividend divided by most recent price. Beta calculations are based on 10-years of monthly price returns for the S&P 500 and its sub-indices. *Communication Services (formerly Telecom) averages and beta are based on 5-years of backtested data by JPMAM. **Real estate NTM earnings growth is a 15-year average due to data availability. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of December 31, 2018.

J.P.Morgan
Asset Management

THE CURRENT 10 YEAR BULL MARKET

The current bull market which began in March, 2009 has been quite benign, with only six market corrections greater than 10%, but none exceeding the 20% threshold required for a bear market. The challenge as value investors is that while the market has risen almost 400% there were only a few small price declines, and they were declines from higher and higher valuations as every decline over the past decade has been followed by ever rising prices as shown below:

There have been six market corrections since the start of the bull run in 2009



Sources: RIMES, Standard & Poor's. As of 12/31/18.

As of early March, U.S. public equities have an estimated value of close to $33 trillion, about $3 trillion below the highest valuation ever in the third quarter of 2018. The $33 trillion in market value represents about 1.6 times nominal GDP, surpassed only twice in history, the third quarter of 2018 and the first quarter of 2000. Furthermore, stock market values have been higher than the market value of U.S. real estate for the past six years, and the only other period that has occurred is 1998-1999. Again, we are not predicting the future, only comparing stock market values today with a few data points from history.

Finally, while e-commerce has fundamentally changed business models and continues to prosper, the question remains: are current valuations sustainable or are there **segments** of e-commerce that represent another stock market bubble? A chart illustrating several stock market bubbles since 1977 is provided below.

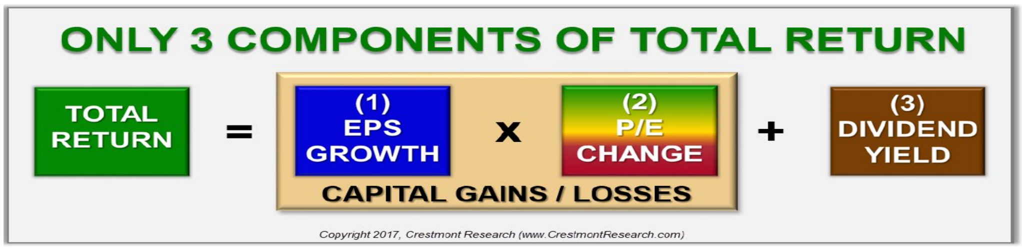
FIGURE 1: Is e-Commerce the 2nd Largest Bubble of the Last Four Decades?

Source: Bloomberg, DoubleLine, Bank of America, Epoch Investment Partners. As of July 31, 2018.
Note: We initially saw this chart in a webinar given by DoubleLine's CEO, Jeff Gundlach in June 2018. All eight series are indexed to begin at 100. Implying, for example, that e-Commerce is up over 8x from its base.

FUTURE STOCK MARKET RETURNS

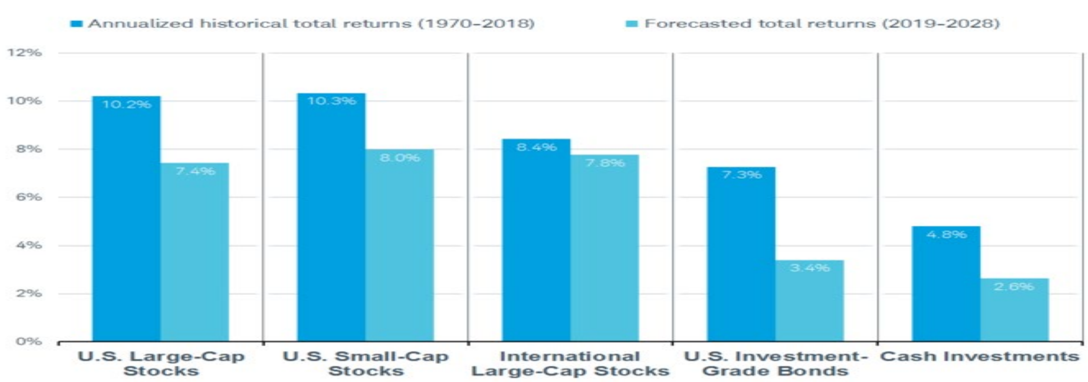
From March 6, 2009 when the S&P 500 hit 666.79 representing the stock market bottom, it has not traded that low since. According to Barron's, since that date the S&P 500 has risen 17.6% annualized including reinvested dividends, far above the S&P 500's average of 10.2% annualized from 1950 through March 6, 2009. Given the **outstanding stock market returns achieved over the past 10 years,** we believe that the **probability of those outstanding returns continuing over the next 5 to 10 years is highly unlikely.**

A stock's total return is a function of three factors as illustrated below:



The late investment legend and Vanguard founder John Bogle believed during the next decade **stocks will return an average of 4% annually while bonds will earn 3.5% annually.** Both forecasts are **well below historic returns since 1974 of 11.7% for stocks and 8% for bonds.** Bogle's stock forecast assumed 4% earnings growth, a 2% dividend yield and negative 2% from a contraction in the price/earnings ratio. For his bond calculation forecast he utilized current yields combined with accepting greater credit risk than U.S. Treasury bonds. **John Bogle was quoted in Barron's on December 28, 2018 stating, "Trees don't grow to the sky, and I see clouds on the horizon. I don't know if and when they'll arrive. A little extra caution should be the watchword."**

We never make any predictions regarding stock market valuation levels, and we are certainly not predicting another significant decline as during the Great Financial Crisis of 2008-2009, however we believe **investors must prepare for far lower returns over the next decade.** The chart below shows the investment firm Charles Schwab's estimates of future returns from 2019-2028.

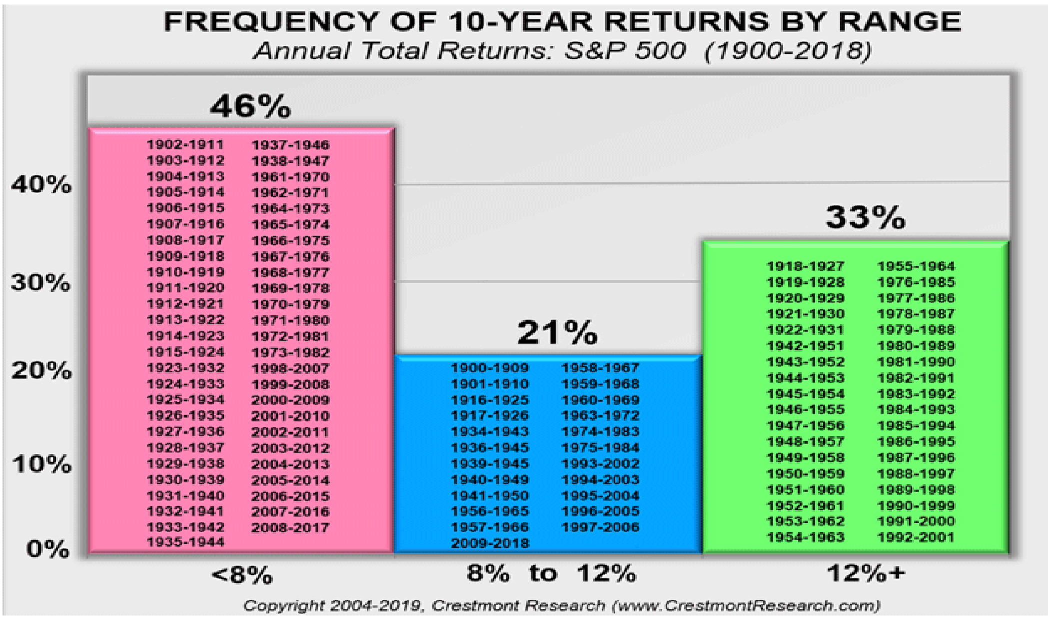


Total return = price growth plus dividend and interest income. Numbers rounded to the nearest one-tenth of a percentage point. Benchmark indexes for the asset classes: S&P500® index (U.S. Large-Cap Stocks), Russell 2000® (U.S. Small-Cap Stocks), MSCI EAFE Index® (International Large-Cap Stocks), Bloomberg Barclays U.S. Aggregate Bond Index (U.S. Investment-Grade Bonds), and Citigroup 3-Month U.S. Treasury Bill Index (Cash Investments). Past performance is no guarantee of future results.

Source: Charles Schwab Investment Advisory, Inc. Historical data from Morningstar Direct. Data as of 12/31/2018.

As the chart above illustrates, **nearly every stock classification is forecasted to have much lower real returns over the next several years** with **similar results** forecast in the **fixed-income space** as well. Clearly, after such strong stock market returns for so many years, the future will likely not be as robust, and it is incumbent among all investors to anticipate **lower returns in the decade ahead.**

A breakout from 1900-2018 of 10-year annual returns for the S&P 500 is illustrated in the chart below. Almost half of the 10-year periods produced returns of less than 8% and only one-third of the returns were 12% or more.



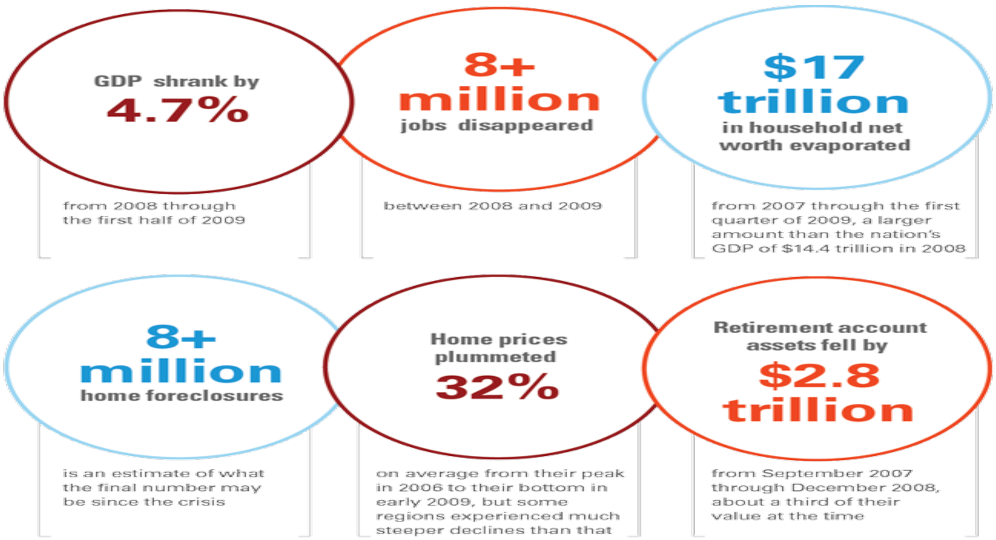
We want to be clear that we are **not forecasting where the stock market will be next week, next month, next year or in five years.** What we do want to do is strongly communicate that **now is not the time to go further out on the risk curve, but rather to exercise extreme caution and prudence in all investment decisions.**

EVALUATING BEAR MARKET STATISTICS

During long periods of strong stock market returns we are reminded of the father of value investing, Benjamin Graham's quote: **"The longer the bull market lasts the more severely investors will be affected with amnesia; after five years or so, many people no longer believe that bear markets are possible."**

We spend no time at all on market predictions, however since we are now at the 10th year of the current bull market that began in March 2009, we remain mindful of several past recessions and the resulting stock market declines.

While the Great Financial Crisis occurred over 10 years ago, it is helpful to reflect upon the magnitude of that crisis and the decline in many financial metrics that reverberated throughout our economy and the world.



The two tables below illustrate market declines of the S&P 500 since 1946, as well as whether they occurred along with a recession, and various other economic variable associated with the declines.

Characteristics of recessions and related stock market declines

Recession	Recession			Related Market Sell-off			Macro Environment		
	Peak Quarter	Trough Quarter	% Decline	Peak Date	Trough Date	% Decline	Commodity Spike	Aggressive Fed	Extreme Valuations
1 Recession of 1949	4Q48	4Q49	-1.5%	6/15/1948	6/13/1949	-21%			♦
2 Recession of 1953	2Q53	2Q54	-2.4%	1/5/1953	9/14/1953	-15%			
3 Recession of 1958	3Q57	2Q58	-3.0%	8/2/1956	10/22/1957	-22%			♦
4 Recession of 1960-61	2Q60	1Q61	-0.1%	8/3/1959	10/25/1960	-14%			♦
5 Recession of 1969-70	4Q69	4Q70	-0.2%	11/29/1968	5/26/1970	-36%		♦	
6 Recession of 1973-75	4Q73	1Q75	-3.1%	1/11/1973	10/3/1974	-48%	♦		
7 Recession of 1980	1Q80	3Q80	-2.2%	2/13/1980	3/27/1980	-17%	♦	♦	
8 Recession of 1981-82	3Q81	4Q82	-2.5%	11/28/1980	8/12/1982	-27%		♦	
9 Early 1990s recession	3Q90	1Q91	-1.4%	7/16/1990	10/11/1990	-20%	♦	♦	
10 Early 2000s recession	1Q01	4Q01	-0.4%	3/24/2000	10/9/2002	-49%	♦		♦
11 Great Recession	4Q07	2Q09	-4.0%	10/9/2007	3/9/2009	-57%	♦	♦	
Non-recession Bear Markets									
1 1962 flash crash, Cuban Missile Crisis	-	-	-	12/12/1961	6/26/1962	-28%			♦
2 1987 flash crash, program trading, overheating markets	-	-	-	8/25/1987	12/4/1987	-34%			♦
Average	-	-	-1.9%	-	-	-30%			

Source: FactSet, NBER, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.
*A bear market is defined as a 20% or more decline from the previous market high. The related market return is the peak to trough return over the cycle. Periods of "Recession" are defined using NBER business cycle dates. "Commodity spikes" are defined as movement in oil prices of over 100% over an 18-month period. Periods of "Extreme Valuations" are those where S&P 500 last 12 months' P/E levels were approximately two standard deviations above long-run averages, or time periods where equity market valuations appeared expensive given the broader macroeconomic environment. "Aggressive Fed Tightening" is defined as Federal Reserve monetary tightening that was unexpected and/or significant in magnitude. Bear and Bull returns are price returns.
Guide to the Markets – U.S. Data are as of December 31, 2018.

J.P.Morgan Asset Management

S&P 500 Index Bear Markets Since WWII

Month of Peak	Month of Trough	% Decline	Recession?
05/1946	05/1947	-29%	No
08/1956	10/1957	-22%	Yes
12/1961	06/1962	-28%	No
02/1966	10/1966	-22%	No
12/1968	05/1970	-36%	Yes
01/1973	10/1974	-48%	Yes
09/1976	03/1978	-19%	No
11/1980	08/1982	-27%	Yes
08/1987	12/1987	-34%	No
07/1990	10/1990	-20%	Yes
07/1998	08/1998	-19%	No
03/2000	10/2002	-49%	Yes
10/2007	03/2009	-56%	Yes
04/2011	10/2011	-19%	No
	Avg (All)	-31%	
	Avg (Recessions)	-37%	
	Avg (No Recession)	-24%	

Source: LPL Research, FactSet 12/20/18

Since 1926 there have been 370 quarterly returns with declines of 17% or more, three of which occurred after 2000. During the 4th quarter of 2018, the S&P 500 had declined 17.1% before finally closing down 13.5%.

Quarter Ending	Quarterly Performance
June 1932	-37.7%
Sept 1931	-33.6%
Dec 1929	-27.8%
Sept 1974	-25.2%
Dec 1987	-22.6%
Dec 2008	-21.9%
Dec 1937	-21.4%
June 1962	-20.6%
Mar 1938	-18.6%
Sept 1946	-18.0%
June 1970	-18.0%
June 1930	-17.7%
Sept 2002	-17.3%
Dec 2018	**-17.1%**

COMMODITIZATION OF BUSINESSES

Today, the **rapidity and magnitude of change is unprecedented and is happening all around us on a global scale; few industries will remain untouched.** Businesses are facing increasing competition, as a confluence of factors come together to force dramatic changes in business models from those in traditional banking, newspapers, broadcast television, cable, retailing and book publishing to name a few. As a result, many historic advantages that once may have protected an industry are all being impacted and fundamentally changed. We call the result the **commoditization of businesses** and to continue to prosper **the quality of people leading, managing and working throughout organizations is becoming ever more important.**

Rupert Murdoch stated, "The world is changing very fast. Big will not beat small any more. It will be the fast beating the slow." His quote perfectly captures what is occurring in a broad range of industries around the globe, including cable television, broadcast television, retailing, banking, healthcare, education and many other industries. **Incumbent firms will need to adapt and change to accommodate the ever-changing competitive landscape. Those firms with management teams that are best able to look around corners and quickly adapt their technology to a rapidly changing marketplace will be the winners.**

It is becoming increasingly difficult to evaluate businesses and the industries in which they compete to gain confidence in the future, given the **speed of change** going on around us and the **magnitude of that change.** Retailing is an excellent example to illustrate the challenges technology is creating for industries. In 2018 several retailers declared bankruptcy including Sears, Mattress Firm, Brookstone, Rockport, Nine West, Claire's, and The Walking Company. Thousands of locations have closed across the country and include not only bankrupt retailers but also many retailers that are continuing to reduce their number of locations given competitive pressures. The list below illustrates the large number of retail store closures in 2019 from both bankrupt and operating retailers.

Retail stores closing in 2019

RETAILER	CLOSURES	RETAILER	CLOSURES
Payless ShoeSource*	2,500	Beauty Brands	25
Gymboree	805	Henri Bendel	23
Shopko	251	Lowe's	20
Performance Bicycle	102	Macy's	9
Charlotte Russe	94	J.Crew	7
Sears	70	Kohl's	4
Destination Maternity**	67	Nordstrom	3
Kmart	50	JCPenney	2
Christopher & Banks***	40	Lord & Taylor	2

*Number includes stores in the US and Canada.
**Company said it would close 42—67 stores. ***Company said it would close 30—40 stores in 2.5 years.

Source: Company filings Insider Inc.

We expect this to continue. Consider this: the retail industry in the United States has 31 sq. ft. per capita of retail space compared to the United Kingdom with 10, Japan with 7, and Germany with 2.

Given the pressure being placed on retailers by online companies such as Amazon, retailers are finding it increasingly difficult to compete. Competition is further intensified by Amazon's aggressive pricing, resulting in low to non-existent profit margins for the firm. The result could be a decline in the massive over supply of retail floor space in this country as more and more consumers purchase products using the Internet, benefiting Amazon and other online companies that lack the more expensive distribution model utilized by traditional brick and mortar retailers.

An even greater challenge going forward is that technology is changing consumer behavior and, when behaviors change, the results can be catastrophic for industries. Furthermore, these changes are happening more rapidly and with far greater magnitude. Each of the industries I have mentioned above -- retailing, banking, cable, and broadcasting -- are fundamentally being transformed and it is very difficult to clearly see their futures. **This has made our job, as investors on behalf of our clients, more difficult requiring more qualitative work to gain differential insights to see around corners and better assess the future.** Valuation will always remain our focus by purchasing securities with a solid margin of safety.

Retailers will have to transform themselves from solid brick and mortar operations to become adept on the Internet as an additional way to better serve all their customers. I recently read that no indoor mall has been built in this country since 2006 and I don't know if that is accurate. Regardless, indoor malls are the ones facing the greatest challenges, even more so than stand-alone stores, strip malls, and outlet centers.

Similarly, we are investors in several companies in the insurance and banking industries including Brown & Brown an insurance broker; Progressive an insurance underwriter; Berkshire Hathaway with large primary and reinsurance operations; as well as U.S. Bancorp. While these companies offer **undifferentiated products,** the primary reason they can generate significantly higher returns on invested capital and better margins is directly related to the quality of the people in the organization.

For example, Progressive has been an auto insurer since 1937 and sells auto insurance through a variety of distribution channels. However, the key factors relate to pricing their product, managing claims, adequately reserving the risks they have underwritten and marketing their product. Progressive's evolution from a non-standard high-risk auto insurance underwriter, distributed exclusively through independent agents into a broader standard and non-standard insurance underwriter, distributed through a variety of distribution channels including the internet, over the telephone, as well as through independent agents, is a further testament to its creative and devoted work force. Progressive's return on equity has historically been significantly higher than the great majority of competitors. The only viable explanation, given their lack of trademarks, patents, and copyrights, is the outstanding quality of their people over the past few decades. **This is becoming an increasingly important competitive dynamic that we must assess in evaluating companies in which we invest.**

While change creates enormous risks in businesses, it is becoming almost a certainty that all businesses will need to evolve at an accelerating rate in order to remain competitive and preferably leaders in their industries. These are the firms in which we seek to invest. **This ability to change and evolve is directly proportional to the quality of management and its ability to execute their vision through the development of great people.**

Our research-driven approach to evaluating both the quantitative and qualitative factors that are knowable and important has served us well during the most difficult stock market period since the 1930's.

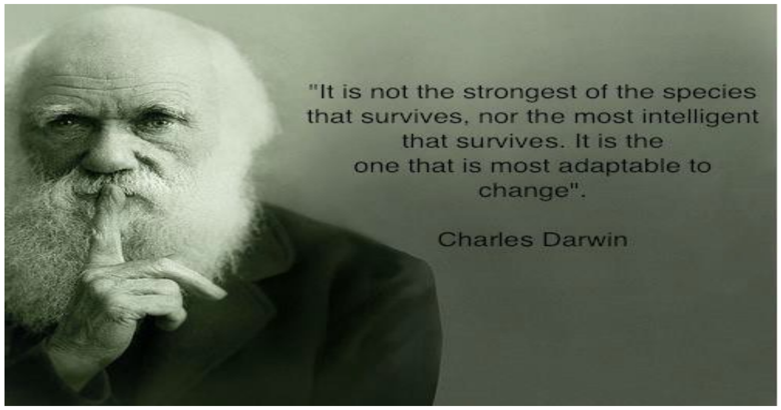
We spend a great deal of our time evaluating the financial characteristics of our companies and their competitors, as well as out in the field seeking unique insights from the marketplace to further enhance our understanding of our holdings and the industries in which they compete. A key additional focus in our field research is learning all we can about the management leadership of our holdings to gain confirmation and conviction in their capabilities in both operating the business and allocating capital.

As Mr. Buffett so eloquently described in his 1999 Fortune article, **"The key to successful investing is not assessing how much an industry is going to affect society, or how much it will grow, but rather determining the competitive advantage of any given company and, above all, the durability of that advantage. The products or services that have wide, sustainable moats around them are the ones that deliver rewards to investors."**

EXECUTIVE LEADERSHIP IN A RAPIDLY CHANGING COMPETITIVE LANDSCAPE

Today, corporate leadership is more important than ever due to the rapid changes in many industries. Many years ago, it was the technology space that was viewed as rapidly changing and therefore making it difficult to foresee the future. Today, almost every industry is undergoing rapid changes and transformations requiring that management teams have the ability to see around corners and adjust to the ever-changing competitive environment.

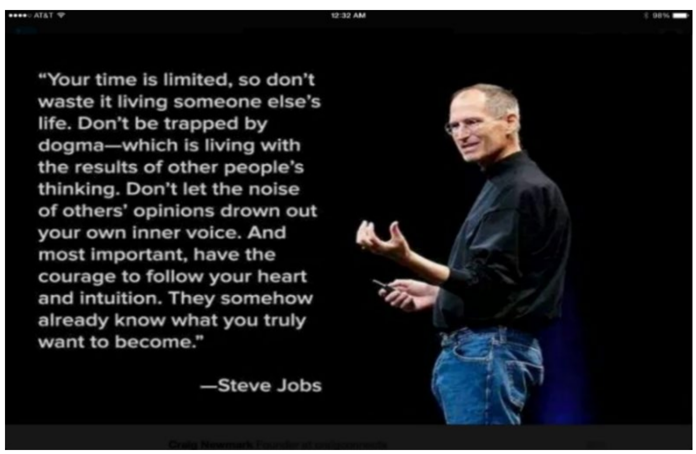
Stephen Hawking, the late theoretical physicist once said**, "Intelligence is the ability to adapt to change."** We are also reminded of Charles Darwin's quote on the following page:



As a result, we continue to focus on companies led by management teams that can navigate our rapidly changing world. We seek management teams that have enormous talent and as Arthur Schopenhauer, the German philosopher, once said, **"Talent hits a target no one else can hit. Genius hits a target no one else can see." We seek brilliant, visionary and courageous leaders.**

We seek leaders that can build great teams with broad and deep visions for their companies and the industries in which they compete, the ability to articulate and communicate that vision, both internally to their colleagues and externally to customers, and finally the ability to successfully execute on that vision by exercising sound judgment.

Steve Jobs' quote below, **on thinking independently** and having the **courage to act,** is sound advice for leaders in today's rapidly changing business environment.



A few years ago, the Boston Consulting Group published a paper entitled *Adaptability: The New Competitive Advantage*, by Martin Reeves and Mike Deimler. In that piece, BCG discussed globalization, new and improved technologies and increasing transparency, along with other factors which have upended the business environment and given many CEO's and management teams significant concerns. The paper describes that since 1980 the volatility of business operating margins, largely static since the 1950's, have more than doubled and the size of the gap between winners (companies with high operating margins) and losers (those with low operating margins) has grown. The historic correlation between profitability and market share has continued to decline, and in some industries doesn't exist at all. The number of companies that were market share leaders **and** profitability leaders declined from 34% in 1950 to 7% in 2007.

Uncertainty has become a way of life and companies led by management teams that can adapt to the ever-changing new environment will be the companies that will succeed.

Throughout the development of successful organizations, there are often only a few key inflection points that differentiate the winners from the losers. It is during those important moments that leaders are truly defined, making difficult decisions and successfully implementing strategies. To illustrate, there were three critical decisions made by Robert Kraft, owner of the New England Patriots, which changed the team from a perennial loser into the winningest franchise in the NFL over the past 15 years. Each of these decisions was unpopular and difficult to come to on a purely analytical basis. First was overspending for a bad team. Second was hiring Bill Belichick after he had failed miserably as the Cleveland Browns head coach. Third was releasing the highest paid player in football after having taken them to the Super Bowl, their star quarterback Drew Bledsoe. These bold decisions in the words of Kraft, **"The key to life, is you try to see things other people can't see.** This league is set up for everyone to go 8 - 8. **How do you differentiate? You have to be bold in any business and do things you take criticism for, but you believe are right."**

A few other characteristics we look for in management teams are **leaders** that **begin with the end in mind,** have a **clear vision about their end goal,** are **flexible on how to achieve that goal** and, finally, they **look at problems, issues and strategies from a variety of different viewpoints** always seeking to **enhance their understanding by accepting various inputs to augment their decision-making process.** Of all the great leaders and companies we have met and studied, the most successful are **extremely focused upon process** and **continuously improving their decision-making process over which they have far more control than outcomes, which are more variable.** As **Pelé** the great soccer player once said, **"Success is no accident. It is hard work, perseverance, learning, studying, sacrifice and most of all, love of what you are doing or learning to do."**

In evaluating management teams, we strongly believe in **Henry Wadsworth Longfellow's** excellent quote**, "A single conversation across the table with a wise man is better than 10 years mere study of books."** We believe meeting executives after having done solid due diligence on them, their teams, as well as their company and industry is a wonderful way to assess their capabilities above and beyond just looking at the numbers, and to gain insight into what the future may hold, and a clearer understanding of their vision, as well as their capabilities.

A recent quote from **Gary Hoover,** an entrepreneur, captures the essence of great leaders seeking to build great institutions, and represent the types of leaders our firm, seeks to invest in**. "Only those who master their craft, who deliver great value, who love what they do for its own sake, and who cherish their customers will create lasting enterprises of great value."**

MANAGING RISK AND OUR INVESTMENT PROCESS

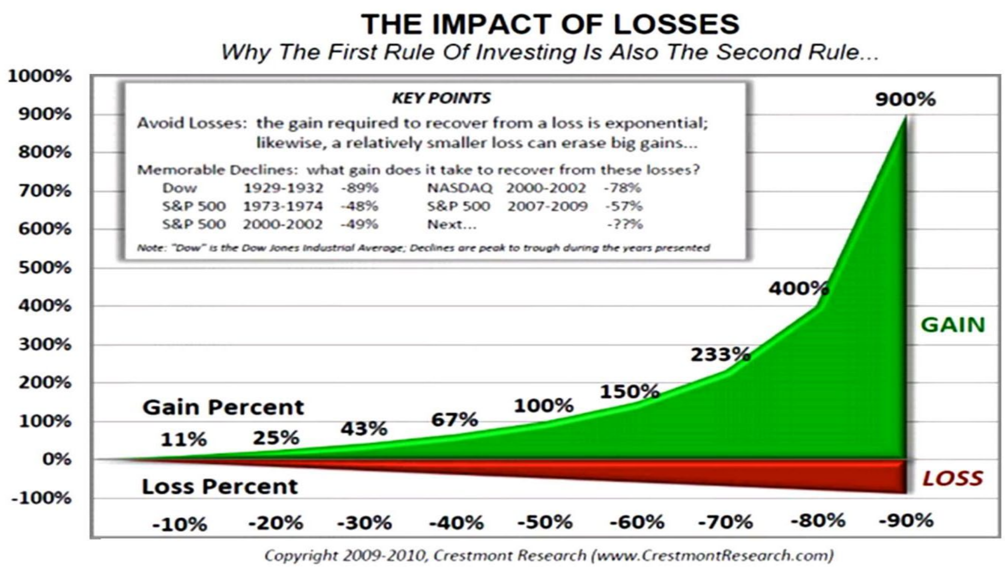
Given the continued rise in the current ten-year bull market, where everyone is happy and feeling smart with solid gains, it is important to remember the father of value investing and Warren Buffett's mentor, Benjamin Graham, who stated, **"The essence of investment management is the management of risks, not the management of returns. The investor's chief problem, and even his worst enemy, is likely to be himself."**

The most important job of any investment advisor is to assess, evaluate and ultimately manage risk in the portfolios of its clients. Risk is a concept that is very difficult to understand, measure and quantify. The unique ability to look around corners, assess management teams and evaluate business models is both an art and a science that requires enormous devotion and focus to be able to avoid the numerous pitfalls that exist in any asset class whether stocks, bonds, commercial real estate or any other asset. While our job as an investment advisor has a broad range of functions including providing superior client service and working diligently to understand the specific needs and objectives of each client, **by far the most important is the ability to evaluate and manage risk in our client portfolios.**

We define risk as the probability of permanent capital loss. That is, an investment is permanently damaged and ultimately leads to losses. We work diligently to avoid permanent capital loss; however, we are not immune to volatility or price fluctuations in businesses in which we have great confidence in the business model and the managers whom we know well.

In the recent tumultuous stock market of December 2018, Will Rogers' 1933 quote comes to mind, "I am not so concerned with the return on my money, as the return of my money."

As many investors have become reacquainted with investment losses during the past 15 years, the **stark realities of future gains required to break even have come into focus.** The economics of investment losses are best illustrated by the following chart and table.



% Investment Decline	% Gain Required to Break Even
20%	25%
30	43
50	100
60	150
70	233
80	400
90	900

The analysis of any investment must consist of assessing both the more commonly discussed **RETURN,** as well as the often-neglected component **RISK**. We always focus on the risks of an investment first and then potential returns.

How do we assess risk at our firm? We focus upon understanding, in depth, the business models of the companies in which we invest, as well as the industries in which they compete. We evaluate the entire industry and the specific companies from the bottom up. We do so quantitatively trying to dig deep into the numbers to truly understand what they really mean, as well as qualitatively by evaluating their products, services, management team, competitive position and corporate culture.

Historically, we have found that corporate cultures led by individuals with unique characteristics and capabilities who are able to communicate their passion and vision to create an outstanding corporate culture that is very difficult to replicate. Common characteristics of these types of individuals are that they truly love what they do and are committed to excellence in every aspect of their business. They can build a culture with many employees that also truly believe in that vision as well. Some examples include: Apple, Amazon, Alphabet (Google), Wal-Mart, Starbucks, Nike, Fastenal, Progressive and, of course, Berkshire Hathaway.

The fact remains that these great enterprises are rare, and their stock prices have fluctuated greatly over the years. **We view our role as that of a risk manager, always seeking to understand first and most importantly what can go wrong in a business and assessing businesses from a variety of perspectives. We remain focused on always enhancing and improving our research process, as opposed to outcomes, which are more variable and over which we have less control. It is from this process that we enhance our conviction.**

Despite periodic declines and volatility, the stock market has continued to rise over time and, as a result, rarely is there a penalty for taking excessive risk except during those infrequent periods of decline or volatility. A corollary is that investors are rarely rewarded for avoiding risk except during significant risk readjustments or major stock market declines. At such times, excessive leverage, poor management, poor capital allocation and bad decisions are often overlooked, resulting in unjustified confidence levels. We operate at Lountzis Asset Management, LLC always focused on risk in everything we do, and we work diligently to avoid it.

We recall Donald Rumsfeld's comments regarding known known's, which are things that we know we know, as well as known unknowns, which are things we know we do not know. There are also unknown unknowns, things that we don't know we don't know and those can be the most challenging for investors!

While we will not allow fear to drive our process, **we remain closely focused on truly understanding everything we possibly can about a business, specifically, what is knowable and what is important, as well as what makes the business unique or special and sustainable. Opportunities to find such businesses are rare, but when we find them, we make meaningful commitments.**

Let me reiterate our view that **there typically is not an immediate penalty for taking excessive risk or a reward for avoiding excessive risks. In all our investments we seek a margin of safety which reduces dependence upon forecasts.** Often, we are reminded of a **quote from the late Johann von Goethe, "To think is easy. To act is hard. But, the hardest thing in the world is to act in accordance with your thinking."** We operate in a business where success is dependent upon appropriately balancing confidence and conviction in your process, balanced with the humility of acknowledging that mistakes can be made and will continue to be made.

We continue to focus upon and refine our process, always focusing on generating unique differential insights that we hope will give us an edge in better understanding the businesses in which we invest. Listed on the following page are the five criteria that were enumerated in Warren Buffett's 1993 annual report that beautifully captures the thought process in making an investment:

1. The certainty with which the long-term economic characteristics of the business can be evaluated;

2. The certainty with which management can be evaluated, both as to its ability to realize the full potential of the business and to wisely employ its cash flows;

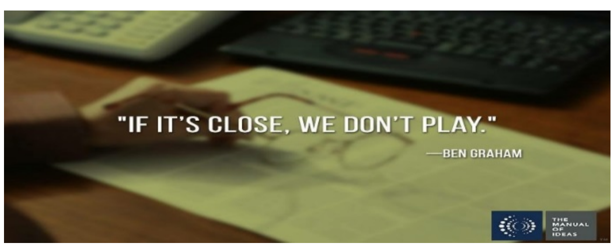
3. The certainty with which management can be counted on to channel the rewards from the business to the shareholders rather than to itself;

4. The purchase price of the business;

5. The levels of taxation and inflation that will be experienced and that will determine the degree by which an investor's purchasing-power return is reduced from his gross return.

We are continually working to **improve our process** speaking with customers, competitors, vendors, suppliers and former employees to gain insights into business models, industries and management teams. We have found that while the numbers are a wonderful tool, they simply are not enough and that the qualitative characteristics need to be dovetailed on top of the numbers to give us a full picture of the company and the industry in which it competes. In fact, our experience is that the qualitative factors such as unique corporate cultures, outstanding products and services, long-term vision, passion, etc., are often the precursor to outstanding numbers that ultimately become recognized by all investors leading to much higher valuations. One of our goals is to identify these businesses before that occurs, or to be able to buy these businesses during short-term cyclical challenges that are temporary in nature and not long-term problems. **In investing, we follow a quote from the great scientist Marie Curie, "Nothing in life is to be feared, it is only to be understood."**

As risk managers with our primary goal of capital preservation and secondary goal of capital appreciation, we believe in investing only when the odds are significantly in our favor. In the words of Benjamin Graham:



Our goals as stated in our literature,

"Our investment philosophy guides our objective to maximize the long-term after-tax returns for our clients in various economic and market conditions while emphasizing the preservation of capital.

Our primary field-based personal interviewing supplements and enhances our understanding of the company's core financial characteristics and the fundamentals of the industry in which it operates."

Our research process begins with our extensive database of companies that we have screened and studied for almost three decades on both a financial basis (quantitative) and by evaluating various qualitative factors, such as their products, management teams, competitive forces and various other measures. In performing our extensive quantitative analysis of companies, today we are finding fewer and fewer companies that meet our evaluation criteria, and this encompasses several thousand companies almost exclusively in the developed world; the U.S., Western Europe, Canada and Japan. Our valuation screens remain an important initial component of identifying attractive potential investment opportunities. However, financial analysis alone is not enough, as ultimately businesses with outstanding financial characteristics are a by-product of terrific qualitative characteristics. **Companies with attractive financial metrics provide insights into the company's past, but what we really are seeking is an understanding of the company's prospects, which are driven by qualitative factors such as their products, quality of all their people, service levels, sustainable competitive advantages and outstanding visionary leaders as well as other non-**financial factors.

A critical difference at our firm is that we spend a great deal of time performing field-based research. In addition to the in-depth quantitative analysis, we have spent thousands of days on the road over the last two decades speaking with competitors, customers, industry consultants and other knowledgeable industry experts, always seeking to gain what we call "differential insights", that is ways at looking at a business or industry that come from the marketplace and help us bring the numbers to life. We perform our research in person to build long-term relationships with customers, competitors, suppliers, retired executives, industry consultants and others to build a broad and diverse network in a variety of industries. We have found that the greatest insights have come from speaking to individuals in person that have spent decades within specific companies and industries. We believe in diligent and thoughtful questioning derived from the financial analysis and supplemented by our personal interviews to create a deep and penetrating analysis of potential investments. We strongly believe in the Socratic method of constantly seeking better questions to stimulate critical thinking and to better illuminate ideas. **We agree with the American writer and naturalist Henry David Thoreau, who said, "It's not what you look at that matters, it's what you see." We also agree with the French philosopher Pierre Abelard, who stated, "By doubting we are led to question; by questioning we arrive at the truth." We will continue to seek the truth in all our research efforts and remain diligent and extremely risk averse**.

We also spend a great deal of time evaluating mistakes we have made in the past and find that to be a very valuable exercise to learn from and hopefully assure that they do not occur again. **In the words of Warren Buffett; "The less prudence with which others conduct their affairs, the greater the prudence with which we should conduct ours."** There is not that much prudence around today; so, it's our job to be even more prudent.

The **primary purpose of our extensive travel and personal interviewing is to enhance our knowledge first and foremost to mitigate the risk of permanent capital loss in our investments.** Our **secondary purpose is to gain unique insights that will give us additional confidence to make larger investment commitments to our holdings.** Finally, **in performing our field-based research, we have often found new ideas for investment, which is a terrific by-product of our research process.**

Please be assured we will continue to work diligently to continually enhance our research process, both our quantitative analysis and qualitative process with the primary focus of seeking to avoid permanent capital loss and, secondarily, seeking to achieve attractive rates of return.

In describing in some depth our research process, I believe it is imperative to share some of my professional background with you, since it has had such a profound impact on the investment philosophy and research process utilized at Lountzis Asset Management, LLC. I began my business career in consulting, helping to build a competitive analysis program evaluating many industries and learning about the key competitive forces that drive companies and the industries in which they compete. After consulting I had the privilege of working directly with several of the finest investors in the world. I began my career with Chuck Royce, the CEO of the Royce Funds. Chuck is a pioneer in small cap investing, as well as a terrific investor, outstanding businessman and a terrific person. My career was further guided by the outstanding investors at Ruane, Cunniff & Goldfarb, Inc. -- the late Bill Ruane, Richard Cunniff and Carley Cunniff, as well as Bob Goldfarb and Greg Alexander. I might add, not only were they great investors they were also outstanding people.

There have been many others as well, including the late Peter Cundill, whom I met briefly, but never had the privilege of getting to know. In his book, *There is Always Something to Do,* he had a paragraph that beautifully captures how we look at research and the investment process. "To my knowledge there are no good records that have been built by institutions run by committee. In almost all cases the great records have been the product of individuals, perhaps working together, but always with a clearly defined framework. In reality, outstanding records are made by dictators, hopefully benevolent, but nonetheless dictators. And another thing, most top managers really do exchange ideas without fear or ego; they always will. I don't think I have ever walked into an excellent investors office who has not openly said, "Yeah sure, here's what I am doing", or, "what did you do about that one? I blew it." We all know we aren't going to get it right all the time and it is an invaluable thing to be able to talk to others who understand."

One additional lesson I have learned is **being intellectually honest with myself and admitting that every so often, no matter how hard you work, how much you read, how many intelligent people you speak to, you simply cannot avoid all risks, nor have the insights one needs to always make good investment decisions. Many people find it difficult, but I feel it's an important capability to look at the facts, the research, and the analysis and say, "I simply don't know.'"**

Investing remains one of the world's most humbling businesses. Despite long hours, diligent research, and years of experience the markets continue to unfold in unanticipated ways. The only thing that is certain is that the future is inherently uncertain. We will continue to maintain our discipline and focus seeking unique insights and exercising sound judgement.

Investing often requires **following a road less traveled,** guided by your own research, experience and insight to formulate conclusions.

Mistakes are unfortunately unavoidable, though we do hope to minimize their frequency and their impact. We also sincerely hope to learn from our mistakes and never repeat them. As Will Rogers said, **"Good judgement comes from experience and a lot of that comes from bad judgement."**

Being skeptical is an important trait as an investor. In the first century B.C, two ancient Greek philosophers, Pyrrho of Elis and his follower Aenesidemus created Pyrrhonism or the school of skepticism. The Pyrrhonian method was to **deeply develop both sides of an argument before making a final decision.** It involves **carefully suspending judgment, a constant challenging of one's own knowledge, and seeking to avoid ideology and biases.**

We seek to create an environment that spawns individual creativity and in **Ray Dalio's words "Thoughtful disagreement which leads to the beginning of understanding. People and culture are all that matter. We seek meaningful work and meaningful relationships through radical truth and radical transparency."**

Intellectual honesty sets the foundation for all relationships within an organization and in all external dealings with clients and vendors. Every individual brings a unique set of skills as people are smart and talented in very different ways. We remain focused upon building a unique culture as **Peter Drucker says, "Culture trumps strategy."**

We seek to **question everything we can**, including conventional wisdom, to learn as much as we can about where we are allocating our clients' hard-earned capital. **Voltaire, the French philosopher wrote, "Judge a man by his questions rather than his answers."**

To avoid mistakes at our firm, we continuously evaluate our process. Let me share with you some of the principles we utilize in our investment philosophy and research process.

1. We always focus, first, upon **assessing the risks of any investment** and what the **potential downside** is before evaluating potential returns.

2. **We utilize a field-based approach**, speaking to competitors, management teams and consultants to augment our analysis of financial statements, and to bring the numbers to life. We believe our research process gives us an edge.

3. We always seek a **margin of safety** in our purchases; a long-term value significantly above the current purchase price.

4. We focus our research on individual companies within our **circle of competence,** and not on guessing where the economy, interest rates, or other economic factors are going. Our approach remains **bottoms up**.

5. We attempt to **minimize portfolio turnover**, holding stocks for several years, thereby reducing both trading costs and taxes.

6. We believe in **prudent concentration of investments in our best ideas**, typically 10 to 20 issues, not the wide diversification employed by most management firms.

7. We seek **clients whose investment philosophy is consistent with ours**. This enables us the flexibility in managing their assets to invest only when we deem the risk/reward characteristics in our favor.

8. We **define risk as permanent capital loss, not short-term declines in stock prices**. Volatility or the fluctuation in prices provides us the opportunity to buy when prices are cheap and sell when prices are high.

9. We seek to **balance confidence with humility** while avoiding arrogance and fear, which lead to investment mistakes or making no investments at all. Humility is critical and an important quality in all outstanding investors.

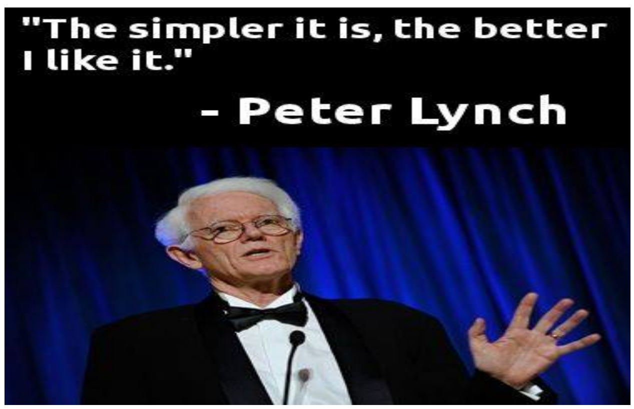
10. **Learning** is a never-ending process and we attempt to **continuously improve our knowledge** through deep and thoughtful questioning across industries, companies and leadership teams. Mr. Munger calls Mr. Buffett a **learning machine.**

11. **Simplicity** is a key component in any analysis and investment. The ability to simplify every investment into a few key points is critical. In the words of Mr. Buffett, we **focus upon what is knowable and important.**

While each of the investment lessons noted above is very important, I want to discuss a couple of them in more detail.

First, being **intellectually humble** is a critical quality required by all investors. No matter how hard one works, how solid your investment process is, or how successful you may have been, it is impossible to clearly know the future and to always achieve outstanding results. **Investing is one of the most humbling businesses in a world** where you are constantly being challenged about your analysis and judgment. **A successful investor must maintain a delicate balance between being confident but not arrogant and humble yet not fearful.** It is a difficult balancing act that one must vigilantly seek to maintain in a highly volatile, short-term oriented and emotional world. As **Warren Buffett has stated, "Temperament is more important than IQ,"** and I could not agree more. We will continue to remain humble yet confident while avoiding arrogance and fear as we navigate the current very challenging global financial markets.

Second, **keeping things simple** is profoundly important and a critical component of investment success. Complexity needs to be simplified to be clearly understood. If an idea cannot be simplified it is often not well understood. We agree with the great investor Peter Lynch in the illustration below.



Simplicity is universal in its appeal and importance, not just in investing. In the words of author and editor, Michael Korda, "**Great leaders are almost always great simplifiers, who cut through argument, debate and doubt to offer a solution everybody can understand and remember."**

We seek leaders that have this quality and are constantly looking for the best executives we can find, and it has been our experience that the best executives are great simplifiers. One executive for whom we have enormous respect, but unfortunately have never owned the stock is Jeff Bezos at Amazon. Bezos is truly a genius and possesses a broad range of unique gifts not unlike Warren Buffett that have enabled him to create an extraordinary organization with many talented colleagues. Simplicity is a key tenet of Amazon's success.

In 2009 Jeff Bezos articulated Amazon's simple philosophy, **"It is the basics. It is focusing on selection, low prices and reliable, convenient, fast delivery. It's the cumulative effect of having this approach for 14 years. I always tell people, if we have a good quarter, it's because of the work we did three, four and five years ago. It's not because we did a good job this quarter."**

While simplifying concepts is critical to success for any investor and leader, the challenge lies in successfully implementing those simple concepts into successful investments and a successful organization.

Finally, in our business, we seek to work with first-class clients, company management teams, vendors, etc., that are run by first-class people. We strive to invest in the best management teams and we also seek to deliver excellence in all we do as a firm serving our clients. The following quote best describes how we like to view the management of companies in which we invest, and how we hope our clients, vendors, and others with whom we deal with, view us.

Tony La Russa the St. Louis Cardinals manager recently described Albert Pujols, baseball's best player, "He isn't colorful, and he isn't controversial – he's just great."

This approach has served us well and we are grateful and thankful for a client base that understands our approach. We will maintain our discipline, and thankfully, thus far, we have avoided businesses that have gone bankrupt or whose value has dissipated wiping out 80-90% of the company's market value. While we cannot predict the future, it is our sincere hope that we will continue to avoid securities whose business models, balance sheets and management teams are not of the highest quality. We have remained committed to our research process seeking to add value and develop an edge in understanding our businesses, the industries in which they operate, and their management teams as best we possibly can, combined with the most important factor – an attractive valuation.

Despite the many challenges we are confronting, we remain optimistic that our country, our people and our collective ability will overcome obstacles as we have in the past to continue to innovate, create jobs, and slowly but surely emerge from deep in the valley. While the challenges of valuing businesses are hard as ever, there are many factors that cause us to be optimistic.

The creative and innovative capabilities of our companies, over time, will continue to enable many U.S. businesses to maintain their worldwide leadership, as well as build, create, and improve upon both existing and new industries in the future. I believe our companies' collective ingenuity will enable our country to continue to lead in many areas and prosper serving the rapidly growing middle-class populations in China, India and throughout the world.

We remain disciplined, humble, patient and thankful to all our clients who have continued to believe in our investment philosophy and research process.

VALUATION OF BUSINESSES AND PEOPLE IS AN ART FORM

Investing requires a deep understanding of both the quantitative and qualitative factors in evaluating companies and their management teams. At our firm, we work diligently to understand the financial characteristics of the businesses we are studying as well as the industries in which they compete. We also spend a great deal of time evaluating the qualitative characteristics such as their products, management, customer loyalty, and many other factors that may lead to success.

In **Warren Buffett's letter to his partners in 1967, he clearly articulated the importance of both quantitative and qualitative factors in evaluating securities and making investment decisions**.

“The evaluation of securities and businesses for investment purposes has always involved a mixture of qualitative and quantitative factors. At the one extreme, the analyst exclusively oriented to qualitative factors would say “Buy the right company (with the right prospects, inherent industry conditions, management, etc.) and the price will take care of itself.” On the other hand, the quantitative spokesman would say “Buy at the right price and the company (and stock) will take care of itself.” As is so often the pleasant result in the securities world, money can be made with either approach. And, of course, any analyst combines the two to some extent - his classification in either school would depend on the relative weight he assigns to the various factors and not to his consideration of one group of factors to the exclusion of the other group. Interestingly enough, **although I consider myself to be primarily in the quantitative school** (and as I write this no one has come back from recess - I may be the only one left in the class**), the really sensational ideas I have had over the years have been heavily weighted toward the qualitative side where I have had a "high-probability insight". This is what causes the cash register to really sing.** However, it is an infrequent occurrence, as insights usually are, and, of course, no insight is required on the quantitative side - the figures should hit you over the head with a baseball bat. **So, the really big money tends to be made by investors who are right on qualitative decisions but, at least in my opinion, the surer money tends to be made on the obvious quantitative decisions.”**

Valuation is truly an art form and combines a broad range of **quantitative** and **qualitative factors** in assessing both businesses and leaders. To illustrate, I was reminded of the NFL Scouting Report on a quarterback in the 2000 NFL Draft. Several quantitative measures were used to evaluate this quarterback, along with comments, which are listed below:

- One of the slowest quarterbacks ever timed in the 40-yard dash (5.2 seconds)
- Very poor vertical jump measurement
- Lacks great physical stature and strength
- Lacks mobility and the ability to avoid the rush
- System type player who can get exposed if forced to ad lib
- Lacks a strong arm and does not throw a really tight spiral, cannot drive the ball down field
- Poor build, skinny, gets knocked down easily

The analysis given above focuses primarily upon physical skills that can be evaluated quantitatively with numbers such as speed, arm strength, vertical jump, overall strength and quickness to name a few. Unfortunately, there is a broad range of characteristics and qualities that are not quantifiable and measurable such as desire, resiliency, intellect, composure under pressure, ability to overcome obstacles, ability to quickly read defenses, persistence, emotional makeup, work ethic and many other unquantifiable qualities.

This quarterback was the 199th player chosen, drafted in the 6th round of the 2000 NFL Draft, as 6 quarterbacks were chosen ahead of him. Each one had far better physical skills, as measured at the NFL Combine, which evaluates players on a broad range of attributes. In fact, in the 32 years of the NFL Combine, 576 quarterbacks were evaluated, and his scores were dead last at number 576.

The quarterback I am describing is Tom Brady of the New England Patriots who has played in 9 Super Bowls and won 6 of them. The Patriots easily could have won the other 3 Super Bowls. He has virtually every playoff record for a quarterback including: most career playoff games played, touchdown passes, and passing yardage to name a few. Steve Young, a Hall of Fame quarterback for the San Francisco 49’ers stated,” Tom Brady has done more with less talent around him than any other quarterback in history.”

If one studied his life and career in depth, several key attributes become apparent. While playing for the University of Michigan, the only real school that recruited him, he repeatedly led the team to several comeback victories. His coach at the University of Michigan, Lloyd Carr stated, "This game is a struggle and Tom Brady embraced that struggle more than anybody I have ever known."

In his final game at the University of Michigan, they faced Alabama in the Orange Bowl and fell behind 14-0, then tied it and fell behind again 28-14 and tied it again before winning in overtime 35-34. Lloyd Carr stated, "As fine a quarterback performance as I have ever seen and there is no greater leader than Tom Brady."

Tom's entire career has been a fierce struggle of always trying to prove himself at every level. He was not highly recruited out of Serra High School in California, while at Michigan he shared the job with Drew Henson his senior year and he was the 199th draft pick in the NFL after 6 other quarterbacks were chosen. Coach Lloyd Carr received only one phone call from an NFL team about Tom and he stated to them, "You will never regret drafting Tom Brady."

Those struggles and obstacles served to strengthen his resolve and have helped make him arguably the greatest NFL quarterback in history.

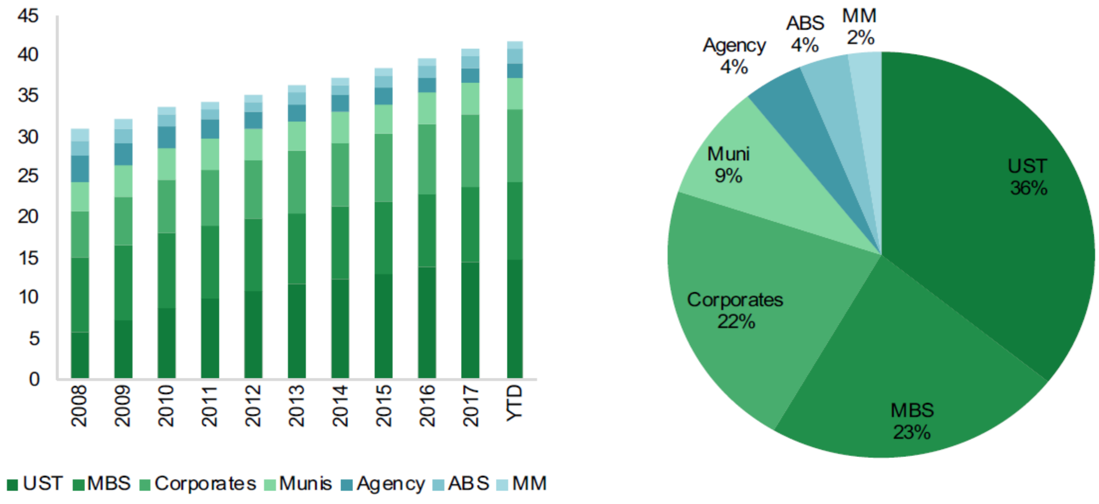
Tom Brady's story resonated with me because evaluating businesses and people go hand in hand and it is so very difficult to determine the qualities and characteristics that lead to success. In fact, **none of the hundreds of scouts, coaches and general managers in the NFL were able to recognize the qualities in Tom Brady that made him unique, illustrating how assessing people (and I might add businesses) is very, very difficult and truly an art form.**

MACRO AREAS OF CONCERN

Given our emphasis on risk management, over the past few years we have discussed in detail many areas of concern such as our federal government's overall debt levels, budget deficits, rising entitlement programs (namely social security, medicare and medicaid), underfunded corporate pension plans, and underfunded state and local pension plans. A few **current areas of concern are corporate bonds which have grown rapidly over the past several years, leveraged loans, the large number of IPO's that have gone public with no earnings, unregulated non-banks that are continuing to grow their market presence in many areas of credit extension, lack of fixed-income inventory which may create liquidity and pricing issues and finally global debt levels that continue to rise to unprecedented levels.**

While often investors focus upon the U.S. equity market which is about $30 trillion, the U.S. bond market is over $41 trillion.

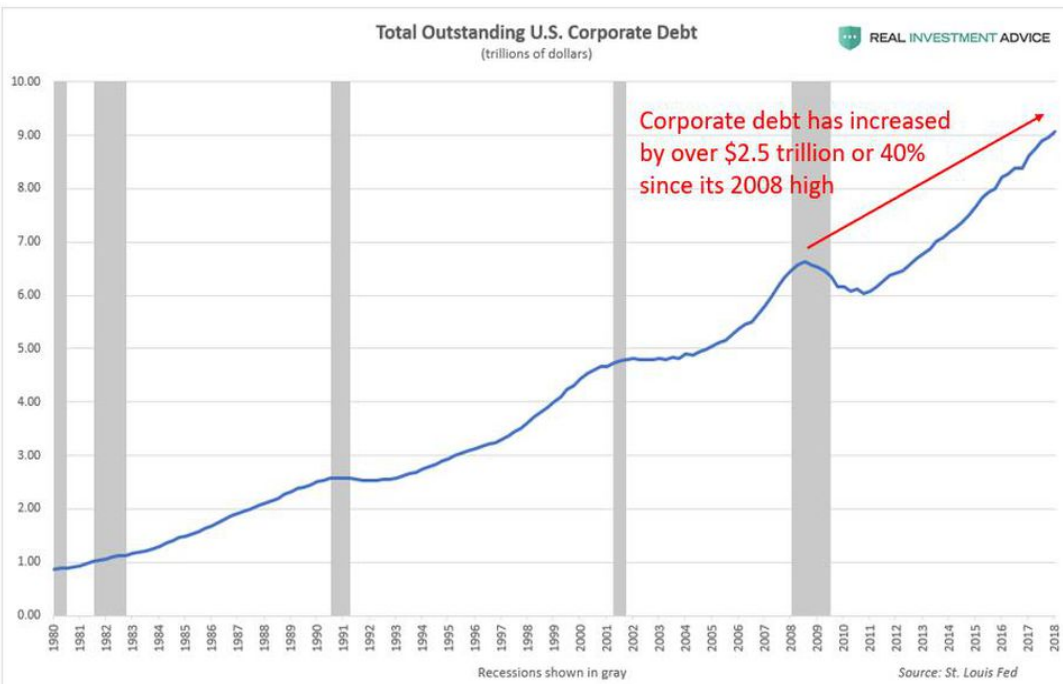
US Fixed Income Outstanding, $41.9T

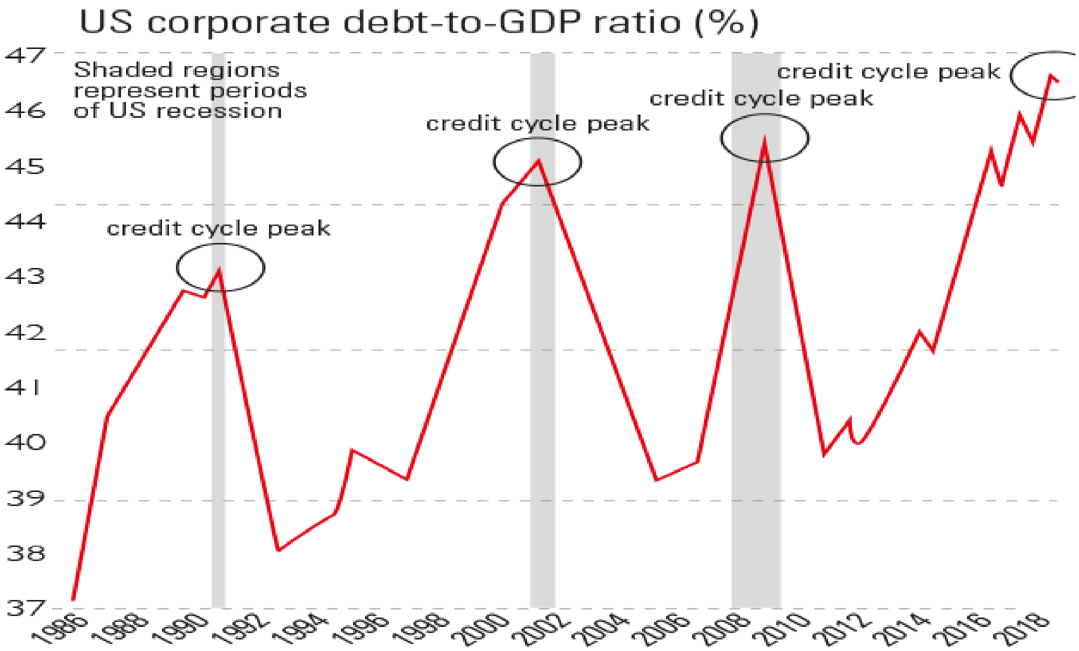


Source: SIFMA

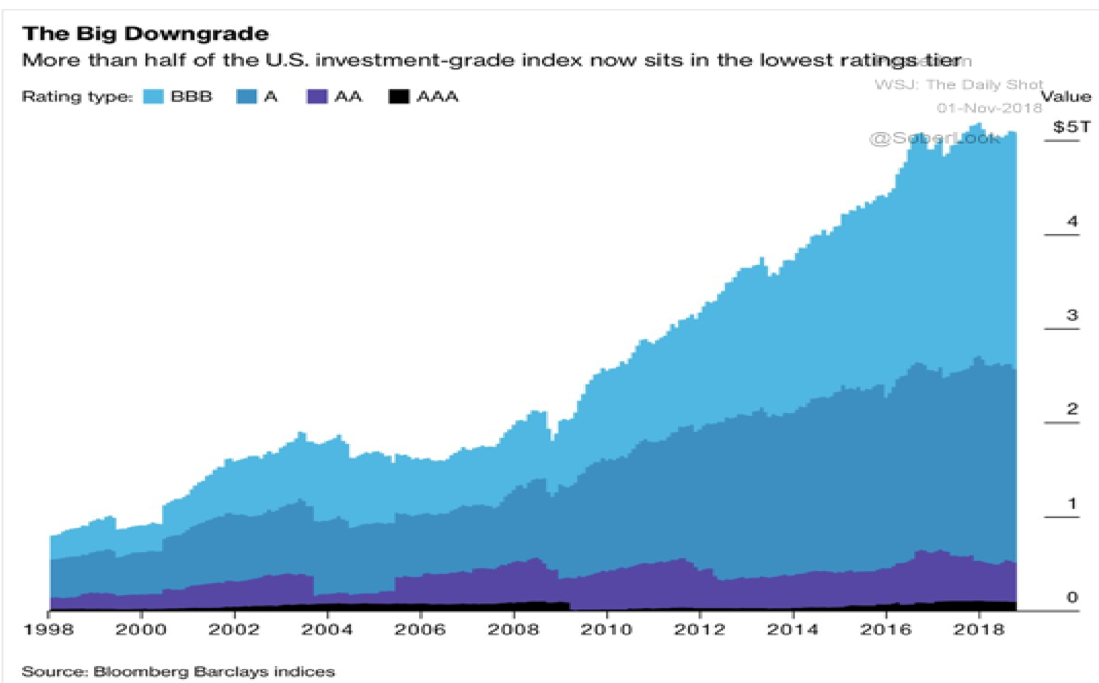
Note: As of June 2018

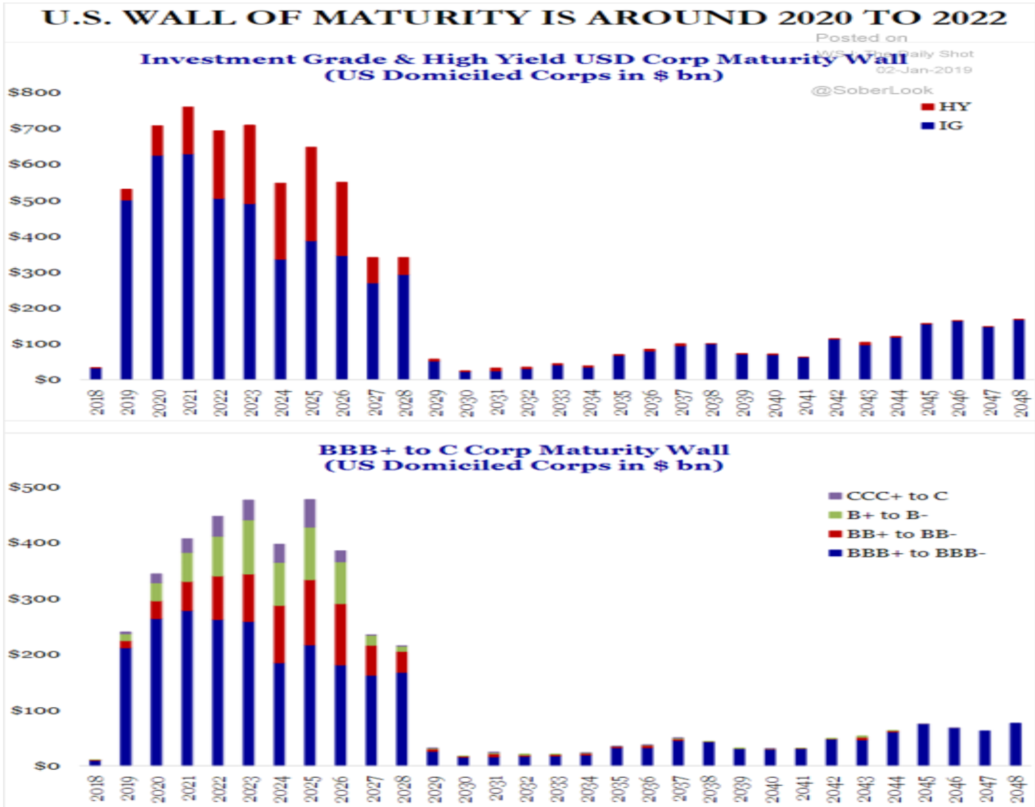
Corporate debt has risen from $5 trillion in 2006 to over $9.1 trillion today.



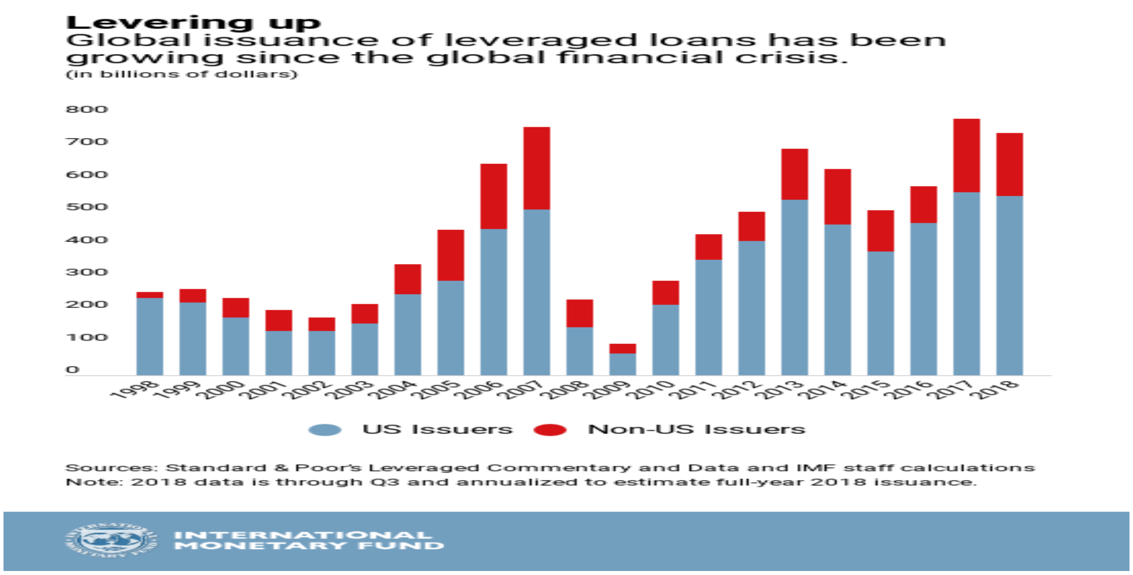


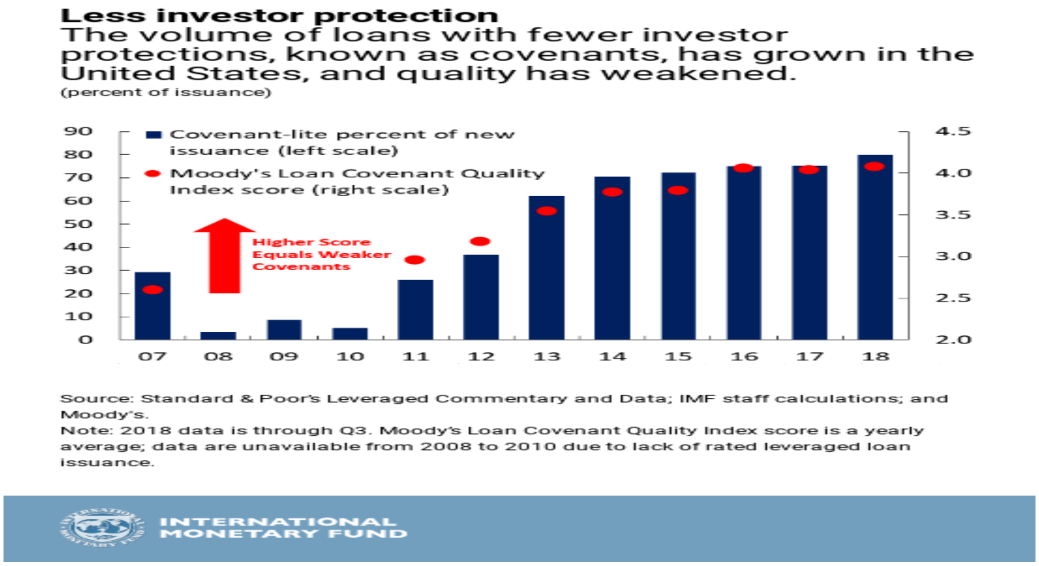
The BBB market is about 2.5 times larger than the high-yield market and about half of the U.S. investment grade index is in the lowest tier of BBB bonds as shown below. In fact, according to Jeff Gundlach a leading fixed-income investor, based upon the leverage ratio of the underlying corporations, it is estimated that over 50% of BBB rated bonds would be rated as junk. Finally, there is a large maturity wall for BBB bonds occuring over the next 5 years as shown in the following charts.



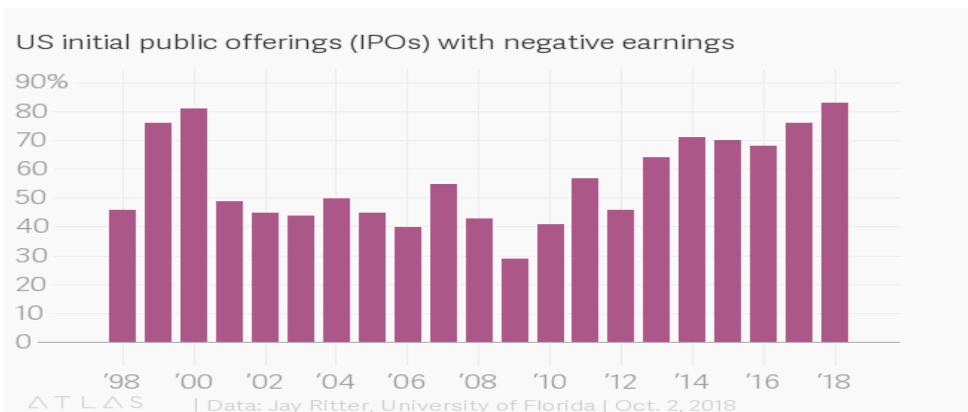


The **International Monetary Fund (IMF) in its recent report warned about the $1.3 trillion leveraged loan market and the risks to the global economy.** A leveraged loan is credit extended by bank and non-bank lenders to risky or highly-indebted companies that are not investment grade. In the **early and mid-1990's over 70% of leveraged loans were funded by banks with about 30% from nonbanks, while now over 90% of leveraged loans are made by nonbanks.** Today, the **leveraged loan market at $1.3 trillion is more than double the level before the 2008 Great Financial Crisis,** driven by several years of record or near-record global issuance as yield hungry investors accept ever rising risks. Furthermore, **investor protections from loan covenants also continue to decline, raising risk even further as illustrated in the following charts.**



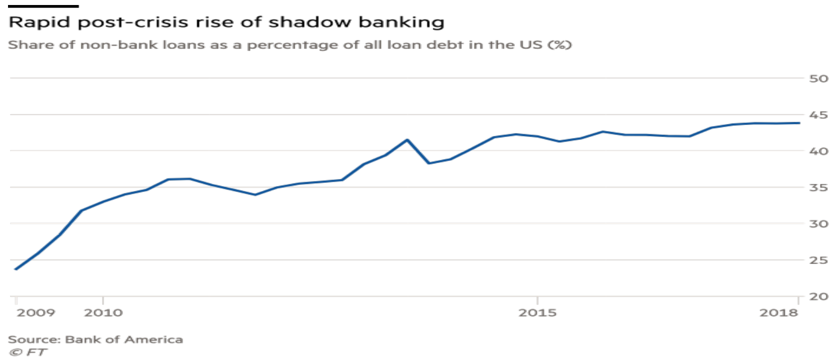


In 2018 over 80% of IPO's had negative earnings per share, an even higher percentage than during the tech bubble of 1999-2000.

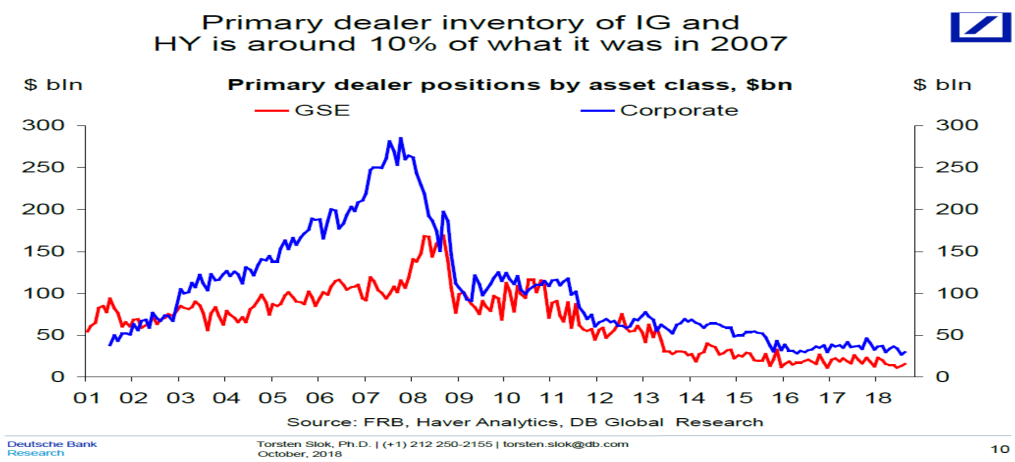


Another area of concern is the large increase in non-banks since the Great Financial Crisis. As banks became more and more regulated after the crisis, leaving some of their traditional business entirely or significantly reducing their participation, a void was created that has been filled by many unregulated non-banks. Banks raised their underwriting standards and will often only deal with the highest quality customers, those with the highest credit scores, while the non-banks are dealing with a broader range of customers, including higher risk buyers with lower credit scores. Our concern is that many of these firms have never been through a full credit-cycle and the risks they pose are simply unknown and could pose threats to the economy and the financial system. While none of the non-banks are as large as our country's largest banks, collectively they do pose risks in an economic downturn.

In the mortgage origination space, companies such as Quicken Loans, Loan Depot, PennyMac and others accounted for over 50% of all mortgage originations, up from 9% in 2009. Non-bank lenders have originated over 85% of FHA mortgages guaranteed by the government. Other non-bank lenders include Prosper, Lending Club, SoFi, Credible and many others.



The significant reduction in primary dealer inventory of investment grade and high yield debt is the lowest it has ever been, as illustrated below. The **reduced inventories** will inevitably lead to **significant liquidity and pricing issues for fixed income securities,** creating enormous challenges for the fixed-income markets **and outstanding opportunities for patient investors.**



Finally, **global debt levels continue to rise from $170 trillion in 2007 to over $244 trillion today** according the International Institute of Finance. **Total global debt levels are over 320% of GDP,** an increase of over 40% from a decade ago. China's debt is $40-45 trillion with GDP of $12 trillion representing 333%-375% of GDP. **Debt levels have consequences and debt continues to rise around the world, fueled by quantitative easing, artificially low real interest rates, and enormous amounts of capital seeking returns.** We certainly have no crystal ball, but we believe **these debt levels present enormous long-term challenges for economies around the world, and a fallout is inevitable, though the magnitude and timing are unknown.**

FUND FLOWS AND THE PUBLIC SECURITIES MARKETS - STOCKS AND FIXED-INCOME

More and more capital is chasing fewer and fewer good ideas. Money fund flows are raising company valuation levels in public markets, private markets and venture capital, which we discuss in the sections that follow.

Public markets are experiencing large increases in passive investing vehicles, where information is irrelevant, as when cash is received it is immediately invested and when investors want liquidity, the securities are sold. As passive investing assets continue to increase, rising purchases will continue to drive valuation levels higher as in our current bull market, and when redemptions dominate fund flows the valuation levels will decline. Passive investing is directly tied to fund inflows and has nothing to do with any company or industry information that drives active investing, such as earnings growth, strong balance sheets, industry competitive dynamics and other variables. **Capital flows** in the **current bull market** are **driving rising valuations.** This phenomenon may very well **reverse itself at some point,** and while we have no insight as to the timing or magnitude, we do know that when it happens, the **rapidity** and **magnitude of declines could be significant, creating great opportunities for active investors.**

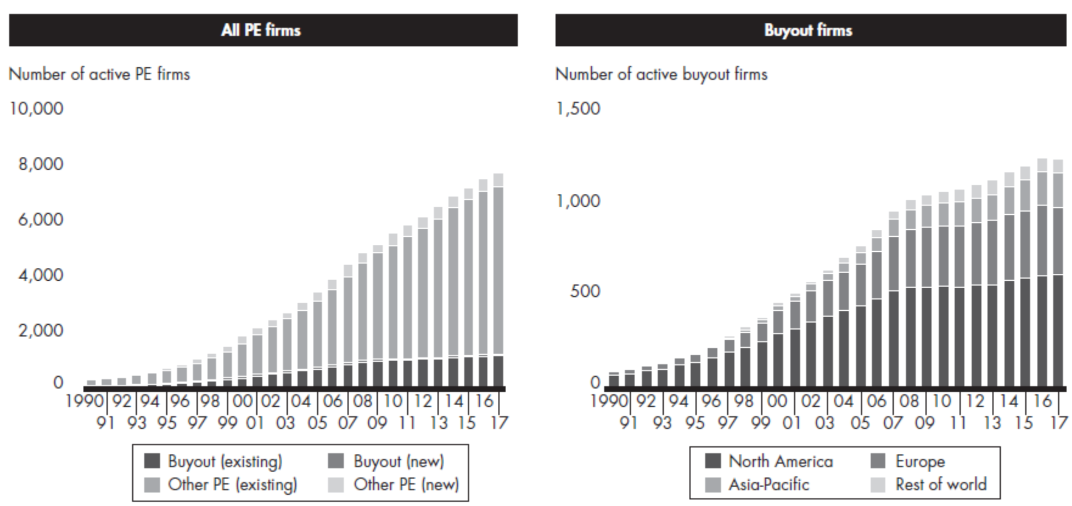
THE GOLDEN AGE OF PRIVATE EQUITY

Over the years we have continued to monitor the private equity space as business valuation levels in both the public and private markets are related. We also keep an eye on venture capital markets to get a perspective on investor risk tolerances, new business models, disrupters to incumbents in various industries and valuation levels of private start-ups.

Global financial markets are becoming increasingly interdependent as private equity, public equity, and venture capital are all converging seeking investment opportunities in various industries on a global scale. Barriers are coming down and today integrated investment firms offer a broad range of products-traditional private equity leveraged buyouts, distressed debt, real estate, infrastructure, venture capital, public equity, public and private fixed income securities.

In 1980 there were 24 private equity buyout firms, which has risen to just under 8,000 at year-end 2017, as shown below, and it is estimated at year-end 2018 there are over 8,300 firms.

The number of PE firms globally continued to climb



Notes: Excludes PE firms that do not manage and invest out of distinct funds; a PE firm is considered active for 10 years after raising its last fund; new PE firms based on the vintage of firm's first fund; geography based on location of firm's headquarters
Source: Preqin

Our world is awash with capital, fueled domestically by our Federal Reserve Bank and globally by other central banks, which have kept interest rates artificially low for over a decade now. Private equity funds continue to raise vast amounts of capital as public equity and fixed income markets provide less appeal. To illustrate, in the period from 1990-2000 private equity funds raised just under $300 billion and the majority was raised at the tail end of that period. Bain & Company estimates that private equity firms have raised $8.4 trillion since 2000 and $3.7 trillion since 2014 with $714 billion in 2018 alone. The tables on the following pages illustrate the industry's fund raising since 2003 cumulatively and annually:

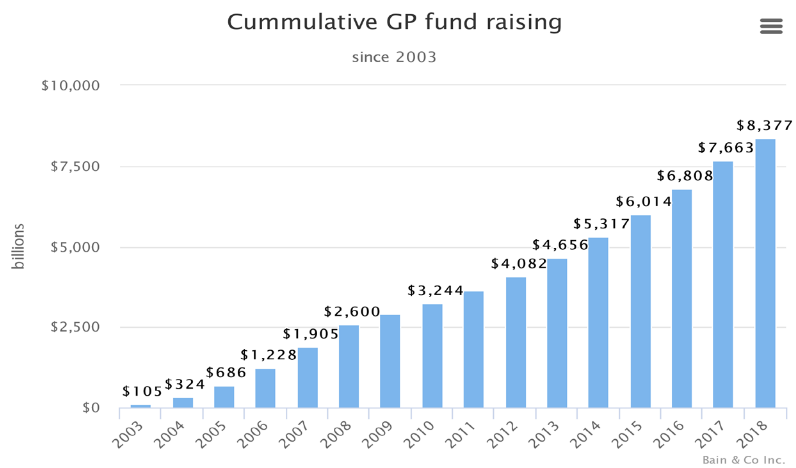
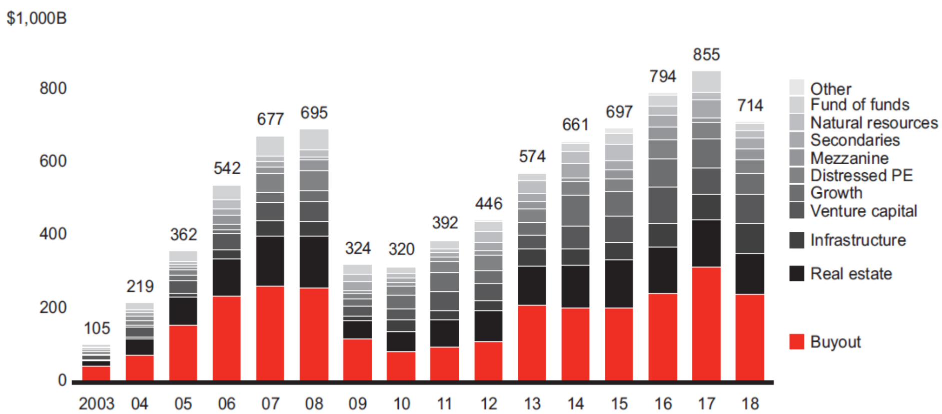


Figure 1.18: While PE fund-raising fell off slightly in 2018, GPs have attracted more capital since 2014 than during any previous five-year stretch

Global PE capital raised, by fund type

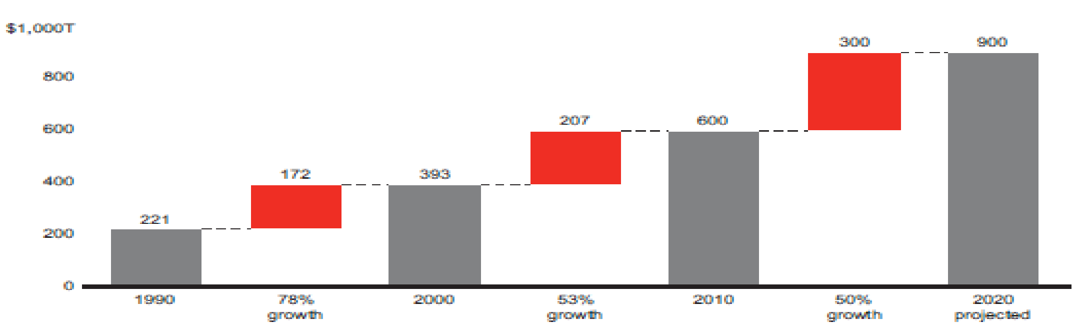


Notes: Includes funds with final close and represents the year in which funds held their final close; buyout includes buyout and balanced funds; distressed PE includes distressed debt, special situation and turnaround funds; other includes private investment in public equity and hybrid funds
Source: Preqin

According to a Bain & Company report, global financial capital has increased four-fold from $221 trillion in 1990 to a projected $900 trillion in 2020, rising 50% or more in each decade since 1990 as illustrated below:

Figure 3.1: The rapid growth of financial capital has shaped the global economy—and private equity—since the 1990s

Total world financial assets

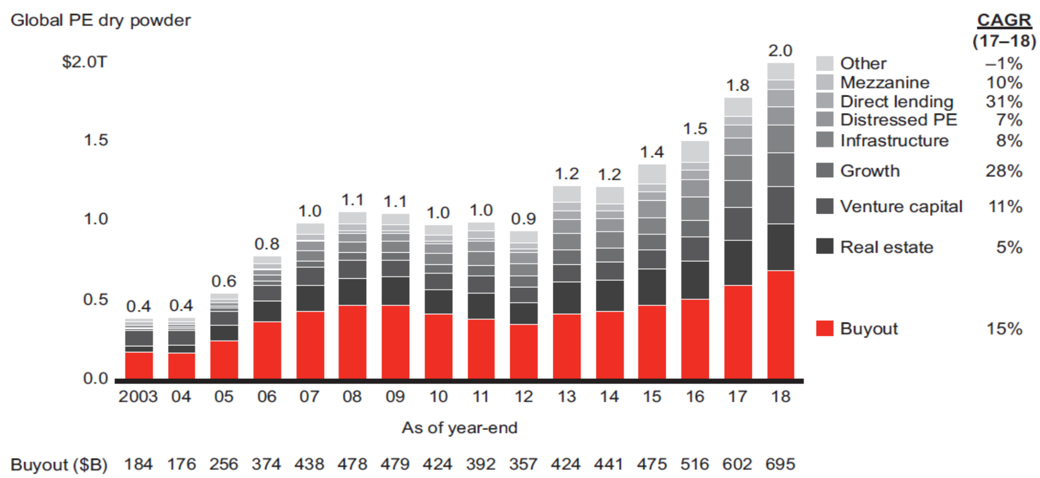


Note: All figures are in real 2010 US dollars at 2010 exchange rates
Sources: International Monetary Fund, *World Economic Outlook: Slowing Growth, Rising Risks*, September 2011; Organisation for Economic Co-operation and Development; national statistics; Bain Macro Trends Group analysis

Bain & Company reports that over the past two decades private-market capital has grown at double the rate of public market capital and we believe this could continue into the years ahead for several reasons. First, a lack of attractive investment opportunities in the public equity and fixed income markets. Second, the world is awash with money as sovereign wealth funds, hedge funds, endowments, corporations with investment divisions, pension funds, and insurance companies are all seeking places to invest their capital; **there is far more capital available than great idea**s. Third, corporate leaders prefer to remain private rather than deal with the short-term scrutiny and regulations of being a public company.

The world is awash in capital, as global private equity firms have over $2 trillion in dry powder seeking investments as illustrated below:

Figure 1.6: Dry powder continues to pile up globally, setting a new record in 2018



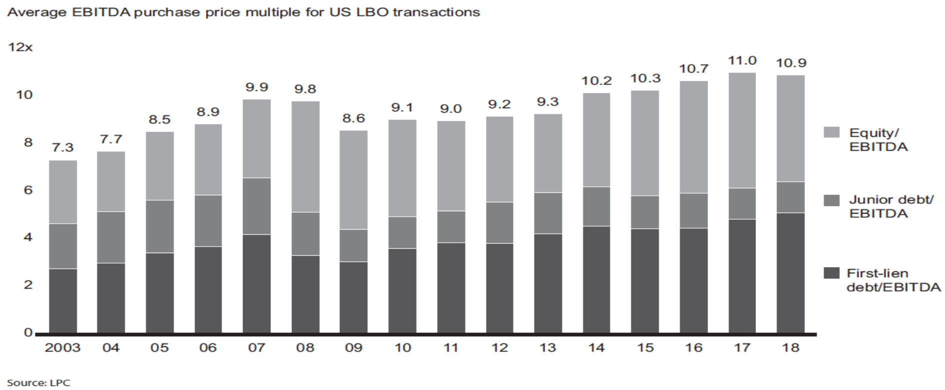
Note: Discrepancies in bar heights displaying the same value are due to rounding
Source: Preqin

In an interview in **April 2013, Leon Black the founder of Apollo Management** stated, **"We are selling everything that is not nailed down."** While **William Conway, Carlyle's co-founder** stated, **"It is clearly an easier time to sell than it is to buy, and it is hard to put money to work right now."** Considering, those comments six years ago these and other firms continue to raise money at an unprecedented pace and continue to pay ever higher purchase multiples.

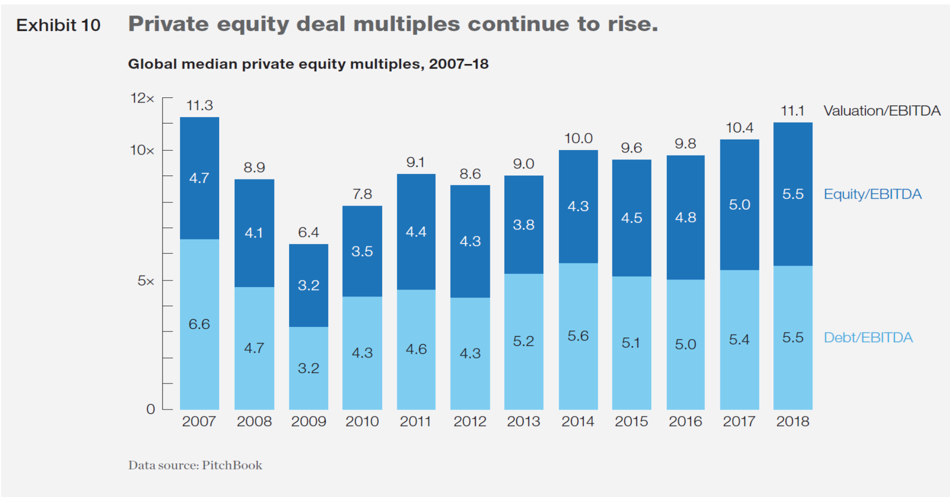
The robust merger and acquisition environment during that time provided an attractive exit for many companies owned by private equity firms. Many firms sold several of their holdings in 2013-2015, that were purchased during the crisis from 2008-2010. The sale to purchase ratio for some private equity firms such as Apollo Global Management, Providence Equity Partners, KKR, Carlyle and TPG has been 5-10x since 2013. However, now in 2018-2019 a new cycle of raising enormous amounts of capital and finding places to invest has begun, which we discussed in detail earlier in this section.

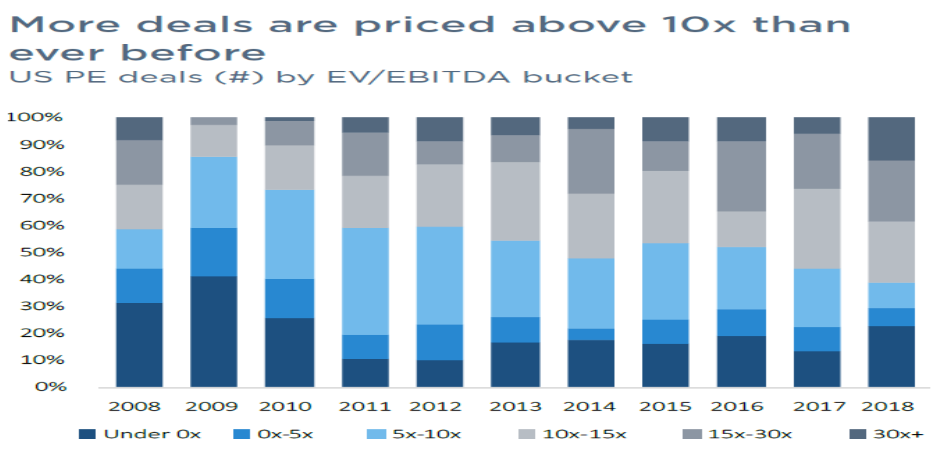
The large amounts of capital available worldwide is placing upward pressure on private equity purchase multiples, now amongst the highest they have ever been as illustrated in the following pages.

Figure 1.9: The average multiple for US leveraged buyouts continues to hover near record-high levels



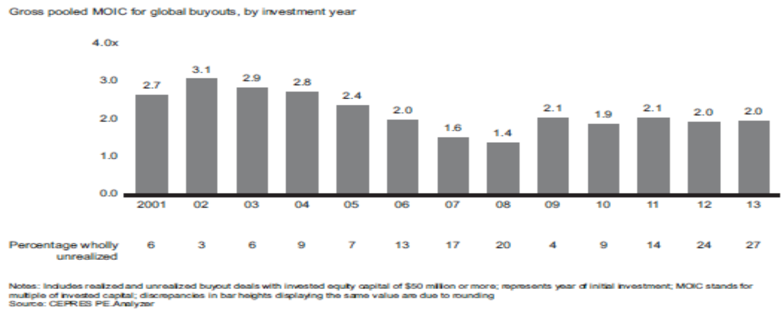
Source: LPC





Many buyouts are taking place at 12-14x EBITDA, meaningfully above the average of 11x illustrated in the above chart. As a result, long-term returns for private equity must come down and will not match the returns achieved in prior periods when average purchase multiples were 5-8x EBITDA. While there will be some exceptions for truly outstanding businesses with solid and sustainable growth, the great majority of purchases will not achieve historical IRR's of 20-30%. The table on the following page illustrates the lower buyout returns since before the financial crisis, as measured by multiples of invested capital (MOIC).

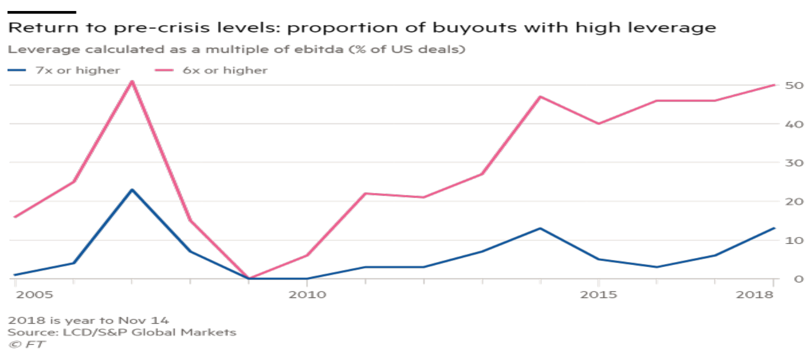
Figure 1.28: Buyout returns in the current cycle have fallen from levels recorded before the global financial crisis



Leon Black, the co-founder of Apollo Global Management, recently stated, “The credit markets, unlike the equity markets, have gone to bubble status. The **amount of covenant-less debt is more than in 2007, as you have a thirst for yield that exists on a global basis, so there is true excess. “**

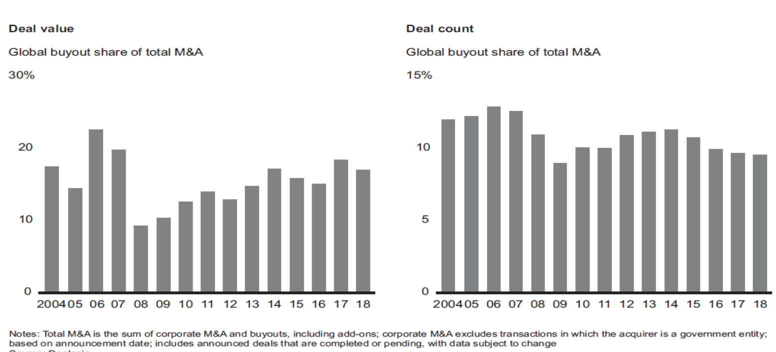
Black’s firm Apollo Global Management, in their private equity business, is taking advantage of the covenant-less and covenant light credit markets along with fixed-rate debt, while in their much larger credit business, they seek strong covenants to protect them under various conditions and outcomes. Black and his team view their credit and insurance businesses growing to $300-400 billion in the next three to four years, double the current size.

In addition to the higher multiples being paid and resulting lower returns, private equity buyouts are also **utilizing more leverage** as shown below:

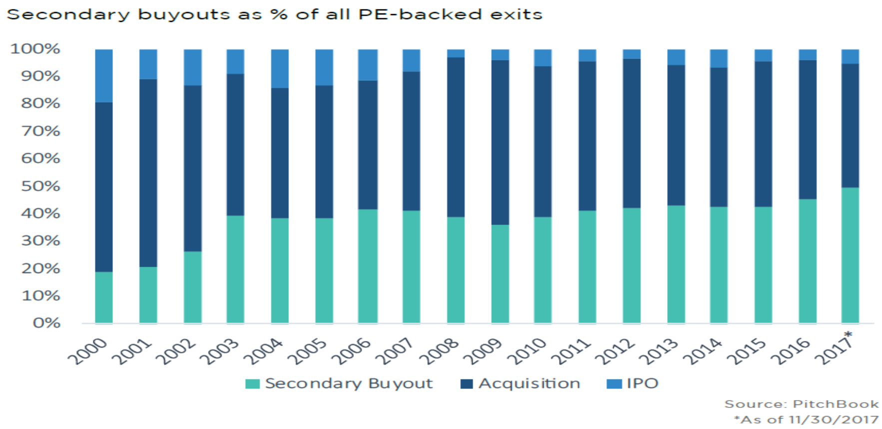


Despite the continued growth of private equity, both in terms of number of firms in the industry and deal volumes, a **long runway remains for continued industry growth,** as private equity still has a small share of the global mergers and acquisitions market as measured by deal value and deal count as illustrated.

Figure 1.3: Private equity is not increasing its share of the total market for mergers and acquisitions

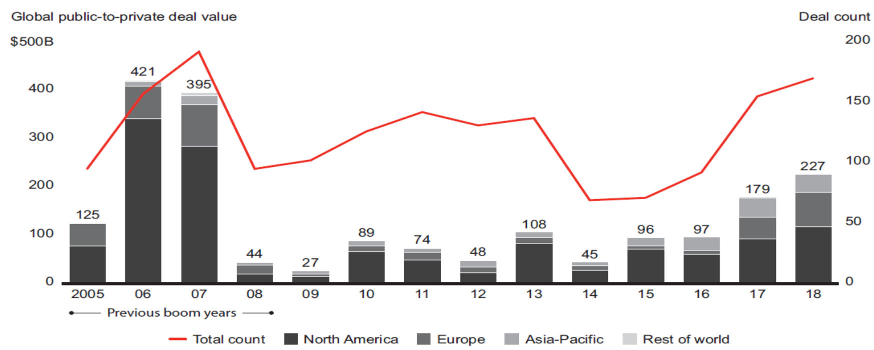


Private equity firms are increasingly selling to one another as they need to exit investments to create liquidity and returns for Limited Partners. As a result, **secondary buyouts,** are continuing to increase, reaching **50% of all private equity exits in the 4th quarter of 2017,** as shown below:



Public to private deals are also rising and should continue to increase in the years ahead with the enormous amounts of dry powder looking for deals, and the desire of management teams to partner with private equity rather than deal with public investors.

Figure 1.5: Public-to-private deals reached their highest level since the previous boom years, in terms of both value and count



Notes: Includes add-ons; based on announcement date; includes announced deals that are completed or pending, with data subject to change; geography based on target's location
Source: Bain global public-to-private deal database

A list of several metrics comparing the private equity markets in 2007 and 2018 is illustrated below:

Exhibit 17 **Private markets in 2018 featured higher deal volume, similar prices, and less leverage than 2007—though dry powder ratios are higher.**

	Metrics	2007	2018
PE deal environment and multiples	Deal volume, $ billion	1,398	1,405
	Valuation/EBITDA	11.3×	11.1×
	Median debt, %	58.3%	50.0%
Private markets fundraising and dry powder	3-year trailing fundraising, $ billion	1,480	2,459
	Total AUM,[1] $ billion	2,231	5,827[2]
	Total dry powder, $ billion	992	2,099[2]
	PE inventory on hand,[3] 3-year trailing	1.58	1.91

[1] AUM = dry powder + unrealized value.
[2] 1H 2018.
[3] Capital committed but not deployed, divided by equity deal volume.
Data source: Pitchbook; Preqin

While there are some similarities, the largest differences relate to the total assets under management that have almost tripled and the dry powder, which has more than doubled.

THE GOLDEN AGE OF VENTURE CAPITAL-BUBBLE VALUATIONS

Over the past several years there have been several areas of excessive valuations in the venture capital space. The new "buzzword" is "unicorn", referring to private startups funded by venture capital that have valuations exceeding $1 billion. It reminds us of the technology, media and telecom bubble in the public markets of the late 1990's, now occurring in the private startup markets. As **Keith Rabois, a Khosla Ventures partner** stated a few years ago, **"We may be seeing the end of the steroid era of startups." He sees values declining from 25% to 75% for many companies." Rabois made this statement several years ago and valuation excesses continue today**.

It remains to be seen how these valuations play out as they have been elevated for several years now and the numbers continue to escalate with more and more private startups achieving unicorn status. However, with no market clearing mechanism, that is, no public market for these companies and a limited IPO market, their true value is difficult to assess. **Venture capitalist Jim Breyer stated several years ago, "There will be blood in the water and 90% of unicorns will need to be substantially restructured or revalued at much lower levels."**

Bill Gurley, a leading venture capitalist from Benchmark Capital stated almost five years ago, "No one's fearful, everyone's greedy, and it will eventually end." Gurley also stated, "I think that Silicon Valley as a whole, or that the venture-capital community or startup community, is taking on an excessive amount of risk right now—unprecedented since '99." His comments were in **September 2014** and this has continued until today and it may go on further, but excesses are becoming more pronounced and **risk levels continue to rise.**

Many mutual fund companies such as Fidelity, Vanguard, T. Rowe Price and others are investing in some of the startups. An SEC rule allows mutual funds to invest as much as 15 percent of their assets in private companies, and several of them are doing so, though most are below that threshold. **Many mutual funds began investing in unicorns and other private firms several years ago,** a brief table illustrating mutual fund investments in private companies from 2015 is shown below.

FUNDS THAT GIVE YOU A RIDE ON A UNICORN

A TREND THAT BEGAN BEFORE FACEBOOK WENT PUBLIC HAS GONE WILD IN THE AGE OF UNICORNS, WITH DOZENS OF MUTUAL FUNDS REACHING FOR PRE-IPO INVESTMENTS THEY EXPECT TO BE MARKET DARLINGS. THE FUNDS LISTED BELOW, MOSTLY AVAILABLE TO EVERYDAY INVESTORS, ARE AMONG THOSE THAT HAVE COMMITTED AT LEAST A PORTION OF THEIR ASSETS TO PRIVATE COMPANIES.

TICKER	FUND	SALES LOAD	ASSETS ($MIL)	% IN PRE-IPO	TTM PERFORMANCE	NOTABLE UNICORN BETS
FCNTX	FIDELITY CONTRAFUND	NONE	$103,400	2%	5.90%	BLUE APRON, TWILIO, PINTEREST, UBER
FDGRX	FIDELITY GROWTH CO.	NONE	37,200	2%	8.60	UBER, SNAPCHAT, CLOUDFLARE
FBGRX	FIDELITY BLUE CHIP GROWTH	NONE	19,300	2%	7.50	UBER, APPNEXUS, MEITUAN, BLUE APRON
PRNHX	T. ROWE PRICE NEW HORIZONS FUND[1]	NONE	15,500	2%	8.60	ATLASSIAN, EVENTBRITE, WEWORK
PVSAX	PUTNAM CAPITAL SPECTRUM	NONE	8,600	1%	−3.20	UBER
VWUSX	VANGUARD U.S. GROWTH	NONE	6,200	1%	9.50	UBER, PINTEREST, CLOUDERA, WEWORK
HGOIX	HARTFORD GROWTH OPPORTUNITIES	NONE	4,900	6%	12.90	DOCUSIGN, DRAFTKINGS, HONEST CO., PINTEREST, UBER
PRGTX	T. ROWE GLOBAL TECHNOLOGY FUND	NONE	2,106	1%	13.8	FLIPKART, DROPBOX, COUPA SOFTWARE
ITSAX	TRANSAMERICA GROWTH OPPORTUNITIES	5.5%	448	2%	−8.90	DROPBOX, PALANTIR
DGFYX	DAVIS GLOBAL FUND	NONE	385	4%	0.70	DIANPING, DIDI KUAIDI

NOT A COMPLETE LIST OF EACH FIRM'S UNICORN INVESTMENTS. AS OF MOST RECENT PORTFOLIO DISCLOSURE. [1]FUND IS CLOSED TO NEW INVESTORS.
SOURCES: FUND FILINGS; MORNINGSTAR; FORBES RESEARCH.

US financing trends

> 2018 was a phenomenal year for US venture capital, with $99.5B invested --- a record-breaking 55 unicorn births, 184 mega-rounds, and funding levels at their highest since 2000 ($119.6B).
>
> — ***Tom Ciccolella****, Partner, US Ventures Leader at PwC*

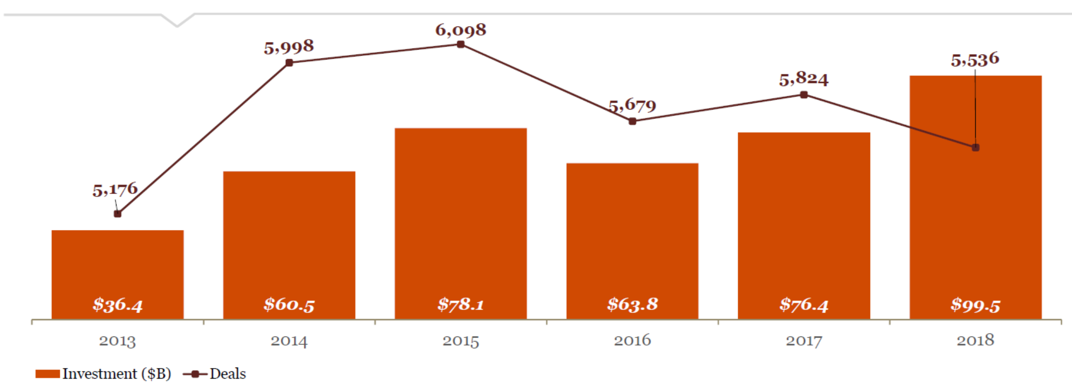
PwC | CB Insights MoneyTree™ Report Q4 2018 10

Venture capital funding in 2018 rose to the highest level since 2000, with startups in the US raising $99.5 billion in over 5,536 deals as shown below:

Annual US financing trend

US annual funding hits $99.5B amid falling deal activity

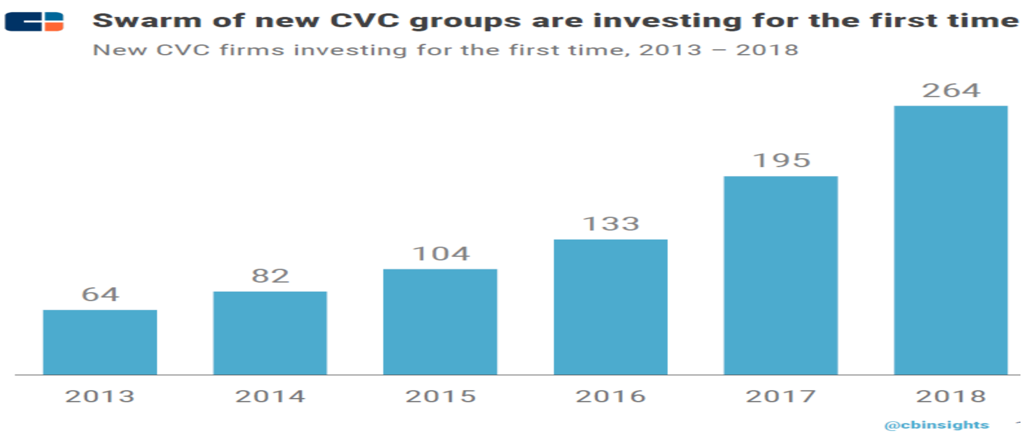
- Total annual funding in the US increased by 30% in 2018, as $99.5B was invested across 5,536 deals.
- US deal activity fell to its lowest level since 2013, though later-stage mega-deals pushed annual funding to its highest level since 2000.



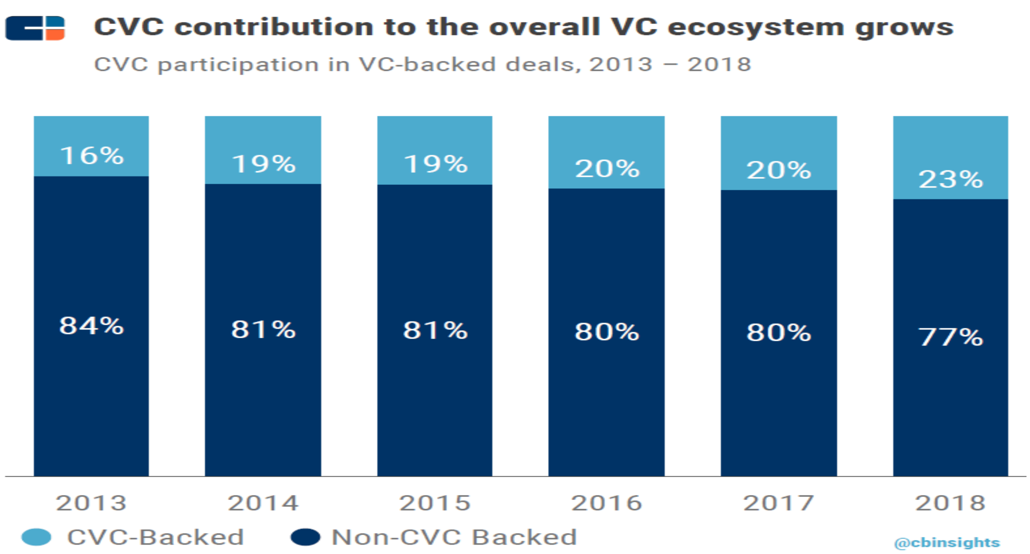
PwC | CB Insights MoneyTree™ Report Q4 2018

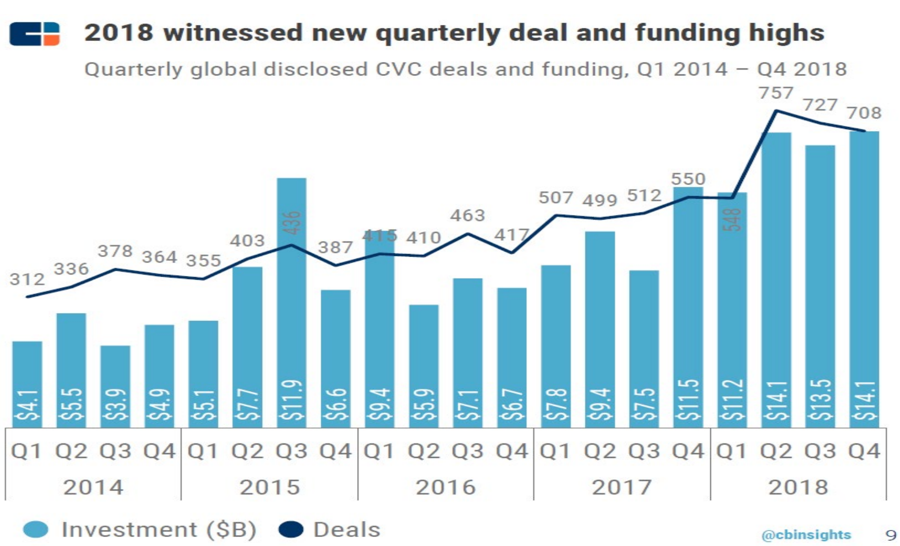
In addition to the traditional venture capital firms such as Sequoia Capital, Kleiner, Perkins, Caufield & Byers, New Enterprise Associates, Benchmark Capital and several others, capital is coming from many other sources today. Many public companies such as Intel, Johnson and Johnson, Time Warner have specific divisions that invest in both public and private companies in which they may have strategic or financial interests. When SoftBank, the Japanese conglomerate created the Vision Fund, several companies such as Apple, Qualcomm, Sharp and Daimler were investors. Increasingly, the public and private markets for buying businesses are converging as never before.

We believe it is important to understand the marketplace dynamics to provide complementary perspectives on asset raising, valuation multiples, transaction volumes and values. Corporations are creating corporate venture capital (CVC) divisions and investing for the first time, as everyone wants to participate in the venture capital boom and suffers from the Fear Of Missing Out (FOMO) syndrome.



As a result, while several years ago corporate venture capital (CVC) represented a small portion of overall venture capital deals their volume, and funding status has risen significantly as shown in the following charts:





A list of some of the most active companies with corporate venture capital divisions is illustrated below:


Google Ventures was the most active in 2018

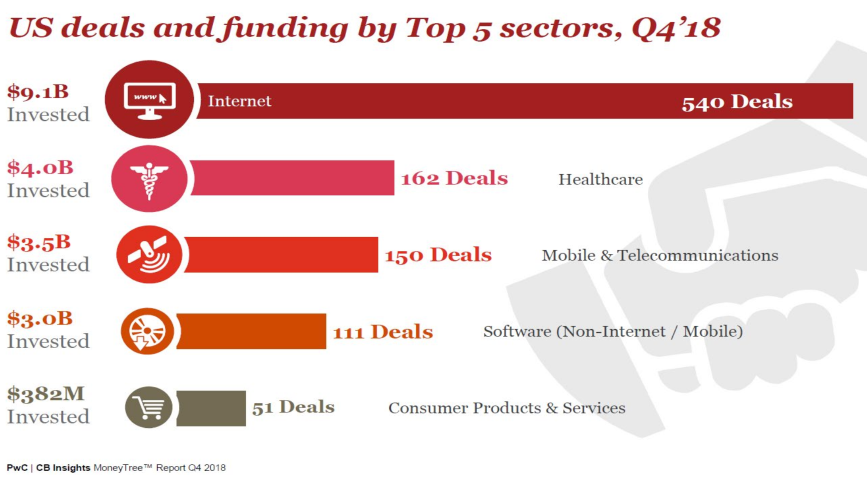
Rank	CVC Investor	Select 2018 Investments
1	GV	Alector, Brandless, Collective Health, GitLab, Intercom, Lime, Relay Therapeutics, Tamr, Yesware
2	salesforce ventures	Docker, Measurabl, Quovo, SessionM
3	intel capital	CloudGenix, DataRobot, Good Data, Syntiant,
4	Baidu.ventures	Pear Video, Yunding Network Technology, Xgimi
5	LEGEND CAPITAL 君联资本	Bellen Chemistry, Phoenix Travel Worldwide, Zuoyebang
6	SBI Investment	FiNC, Origami, solarisBank, Tamr, WHILL
7	ALEXANDRIA	Benson Hill Biosystems, Kallyope, Relay Therapeutics, Skyhawk Therapeutics
8	kakaoventures	Lunit, TimeTree, WONDERS
9	Mitsubishi UFJ Capital	CureApp, Plaid, WealthNavi
10	FOSUN RZ CAPITAL 复星锐正资本	CassTime, UniCareer, XPeng Motors,

GV (Google Ventures) was once again the most active CVC, investing in over 70 unique companies in 2018.

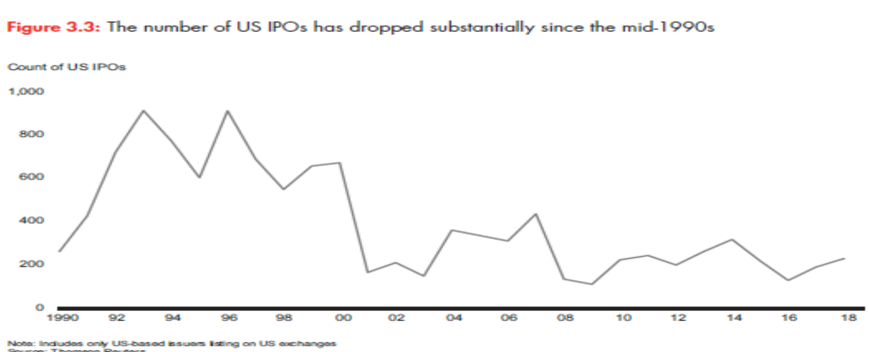
Salesforce Ventures was the second most active CVC in 2018 (moved up from 3rd in 2017), followed closely by Intel Capital (2nd in 2017).

Baidu.Ventures and Legend Capital rounded out the top 5.

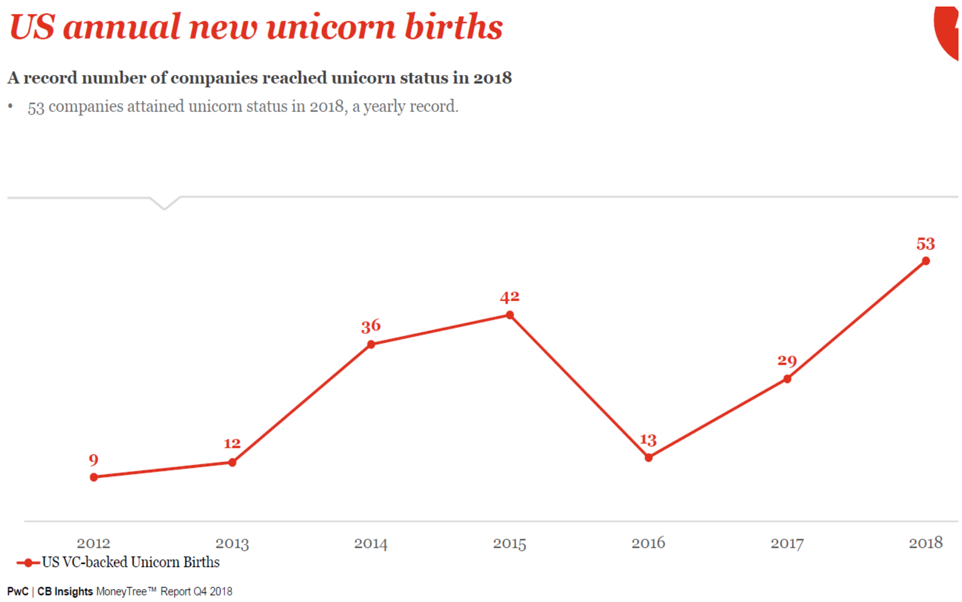
As investors in the public space, it is important to continually develop your understanding of the rapidly changing business models and industry dynamics occurring in almost every industry today. We find it helpful to at least keep an eye on potential industry disruptors in a broad range of industries. The largest number of transactions and funding are in the following five areas shown in the chart below.

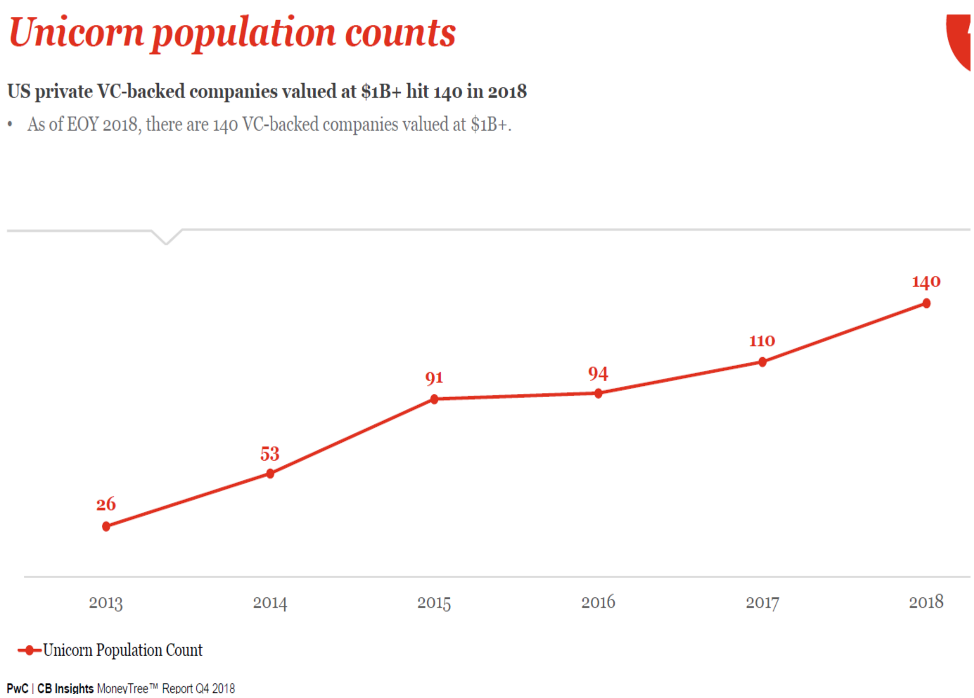


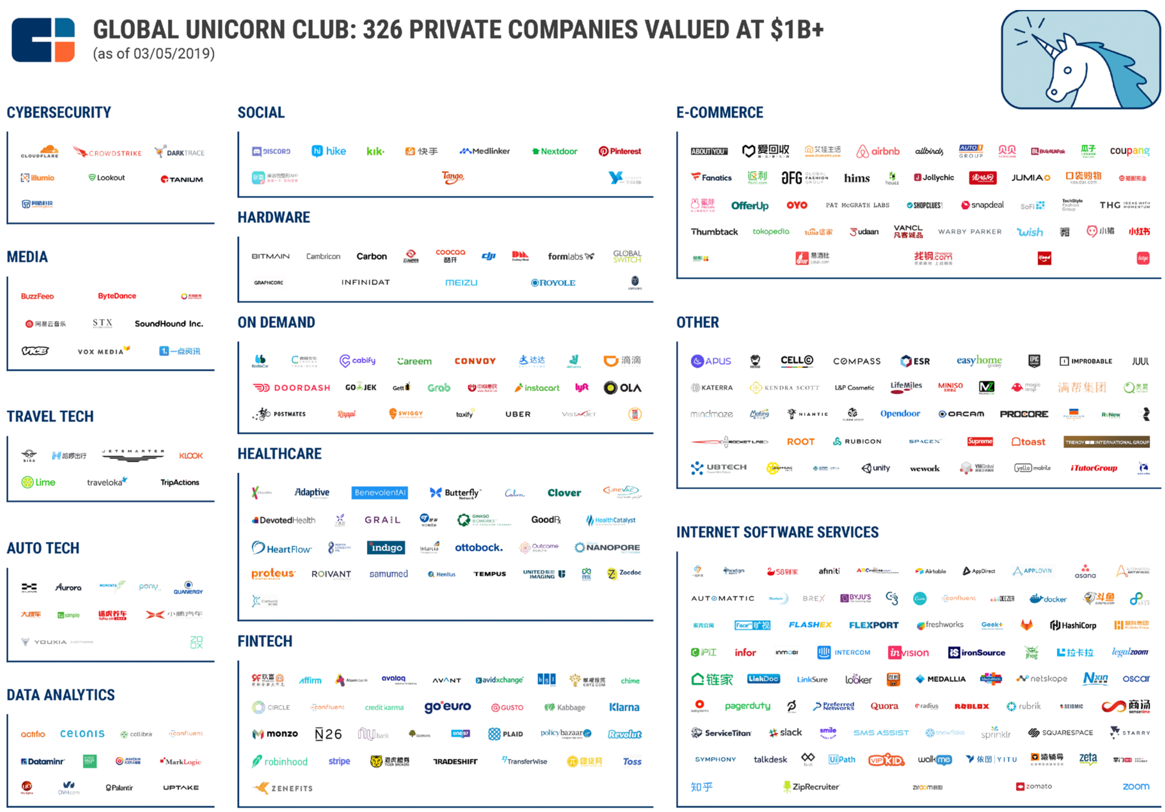
Many startups can stay private longer, or indefinitely, as the abundance of pools of capital provide adequate financing without requiring them to go public, resulting in fewer and fewer IPO's, as illustrated below:



With the creation of over 53 startups valued at over $1 billion or higher in 2018 alone, today there are now 140 unicorns across the country. We believe it simply astounding that 140 startups have valuations of over $1 billion. Globally, there are 326 unicorns as of February 2019, according to CB Insights. Our guess is that in a few years the great majority will not exist and those that remain will have substantially reduced valuations. We think this is a bubble ready to burst. The charts below illustrate the number of U.S. unicorn births since 2012, the cumulative number since 2013, and a chart of global unicorns.







VIEWS ON THE US BANKING INDUSTRY

We have several investments in banks, both as common stocks and fixed income securities. Therefore, our team felt it was important to share our thoughts on the overall US banking industry and then more specifically on Wells Fargo.

During the Great Financial Crisis of 2008-2009, the US financial services industry (especially investment banks) was at risk and had the federal government not stepped in with various initiatives, several institutions would have failed. Rather than review the specifics of that time period we wanted to provide an update on the US banking industry today and the many changes that have been made to strengthen and significantly reduce the risks that contributed to the Great Financial Crisis over a decade ago.

Several laws were passed by the government to address the risks that impacted the Great Financial Crisis. The Dodd-Frank Wall Street Reform and Consumer Protection Act was passed in 2010 and included the Financial Stability Oversight Council to monitor large financial institutions that would have a large negative impact on our economy. The Orderly Liquidation Authority would facilitate liquidations and restructurings for institutions in trouble. The Consumer Financial Protection Bureau was created to protect consumers from predatory mortgage lending and the Volcker Rule which placed limits on how banks invest, aimed to reduce speculative trading and eliminate proprietary trading. The goal of the Volcker Rule was to significantly reduce risks at large financial institutions and to help separate the investment banking and commerical functions of a bank, reflecting a change in direction from the 1999 repeal of the Glass-Steagall Act of 1933.

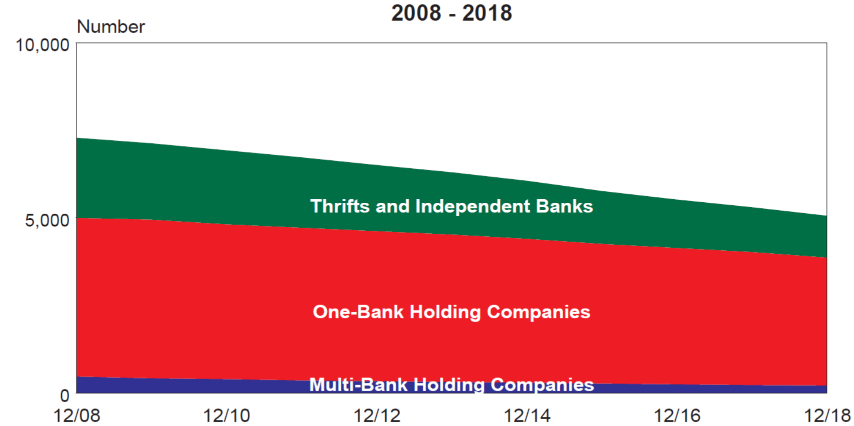
In additon, on an international scale Basel III was introduced in 2010 to reduce the probability that banks will damage the economy by taking on excessive risks. Basel III has many features, including raising minimum capital requirements, supervisory review, and transparency in disclosing bank capital structures to assure the institutions have adequate capital standards.

While some may argue that the laws created and implemented after the financial crisis were too restrictive and there have been some reductions, overall today's US banking system is far better capitalized and much safer than in the past.

Today, there are just over 5,000 FDIC-Insured Banking Organizations down from over 15,000 in 1990 and 7,300 in 2008, as shown below.

Number of FDIC-Insured Banking Organizations

2008 - 2018

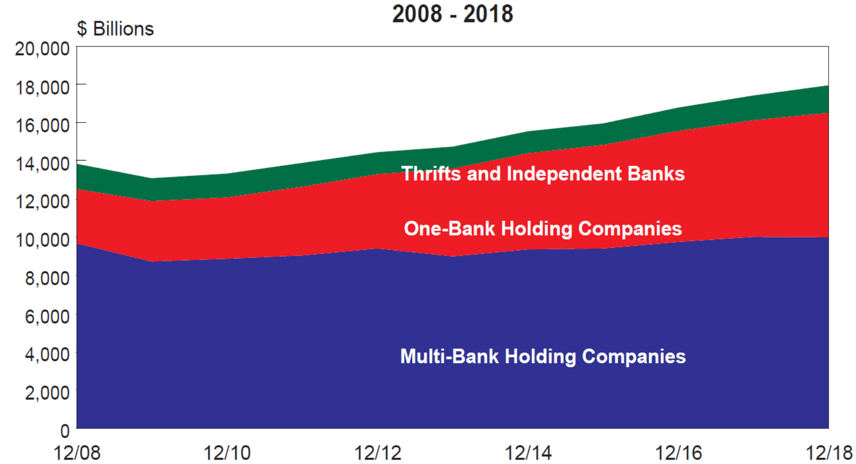


	12/08	12/10	12/12	12/14	12/16	12/18
Thrifts* and Indpt Banks	2,287	2,096	1,882	1,655	1,385	1,196
One-Bank Holding Co.'s	4,521	4,420	4,279	4,115	3,894	3,653
Multi-Bank Holding Co.'s	477	400	341	284	242	215
Total	7,285	6,916	6,502	6,054	5,521	5,064

Assets of FDIC-Insured Banking Organizations are just under $18 trillion as illustrated below:

Assets of FDIC-Insured Banking Organizations

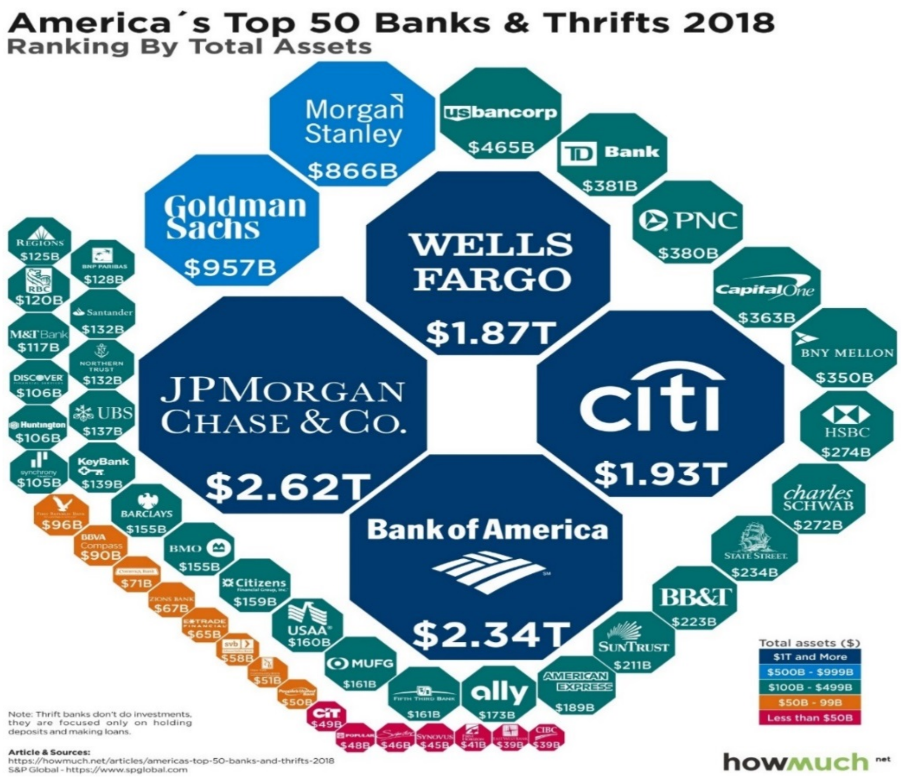
2008 - 2018



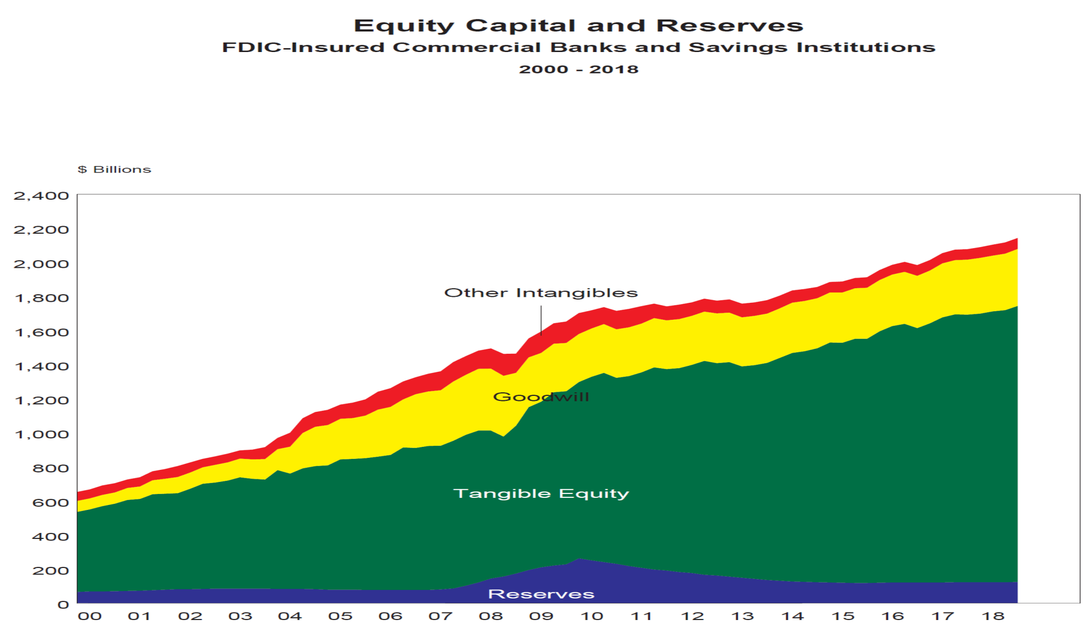
	12/08	12/10	12/12	12/14	12/16	12/18
Thrifts* and Indpt Banks	1,324	1,219	1,146	1,153	1,203	1,430
One-Bank Holding Co.'s	2,841	3,224	3,893	5,025	5,832	6,504
Multi-Bank Holding Co.'s	9,676	8,876	9,411	9,376	9,745	10,008
Total	13,841	13,319	14,450	15,554	16,780	17,943

* Includes thrifts owned by unitary thrift holding companies or multi-thrift holding companies.

The 50 largest banks in the United States with their respective assets listed are shown below:



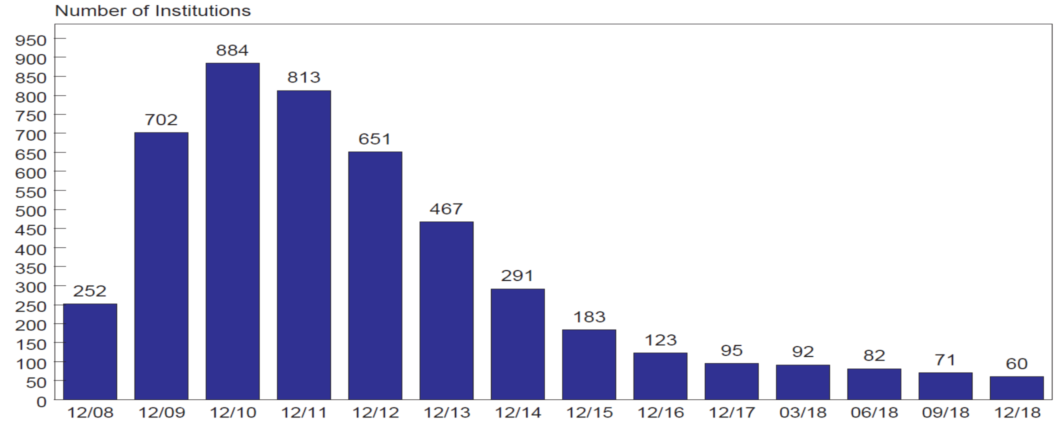
Bank equity capital and reserves are at their highest levels ever creating a solid buffer of over $2 trillion, up from $600 billion in 2000, when difficult times recur in the years ahead as shown below:



The charts on the following page illustrate the number of "Problem" banks and their respective assets which continue to decline from the Great Financial Crisis of 2008-2009.

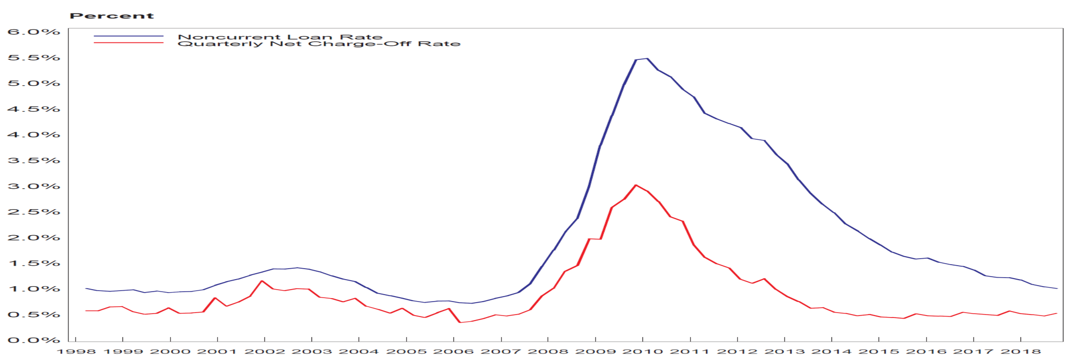
Number of FDIC-Insured "Problem" Institutions

2008-2018



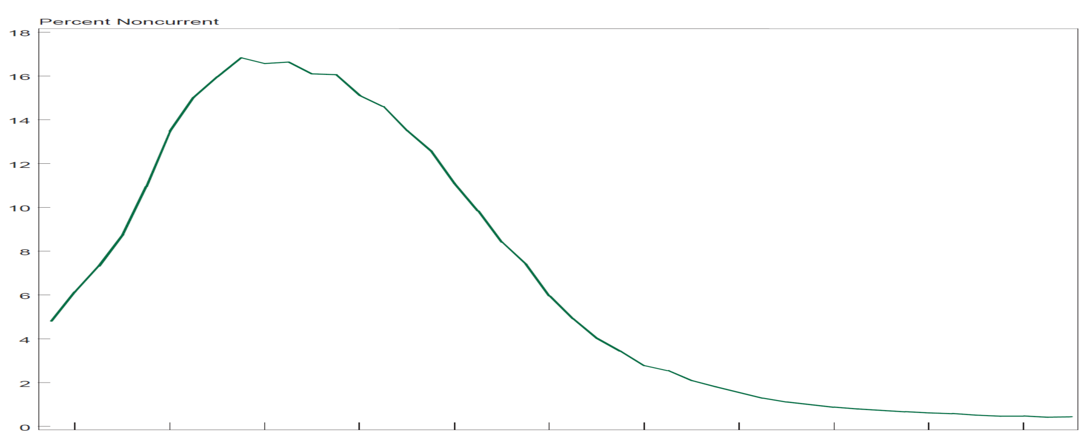
Non-current loans and charge-offs have also significantly declined since the financial crisis, as shown below:

Noncurrent Loan and Quarterly Net Charge-Off Rates
1998-2018



Finally, real estate construction and development loans, among the riskiest loans that financial institutions make, have also greatly declined, as shown below:

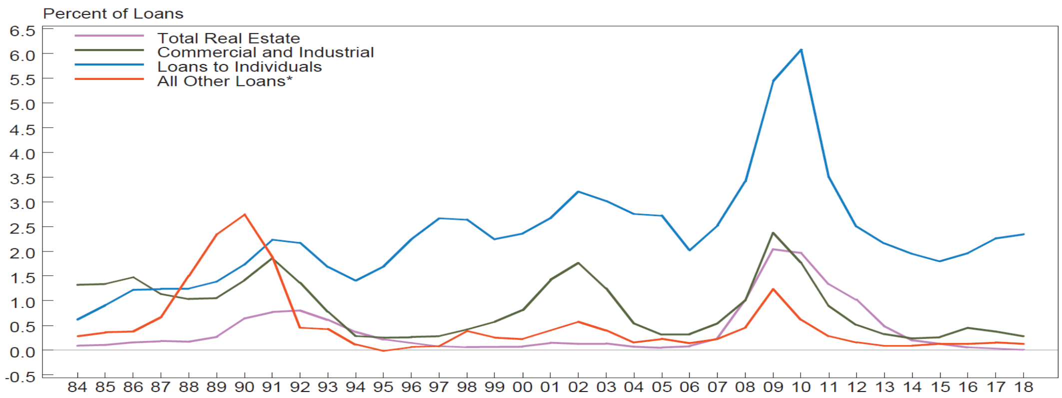
Noncurrent Rate on Real Estate Construction and Development Loans
2008-2018



Most banks have significantly tightened their underwriting standards for all loans and even more so for the riskiest loans such as real estate construction and development, land loans and other higher risk loans that created the largest loan losses during the financial crisis. Annual net charge-off rates on bank loans have continued to decline.

Annual Net Charge-Off Rates on Loans

1984-2018

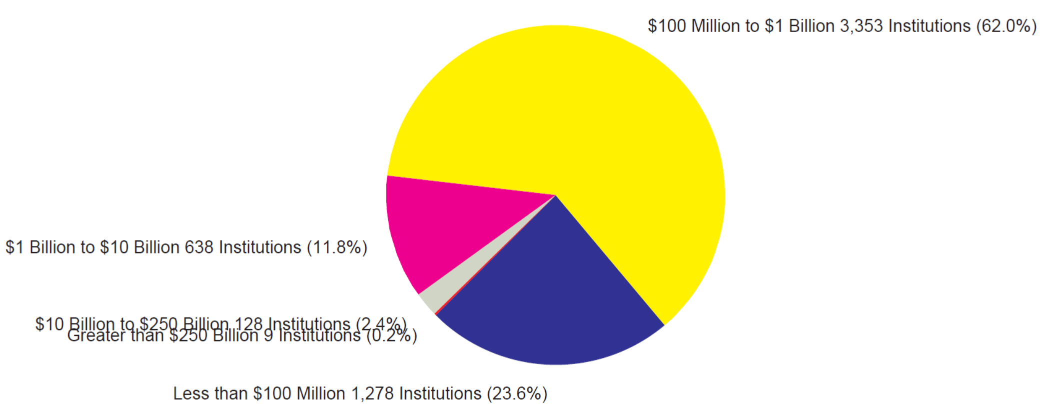


* Includes loans to foreign governments, depository institutions and lease receivables.

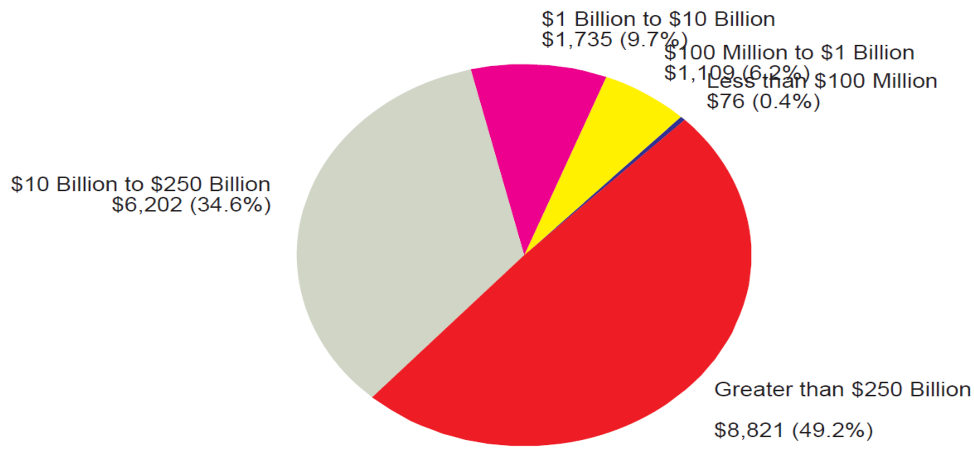
The number of financial institutions and industry assets by asset size are illustrated in the following two charts. The second chart on the following page is particularly interesting as it illustrates that financial institutions with over $250 billion in assets control almost 50% of all banking assets. This concentration is continuing to grow as the larger institutions have significant and sustainable competitive advantages over smaller banks, which I will discuss in greater detail shortly.

Number of Institutions By Asset Size

December 31, 2018



Industry Assets By Asset Size
December 31, 2018
($ Billions)



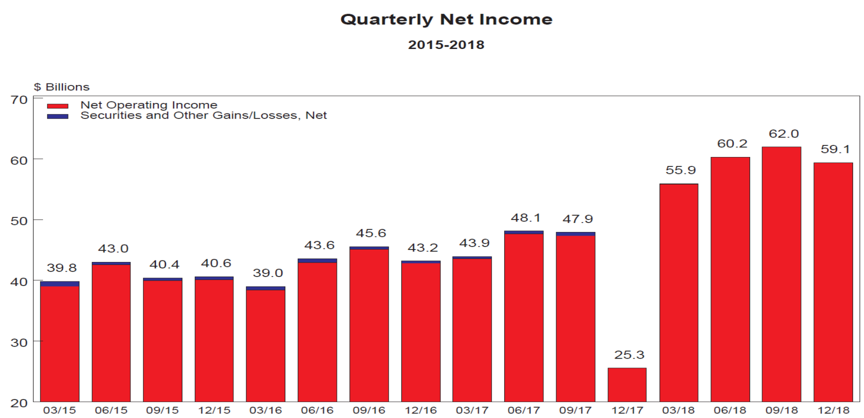
We believe the financial institutions that we own, Bank of New York, BB&T, US Bancorp and Wells Fargo are all continuing to remain diligent in their underwriting standards across all lending businesses to mitigate losses when the economy ultimately experiences challenging times and even a recession.

We believe that larger financial institutions have significant competitive advantages over their smaller competitors, hence our ownership of larger banks. Some of the advantages are listed below:

1. Revenues with geographic diversity.
2. Revenues with product diversity.
3. Several fee-based businesses such as mortgage originations, mortgage servicing, wealth management, insurance brokerage, credit cards, investment banking and trading, as well as several others.
4. Large capital budgets for technology investments required for mobile applications to reach consumers on their mobile devices and online.
5. Large capital budgets for cybersecurity investments, dealing with the regulatory environment and acquisitions of FinTech firms and other institutions.
6. Expense leverage utilizing technology-artificial intelligence, fewer branches, fewer employees, systematizing processes.
7. Opportunity to build deeper relationships with customers by offering a broader array of products and services.

Smaller institutions, which lack many of the advantages listed above, will find it more and more difficult to compete with their larger competitors. In a report entitled "The State and Fate of Community Banking" from the Harvard Kennedy School and authored by Marshall Lux and Robert Greene, the continued decline of community banks (<$10 billion in assets) in America is discussed. For example, community banks' share of U.S. banking assets and lending markets has fallen from over 40% in 1994 to about 20% today, yet they still provide over 50% of small business loans and 77% of agricultural loans.

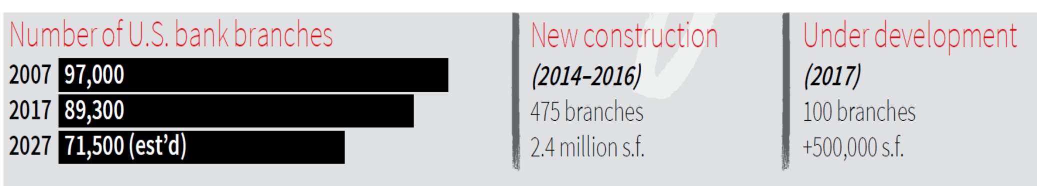
Banking profits continue to rise to the highest levels ever despite significantly reduced net interest margins on their loans since 1996, when net interest margins were 4.35%, declining to 2.98% in 2015 and currently just over 3%.



The future of banking as with so many other industries is fundamentally changing in many ways. The banks that will succeed in the future must adapt and modify their ways of thinking and begin to implement new ways to communicate and interact with customers, on their terms, in ways that fit their lifestyles and financial needs.

Technology will continue to augment credit underwriting, customer interactions on mobile applications, changing branch networks, streamlining business processes and many other changes.

Branch banking will change in many ways including fewer branches, according to the real estate firm Jones Lang LaSalle as shown below:



In addition to fewer bank branches overall, many banks will reduce the size of many of their branches and even create automated branches with tellers at a central location, serving customers from several branches simultaneously. Branches will be customized to the specific demographics and customer needs required to best serve them. Customers will continue to reduce their visits to branches, utilizing mobile applications on their phones and online with their computers. Fewer branches will save billions in real estate costs and employee costs for banks.

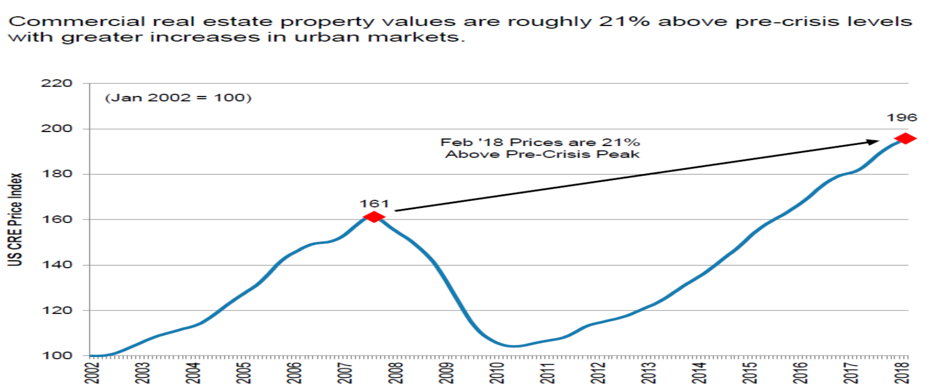
The largest banks have enormous expense leverage from branch reductions, smaller branch sizes, fewer employees and lower operational costs associated with ATM's, online and mobile banking. It is estimated that the typical bank costs to make a deposit are:

Item	Cost to make a deposit
Teller	$6-9
ATM	$.65-.95
Mobile	$.03-.09

Our thesis on banking remains positive and we believe that while challenges always remain the following characteristics of the banks we own will provide for solid long- term investments.

1. Highest capital ratios providing greater safety and protections.
2. Expense leverage through technology driving lower deposit costs, employee costs, branch and processing costs.
3. The passage of Dodd-Frank, Volcker Rule and Basel III initiatives have forced banks to re-evaluate their business models, resulting in a reduction in higher risk businesses, greater transparency and a re-focus on returns on capital. Meanwhile, regulatory hurdles have lessened under the Trump administration.
4. Valuation levels are very attractive with price earnings multiples ranging from 9-13x forward earnings.
5. Tax reform benefits.
6. As banks have left or reduced their focus on higher risk lending and other higher risk businesses, many unregulated non-bank companies such as Quicken Loans, Loan Depot, On Deck, Lending Club as well as private equity firms, life insurance companies, endowments, pension funds and others have stepped in to fill the void in the credit markets. We believe that many of these companies and investors will face enormous challenges in the next economic downturn.

We recognize that the benign environment of the past decade will not continue. Loan losses and charge-offs will inevitably rise. However, we believe the banks we own will be able to weather the storms given the specifics discussed earlier. Though one area of concern for the entire banking industry as well as our holdings is commercial real estate; the artificially low interest rates of the past decade continue to fuel building nationwide raising commercial property values, which are now 21% above pre-crisis levels, as illustrated below:



Note: CRE concentration defined as CRE exposure divided by total regulatory capital. The methodology for CRE exposure is based on the definition provided by the OCC. For each bank, we include concentrations for the entities regulated by the Fed, FDIC, and OCC. The Fed-regulated entity represents the holding company concentration level, except at FRC and SBNY, which are not bank holding companies (please defer to FDIC concentration for these two banks).
Source: SNL Financial, Company data, RCA/Moody's, Morgan Stanley Research; Data as of February 2018.

OUR VIEW ON WELLS FARGO

In order, to understand the current Wells Fargo, it is important to take a brief historical perspective on the large merger that took place in 1998 with Norwest acquiring Wells Fargo and then keeping the Wells Fargo name.

Wells Fargo was founded on March 18, 1852 and moved to San Francisco in July of 1852. Fast forward to 1983 when Carl Reichardt became Chairman and CEO of the holding company and Wells Fargo Bank. Wells experienced a sharp decline in operating performance in the early 1980's and Reichardt upon his appointment began refocusing the bank by cutting costs, eliminating 100 branches, 3,000 jobs and closing the bank's European offices. Paul Hazen succeeded Reichardt as Wells Fargo's President in 1984.

Wells Fargo purchased Crocker National in May, 1986 from Britain's Midland Bank; it continues to be viewed as one of the most successful bank acquisitions ever. In the 18 months after the acquisition, Wells Fargo eliminated 5,700 jobs, and 120 branches. In October 1995 the bank made a hostile bid for First Interstate Bancorp, a Los Angeles based bank holding company. The acquisition of First Interstate was a near disaster as corporate cultures were very different, as Wells Fargo was focused on high-tech banking with ATM's, online and supermarket branches, while First Interstate focused on personalized relationship banking. Furthermore, integrating the systems of the two banks was a total disaster and created enormous challenges for the merged banks.

With Wells Fargo's financial performance and stock price both negatively impacted by the merger challenges with First Interstate, an opportunity was created for other banks to step in and purchase the bank. Norwest purchased Wells Fargo in June of 1998.

Under Carl Reichardt and Paul Hazen, Wells Fargo had built a solid institution with an **outstanding credit culture, outstanding cost culture and an average sales culture.**

Norwest's earliest predecessor was Northwestern National Bank founded in Minneapolis, Minnesota in 1872. In the early 80's Norwest began experiencing rising non-performing loans in their large farm loan portfolio as well as in foreign markets. In 1986 Lloyd Johnson brought in Richard Kovacevich from Citigroup as Vice Chairman and CEO of Norwest's Banking Group.

Under Dick Kovacevich and his team, Norwest made hundreds of acquisitions to fulfill Dick's vision of creating a **diversified financial services company,** beyond just a traditional bank lending institution. Kovacevich believed the financial services industry was several times the size of traditional banking, namely lending for commercial and industrial loans as well as commercial real estate. Furthermore, he believed that creating a broader financial services firm would mitigate to some extent the cyclicality tied to traditional banking. That is, when the economy began to soften, the traditional lending businesses also suffered with rising loan losses, requiring higher reserves and earnings declines.

The second major initiative for Kovacevich and his team was to focus upon a higher **penetration of individual households** by having **several accounts per household.** Norwest sought the traditional customer checking and savings accounts, as well as their mortgage, credit cards, certificates of deposit, business loans and personal loans. This concentration of accounts per household was unique among banks and, while many banks tried to do it few succeeded, and Norwest was the best at implementing this very challenging marketing strategy. The result was higher customer retention, lower servicing costs, and better financial metrics.

Norwest under Dick Kovacevich and his team built a leading financial services institution with an **outstanding credit culture, outstanding sales culture and an average cost culture,** though Kovacevich would argue their costs were higher than most banks because of the diversity of their businesses. At the bank level he believed their efficiency ratio was similar to most comparable banks.

When the two banks merged in 1998, two different cultures were united resulting in many issues that have contributed to the current Wells Fargo challenges. As I have described above, the old Wells Fargo was driven by a focus on credit and costs with an average sales culture, while Norwest was focused upon credit and sales with an average cost culture.

Integrating two very different and very large organizations is an enormous challenge with many risks. Many key senior executives, both operating and staff roles, left after the merger, including Les Biller, Dan Saklad, John Thornton, John Ganoe and several others. Dick Kovacevich was going to leave in 2007, at the mandatory retirement age of 65, though he stayed on longer at the request of the Board due to the financial crisis, fully retiring in 2009.

John Stumpf was made Chief Executive Officer in 2007. Under John Stumpf and Wells Fargo's new leadership, the implementation of the Norwest sales culture throughout the new organization was neither fully understood, nor successfully implemented. This has resulted in several unethical sales practices that have been discovered. It began with a 2013 Los Angeles Times article that described the firing of several Wells Fargo employees that had opened accounts for customers without their knowledge. This was a follow up to a 2011 Los Angeles Times story on Wells Fargo issuing reports to L.A. district managers regarding branch performances at signing up customers for overdraft protection.

It is our understanding that the majority of the unauthorized accounts were in California, Arizona and Florida, all regions outside of the traditional Norwest footprint. California and Arizona represent the historical Wells Fargo region pre-Norwest's acquisition and Florida was from the Wachovia purchase. It illustrates how difficult it is to merge large organizations in multi-state regions with very different cultures.

Wells Fargo issued a press release in August 2017 outlining that 3.5 million unauthorized accounts were created and 190,000 of those accounts incurred fees and charges, with Wells Fargo providing $6.1 million in refunds and credits. Wells Fargo has found violations in other areas charging inappropriate fees for mortgages and auto insurance. When Janet Yellen left the Federal Reserve Board she imposed a limit on Wells Fargo's growth so that bank assets may not exceed 2017's year-end figures until all shortcomings have been addressed.

We are most disappointed that the bank's new leadership over the past several years did not address the problems raised in the Los Angeles Times articles of 2011 and 2013, until a couple of years later. Once they were forced to focus on the problems, many important and appropriate changes have been made, including:

- Replacing several members of the Board of Directors
- Replacing many senior executives in several areas,
  - Chief Risk Officer
  - Head of Technology Operations
  - Government Regulatory Relations
  - Chief Auditor
  - Western Regional Bank leader
  - Human Resources

While the bank has settled many federal and state lawsuits and continues to increase its litigation estimates, we believe the bank is well on its way to resolving the many challenges it faces. Wells Fargo continues to have a strong credit culture, geographic and product diversity, strong fee income in wealth management, mortgage originations and servicing, insurance brokerage and several other lines, low cost funding, leadership in mobile and online banking and a broad branch network with solid low-cost deposits, though higher than their industry leading results before their current challenges.

Wells Fargo should generate 2019 revenue of $85 billion with net income exceeding $22 billion and $5 in earnings per share, rising to $5.85 in 2020. With an estimated 2019 tangible book value of $33.81 and book value of $40.11 the stock is trading at 9.9X 2019 earnings, 8.6x, 2020 earnings, 1.5x 2019 tangible book value and 1.2x 2019 book value. Furthermore, the banks efficiency ratio, which was once 55% is now in the mid-60% range, which we believe they can reduce to the high 50's in the next couple of years and further out back to 55% resulting in solid upside to future earnings. The bank will pay out over $7.5 billion in dividends, with net stock repurchases exceeding $21 billion for total shareholder returns of $28.5 billion.

Wells Fargo was a leader for many years in the financial services industry, with some of the finest financial results and metrics of any bank in the world. We believe that senior management is now doing everything they can to assure that they are complying with all regulatory requirements and positioning the bank to once again return to excellence as one of the finest financial institutions in the world.

2018 PORTOLIO ACTIVITY - EQUITIES

We purchased Berkshire Hathaway, US Bancorp and Wells Fargo for new accounts as well as added to our holdings for existing clients. We sold our entire position in World Fuel Services, which I discuss further below.

We continued to sell portions of some of our key holdings, as we have done over the past couple of years, primarily due to valuation levels exceeding our risk thresholds, as their appreciation led to rising percentages of client portfolios. We sold portions of the following securities: Bank of NY/Mellon, BB&T, Brown & Brown, LabCorp, Lowes, Mohawk Industries, Progressive, UnitedHealth Group and Zoetis.

WORLD FUEL SERVICES (INT) is a global leader in fuel logistics, engaged in the marketing, sale, distribution and financing of aviation, marine and land fuel products and related services. World Fuel Services was founded in 1984 and in 2018 generated $39.8 billion in revenue. The company provides one-stop shopping for customers in this highly-fragmented industry, utilizing several advantages, including a global network, centralized purchasing, and a strong balance sheet to provide credit and hedging services for customers, to name a few.

World Fuel operates in a very competitive industry, evidenced by the large revenues they generate and the low margin of net income achieved. The company reported very poor results in the fourth quarter of 2016 and several quarters in 2017 and 2018. Marine fuel pricing along with management's conference call comments on fierce competition contributed to a decline in the stock price from the mid-30's to the mid-20's in late 2017 and throughout 2018.

World Fuel's **aviation business** continues to do well. The global aviation market is a 70-75 billion-gallon market, of which World Fuel's 10-12% market share represents about 8 billion gallons. The company operates in two aviation segments, Commercial and General. The Commercial aviation segment, representing 60%, is a predictable business with pricing done once a year, resulting in management visibility into total gallons sold during the year. General aviation is much more variable and accounts for 40% of business, of which half is for service-related jobs. This is far less predictable, creating variability in results. Over the past several years, the company has had a very profitable business in Afghanistan serving our troops, which represented 20% of the aviation segment's gross profit, generating $5-6 per gallon, much higher than the majority of their business. As our country's operations have declined in Afghanistan, there has been a significant decline in gallons used and a reduction in volumes and profits. However, with the integration of the Exxon acquisition they have been able to continue to do well in aviation.

World Fuel's **marine segment** continues to struggle as industry dynamics remain very poor, though volumes have been reasonably consistent. The global marine fuel market is 250-275 million metric tons and they have a 10-12% market share, or a 30 million gallon-plus run rate. The company faces headwinds from the decline of global trade, as well as shipping companies going bankrupt, impacting credit losses and pressuring pricing. The company has also been negatively impacted by the decline in the number of offshore oil rigs, which have been reduced by half over the past few years, as this represented another very profitable segment. The marine segment is also highly unpredictable as the entire business is based on spot pricing with little visibility going forward. Additionally, the company has not been able to provide marine fuel hedging for customers due to less fluctuation in prices, further impacting revenues and profits. Finally, we believe management has been slow in right-sizing their cost structure in this segment.

World Fuel's **land segment** has been the **biggest disappointment** over the past several years, but also represents their largest opportunity. The global market in the land segment is enormous and highly fragmented with thousands of companies competing. Total market size is over 650 billion gallons, of which World Fuel has a 1% share. About 50% of the business is predictable, providing visibility with 7-10-year contracts while the remainder is much more variable. The company made several acquisitions in this space beginning in 2008 with Texor and followed by Lakeside and Western Gas. They have had a very difficult time integrating all the acquisitions, as each company is very different in their products, geographies and customer bases. The recent hiring of Jeff Smith as Chief Operating Officer, formerly of IBM, is aimed at driving the integration of technology further throughout the firm and integrating the acquisitions. To begin, the company is integrating all the acquired companies onto an Oracle system, both on the front and back end. Hopefully, these developments will provide a platform for growth into the future where World Fuel has a very small market share in a very large global market.

After the financial crisis of 2008-2009, the company benefited on several fronts, as many of their smaller competitors lacked World Fuel's strong balance sheet, size and scale. World Fuel was able to offer credit to customers, as they required more working capital to manage higher oil prices, which reached $140 per barrel in May 2008. Today, the large decline in oil prices has reduced the working capital needs of customers, and smaller players are able to compete. The fluctuations in oil prices also provided large opportunities for the company to provide very profitable hedging services for customers, which has also declined along with oil price fluctuations over the past few years. Finally, as I mentioned earlier, profits from offshore oil drilling and serving our troops in Afghanistan, both of which have been significantly reduced, have provided additional headwinds.

As I mentioned, we sold our entire position in World Fuel Services as we lacked confidence in management to continue to rationalize expenses and navigate the challenging business environment in which they are operating.

2018 PORTFOLIO ACTIVITY-FIXED INCOME

The fixed-income markets remain challenging as they have been for over a decade since the Federal Reserve reduced the Federal Funds rate to 0% in December 2008 to address the Great Financial Crisis. After almost 40 years of declining interest rates, virtually all fixed-income investments continue with historically low yields, including Treasury Bills, Notes and Bonds, Municipals, Corporates, Agency and Mortgage Backed Securities, Bank Loans and High Yield Securities.

The primary focus in our fixed-income investments remains capital preservation and, secondarily, income. While rates of return remain at historically low levels, we are unwilling to either lower our standards in credit quality or take undue interest rate risk by purchasing long dated maturities.

Several years ago, we sold many of our fixed-income investments, primarily municipal bonds and corporate bonds, and replaced them with fixed/adjustable rate preferred stocks, as we believe the risk/reward is far more favorable, as discussed in our preferred stock section below.

Preferred stocks date back to 16th Century England and were issued in the United States in the 1850's, later becoming a major financing tool in the 1980's used by utilities. Over the past several years, financial institutions have been the biggest issuers.

What continues to drive our purchase decisions begins with the excellent credit quality of the bank. We have followed every one of the banks we own for over 20 years and have significant stock ownership in both US Bancorp and Wells Fargo, two of the finest banks in the world, while PNC is also an excellent bank.

We purchased several preferred stocks below, at, or slightly above par over the past year. This December was a particularly attractive time to purchase these securities as several of the securities provided yields to the call date of 5.5% to over 9%. The dividend payments on each of these at purchase were yielding approximately 300 basis points to over 600 basis points above comparable maturity treasury obligations and provide significant tax benefits. These securities begin as fixed rate securities that convert to an adjustable rate if they are not called by the respective banking institutions. This rare adjustable rate feature reduces both interest rate risk and the security's duration.

The key risks are: 1) they are perpetual securities with no maturity or mandatory redemption date, 2) credit risk, as they are junior to most securities other than common stock, 3) regulatory risk, as Dodd-Frank and **other regulations may change, resulting in the banks redeeming these securities early at par, 4) tax law changes that may impact the qualified dividend treatment for these issues, 5) the switch from 3-month Libor to the Secured Overnight Funding Rate (SOFR) in 2021, and 6) liquidity issues if one is a forced seller during a difficult time in the fixed-income markets (we plan on holding the securities until they are called, and we are protected with the back-end adjustable rates if they are not called).**

An important benefit for our clients with taxable accounts is that these dividends represent qualified dividend income, or QDI, and are considered dividend income for Federal tax purposes, which is taxed at favorable capital gains tax rates. For most of our clients that will be either 15% or 20%, which now includes an additional 3.8% tax from the healthcare bill's medical surtax, resulting in rates of 18.8% to 23.8%. These rates are still well below ordinary income tax rates exceeding 37%.

While historically most preferred stocks did not qualify for our purchase, we believe the preferred stocks that we own satisfy our rigid criteria and we have purchased them for accounts in which we feel we can hold them until they are either called several years from now or adjust to the 3-month LIBOR rate and the very favorable interest rates added to that. Furthermore, **we**

have locked in very solid cash flows for our clients going forward for several years at rates much higher than available from 10-year or 30-year treasuries with only minimally more credit risk. Should interest rates rise meaningfully over the next several years, they may trade at a discount to par or our purchase price, but we do not anticipate selling them then either. We simply focused on locking in solid cash flows until they are either called or adjust to the very favorable adjustable rates mentioned.

While the principal value of our fixed/adjustable preferred stocks varies, we do not trade them and typically hold them to the call date. Many of our purchases were made below par, at par and above par. **Whenever we purchase these securities above par our clients will note a loss upon the securities being called at par, since we paid a premium.** However, **even though we paid a premium for the security, the dividend payments and yield to the call date reflect that a loss will occur when the security is called. Our investments have often yielded 3-5% (300-500 basis points) above comparable maturity Treasury securities and that includes the loss when the security is called if we paid above par.** We believe that these excess returns adequately compensate us for purchasing these securities above par, justified by their **high credit quality,** very **attractive yields, favorable tax treatment** and an **adjustable rate** to **protect our clients should the security not be called.**

CLOSING

We would like to thank all our clients for the privilege of serving your investment needs. We are grateful for the confidence and trust you have placed in us for this enormous responsibility. We always welcome your thoughts, questions and comments.

Paul J. Lountzis
President