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Election Update

December 2016

America's newest Nobel laureate in literature (Bob Dylan) famously said: "The times they are a changin'". Whether one agrees or not, investors need to focus on the future political environment and understand the policy ramifications of a Trump Presidency. This election exposed how deeply polarized our country is. While many are struggling to accept a "President Trump", we need to focus on the future. Ready or not, a transition is occurring. We attempt to decipher what was political campaign talk versus what we might encounter. We will address populist pledges versus protectionist policies (while avoiding controversial social issues).

Change:

What did we learn? The election had one simple takeaway – *change*. American voters looked past or through all the debris of this "nasty" campaign and their primary choice at the end of it was to vote for *change*. From the early outset of his political campaign, Trump was frequently unscripted, off-message and controversial. But he succeeded in driving home a message of *change* to the average American. This brash style shocked the establishment and even shocked many in his party. However, now that Trump has won, Republicans will follow suit and adopt a more populist, America-first approach. The self-styled "political outsider" successfully challenged the establishment, Washington elites and mainstream media. While Trump is facing a monumental challenge to take over a deeply divided country, we attempt to focus on how our portfolio will respond under various potential policy changes.

Some will claim the election was determined by differences in economic policies. Some believe it was the direction of politics or the state of our culture. Trump's brash talk and ultimate success tapped into a yearning for *change*. There was a significant swath of the American public that felt left behind. Many elites, especially in the media, failed to grasp this trend. Trump's victory is a continuation of anti-establishment sentiment. There is a global wave of *change* occurring. This message resonated with US voters and it likely will expand globally. This is the most powerful force sweeping the world, not just our 2016 election. Trump's victory, like Brexit, is another sign that the world is becoming divided on several fronts. It is not just left versus right, but it is becoming national versus global. It is becoming working class versus the elite. The trend is populist versus establishment. There is a profound rejection of the postwar global economic order. This could leave a lasting cloud of uncertainty over the markets.

Consensus:

For the last year or so, consensus thinking has been totally off. We strive to anticipate the future and, at all costs, to avoid consensus thinking. Herd mentality, especially in the investing world, can be very dangerous. By just listening to the consensus viewpoint, one would have gotten the timing of interest rates, Brexit and our election dead wrong.

British bookies sustained large losses following the Trump victory, as his odds of winning were roughly 20%. This followed another high-profile miss, with the market failing to grasp the chance of a Brexit decision to leave the European Union last June. The last six months have been full of surprises and we anticipate additional volatility and uncertainty going forward. Following Brexit, the market had two days of declines with cumulative losses of over 5%. After the initial surprise and response, the market went on a three-month rally. After peaking around August, the market began to focus in on the presidential debates. The equity market slowly receded, as we approached the uncertainty of Election Day.

Right around Halloween, the S&P 500 fell 3% and had nine straight days of declines, which was the worst losing streak in 36 years. In 1980, the market also fell nine straight days but the cumulative decline was 9.4%. In October of 2008, during the peak of the Financial Crisis, the market was down for eight consecutive days and 23%. Back in July of 1975, the market fell for ten straight days with a total decline of 7.8%. Times are much different today, as that environment had a Federal Reserve raising interest rates towards 20%, to fight off terrifying inflation.

What we just experienced in October was not a market correction. This is not a capitulation or market dislocation. This was a mild re-pricing of risk. We just had the 29th anniversary of "Black Monday", which occurred on October 19th of 1987. The Dow Jones fell 22.6% that day, which still represents the single largest one-day drop in market history. That decline was a correction. In our

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opinion, the market's recent blip was entirely related to election anxiety. Economic and policy uncertainty crests around all elections and then decreases thereafter. The recent market decline occurred directly before the US Presidential election. This is exactly the heightened uncertainty, angst and political worry we see before all elections. Please do not misinterpret our point – we did not expect a Trump victory. We were as surprised as others. But we did not panic. Beforehand, we conducting various "what if" scenarios, just in case. We were therefore quite comfortable that our portfolio would perform well under significant volatility and potentially higher interest rates. Once the election results were finalized, the portfolio performed quite well.

History:

The media likes to state how everything is historic and that "we've never seen anything like this before". To quote one media host following the election, "I've never seen anything like this and I don't think we're ever going to see anything like this in our lifetimes." There is no doubt that this Presidential campaign and election will be remembered for quite a while.

Election day is traditionally a high-water mark or a moment of maximum uncertainty. Once Election Day came and went, our market handled the initial shock and promptly responded. During the intense and nerve wracking media coverage of November 8th, the market was quite chaotic. Once it became clear that it was going to be Trump's night, the international markets began to fall. When Ohio went to Trump at 10:37pm, the market declined. At 10:51pm, Florida was called for Trump and futures continued to fall. By midnight and after Trump won North Carolina, overnight futures fell to their maximum decline level of (8%). Once Trump was declared the victor at 2:33am, an interesting dynamic took hold. S&P 500 futures contracts began to sharply rise. Over a 12-hour period, stocks, bonds, currencies and commodities plunged, and then began to ricochet higher. We cannot help but find it ironic that Monday November 7th was a positive equity market, known as the "Hillary rally". This was due to FBI Director James Comey claiming recently discovered emails were essentially a non-event. Counter this with the positive equity market rally on Wednesday November 9th, known as the "Trump rally". Most experts predicted a Trump victory would cause the markets to fall anywhere from 10% to 15%.

This is what makes the US such a great country. We can go through two years of contentious and bruising political theatre. Democracy requires us to accept the result and move on. There is no doubt that this was one of the most brutal and uncivil campaigns in recent memory. The bellicose political rhetoric was beyond what many Washington experts had seen in decades. A new reality has set in. Our country has decided on a new leader and we must all focus on moving forward. There will be time for honest disagreements later, but our immediate focus is to best position the portfolio to capture this new reality.

Transition:

Following one of the most divisive elections in history, emotions are running high and run the gamut from exhilarated to despondent. As a country, we can still fight for our social beliefs, but we all share the same basic core values as Americans. After the election, President Obama guaranteed a smooth transition of powers and stated we are all on "one team". The successful transition of power is a democratic tenet that is the envy of the world. President Obama stated "We're not Democrats first. We're not Republicans first. We are Americans first." Secretary Clinton, in her concession speech, stated that it was time to "come together" and "support our new president". In his acceptance speech, Trump mentioned how he wanted to "unify our great country" and how he planned to seek "guidance and help from those that disagree with him." As both candidates stated, now is not the time to remain divided, but rather it is time to work together for the mutual benefit of all Americans.

This type of hope for the future is wonderful to hear, but we are skeptical. This bipartisan approach would be ideal, but it would be wise to plan for discord. Will the campaign Donald Trump resurface or will President Trump act more dignified? Will a cooperative President Trump enrage the base which got him elected? It will be a delicate challenge to have it both ways. He might have some short-term success at pacifying those whose blood he boiled, but as he makes good on some of his campaign policies, all

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bipartisanship will disappear. As the real Donald Trump emerges, investors might experience volatility similar to the night of the election. We need to focus our attention and time on the impact of this new administration on the economy.

Where do we go from here?

The one thing we are certain of is…uncertainty. We do not expect near-term clarity on many important issues. We anticipate heightened volatility and we are prepared for these sizeable shocks to the system. We are following a mantra of "Out with the old uncertainty, in with the new uncertainty."

Volatility:

Markets love clarity, but the uncertain times we live in will lead to heightened volatility. Fortunately, our investment process and philosophy both thrive in this environment. On November 9th, our exchanges reacted quite favorably. For example, CME Group (ticker CME) was up 7% and the market once again appreciated their transaction-based, recurring revenue business model. How good was business following the election? CME volumes reached an all-time high of 44.5 million contracts. Not only was this 13% higher than the previous all-time record, it was also over 3 times normal volumes. While we never know when huge volatility and volumes will arise, we love to find business models and companies that can capture nearly 100% of this incremental profit. In our opinion, this is just another example of leveraging one's infrastructure and capturing the benefits of dominant market share. If you would like to see our detailed CME analysis from May of 2016, please click here.

We are not certain about what will happen with interest rates, the price of oil or the overall level of the stock market for that matter. What we are certain of is increased volatility. We have been investing money through difficult times and different market cycles. We managed portfolios through the dot-com era, The Financial Crisis, Brexit and now as we head towards a Trump Presidency. We are not macro economists or forecasters. We prefer to test our models and companies under various scenarios. We do deep-dive, bottom-up fundamental research. We focus on the underlying trends impacting our companies, while also always striving to understand any macro issues that impact the numbers.

Quality:

A slow and steady move higher in the markets fails to differentiate between high and low quality (often deemed "junk"). One could argue that we have been in this boring, quiet market for one to two years now. We liken this to a "rising tide lifting all boats". We tend to outperform when the market distinguishes between winners and losers. Our portfolios are filled with companies that are gaining market share and growing faster than peers. During 2002 through 2006, high-quality franchises outperformed lower quality ones by 50%. During 2007 through 2009, quality outperformed junk by 20%. By focusing on secular growth franchises, we are inherently less volatile, and experience better than average organic growth.

The payments sector, which represents roughly 1/3rd of our "Fin Tech" portfolio, is a perfect example of secular growth. The simple displacement of cash and checks for card-based payments will occur for decades. These predictable, sustainable and recurring revenue business models are a good example of our investment philosophy. To see our recent *Payment Presentation*, and for further details on why we like the payment industry, click here.

The initial downward move in the market was not nearly as bad as feared. Just like in the Brexit example in June, the market assessed the situation and assumed a glass half-full mentality. It is our opinion that in times of stress, it pays to own quality. In all of our newsletters (seen here) and quarterly summaries (seen here), we discuss the characteristics we look for in any position. These characteristics are what define a high-quality company and are exhibited in many of our concentrated equity portfolios.

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Characteristics:

How do we define high quality? It can be found with companies that have dominant market share and a sizeable moat around their franchise. It is found in businesses generating recurring revenue and setting prices (not price takers). We are attracted to companies with predictable and sustainable operating margins. We demand our companies generate ample free cash flow. This allows a company to weather a volatile storm and insures it is not dependent on access to the debt market to fund its operations. We tend to focus on free cash conversion, or the ability of a company to turn $1 of revenue into free cash flow. We expect our management teams to properly allocate capital, and use cash-rich balance sheets to fund organic growth, make acquisitions, buyback stock and/or pay steady dividends. This is our definition of high quality, and we believe these businesses will outperform in times of difficulty.

US:

Data points to US growth ranging from 2% to 4% in 2017. According to the Commerce Department, the 3rd quarter of 2016 was the fastest GDP growth in 2 years, although it was only 2.9%. The market and the Fed liked the +3.1% increase in private sector average hourly earnings increasing to $25.92 per hour, the fastest increase experienced since 2009. Unemployment has fallen to 4.6% from over 10% seven years ago. Looking at the largest advanced economies in the world, unemployment has gone from 8.4% in 2009 down to 5.4% last summer. With US unemployment now well below 5% and inflation beginning to perk up, expectations are for interest rates to rise in 2017.

Interest Rates:

We cannot help but get a feeling of déjà vu. In February 2014, the FOMC was expecting GDP growth of 2.8% to 3.2% for the year. Real GDP disappointed and turned out to be only 2.5%. In February 2015, the FOMC once again over-estimated expected growth. With initial expectations ranging from 2.6% to 3.0%, real GDP growth was only 1.9%. In 2015, after many delays and deliberations, the Fed initiated an underwhelming hiking cycle in December. In 2016, the Fed initially was leaning towards four hikes throughout the year. After a dreadful start to January (the worst since 1932), the surprise Brexit in June and then the election in November, the only interest rate increase should occur in December. As we look forward to 2017, the market is once again expecting two to three rate increases. We remain skeptical of material increases to Fed Funds. We expect a slow and steady increase off these historically low rates, but there seems to be a different dynamic taking place. Instead of the Fed controlling interest rates, we are now seeing market forces taking over.

Following the surprise election of Trump, the markets reacted and have taken a leadership position. Instead of waiting to see if our Fed would increase interest rates, global yields moved materially higher. Government bond prices tumbled, sending yields soaring. After the election and over the course of a day or two, the 10-year Treasury went from 1.7% to over 2.1%. 30-year bonds rose to 2.9%, posting their biggest increase in over five years. Treasuries are typically a safe haven in times of market turmoil and uncertainty. Instead of rallying post-Election Day, Treasuries were under pressure. Yields did not just move here in the US, they climbed globally. After spending most of 2016 in negative territory, German bunds rose significantly. This was not a steady move higher, but rather a massive change that the market demanded.

Instead of waiting to hear Trump's economic proposals, the market is building in fiscal policy changes. The market is expecting higher budget deficits, large spending increases (for defense and infrastructure), as well as sizeable tax cuts. These expectations, along with heightened geopolitical risks and trade barriers would be inflationary—lifting global interest rates.

The Fed:

Only time will tell if the Fed can "read the tea leaves" and be anticipatory. Unfortunately, the last few years indicate they are becoming more and more reactionary to data. The Fed is looking for clear signals of an improving economy before removing

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monetary stimulus. We continue to believe expected growth and improving trends are clues justifying higher rates. The Fed simply will not paint itself into a corner and will act when it sees fit.

Over the first 18 months of his administration, Trump will be able to nominate five new members to the seven-member Board of Governors. Prior presidents have refrained from commenting on the Fed or making statements regarding monetary policy. The subject was considered by many to be "off limits". We do not expect President Trump to stay quiet on this subject. In fact, we would anticipate heightened political pressure and Trump to attempt to completely re-shape the Fed. Trump will likely call for improvements in transparency, as well as allow for greater congressional scrutiny. We totally disagree with politicizing this independent institution, but we must adjust to the new environment.

During the campaign, we heard two contradictory statements on interest rates from Trump. One said low rates were beneficial and Trump wanted to see definitive evidence of inflation before advocating for higher rates. The counter argument he made was that Janet Yellen was playing a political game and was creating asset bubbles by keeping rates too low. Yellen's term as Fed Chairwoman runs through February of 2018 and we do not expect Trump to re-nominate her. Over the course of the next year or so, this will create uncertainty and volatility to interest rate expectations.

While we have articulated (in prior newsletters), a desire to see higher interest rates, we have been wrong on the timing. If one wishes to see market consensus for interest rates, we believe the best forecast is the CME website (located here). We know consensus has been wrong for quite a while, but this remains our best source of market expectations.

Washington:

Our new President seems intent on making good on several of his campaign pledges. With a Republican Congress and White House, we anticipate a positive response to some economic policies we heard on the campaign trail. If Trump prioritizes strengthening the economy and rebuilding the military, we expect the market to favorably respond.

Both Republican and Democrat candidates were pushing for a sizeable infrastructure spend and various pro-growth measures. The absolute dollar amount is unknown, but we are confident that US fiscal deficits will rise. Borrowing money to spend on "bridges to nowhere" is not a wise plan. We would like to see stimulus that re-invests in our aging infrastructure—this type of infrastructure spending will lift yields and interest rates, which ultimately will benefit several positions in our portfolios.

Taxes:

Trump's victory will embolden Republicans to tackle one of their core tenets – tax reform. While there might be differences of opinion concerning trade and immigration, the Republican establishment seems to agree on lowering taxes. Trump has pledged to tackle tax reform during his first 100 days in office. He and his economic advisors seem to favor corporate tax reform, which we believe will be the largest tax-code change since 1986 (under President Reagan). On the campaign trail, Trump called for cutting corporate tax rates from 35% to 15%. The thesis is that lower taxes equates to accelerated US economic growth. Lessening tax burdens on corporations, in theory, will ultimately benefit employees and individuals. The biggest impact, in our opinion, is the benefit to the stock market. If companies can retain more of their free cash flow, they ultimately will be better off. This should lift growth, lift earnings and lift valuations. We believe this is partly reflected in the positive response in the equity markets following the election.

In addition to corporate tax reform, Trump called for reducing the top tax rate on individuals from 39.6% to 33%. Additional proposals are eliminating personal exemptions, changing the head of household filing status for single parents and instituting breaks for child-care costs. Allowing individuals to keep more of their paycheck is always popular on the campaign trail. However, enacting these proposals will be difficult to pass, as the increase to budget deficits will be sizeable. This individual tax policy

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proposal will be extremely unpopular with some Americans, as the plan would ultimately reduce taxes for the highest-income households. It is estimated that the top 1% of households will see a 13.5% boost in after-tax income, while the entire population will only see a 4.1% rise.

Paul Ryan:

Enter Paul Ryan, the leader and Speaker of the House. In his first comments following the Trump victory, Ryan stated: "The opportunity is to go big, to go bold, to get things done for the people of this country." Ryan has made his reputation on his laser focus towards tax policy. While others were focused on the election, the House Ways and Means Committee staff turned a conceptual Republican tax plan into a concrete legislative blueprint. The House plans to set corporate taxes at 20% and will also attempt to adjust international-border adjusted corporate taxes.

Ryan's *Path to Prosperity* lays out his plans for tax changes that he believes benefit our economy. It strives to grow the economy, simplify tax codes for families, lower the overall tax burden and modernize and re-design the IRS. To avoid needing any Democratic votes of support, Republicans can use budget procedures known as reconciliations. These are the kinds of tactics, Ryan and other Washington insiders understand, are necessary to enact change. Yet, these quirky procedures are exactly the insider political maneuvers that Trump ran against. Every four years, we always hope for bipartisanship. The harsh reality though is that this is usually hard to come by, and so enacting change in Washington is difficult to accomplish. We do not anticipate a bipartisan approach with a Republican majority government.

Once again, whether or not you wholeheartedly agree with Ryan or Trump, or with Republican tax policy, it is unwise to ignore the winds of change. Any successful investor needs to comprehend the ramifications of potential, impending changes, and this is exactly what we do in our scenario testing. Over the long-term, lowering corporate taxes will lead to higher deficits, especially if growth does not materially improve. According to the Tax Policy Center (inside the Brookings Institution), Trump's plan will reduce federal revenue by $6.2 trillion over the next decade. In the short-term, we are more concerned with how these changes will impact our portfolio. The simple answer will be a rising stock market.

Repatriation:

The repatriation of overseas cash seems to be a rare issue with bipartisan consensus in Washington. If companies are allowed to repatriate overseas cash, this should lift growth and investments in our economy. American companies with overseas earnings pay international taxes, but no US federal tax on those profits. If companies decide to bring that cash back to the US, they are required to pay the relatively high corporate tax rate of 35%. This creates an incentive for US companies to house money abroad rather than reinvest it at home. The last repatriation tax holiday was in 2004. Companies brought home $299 billion of overseas earnings in 2005 (per the Bureau of Economic Analysis). It is estimated that US companies *could* bring home closer to $2 trillion now. Those companies with big global operations should benefit with a repatriation bill.

Regulation:

Lastly, many companies have been complaining about an unfair and burdensome regulatory environment. We heard significant chatter on the campaign trail about the repeal of some of Dodd-Frank's financial regulations. President Obama helped usher in Dodd-Frank reforms, to rein in perceived risks on Wall Street. Many financial institutions were blamed for causing the Financial Crisis, and the government's response was to institute rules to limit their risk-taking ability. Over seven years later, many Americans believe abusive financial sales practices and excessive risk taking were not properly punished with executives receiving jail time. In our opinion, reducing protective regulations, especially on our largest banks, is <u>not</u> the answer. We believe some banks still do not possess the proper internal controls to prevent excessive risk taking. Ultimately, whatever our/your opinion on this matter, we

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believe the best course of action for investors is to understand the ramifications of coming change; including what this might mean given the possibility that a Trump administration may move to lessen the sting of regulation on the industry.

If a Republican administration does lessen some of these regulatory rules, the equity markets will respond favorably. Specifically, the financial sector and banks had material moves higher immediately following the election. The impact of a Trump presidency, specifically on the payments industry, is unknown as of today, but may be quite positive over the next year or two. Among the possible actions mentioned are a repeal of Dodd-Frank, advocating for The Financial Choice Act, offered by US Representative Jeb Hensarling of Texas or an outright repeal of the Durbin Amendment. That bill set a cap on debit card interchange rates and established network-routing choice. This specifically had a negative impact on many of our payment holdings back in 2010.

Could we be wrong?

Our founding founders designed the American system to ensure government could not easily make changes. We live in polarized times and so many Americans have different visions for our country. The popular vote was unbelievably close, with over 130 million people casting votes with a difference of only 0.02%. Trump is only the 5th President to lose the popular vote but win the Electoral College, and he was elected with history's lowest favorability ratings, with exit polls at 38% of voters saying they liked him. His sizeable electoral victory (306 to 232) will provide him some cover however, to claim his policies have a nationwide mandate.

Trump led a populist campaign that lacked many of the conservative ideologies some Republicans favor. Many Republicans failed to support Trump during the campaign and some could still cause gridlock, if they do not support his agenda. Throughout Trump's populist campaign, many Republicans sought to separate themselves from his proposals and comments, as they were quite different from established party principles.

Some will support his pro-growth, economic policies. Others might disagree on governmental involvement, foreign policy or immigration reforms. Hard-line fiscal conservatives are loath to raise the debt ceiling and Trump's fiscal plans would increase levels dramatically. Specifically, Republicans will need to increase the debt limit sometime after March. A fractured Republican party could prevent many policies from passing.

Trade:

The US remains the world's largest trading economy. With Trump's victory and his pledge for "upending global trade", we foresee more uncertainty. Trump's anti-trade campaign comments have already created policy-related problems with some of our largest trading allies. There seems to be no way to want a smaller trade deficit and more US manufacturing jobs, yet arrive at concessions that would be palatable to our trading partners. If negotiations do not lead to new deals, will Trump resort to unilateral actions like higher tariffs? Will he usher in an era of US combativeness with important trade partners like China, Mexico, Canada and Europe?

In a correlated economic world, a trade war benefits no one. Rattling a shaky global economy also has major ramifications for growth. As former International Monetary Fund official Louis Kuijs stated, "the election results imply more uncertainty, on policies, and politics and therefore on the global economy." A component of the market rally starting on Wednesday November 9th was the conciliatory nature of Trump's acceptance speech. For now, markets are giving Trump the benefit of the doubt. We remain skeptical.

China:

The world's most consequential bilateral relationship is China & the US. Many of Trump's comments calling China a "currency manipulator" could un-settle the global markets. Trump's anti-free-trade stance is raising fears about the possibility of a trade war with many international leaders viewing our election outcome with apprehension. Furthermore, trade uncertainty raises the fears

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and anxiety for those that seek clarity – the market. Historically, Beijing has done a good job of tuning out hostile rhetoric coming from US presidential candidates. While we can appreciate Trump's deal-making ability, we also expect him to quickly understand that no problem can be solved without China's help. A good deal needs to be good for both sides. America can prosper only if China does as well. A trade war would only produce losers.

The risk is that all presidents have a large measure of authority over trade policy, even without congressional approval. Yet, we believe that there is very little likelihood of Trump following through on his comments to "slap 45% tariffs on Chinese imports". Propaganda messages to the masses are not how one governs. These actions would cause retaliatory tariffs that would crush profits of our global businesses. This would cause serious damage to our economy, which runs counter to Trump's desires. Indeed, instituting trade tariffs on any top trading partner runs serious risks for Trump's pro-growth plans. Economists would be quick to point out that this would hurt US profits, slow the economy, reduce our exports and make imports dramatically more expensive.

The relationship might experience a higher level of tension, but we trust that cooler heads will ultimately prevail. To win, Trump had a message that resonated with voters who believed globalization left many in the US behind. Yet, following through on some of these campaign promises will be difficult to implement. We believe Trump's economic advisors will help soften Trump's stance on some of his campaign threats. We expect President Trump to be more nuanced than candidate Trump.

Security:

International markets are not just feeling the economic anxiety of a Trump win, but have serious questions about their security. Campaign comments from Trump were quite negative on NATO (North Atlantic Treaty Organization). Jens Stoltenberg, NATO's secretary-general, has pushed back against Trump's comments on the alliance. Japan and South Korea are quite worried about Trump's pledges to withdraw "tens of thousands" of US troops unless they boost their payments. During the campaign, Trump portrayed both as "free riders" taking advantage of America's security guarantee. Once again, the global order has been shaken. Many international leaders are questioning America's position - as world leader - if it can produce this kind of shock.

A stronger US dollar would mean that we begin to export global inflation. We would anticipate a material slowdown in many emerging markets. International debt levels and negative yields have troubled us for some time (see here) and we believe there is imminent volatility. The world is more correlated than ever, so we will continue to model and prepare for more volatility as we closely monitor China, Europe, Japan and other important countries.

The Italian Referendum on December 4th is yet another reason for heightened volatility. The "no" vote raises more questions than answers. We now need to watch and understand the anti-EU movement in Italy, advocated for by their 5 Star Movement party. What are the Brexit maneuvers in the UK, following their decision to leave the single market? What will happen with the French, German and Dutch elections? How will the corporate tax battle between Ireland and the EU get resolved? In this environment, having significant European exposure could be painful, and we are aware that a tightly correlated global marketplace spares no one.

2017:

Barron's fall 2016 "Big Money Poll" ranked each of the 11 sectors for expected 2017 performance. Financials were ranked #1 by these "experts", receiving 24% of total vote. Technology was 2nd, receiving 22% of the vote. These two sectors represent roughly 1/3rd of the overall market weight, but dominate our "Fin Tech" portfolio.

On the financial front, we are quite optimistic. Whether it is the Fed or the market that lifts rates, we expect changes to global yield curves. We anticipate higher levels of inflation and a steeper yield curve, which significantly benefit our financial positions. Inflation is coming back to life, but it is not soaring higher. Inflation still is less than the Fed's 2% target. Some blame the Fed's policy for

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promoting risk taking and creating asset bubbles. Others recognize that the Fed helped steer our economy out of the Financial Crisis abyss. Either way, the era of cheap money seems to be coming to an end.

Conclusion:

The US Presidential election is finally over. As we start a new year, many are looking forward to change and renewal. The financial markets are no different. On the campaign trail, Trump advocated for less regulation, lower taxes and more fiscal spending. If implemented, these policies should lift an economy stuck in its slowest recovery since the postwar era. For the next few months, many of his proposals will be uncertain and unknown. Over the first few quarters of this new administration, we expect pro-growth policies to benefit the equity markets. Trump will get the benefit of a unified Congressional base. Whether you approve of his policies or not, decision-making and change is coming to Washington. We believe significant opportunities on both the long and the short side exist, and that good individual stock selection and timely tactical repositioning can drive total returns higher.

As Maya Angelou wrote," You may encounter many defeats, but you must not be defeated. In fact, it may be necessary to encounter the defeats, so you can know who you are, what you can rise from, how you can still come out of it." We were surprised by the US Presidential election, but we remain confident. We continue to focus our attention on "Fin Tech" industry and stick to our area of expertise. The overall market expansion is now seven years and 1 quarter old. It is the 4th longest on record. While we do worry that this bull market and economic expansion is already quite old, we return to our core principles on valuation. Are certain equity valuations elevated? We believe some are, but we also find many of our specific holdings to be quite attractively priced. We will continue to think deeply about the downstream implications of a Trump administration. Active management requires daily testing of our thoughts, investments and strategy. We do not employ legacy assumptions and we strive to test our investment strategies every day.

In closing, we would love for you to *"Cheer up, if you can"*. Did we mention that the Chicago Cubs won the World Series for the first time since 1908? Our history shows that there will always be worries and threats. The pessimists will continue to highlight our weaknesses. We believe that our economy and market capitalism is too strong to stop. Our companies continue to produce the technology marvels of the world. Our high standards of living and democratic policies should continue to be the envy of the world.

Thank you for your interest in Manole Capital. As of today, we remain the largest personal investor in our products. We believe that the portfolio provides excellent upside and growth. If you have any questions or comments, please do not hesitate to reach out to us. We hope that you consider our "Fin Tech" portfolios as you seek to *"Make your portfolio great again".*

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The SEC states that investment advisers should furnish disclosures on fees, when it comes to showing gross versus net performance results. Our performance figures are gross performance numbers. All performance figures, including the benchmark shown, are calculated as total gross returns. This includes the impact and re-investment of any applicable dividends.

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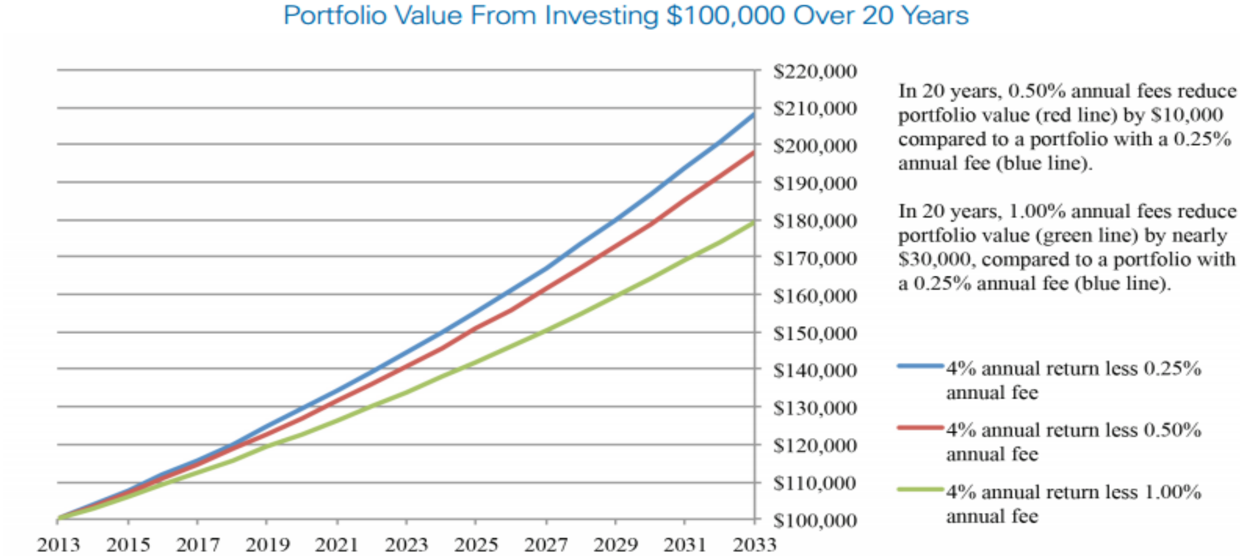
- performance figures do not reflect the deduction of investment advisory fees;
- a client's return will be reduced by the investment advisory fees;
- a return can be reduced by other expense in the management of an account;
- investment advisory fees are described in an adviser's Form ADV;
- A representative example showing the effect of compounding of an advisory fee

Portfolio Value From Investing $100,000 Over 20 Years



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