LOUNTZIS® ASSET MANAGEMENT, LLC

March 1, 2017

RE: 2016 YEAR-END REVIEW

As we write in early 2017, all three major stock indices, the S&P 500, DJIA and Nasdaq Composite, continue to reach new highs. The 2016 stock market began with steep declines in January and February creating fear and uncertainty, before ending the year making up the lost ground and hitting new highs. After lackluster 2015 returns, both the S&P 500 and DJIA, with dividends reinvested, bounced back to continue their bull market run generating **double-digit returns for the 6th year** out of the past 8.

A breakout of stock market returns for 2016 and the annual returns since 2014 are given below:

Stock Market Index	2016	2015	2014
S&P 500	12.0%	1.4%	13.7%
Dow Jones Industrial Average	16.5	0.2	10.0

PERFORMANCE OF KEY HOLDINGS

A breakout of the performance of our key holdings for 2016, which followed strong performances in the full years 2014 and 2015, are given below.

Company	% Change for 2016	Company	% Change for 2015	Company	% Change for 2014
Martin Marietta Mtl.	62.2	Martin Marietta Mtl.	23.8	Zoetis	39.8
Brown & Brown	39.7	Mohawk	21.9	Lowe's	38.9
UnitedHealth Group	36.0	Progressive	17.8	UnitedHealth Group	34.3
BB&T	24.4	UnitedHealth Group	16.4	Berkshire Hathaway B	26.6
Berkshire Hathaway B	23.4	Lab Corp.	14.6	Wells Fargo	20.8
US Bancorp	20.4	Zoetis Inc.	11.4	Lab Corp.	18.1
World Fuel Services.	19.4	Lowe's Companies	10.5	Abbott Laboratories	17.5
Loews Corp.	17.6	PepsiCo Inc.	5.7	Bank of New York	16.1
Bank of New York	14.9	Bank of New York Co.	1.6	PepsiCo	14.0
Zoetis Inc.	11.7	Wells Fargo & Co.	-0.8	Mercury General	14.0
Progressive Corp.	11.6	Brown & Brown	-2.5	US Bancorp	11.3
Mohawk	5.4	BB&T Corp.	-2.8	Martin Marietta Mat.	10.4
PepsiCo Inc.	4.7	US Bancorp.	-5.1	World Fuel	8.7
Lab Corp.	3.8	Loews Corp.	-8.6	TJX Companies	7.6
Wells Fargo	1.4	Berkshire Hathaway B	-12.1	Brown & Brown	4.8
Lowe's Companies	-6.5	World Fuel Services	-18.1	Mohawk	4.3
				BB&T	2.3
				Thor Industries	1.2
				Progressive	-1.0

60 COMMERCE DRIVE ▪ WYOMISSING, PA 19610
260 MADISON AVENUE ▪ 8TH FLOOR ▪ NEW YORK, NY 10016
610.375.2585 ▪ FAX: 610.375.3324

We wanted to touch on several important topics in the current investing environment.

We will begin by discussing **stock market valuation levels by reviewing 2016; the current stock market; taking a look back at the Global Recession in 2008-2009; accepting the inevitable stock market fluctuations; and future stock market returns.**

We will also share some thoughts around our firm's focus on **long-term relationships with employees, clients, vendors and companies; our investment philosophy and process; managing risk; evolving as investors in the ever-changing financial markets; impatience as a critical behavioral flaw for investors; and active vs passive investing.**

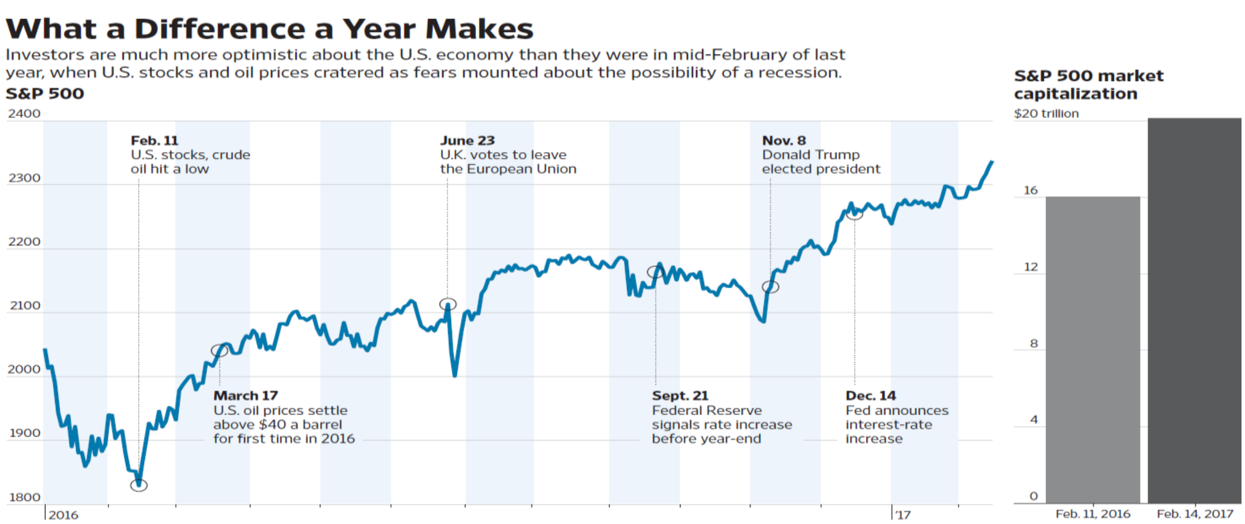
We have several specific concerns that we briefly touch on, including: **global debt levels including rising domestic debt levels for student loans and autos, US Gov't budget challenges, State and municipal debts, changing global demographics, and bubble valuations in private companies seeking to go public.**

Finally, we provide a **brief review of our investments in both stocks and fixed income securities with a brief discussion on our key stock investments.**

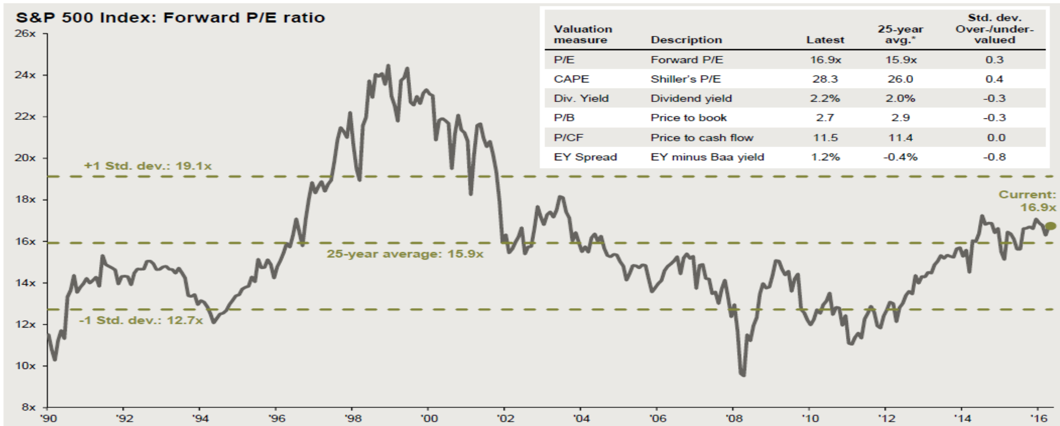
STOCK MARKET VALUATION-REVIEW OF 2016 AND EARLY 2017

The stock market began 2016 with declines that fueled fears of an imminent recession before bouncing back and finishing 2016 at new highs, rising 12% with dividends reinvested. In fact, the stock market's 4.9% decline during the first 4 trading days in January 2016 was the worst in history, preceded only by 4.5% declines in 2000 and 1991.

Since the election, the market has risen further in anticipation of several changes that may improve our economic future, such as lower corporate and individual tax rates, the repatriation of $1-2 trillion in foreign cash held by US-domiciled corporations, infrastructure spending and several other anticipated initiatives. A Wall Street Journal Article entitled "What a Difference a Year Makes" clearly contrasts the differences between the stock market returns achieved to begin 2016 and after the November Presidential election and into early 2017 as shown below:



The stock market's valuation level as measured using the S&P 500 Index on a forward price/earnings ratio was at 16.9x on December 31, 2016, slightly above the 15-year average, as illustrated below:



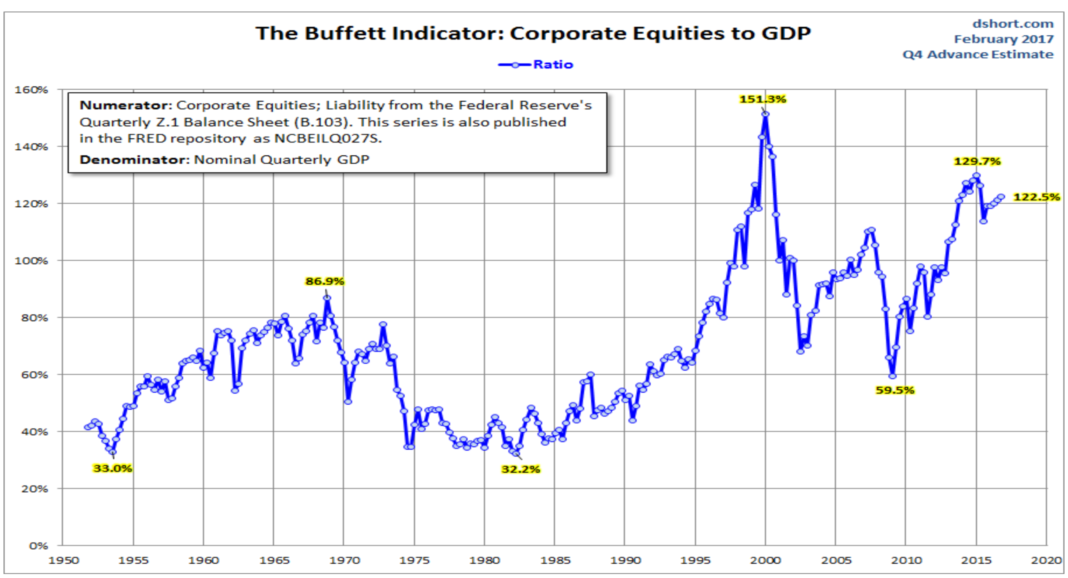
Source: FactSet, FRB, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.
Price to earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend 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, 2016.

J.P.Morgan
Asset Management

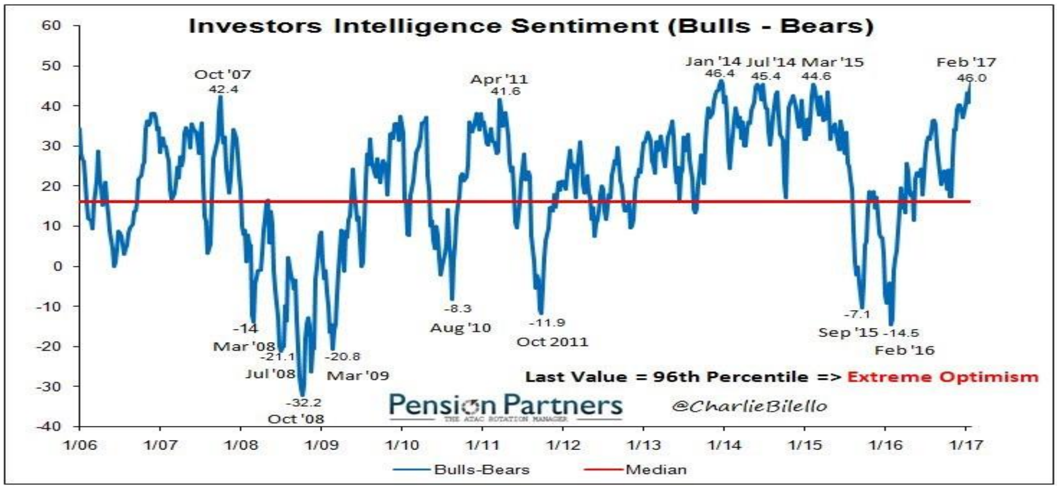
The stock market has continued to rise since the November elections, reflected in the **S&P 500's current trailing price earnings ratio of 24.5x and forward price earnings ratio of 20.5x, both quite high compared with historical levels**. Furthermore, the **S&P 500's median price earnings ratio in late February is 24.2x, or 30% above the 53-year median price earnings ratio.**

The Dow Jones Industrial Average (DJIA) as well as the S&P 500 and NASDAQ continue to reach new highs in 2017. The DJIA has hit 12 consecutive all-time highs and the stock market remains very calm as the S&P 500 has not experienced a 1% intraday move since December 14, 2016, or over 60 days.

One of Warren Buffett's favorite measures of stock market valuation is the value of corporate equities to GDP, and as of February 2017, the **current stock market value is the third highest in history** as illustrated below:



Stock market euphoria continues as the bull market rolls on and **investor optimism keeps rising** as illustrated below:



STOCK MARKET RETURNS SINCE THE FINANCIAL CRISIS 2008-2009

The S&P 500's 12% increase in 2016 represents the eighth straight annual increase since the 37% decline in 2008. In fact, **the stock market has generated double-digit returns in 6 of the past 8 years**, reflecting the significant undervaluation in late 2008 and early 2009, fueled further by global monetary easing and various other factors which we discuss herein. Shown below is a breakout of the S&P 500 returns over the past nine years.

YEAR	S&P 500
2008	- 37.0%
2009	26.5
2010	15.1
2011	2.1
2012	16.0
2013	32.4
2014	13.7
2015	1.4
2016	12.0

The S**&P 500 has risen relatively unabated for 8 years**, as have several **other indexes,** including the Dow Jones Industrial Average and NASDAQ, both having generated outstanding returns as illustrated below:

Total Returns (2009 - 2016)			
Year	S&P 500 (SPY)	Dow (DIA)	Nasdaq 100 (QQQ)
2009	26.4%	22.8%	54.7%
2010	15.1%	14.0%	19.9%
2011	1.9%	8.1%	3.4%
2012	16.0%	9.9%	18.1%
2013	32.2%	29.6%	36.6%
2014	13.5%	9.8%	19.2%
2015	1.2%	0.1%	9.4%
2016	12.0%	16.4%	7.1%
Cumulative (2009 - 2016)	192%	176%	332%
Annualized (2009 - 2016)	14.3%	13.5%	20.1%

Pension Partners @charliebilello

The S&P 500's 8-year winning streak is among the longest in history as illustrated below:

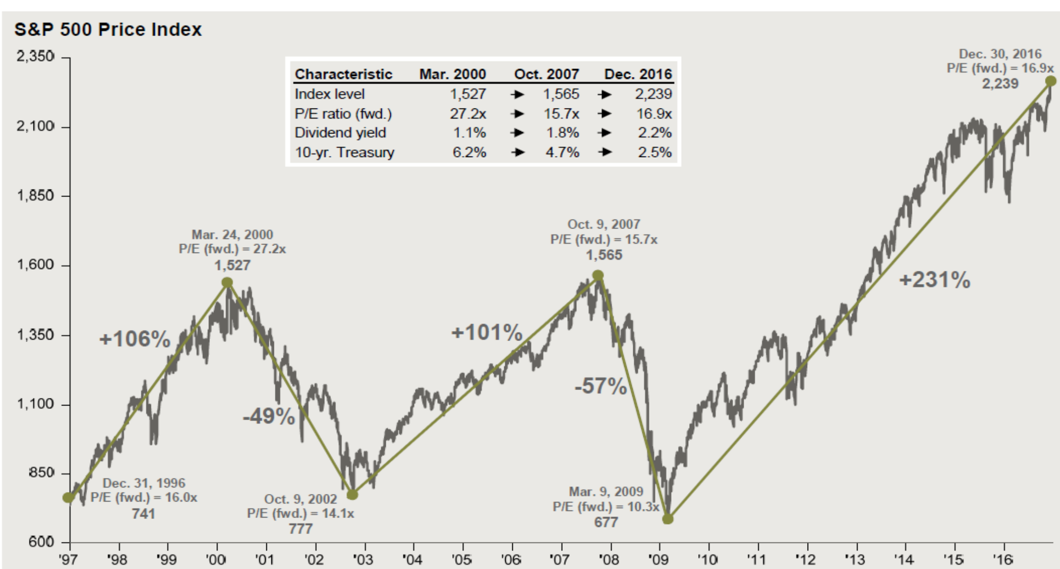
# of Consecutive Years of Positive Returns	Start	End	Cumulative Return	CAGR
3	1904	1906	67%	19%
3	1954	1956	111%	28%
3	1963	1965	60%	17%
3	1970	1972	40%	12%
4	1942	1945	143%	25%
4	1958	1961	102%	19%
5	2003	2007	83%	13%
6	1947	1952	148%	16%
8	2009	2016	194%	20%
8	1921	1928	435%	23%
8	1982	1989	291%	19%
9	1991	1999	450%	21%
			Avg. CAGR	19%

Data as at December 31, 2016. Source: Factset.

STOCK MARKET FLUCTUATIONS AND DECLINES ARE INEVITABLE

It is very important to recognize that financial markets experience frequent fluctuations and one should conduct their affairs accordingly. Charlie Munger has stated, **"If you cannot withstand a 50% stock market decline, you should not be investing in the stock market."** Even Berkshire Hathaway, a great company, has experienced a few 50% or greater stock price declines over its 50 plus year history. Therefore, investors need to recognize and be prepared for stock market fluctuations and the emotional challenges they present. While large price declines often provide compelling investment opportunities that need to be capitalized upon, large price increases provide excellent selling periods to realize long-term profits.

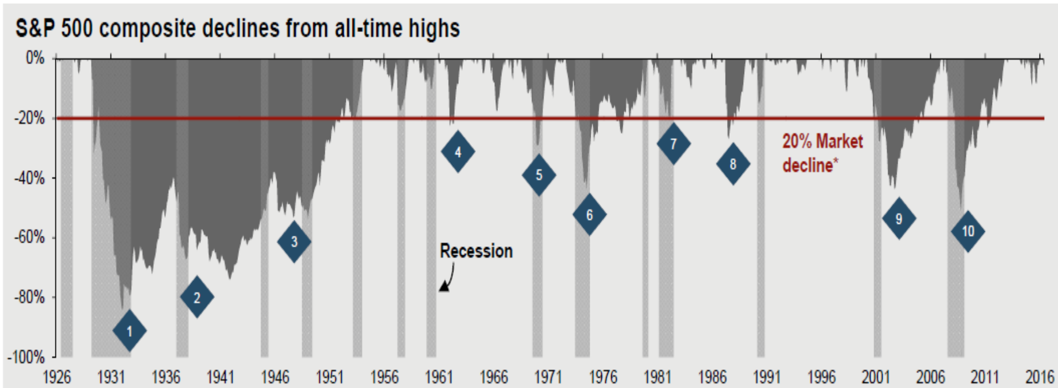
The table below illustrates the market fluctuations of the S&P 500 since 1997, with two large peak-to-trough declines of 49% and 57% that preceded the current bull market.



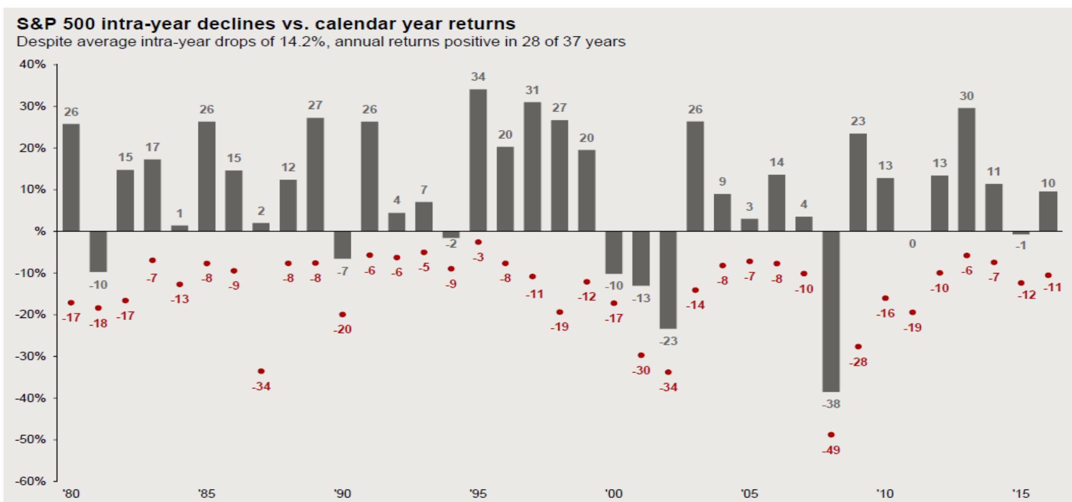
Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat. Forward price to earnings ratio is a bottom-up calculation based on the most recent 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, 2016.

J.P.Morgan

The table below illustrates 10 major S&P 500 declines from all-time highs since 1926, the last being the Global Financial Crisis that bottomed in March 2009.



A breakout of **S&P 500 intra-year declines since 1980 (which averaged -14.2%)** and calendar year returns, which were positive in 28 of 37 years, excluding reinvested dividends is illustrated below:



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2016.
Guide to the Markets – U.S. Data are as of December 31, 2016.

As an investor, one should always conduct their affairs to be prepared for stock market declines of various magnitudes. The table below illustrates the frequency of stock market declines over the past 115 years:

A History of Declines (1900–December 2015)

Type of Decline	Average Frequency[1]	Average Length[2]	Last Occurrence
-5% or more	About 3 times a year	47 days	August 2015
-10% or more	About once a year	115 days	August 2015
-15% or more	About once every 2 years	216 days	October 2011
-20% or more	About once every 3½ years	338 days	March 2009

Source: Capital Research and Management Company
[1]Assumes 50% recovery rate of lost value.
[2]Measures market high to market low.

In the last eight years since the S&P 500's March 9th, 2009 low, there have been **few** significant stock market declines. In fact, the S&P 500 index has had 15 declines of 5%-10%, 5 declines of 10%-19% and **only 1 decline exceeding 20%.** As a result, it has been very difficult to find truly compelling investment opportunities in the past several years. That will not go on forever, though at times it seems as it may. W**hen opportunities become available we will be prepared**.

FUTURE STOCK MARKET RETURNS

We are now in one of the longest lasting bull markets in history. Our team finds it helpful to reflect and gain some historical perspective on stock market returns in the recent past. Over an 18-month period from the fall of 2007 through the spring of 2009 the Dow Jones Industrial Average declined over 54%, falling from 14,100 to just over 6,500, while the S&P 500 declined almost 60%. We also recall that during the technology bubble in 1999-2000, the NASDAQ declined almost 80%. These declines were startling and many investors chose to sell, losing large amounts of their hard-earned capital, permanently (i.e., a realized loss).

Given the attractive returns generated by the stock market over the past eight years, we believe future returns will be less robust given that we have borrowed from future years' performances. Starting from stock market lows in March 2009, the markets have appreciated substantially and six of the past eight years have generated double digit returns including a couple years with well over 20% returns. It is highly unlikely these results will be repeated in the next eight years. **We do not make any predictions about future stock market levels, rather we want to be clear that given the significant increase over the past eight years there is a high probability that future returns will be lower.** As a result, now is an excellent period for our firm to maintain our valuation discipline and, while we continue to seek investment opportunities for our clients, we want to remain ever mindful of the risk/reward parameters in the current stock market.

While there are external factors such as interest rate levels that impact stock valuation levels, stock market returns are primarily a function of earnings growth, dividend growth and price earnings multiples applied to those earnings. Over the past eight years, companies have generated earnings growth, particularly in the early years after the 2008 crisis when earnings bottomed out. Revenue growth has been far less robust over the past decade and, in fact, many large companies have had no revenue growth at all. Earnings growth has been less dramatic in the past few years, despite the tailwinds for earnings from many companies borrowing heavily to buy back stock. I might add the greater focus on non-GAAP earnings rather than traditional GAAP earnings has also created distortions. Dividends have also continued to rise as companies have increased payouts to mollify yield-starved investors. In fact, many investors have eagerly sought investing in stocks with attractive yields as a substitute for low-yielding traditional fixed income investments such as US Treasury Securities, corporate and municipal bonds. The result has been a sizeable increase in price earnings multiples paid for many higher dividend yielding stocks, creating valuation risk in several sectors such as utilities, consumer products, and others.

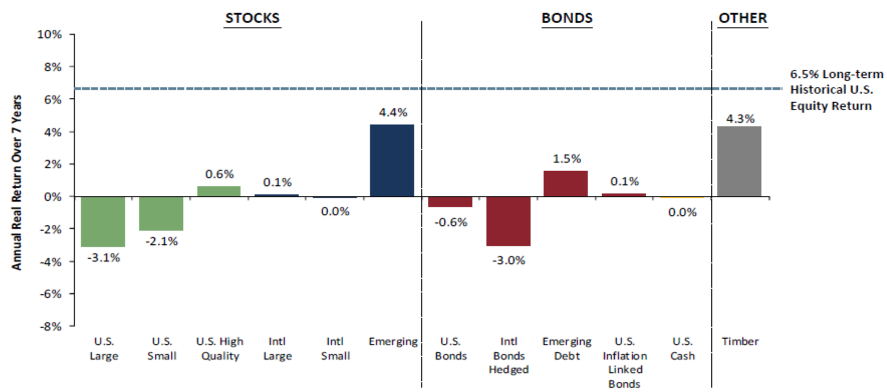
Finally, according to Bill Priest, the Chief Executive Officer and Co-Chief Investment Officer of Epoch Investment Partners, a $43 billion investment firm based in New York, the **MSCI World Index has appreciated over 87% in the past five years and 74% of that increase is attributable to price earnings multiple expansion, as earnings declined 2% and dividends rose 15%.** This expansion of the price earnings multiple has provided strong tailwinds to fuel rising markets, but going forward those tailwinds will subside and could turn into headwinds, especially if interest rates begin to rise. Since the November 2016 Presidential election, the stock market as measured by the Dow Jones Industrial Average rose almost 20% from 18,000 to over 21,000. That is a very rapid increase in a very short period of time. As we write, the stock market continues to rise fueled by investors piling into ETF's and Index Funds which are dominated by the largest companies. Alphabet/Google, Amazon, Apple, Facebook and Microsoft, have a combined market value of over $2.5 trillion or about 10% of the entire stock market's valuation.

Several well-respected investment firms, including GMO, based in Boston, MA and Research Affiliates based in Newport Beach, CA believe that future stock market returns will be much lower than those achieved over the past eight years as illustrated in their graphs below:

GMO

7-Year Asset Class Real Return Forecasts*

As of December 31, 2016

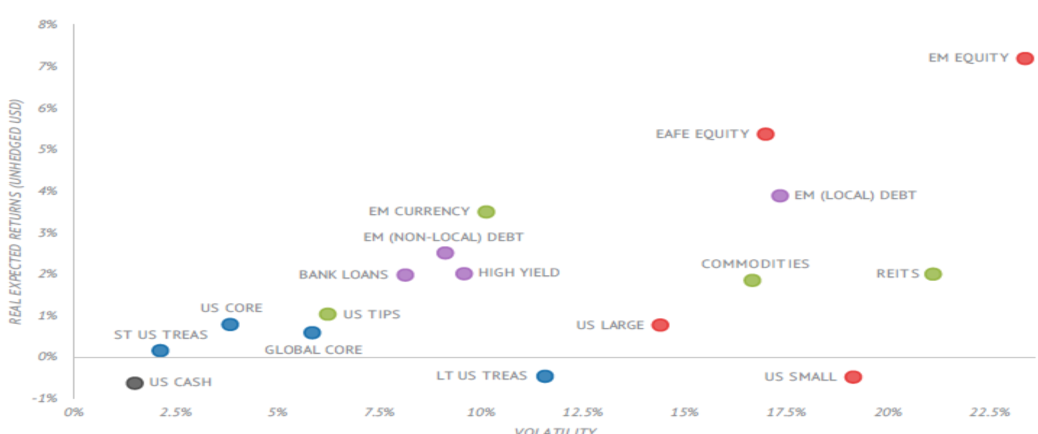


Source: GMO

*The chart represents local, real return forecasts for several asset classes and not for any GMO fund or strategy. These forecasts are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. Forward-looking statements speak only as of the date they are made, and GMO assumes no duty to and does not undertake to update forward-looking statements. Forward-looking statements are subject to numerous assumptions, risks, and uncertainties, which change over time. Actual results may differ materially from those anticipated in forward-looking statements. U.S. inflation is assumed to mean revert to long-term inflation of 2.2% over 15 years.

GLOBAL ASSET CLASSES: 10-YEAR EXPECTED RETURNS

Note: All returns are geometric.



research affiliates

As of 01/31/2017. Source: These expected returns are calculated by Research Affiliates LLC using data provided by MSCI Inc., Bloomberg, and Barclays. Volatility is measured as standard deviation. These forecasts are forward-looking statements based upon the reasonable beliefs of RA and are not a guarantee of future performance. This content is not investment or tax advice or an offer, sale or any solicitation of any offer to buy any security, derivative or any other financial instrument. Any use of the above content is subject to and conditioned upon the user's agreement with all important disclosures, disclaimers and provisions found at www.researchaffiliates.com/en_us/about-us/legal.html. In the event the above content is provided or modified by a third-party, Research Affiliates LLC fully disclaims any responsibility or liability for such content.

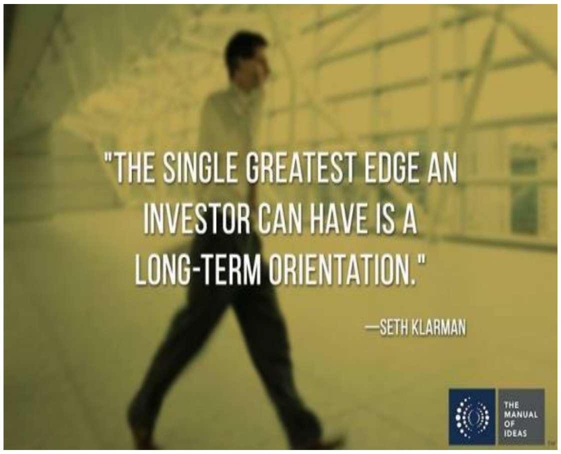
LONG-TERM RELATIONSHIPS – CLIENTS, VENDORS, COMPANIES

We have discussed our focus on long-term relationships in the past and want to re-emphasize how critical it is by including our comments from a few years-ago. In a very **short-term oriented world, one with fewer personal interactions, our firm seeks to build long-term relationships with clients, vendors, colleagues and companies.**

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. **The foundation and future success of any company always begins with the quality of its clients. All companies are defined by the customers they choose to attract and keep and our company is grateful for the outstanding clients we are privileged to serve.**

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:



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 of stock market returns since the Great Depression.

We will continue striving to build and strengthen our relationships with clients who understand our philosophy, long-term approach to investing, and our field-based research process **to first help preserve, and then grow their capi**tal.

LONG-TERM RELATIONSHIPS -VENDORS

In addition to our long-term client relationships, we have also built similar relationships with several vendors over the past 17 years, two of which we highlight below. Lynx Computer Technologies, Inc., our technology partner, and MarketCounsel, our securities law partner, both have played key roles in our firm's success.

Lynx Computer Technologies, Inc., a leading regional technology solutions provider, recently installed our third computer network over the past 17 years. Our new network technology enables our firm to provide a 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. The Lynx team led by Pete Mullenberg and Matt Heffner seamlessly installed our new network, 7 workstations and 7 laptops, while also working with our portfolio software vendor Advent whose applications we use for all our client reporting.

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 you and all of 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 members of his team, including Dan Bernstein and Scott Brown, 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 decades to come.

LONG-TERM RELATIONSHIPS-COMPANIES

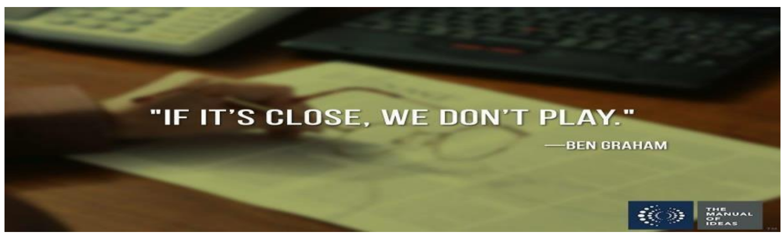
We also seek to invest in companies in which we can remain invested for many years. We diligently search for companies with solid business models, strong balance sheets, honest and capable management teams, both as operators and capital allocators, available at attractive prices. Our **field-based research process augments our financial analysis to bring the numbers to life.** We hope that our 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 in order to gain greater confidence in making meaningful investments.

We want to **thank all our clients, vendors, colleagues and the companies in which we invest, as we continue striving to build long-term mutually beneficial relationships.**

OUR INVESTMENT PHILOSOPHY AND RESEARCH PROCESS

As I discussed earlier in our letter, we believe that current stock market valuation levels are fairly priced to overvalued, fueled in part by the artificially low interest rates driven by our Federal Reserve Bank. Nevertheless, we continue to seek qualifying investment opportunities, as we do throughout all market environments. **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 – not on outcomes, which are more variable and over which we have less control.**

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



We are evaluators of risk as Howard Marks has stated below:

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 valuation criteria, despite a universe that encompasses several thousand companies almost exclusively in the developed world; the U.S., Western Europe 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 future prospects, which are driven by qualitative factors such as their products, quality of their people, service levels, sustainable competitive advantages and outstanding visionary leaders as well as other non-financial factors. **We seek anomalies**, which are **characteristics that differentiate what are otherwise similar companies.** Questions that we ask ourselves in evaluating a company's characteristics, many of which we tie directly to their financials, include:

1. What is unique and different about your firm?
2. How compelling is your product and service for consumers?
3. What problems does your firm resolve for customers?
4. Is the founder still engaged?
5. What is the market size you compete in?
6. What is the nature of the competition?
7. What are the dynamics of the market?
8. What are the barriers to entry?
9. What is your unfair advantage?
10. How long is your runway?

There is a critical difference at our firm from most others. It is that we spend a great deal of time performing what I call "field-based research". In addition to the in-depth quantitative analysis, we have spent thousands of days on the road over the last almost three decades speaking with competitors, customers, industry consultants and other knowledgeable industry experts, always seeking to gain what we call "differential insights"; that is, ways of 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 in order 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 that diligent and thoughtful questioning derived from the financial analysis and supplemented by our personal interviews enables us 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, particularly in our efforts to ensure 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 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 hopefully avoid permanent capital loss in our investments. Our secondary purpose is to gain insights that will give us additional confidence to make larger investment commitments to our particular 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.

One additional lesson I have learned is that **being intellectually honest with myself and admitting that every so often, no matter how hard one works, how much one reads, how many intelligent people one speaks with, you simply cannot avoid all risks, nor have the insights one needs to always make great 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."**

<u>OUR VIEWS ON MANAGING RISK</u>

The inescapable fact of investing is that there are innumerable ways to lose money, very few ways to make money and even fewer ways to keep or preserve wealth over decades. Therefore, the most important job of any investment advisor is the ability to assess, evaluate and ultimately manage risk in the portfolios of their clients, through various ever-changing financial environments.

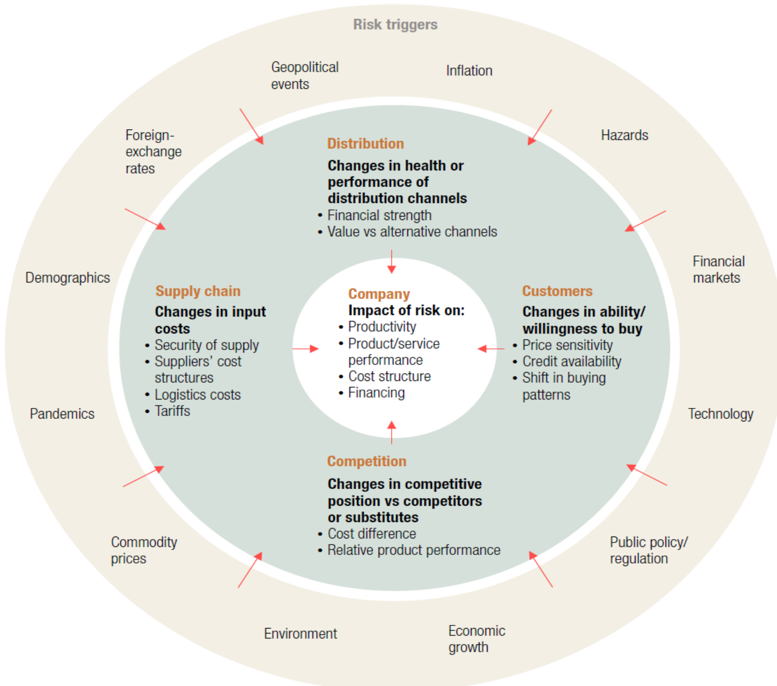
To quote Warren Buffett's teacher and mentor, oft-considered the father of security analysis, the late Benjamin Graham, **"The essence of investment management is the management of risks, not the management of returns."**

Graham's definition of investing remains a sound today as when he wrote the Intelligent Investor in 1949:

"An investment operation is one which upon thorough analysis promises safety of principal and an adequate return. Operations not meeting these requirements are speculative."

Risk is a complex, multifaceted concept that is very difficult to understand, measure and quantify. We agree with London Business School professor Elroy Dimson's definition, **"Risk means more things can happen than will happen."**

The following McKinsey & Company graphic illustrates the many types and dimensions of risk that businesses and companies face.



There are also many different types of risk, including: credit risk, valuation risk, inflation risk, illiquidity risk, interest rate risk, business risk, management risk, and many others. Modern Portfolio Theory tries to measure and quantify risk through a concept called beta. Beta measures a stock's risk based upon how much it fluctuates (volatility) relative to the stock market. A beta of less than 1 indicates the stock is less volatile than the market, and a beta greater than 1 is more volatile than the market. There are many flaws with this idea as beta uses market prices, not fundamental business values, and secondly, assumes the flawed idea that a stock that declines more in value has a higher beta thus greater risk. To illustrate, consider a business with an intrinsic value of $100 whose stock price drops from $80 to $40. According to academia, its beta or volatility increases, implying it is "riskier". The reality is that the opposite is true; it is less risky to pay $40 for a business with a $100 value rather than $80. **While Modern Portfolio Theory's concept of beta is quantifiable and measurable, that does not mean that it represents an appropriate definition or measure of risk.** In fact, **we do not know of any single measure that captures and defines the concept of investment risk.**

We believe 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. **Albert Einstein's quote** beautifully captures the uncertainty of measuring risk, **"Not everything that can be counted counts and not everything that counts can be counted."** 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 averse to volatility or price fluctuations** in businesses in which we have **great confidence** in the **business model** and the **managers** whom we know well. Many of our holdings had substantial declines during the market decline in 2008-2009 and we held firm without selling, but rather, buying more of several of our holdings.

So how do we assess risk at our firm? We focus upon our research process and 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, digging 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 unique corporate cultures are led by individuals with unique characteristics and capabilities who are able to communicate their passion and vision, creating 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 are able to build a culture with a large number of employees that also truly believe in that vision as well. Some examples include: Alphabet/Google, Amazon, Apple, Wal-Mart, Exxon, Starbucks, Nike, Fastenal, Progressive and Berkshire Hathaway.

Historically, the stock market has experienced setbacks, and often significant ones, from the Great Depression in 1929 to the large declines in the early 2000's and 2008 during the financial crisis. **However, despite volatility and periodic declines, the stock market continues over time to rise and as a result, rarely is there a penalty for taking excessive risk (except during those infrequent periods when risk causes a revaluation in the stock market). 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.**

In fact, in the current investment environment with eight straight years of rising stock prices, the best performance has often been reached with those taking the most risk at precisely the time when risk should have been reduced. **Benjamin Graham** stated, "**The risk of paying too high price for a good-quality stock - while a real one - is not the chief hazard confronting the average buyer of securities. Observations over many years has taught us that the chief losses to investors come from the purchase of low-quality securities at times of favorable business conditions."**

However, **in times of favorable stock market periods, investors often suffer from the "I don't want to miss out" phenomenon, as it is extremely painful to see others profiting while you are not. While we feel today's stock market values are full, we do not believe the extreme excesses experienced in 1999 and 2007-2008 are present today. Though we remain cautious, as valuations in most cases lack the adequate margin of safety we seek in every purchase.**

We operate at Lountzis Asset Management, LLC always focused on risk in everything we do and we work diligently to avoid it. We always focus on improving our research process rather than outcomes over which we have much less control. We believe good outcomes are a direct derivative of an outstanding research process. We recognize that the future is highly uncertain and so we focus upon understanding as best we can the current investment environment and do our best to prepare for that uncertain future. We follow the Confucius proverb, **"Real knowledge is to know the extent of one's own ignorance."**

James Montier, an author and investment strategist, now working at GMO, a leading Boston based investment firm, has enumerated **7 Immutable Laws of Investing** that we view as a sound investment framework:

1. Always insist on a margin of safety
2. This time is never different
3. Be patient and wait for the fat pitch
4. Be contrarian
5. Risk is the permanent loss of capital, never a number
6. Be leery of leverage
7. Never invest in something you don't understand

With the current stock market, having risen significantly since the March 2009 lows, it is becoming more difficult to find great businesses available at attractive prices.

Though I might add, the valuation levels achieved in 2007-2008 and 1999 were far greater than current stock market valuations. We believe stock market valuations are reasonable to slightly overvalued in the current artificial low interest rate environment, although there are pockets of opportunity in specific companies that we are evaluating.

We recall Donald Rumsfeld's wonderful comments regarding "known known's", which are things that we know we know, as well as "known unknowns", which are things we know that we do not know. There are also "unknown unknowns": those things that we don't know we don't know, and these 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 otherwise express our view: In the financial markets for the majority of the time, there **is neither an immediate penalty for taking excessive risk nor a reward for avoiding excessive risks.**

In all our investments, we seek a margin of safety which reduces dependence upon forecasts. Often times 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 our process, making investments 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 below are the **five criteria that were enumerated in Warren Buffett's 1993 annual report that beautifully capture 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.**

All of the criteria listed above are profoundly important, but the most important is the purchase price of the business and the associated margin of safety that will hopefully assure that even if your analysis is incorrect, permanent capital loss remains a remote possibility. Warren Buffett has stated, **"Have the purchase price be so attractive that even a mediocre sale yields good results."**

We are continually working to improve our process of 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 informs us 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 Madame Marie Curie, "Nothing in life is to be feared, it is only to be understood."**

EVOLUTION AS AN INVESTOR-LESSONS LEARNED

Achieving investment success continues to become more and more difficult as businesses and industries are changing more rapidly than ever. The rapidity and magnitude of changes across many companies and entire industries is creating a treacherous environment for all investors. Furthermore, the financial markets, as well as companies and industries, are always evolving and we as investors must also evolve to exploit the various investment opportunities that come about from decade to decade. However, we must be mindful to maintain our strict discipline and focus on our core investment values in the ever-changing financial markets. It is more important than ever to seek insights that may not be mainstream, through creative and diligent researching of companies and industries, and to continually assess and evaluate their business models and sustainable competitive advantages.

Among the most enjoyable yet challenging aspects of investing is continuing to grow and learn in the evolving financial markets. As my career evaluating businesses, management teams and industries surpassed 30 years in 2016, I began to reflect on the challenges and changes that have occurred both in my experience, as well as through studying several other great investors. **We have spent a great deal of time over the years studying many great investors to learn more about their investment process and how they evaluate various businesses and industries around the world.**

As most of our clients know, Berkshire Hathaway remains our largest holding and we see that continuing going forward. As a result, following Warren Buffett has been an enjoyable journey that began when I first read about him at age 12 in 1972. Thus, I have followed him for over 44 years, though much more closely and in a more enlightened manner as my knowledge has grown over the past 30 years. His writings, lectures, interviews and presentations have given us an incredible education in becoming a better investor as well as a better person.

In studying Warren Buffett's evolution as an investor, I find many things of interest, but two primary lessons come to mind. First, despite the many investment decisions that he has made since founding the Buffett Partnership in 1956 are a limited number of mistakes of commission, resulting in permanent capital loss, that he has made during an investment career spanning six decades. Only Mr. Buffett knows how many mistakes of omission he has made, and he has spoken about several, including Fannie Mae and Wal-Mart to name two. However, as best I can tell there have been very few investment mistakes of the magnitude of Dexter Shoe, Conoco and a few others.

Second is Mr. Buffett's evolution as an investor, operating in a variety of different stock market and economic environments over the past 60 years, while continuing to generate outstanding returns. He has articulated what he looks for in buying a private business: consistent earning power, high returns on equity with little or no debt, simple businesses, honest and capable management teams in place, and an attractive offering price. What has been less well-known is how his investment approach has evolved over the past 60 years and how he has maintained his core investment principles in various investing environments since 1956. I will discuss this evolution a bit later in this section.

Charlie Munger, Warren Buffett's partner for several decades has often stated, **"Warren is a learning machine."** Mr. Munger recently spoke at length, at the Daily Journal Company Annual Meeting in California, about **how Mr. Buffett has evolved and changed as an investor:**

"If you're in a game and you're passionate about learning more all the time and getting better and honing your skills, etc., of course you get better over time and some people are better at that than others. It's amazing what Warren has done. Berkshire would be a very modest company now if Warren never learned anything … But what really happened was we went out into fields like buying whole businesses and bought into things like Iscar that Warren never would have bought. Ben Graham would never had bought Iscar. We paid five times book for Iscar, and it wasn't in the Graham playbook. Warren learned under Graham, and he just learned better over time. And I've learned better. **The nice thing about the game is you can keep learning.** And we're still doing that. Imagine, we're in the press now for all of sudden buying airline stocks. What had we said about the airline business? We thought it was a joke, it was such a terrible business. Now if you put all those stocks together we own one minor airline. We did the same thing in railroads, we said railroads were no damn good. Too many of them and truck competition, and we were right for about 80 years. Finally, they get down to four main railroads and it was a better business. And something similar is happening in the airline business."

Warren Buffett started the Buffett Partnership in 1956 and **throughout the 1950's and 1960's, given his love of numbers, combined with the teachings of his mentor Benjamin Graham, Mr. Buffett focused primarily on quantitative factors, namely a company's financial metrics, and his investments reflected that.** He wanted to own companies that were statistically cheap based upon their financials (though he did purchase National Indemnity in 1967 which began his ownership and love for the insurance business and the many benefits of owning insurance companies).

In the 1970's Charlie Munger's influence led to the purchase of See's Candies, a private company, as well as portions of the Washington Post and Geico in the public markets. It was Charlie who helped Warren to focus on qualitative factors, not just

quantitative factors or numbers. His investing now included companies with outstanding qualitative characteristics, in addition to being financially cheap. These were better businesses with higher returns, sustainable competitive advantages and long runways.

In the 1980's Berkshire continued to make outstanding investments in public companies that represented an important source of Berkshire Hathaway's value and rising stock price.

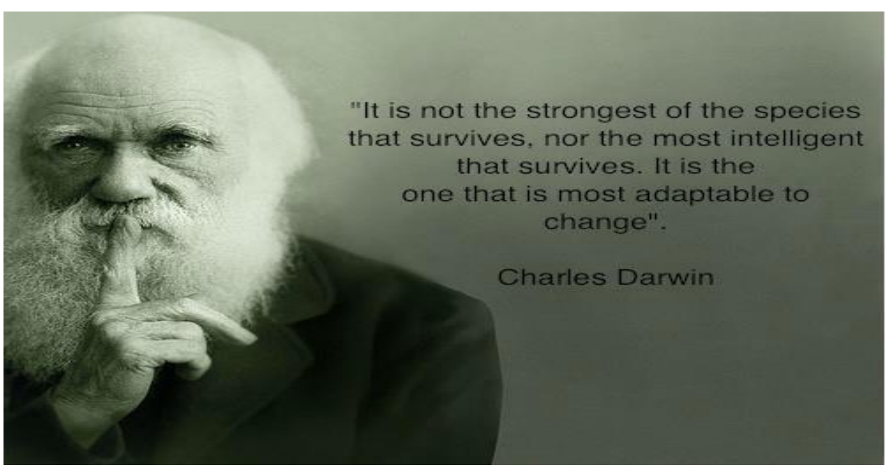
In the 1990's and 2000's Berkshire began buying entire private and public companies to add to the Berkshire family. This ownership of entire companies has made Berkshire Hathaway much less dependent upon the investing skills of Warren Buffett. While Mr. Buffett is simply irreplaceable, he has done an outstanding job in preparing Berkshire Hathaway for the future, through the ownership of a broad range of outstanding companies that will continue on for many years after Mr. Buffett is no longer at the helm. Mr. Buffett, along with Mr. Munger's influence along the way, has helped transform a Berkshire Hathaway that many years ago, was entirely dependent upon his stock picking skills, into a diversified company that includes Burlington Northern, Iscar, Lubrizol, Geico Insurance, Berkshire Hathaway Energy and many other outstanding companies.

With regard to the public markets, Berkshire has also evolved and today owns IBM, a technology company that he never would have owned years-ago. His recent investments in the airline industry and Apple, another technology firm. Berkshire Hathaway has added two outstanding investors to its investment team, Todd Combs and Ted Weschler, who are given enormous freedom in choosing securities to make purchases for Berkshire's equity portfolio.

Mr. Buffett's evolution as an investor, which began with a focus on numbers, evolved to include a qualitative focus seeking better businesses and finally to purchasing entire businesses outright, both public and private, outright.

His evolution is one that all investors should embrace, study and implement, as the next 40 years will reflect many unforeseen changes. An investor's ability to adapt to the ever-changing financial markets, by continuing to maintain valid core investment principles but applying them in a variety of different environments, will be critical to achieving the investment success we seek for our clients.

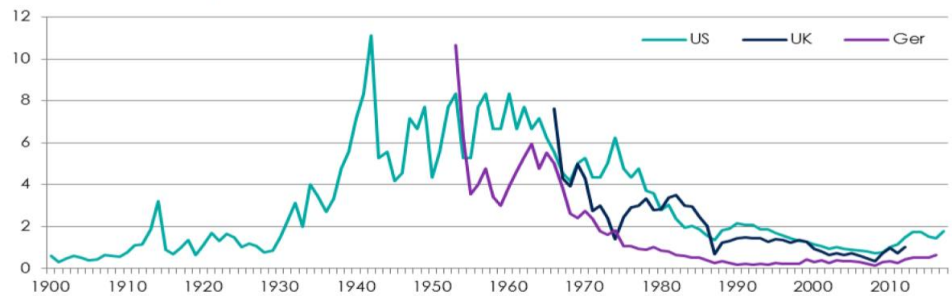
Charles Darwin's quote below beautifully captures the essence of adaptability, which is critical for investors to succeed in the future.



IMPATIENCE IS AN ACHILLES HEEL FOR INVESTORS

One of the foundations of successful investing is having a long-term horizon of 5 years or more for holding an investment, which defers taxes and allows a great company to continue to build value (and compound). Unfortunately, in our very short-term oriented world, fewer and fewer investors follow this long-term approach, creating a trading mentality that lacks the benefits of a long-term investment approach. The chart below illustrates the average holding period for stocks in the US, the UK and Germany over the past 116 years:

Figure 1 – Average holding period of equities (years)



Note: Based on stock market turnover and market capitalisation data. UK is only to 2012 as the LSE no longer publishes some of the turnover data.
Source: NYSE, LSE, Global Financial Data, World Federation of Exchanges and Source Research.

We believe that the short term approach prevalent throughout the investing world today works to our benefit as we are able to remain patient and selective in finding outstanding businesses with excellent management teams available at attractive prices. As most investors are constantly buying and selling stocks and bonds, we are able to remain patient and take advantage of the opportunities born from frequent trading.

ACTIVE VS PASSIVE INVESTING

Over the past couple of years there has been a great deal of discussion regarding “active” or “passive” investing, and which is best for individual investors. The movement into index funds has grown a great deal over the past few years and specifically in the past year. We believe this is appropriate in many cases as many investment firms are managing portfolios which are virtually equivalent to index funds, yet charging much higher fees. This is referred to as “closet indexing”, and many customers are beginning to recognize this and have chosen to move their money to index funds or ETFs to receive similar investment portfolios with much lower costs.

This topic has been given even greater visibility with the discussion by Warren Buffett in the latest Berkshire Hathaway annual report regarding passive indexing as an attractive choice for most individual investors. Buffett discusses the hedge fund industry and typical fees of 2% plus 20% of any profits, which we agree in most cases are far too high given the typical returns achieved by most investors in hedge funds over long periods of time. We would contrast hedge funds with their 2% annual fees plus 20% of the profits as very different from our individually customized potfolios in which we charge a 1% annual fee (not 2%) and we receive none of the profits as they flow to our investors, as they should.

John Bogle, as the “father of passive investing”, has also always believed that passive investing is the best choice for individual investors.

While we believe that passive investing has a place for investors and the low costs are certainly an attractive component of these investment choices, however, **cost alone is not the only important component in evaluating investment choices.**

As a registered investment adviser managing individually customized portfolios for each client, based upon their specific needs and goals, we believe that **costs and performance are two of the most important components in evaluating an investment adviser.** However, there are additional functions that are provided by your investment adviser, including the following:

1. Defining a client's goals and objectives and working diligently to help them achieve them, **particularly during stock market declines.**
2. Understanding the client's risk profile and concerns and helping them develop an investment program that is consistent with such.
3. Managing for tax minimization.
4. Flexibility to manage portfolios and always investing with risk management as the primary focus in a broad range of individual companies and industries.
5. A separate account enabling our clients to directly own securities, unlike mutual funds, index funds and ETF's, which provides broad flexibility, great tax efficiency, and few investment limitations.
6. Providing discipline, focus and helping to manage client behaviors and fears.
7. Helping clients evaluate their financial futures and facilitating those needs and goals.
8. We do not invest in mutual funds, which add another layer of costs for our clients. We only invest in individual stocks and fixed income securities (treasuries, municipal bonds, corporate bonds, preferred stocks, etc.)

One of our most important roles is to help clients during very difficult periods, when the stock market is declining, which often creates a great deal of stress and concern for clients. We believe that our in-depth research process provides us with a great deal of insight into companies, management teams and industries enable us to have the confidence and disicipline to stay with investments despite short-term declines as in the financial crisis of 2007-2009. While **several of our holdings declined, we maintained our disciipline and in many cases bought more of companies we felt were selling at ridiculously low prices relative to their long-term business value.** While it was **emotionally difficult watching stock prices decline 20-75%, our research process gave us the confidence to stick with them, and in many cases buy more, which has served our clients very well over the past decade.** It is during these most difficult times that an investment adviser truly earns their keep by removing emotion and focusing on the long-term fundamentals of a company. As Warrant Buffett has often stated, **"Temperament is even more important than intellect."** It has been our experience that **few investors, individual or institutional have the temperament to stick with their investment program during these stock market declines. When the S&P 500 declined almost 60% from peak to trough during the period between 2007-2009, how many investors, either individual or institutional, stayed the course? We did, due largely to the confidence our research process instilled upon us; a key contributor to our returns over the past 8 years.**

While the past eight years since the global financial crisis have seen this rising market (and we have been fortunate in participating in the stock market's solid appreciation). However **where we will truly earn our stripes is when difficulties arise. As I mentioned earlier in this letter, stock market declines are inevitable and it is during those periods that we need to maintain our discipline and focus in assuring that we are working to preserve and grow our client's portfolios.** While there will certainly be declines in values, our job remains to evaluate the long-term prospects of the companies in which we have invested. **Stock price fluctuations can be very scary and emotionally draining, but they also create enormous opportunities if one can remove emotions and focus on the specifics of a company and its long-term prospects.**

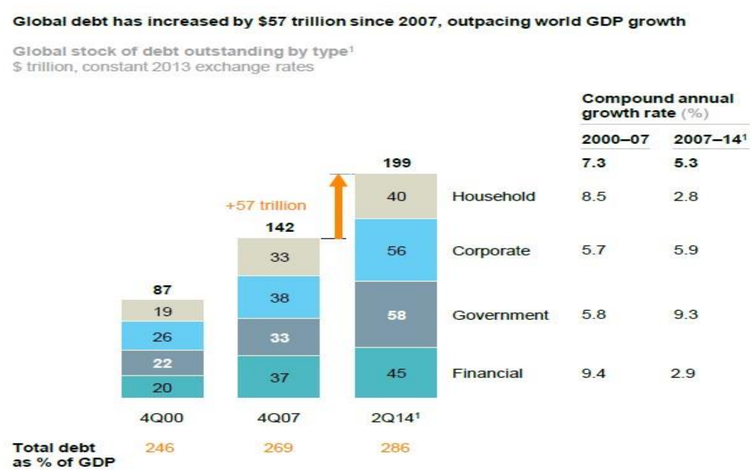
After almost 30 years in this industry, if our team at Lountzis Asset Management, LLC had been looking for an investment adviser, the checklist of criteria we would seek include the following:

1. Impeccable integrity, with complete honesty, openness and transparency in all client communications and meetings.
2. We would ask about the firm's investment philosophy and research process and how they evaluated several specific securities in their portfolio. What is the breadth and depth of their research process and how do they seek insights into companies and industries.
3. While there are exceptions, we would prefer to invest with firms that are owned by the principals, helping to ensure complete consistency between the firm's goals and those of every client.
4. We would ask how and where the investment adviser invests his/her money. Our firm has a partnership that has the majority of my net worth and we buy the same stocks as our clients **after** we have bought them in their individually customized accounts.
5. Awareness of fees and the performance results achieved over long periods of time.

GLOBAL DEBT LEVELS

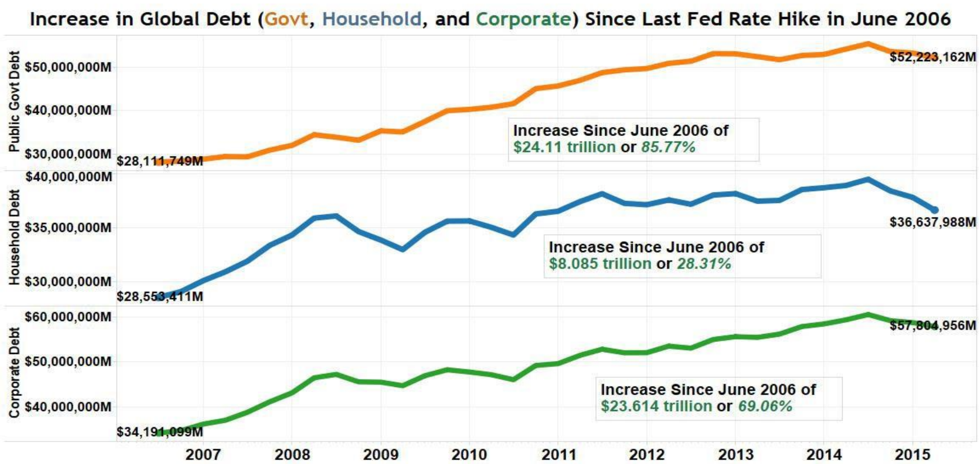
I want to re-visit the important issue of global debt levels as they continue to rise. We believe that the availability of artificially low interest rates on a global scale may lead to a broad range of challenges that will be difficult to deal with. While central banks around the world lowered interest rates to help stabilize global economies after the Great Financial Crisis and provide for economic growth, the question remains: have interest rates remained too low for too long? In the United States, since the Fed lowered the fed funds rate to 0-25 basis point in December 2008, there have been only 3 increases of 25 basis points, in December 2015, December 2016, and March 2017.

The levels of global debt have continued to rise since the world financial crisis of 2008-2009. According to a McKinsey report, global debt has risen from \$87 trillion in 2000, to \$142 trillion in 2007, and \$199 trillion as of the 2nd quarter of 2014, as illustrated below:



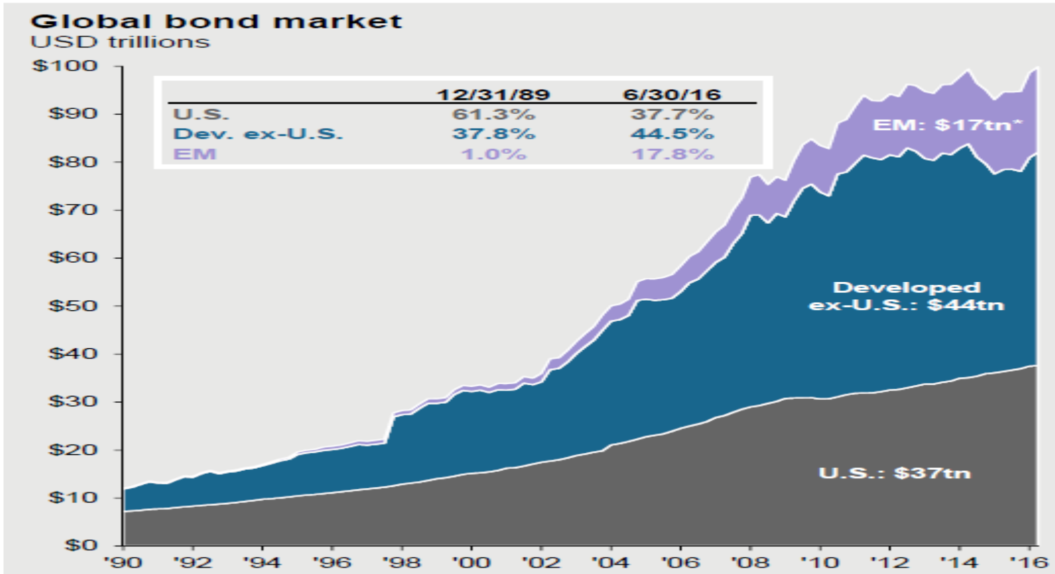
A more recent report from the International Institute of Finance, released in early January, global debt levels rose by $11 trillion in the first 9 months of 2016, reaching new highs at $217 trillion. We estimate that **2016 year-end global debt levels will exceed $225 trillion, or over 330% of the world's global domestic product.** This continued rise in global debt levels, during a long period of artificially low global interest rates may now be rising, and may create enormous challenges for the global economy. Over the past few decades, rising debt levels created many crises: from the Latin American crisis in the early 80's, the Asian Financial crisis in the late 90's and the Global Financial crisis in 2007-2009. While we are not predicting another crisis, with global debt levels higher than ever, risks continue to rise.

According to the International Institute of Finance report, **debt levels in developed markets are at $165 trillion or 390% of GDP, while in emerging economies, debt levels are at $53 trillion or 217% of GDP.** Furthermore, many companies in emerging markets have borrowed in dollars while their revenues are in local currencies, creating additional challenges. We believe that these elevated global debt levels will continue to adversely impact global GDP growth as more resources are allocated to paying down debt levels rather than making productive investments that grow economies. This table illustrates the increase in global debt levels including government, household and corporate since the Federal Reserve's June 2006 rate hike.



These global debt levels will continue to play an important role in our ever more **interdependent global economy.** Emerging markets today represent over 40% of global GDP and have accounted for over 60% of global GDP growth since 2010. China's rapid growth over the past several decades has helped many commodity-based economies flourish such as Australia, Brazil, Canada and many others. Now that the commodity super cycle has ended, the impact has been devastating, illustrating today's greater interdependence in our global economy.

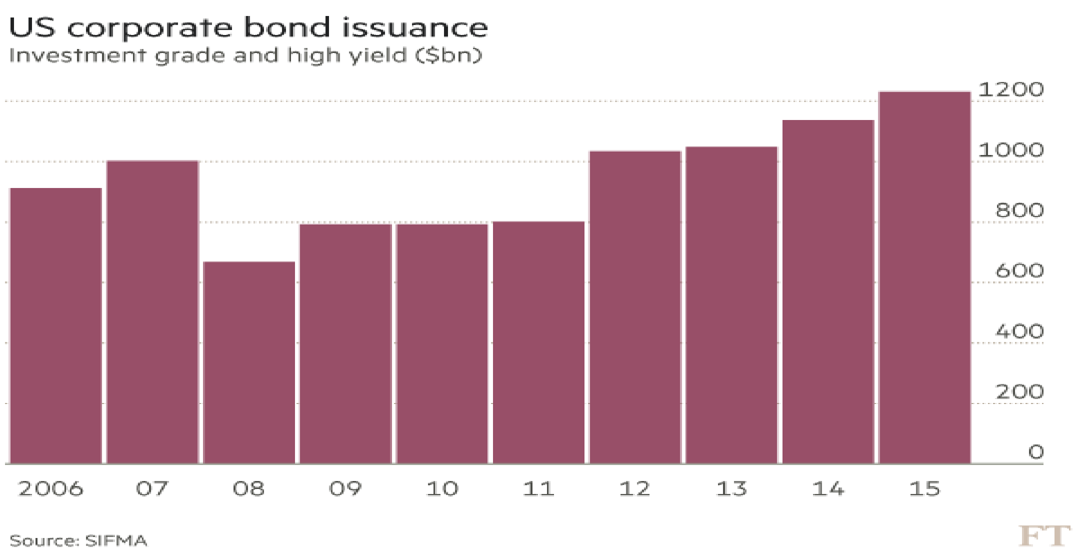
The **global bond** market has tripled in size since 2003, as worldwide demand for debt instruments has grown. The US bond market relative to 1989 is a smaller percentage of the overall global bond market, and the emerging markets have experienced significant increases which is illustrated below:



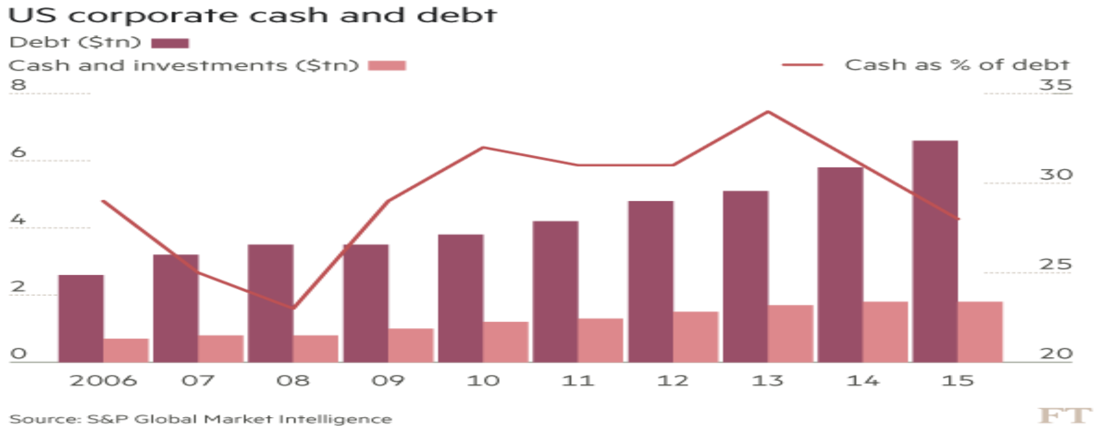
Source: J.P. Morgan Asset Management; (Left) FactSet, Barclays; (Right) BIS.
Fixed income sectors shown above are provided by Barclays and are represented by the global aggregate for each country except where noted. EMD sectors are represented by the J.P. Morgan EMBIG Diversified Index (USD), the J.P. Morgan GBI EM Global Diversified Index (LCL) and the J.P. Morgan CEMBI Broad Diversified Index (Corp). European Corporates are represented by the Barclays Euro Aggregate Corporate Index and the Barclays Pan-European High Yield index. Sector yields reflect yield to worst. Duration is modified duration. Correlations are based on 7 years of monthly returns for all sectors. Past performance is not indicative of future results. Global bond market regional breakdown may not sum to 100% due to rounding. *2Q16 estimate for domestic South Korean debt assumes debt levels are unchanged from the previous quarter.
Guide to the Markets – U.S. Data are as of December 31, 2016.

J.P.Morgan
Asset Management

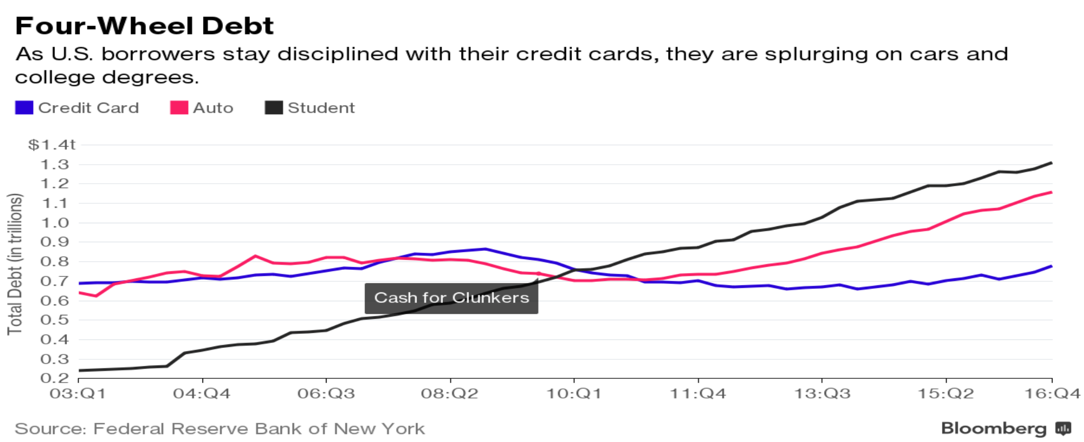
As these low interest rates persist, US companies continue to borrow to fund stock buybacks, refinance higher cost debt and pay out increased dividends. US corporate bond issuance now exceeds the levels of 2007, which preceded the Global Financial Crisis. This is shown below:



While many large technology companies such as Apple, Facebook Google, Microsoft and a few others have very large cash holdings, the great majority of US companies have increased their debt levels, often to fund stock buybacks and pay increased dividends to yield-hungry investors. While most companies lack the large cash holdings (and liquidity) of the aforementioned technology companies that would otherwise offset some of their rising debt levels. The table below illustrates US corporate cash and debt levels over the past decade:



Within our own country there are several areas of concern. Two that quickly come to mind are car loans and education loans. An excellent article by Bloomberg illustrates the rising levels of credit utilized to purchase automobiles and student loans:



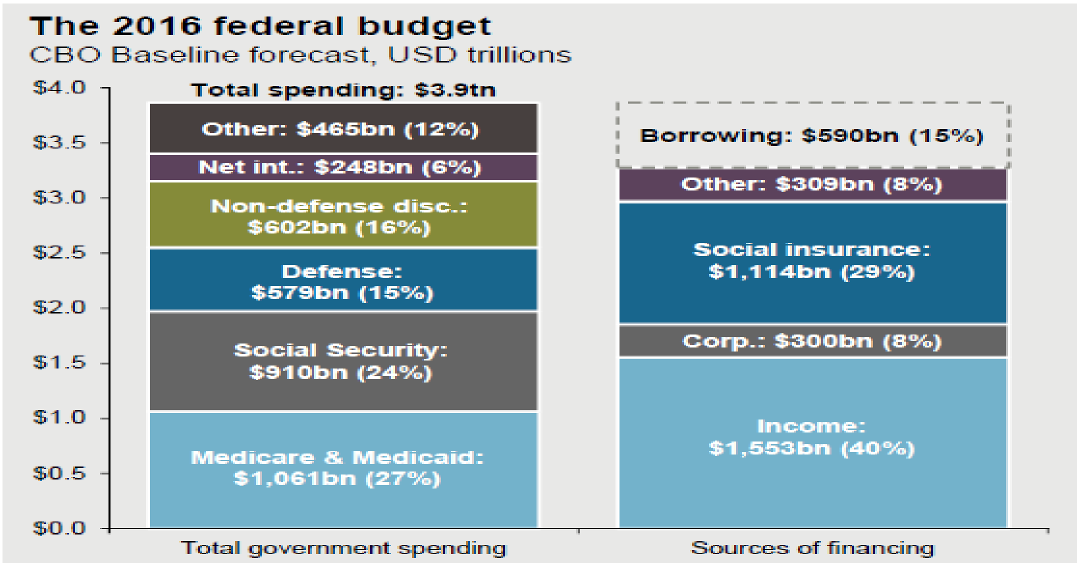
In addition, 90-day delinquency rates for student loans exceed those of autos, credit cards and mortgages, at just under 12% at year-end 2016.

Finally, the **level of sub-prime auto loans, historically the riskiest segment to lend to, has reached its highest level in over a decade.** We remain ever mindful of the banks in which we have invested and their exposure, to the auto loan market and specifically their sub-prime exposure, which is the riskiest and of greatest concern.

Other areas of concern include **commercial real estate**, **housing in a few markets** and the unintended consequences of over eight years of artifically low interest rates in the United States and throughout the world.

US GOVERNMENT BUDGET CHALLENGES

The rapidly rising levels of our federal budget attributed to entitlements such as Social Security, Medicare and Medicaid are placing enormous pressure on our country's budget, and these need, to be addressed, without cutting the benefits of existing participants. A breakout of our Federal Government's budget for 2016 is given below:



CBO's Baseline assumptions

	2016	'17-'18	'19-'20	'21-'26
Real GDP growth	1.9%	2.3%	1.7%	1.9%
10-year Treasury	1.9%	2.4%	3.2%	3.6%
Headline inflation (CPI)	1.0%	2.3%	2.3%	2.4%
Unemployment	4.9%	4.5%	4.9%	4.9%

Source: CBO, J.P. Morgan Asset Management; (Top and bottom right) BEA, Treasury Department.
2016 Federal Budget is based on the Congressional Budget Office (CBO) August 2016 Baseline Budget Forecast. Other spending includes, but is not limited to, health insurance subsidies, income security and federal civilian and military retirement.
Note: Years shown are fiscal years (Oct. 1 through Sep. 30).
Guide to the Markets – U.S. Data are as of December 31, 2016.

A more detailed breakout of our Federal Government's projected revenues and expenses for 2016-2027 in the table below illustrates the rising outlays and the resulting **increasing deficit levels rising to over $1.4 trillion in 2027.**

Summary Table 1.

CBO's Baseline Budget Projections

	Actual, 2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	Total 2018-2022	Total 2018-2027
	In Billions of Dollars													
Revenues	3,267	3,404	3,604	3,733	3,878	4,019	4,176	4,346	4,527	4,724	4,931	5,140	19,410	43,078
Outlays	3,854	3,963	4,091	4,334	4,562	4,816	5,135	5,346	5,554	5,890	6,228	6,548	22,938	52,504
Deficit	-587	-559	-487	-601	-684	-797	-959	-1,000	-1,027	-1,165	-1,297	-1,408	-3,528	-9,426

The majority of the rising outlays in the table above is due to our country's major **entitlement programs, Social Security, Medicare and Medicaid,** as illustrated below:

Table 1-2.

Mandatory Outlays Projected in CBO's Baseline

Billions of Dollars

	Actual, 2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	Total 2018-2022	Total 2018-2027
Social Security														
Old-Age and Survivors Insurance	767	797	847	903	963	1,025	1,090	1,158	1,230	1,306	1,383	1,465	4,826	11,368
Disability Insurance	144	144	148	154	159	167	174	182	190	198	207	217	801	1,795
Subtotal	910	940	995	1,056	1,121	1,191	1,264	1,340	1,420	1,504	1,590	1,681	5,628	13,164
Major Health Care Programs														
Medicare[a]	692	705	716	791	849	912	1,019	1,052	1,085	1,200	1,303	1,402	4,288	10,330
Medicaid	368	389	408	428	450	474	499	525	554	584	616	650	2,259	5,189
Health insurance subsidies and related spending[b]	42	51	61	70	80	85	90	93	98	101	104	106	385	887
Children's Health Insurance Program	14	15	11	6	6	6	6	6	6	6	6	6	34	62
Subtotal[a]	1,116	1,159	1,196	1,295	1,385	1,477	1,613	1,676	1,742	1,891	2,029	2,165	6,966	16,468

A big challenge facing the new administration and Congress is how to prevent reductions for existing recipients of these programs, yet at the same time to assure that they remain funded. We face rapidly rising demand from retiring baby boomers and others in need of these services. **Identifying the problems as in most circumstances is easy, while developing and implementing solutions is far more difficult.**

STATES AND MUNICIPALITIES ARE CONFRONTING ENORMOUS PROBLEMS

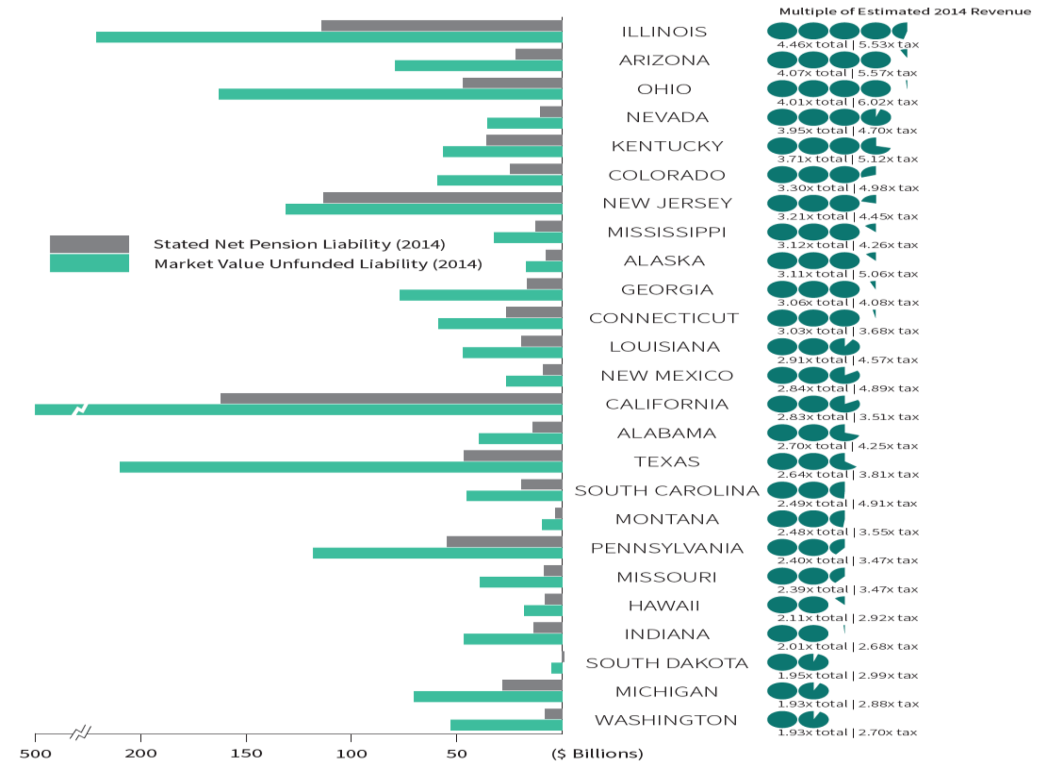
State and local government entities are facing many challenges everywhere. Among their biggest are unfunded pension liabilities. According to a Hoover Institution essay entitled "Hidden Debt, Hidden Deficits" from Joshua Rauh, a finance professor at the Stanford Graduate School of Business, unfunded pension liabilities are at $1.6 trillion, though under newer, more conservative accounting standards they are over twice that at $3.4 trillion and growing.

A Pension Task Force created by the Actuarial Standards Board is evaluating enacting recommendations that would raise the level of unfunded state and local pension obligations to an estimated $5 trillion while Moody's has issued a recent report stating that state public pensions will be underfunded by $1.75 trillion in fiscal 2017. Whatever the ultimate unfunded status is, it is clear that state and local governments in the United Sates are facing unprecedented financial burdens that will be difficult to overcome in the years ahead without major tax increases, and budget cuts reducing vital services and major sacrifices from all their constituents.

Since 2010, thirteen cities have filed for bankruptcy protection, including; Detroit, MI, Stockton, CA, San Bernardino, CA, Central Falls, RI, and Vallejo, CA. Pension shortfalls have been contributors to several of these bankruptcy filings.

The Hoover Institution provided a list of the top 25 states with the largest pension liabilities in relation to revenues as the following chart shows:

Figure 1: State Pension Liabilities in Relation to Own Revenues: Top 25



Various measures are being taken by cities to resolve their financial dilemmas. Recently, Connecticut Governor Daniel Molloy proposed transferring over $400 million in annual teacher pension costs from the state to cities and towns in Connecticut, as the state faces a $1.7 billion budget deficit. Rhode Island, under State Treasurer Gina Raimondo (now Governor), in 2011 was one of the first states to enact pension reforms to combat a $6.8 billion funding gap. Despite being taken to court twice by public-sector unions, Raimondo remained focused on working through the challenges to resolve the funding gap.

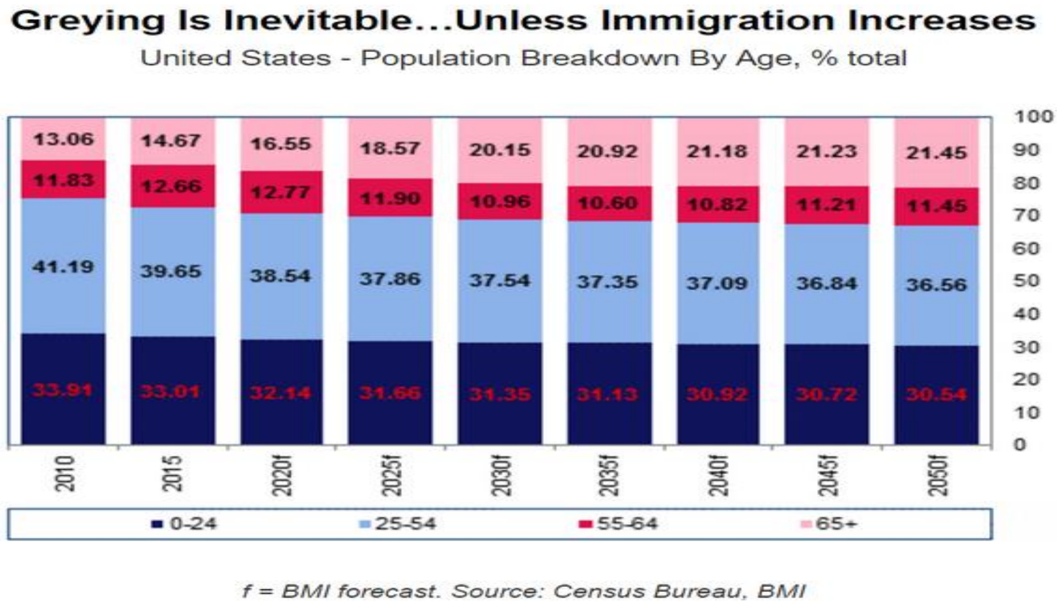
Richmond, California, on the eastern shore of the San Francisco Bay, is one of several cities at risk of bankruptcy. The city has cut 20% of its workforce, or over 200 jobs since 2008, as it fights to battle its ever-rising pension costs that have risen from $25 million to $44 million in the past five years. It is estimated that in just four years, 2021, pension obligations could exceed $70 million, or 41% of the city’s revenues.

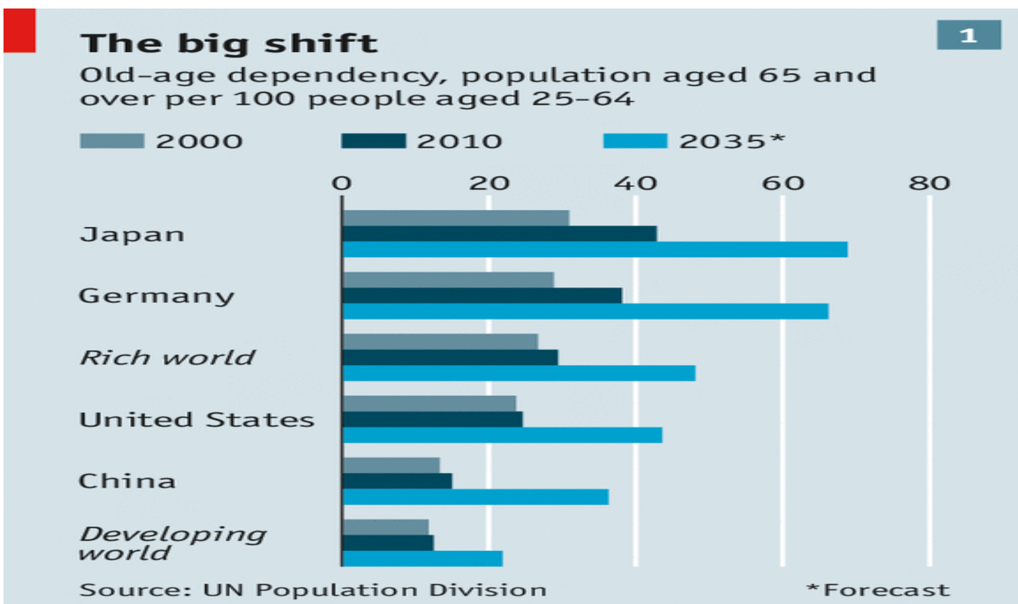
States and municipalities throughout the country have enormous challenges ahead of them as they face these rising pension and healthcare obligations, aging demographics, declining populations and the negative employment consequences brought about by globalization and technology.

GLOBAL DEMOGRAPHIC CHALLENGES

The enormous demographic changes that are taking place around the world are having profound impacts on countries and their respective economies. While **demographic changes occur slowly and over very long periods of time, their implications are profound. Globally, though particularly in the developed world, there will be fewer workers, lower GDP growth, lower growth in consumer spending, and rising government expenditures for elderly programs and services, to name a few**.

A breakout of aging populations in the United States and around the world is shown below:

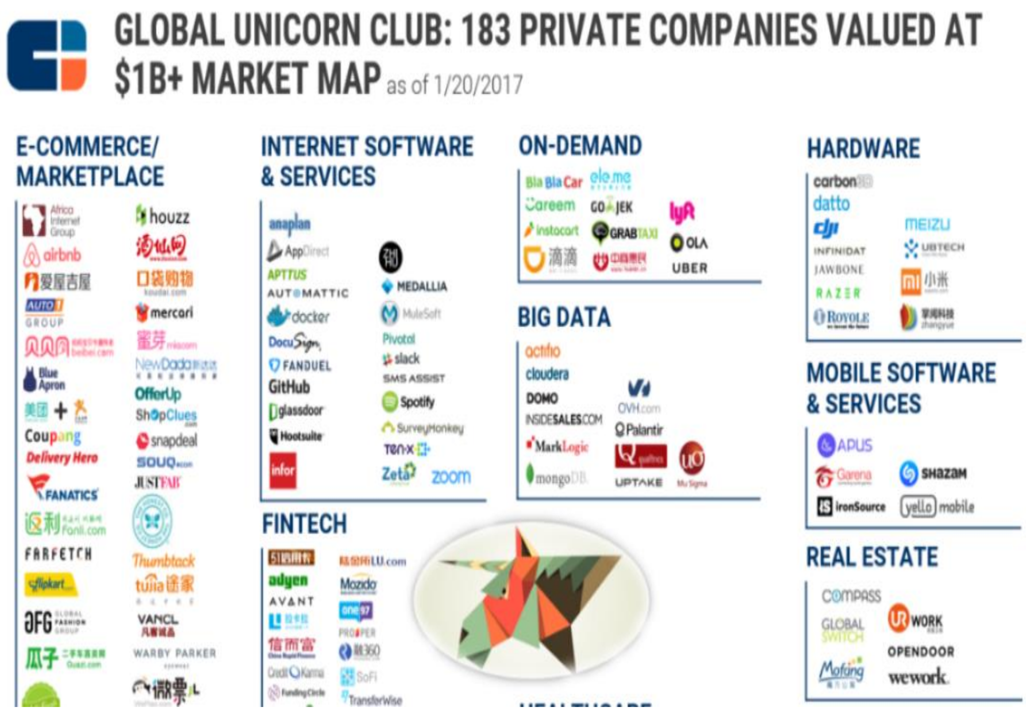




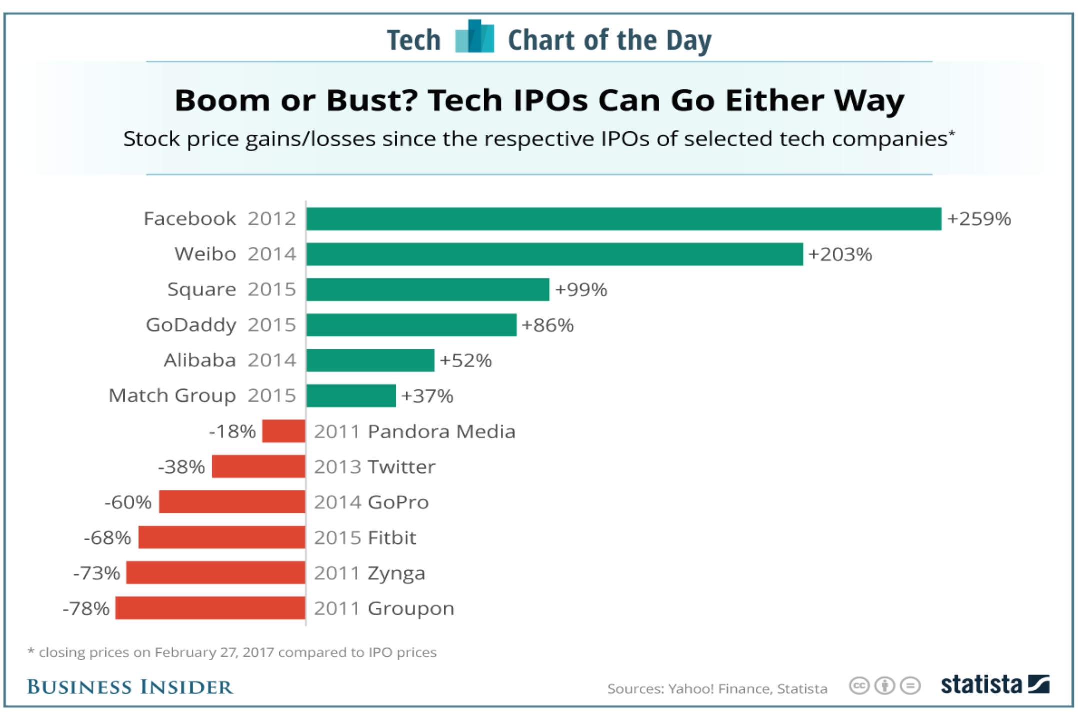
VENTURE CAPITAL BUBBLE

We continue to believe that many privately held technology companies are being funded at valuation levels that remain excessive and will ultimately experience significant declines. The recent Snap, Inc. public offering valued a company with just over $400 million in annual sales (and negative *gross* margins) at over $33 billion in stock market value. We believe **few of these companies will grow into their valuations, whether private or public, leaving many investors with significant losses.**

A representative breakout of 183 Unicorns (private companies with valuations >$1 billion) is given below:



It is virtually impossible to ascertain which companies will prosper after going public and which will not as the table below illustrates:



2016 PORTFOLIO ACTIVITY-EQUITIES

As the stock market, has continued to rise since the market lows in March 2009, **we have gone from being very active buyers to active sellers in 2016. In 2016, we sold our entire position in Loews, as we remained concerned about the future of their energy businesses and the improved performance of CNA is now behind them resulting in a less attractive overall future for the company.** We utilized the proceeds to invest in additional attractive fixed-income securities.

Throughout 2016 we have selectively trimmed our investments in several of our core holdings, some of which we have owned for over a decade, including **Bank of New York Mellon, Brown & Brown, LabCorp, Lowe's, Martin Marietta Materials, Mohawk Industries, PepsiCo, Progressive, US Bancorp, UnitedHealth Group, Wells Fargo and World Fuel Services.** As we have been active sellers throughout 2016, our selling reflects elevated company valuation levels that we believe lack an adequate margin of safety and represent greater risk than reward. During much of 2016, the higher valuation levels made it increasingly difficult to find securities that met our valuation thresholds, those with an adequate margin of safety (loosely defined as selling at a 30% or greater discount to our estimate of the intrinsic value 3-5 years out). However, while we had hoped that the stock market declines in early 2016 would continue and provide us with some attractive investment opportunities in 2016, that did not materialize and thus we remain patient, disciplined and ready to act when an investment with our required risk/reward characteristics becomes available. In early 2016 we purchased a few of our current holdings for new accounts **including BB&T, Berkshire Hathaway, US Bancorp, Wells Fargo and World Fuel Services** during company-specific price declines.

We purchased **Precision Castparts in 2015,** a leading global manufacturer of a broad range of highly engineered specialized components used for aircraft engines and industrial gas turbines. PCP operates through three product segments: investment castings, forgings, and airframes. The company generated 2015 fiscal year revenue of just over $10 billion and $1.5 billion in net income, or $10.66 per diluted share. The company's broad array of products, cost-driven focus, solid acquisition record, leadership positions in most of its segments, and the long-term outlook for the commercial aerospace industry, should deliver many years of continued growth. While the company has experienced short term challenges over the past couple of quarters due to an explosion at one of its facilities, a temporary inventory issue at one of its customers and the continued decline of sales to the oil and gas industry, we believe each of these factors are temporary in nature, and have resulted in a stock price decline of almost 30% allowing us an opportunity to establish a position in this great company.

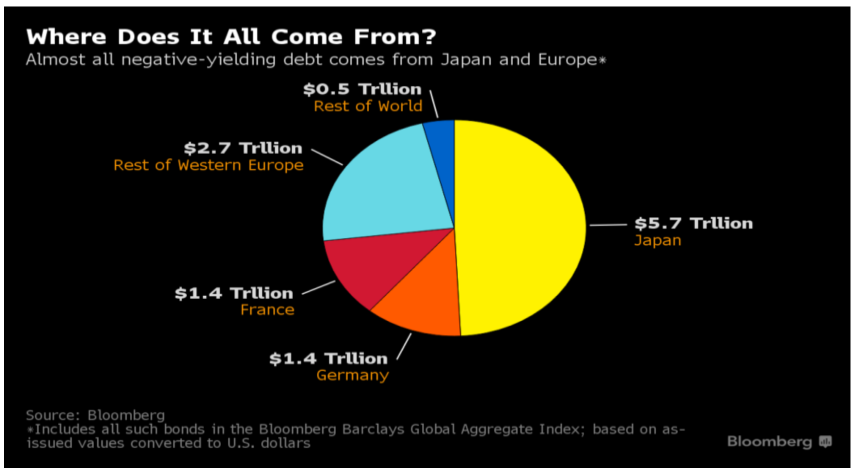
Our analysis was confirmed as Precision Castparts was acquired for $235 per share by Berkshire Hathaway on January 29, 2016. This fine company will now be added to the stable of leading companies owned by Berkshire Hathaway, our largest holding that continues to prosper despite the anchor of its own size.

2016 PORTFOLIO ACTIVITY – FIXED-INCOME

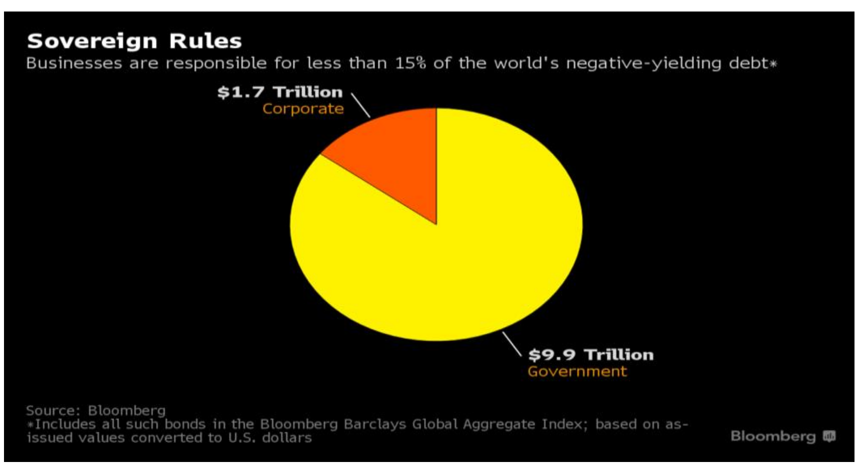
The fixed-income markets in the United States remain challenging. **After over 30 years of declining interest rates, virtually all fixed-income investments are yielding historically low yields including: Treasury Bills, Notes and Bonds, Municipal Bonds, Corporate Bonds, Agency and Mortgage Backed Securities, Bank Loans and High Yield Securities. We continue to find the majority of fixed income securities to be unattractive as the risk/reward is simply unfavorable. As such, we have avoided most of these instruments. The only other area we believe where solid risk-adjusted value exists is in fixed/adjustable rate preferred stocks of the finest financial institutions in the country.**

Globally, we find the fixed income markets even more challenging as there is almost $12 trillion of debt with **negative yields** as of late 2016, illustrated in the graphic below:

A breakout by country or region of the $11.6 trillion of negative yielding global debt is illustrated below:



Finally, following is a breakout of negative yielding global debt by issuer, primarily government entities, around the world:



This low interest rate environment encourages borrowing, distorts capital allocation decisions, and punishes individual savers, and institutions, including pension

funds, insurance companies and banks. Furthermore, **low interest rates create increased risk-taking by investors, both individual and institutional, as they seek higher yields to satisfy their income needs and obligations.** Virtually all fixed income instruments continue to offer historically low yields for desperate investors seeking income. These include: US Treasury bills, bonds and notes, corporate bonds, municipal bonds, bank loans, high-yield securities, government agency debt and other securities.

We have focused on the US fixed-income market which offers higher rates, more liquid markets and overall less risk than global fixed income markets. We have continued to selectively purchase several fixed/adjustable rate preferred stocks of outstanding companies with coupons that range from over 4% to almost 8% and with yields to the call date from over 3% to almost 8%. We have discussed several of these securities, in detail, in our past letters and believe them to be excellent choices for high quality income, tax benefits, and interest rate protection when held to the callable dates.

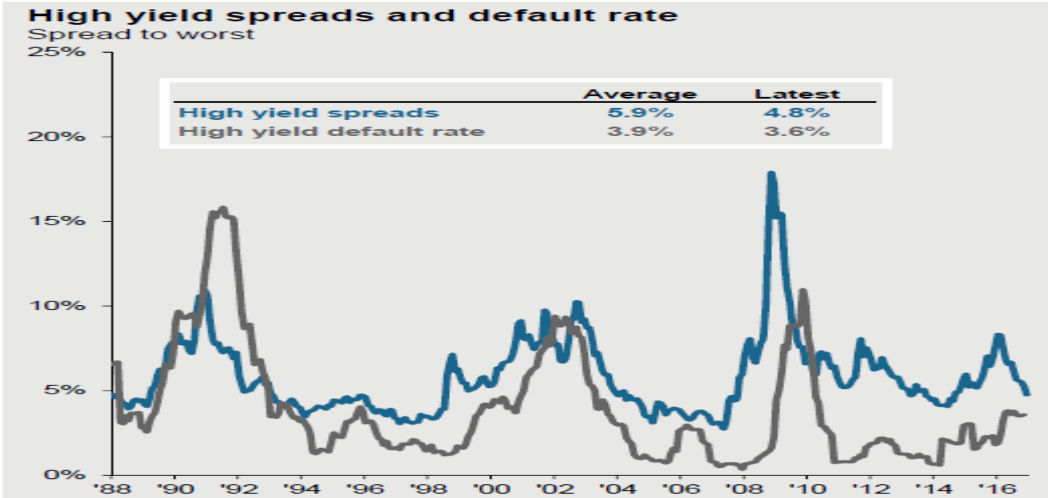
We purchased several of these preferred stocks below, at, or slightly above par over the past year. The dividend payments on each of these, at purchase, were yielding approximately 300-600 basis points above those of 10-year treasury obligations while also providing significant tax benefits. They also begin as fixed rate securities and convert to an adjustable rate if they are not called by their respective issuers. This rare adjustable rate feature reduces both interest rate risk and the security's duration.

The key risks we see 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, and 5) interest rate risk, mitigated some by the adjustable feature.

Another short-term risk is that the prices of these securities will fluctuate, often rising above and even falling below their par value. In fact, **several of our holdings have risen as much as 20% above par and some have declined as much as 3-5% below par, and in the current volatile markets these price fluctuations may increase and result in prices well above or well below par.** These fluctuations do not concern us; rather they provide opportunities to purchase more of these outstanding securities particularly when trading below par. **We caution our clients to please focus on the long-term income generated by these securities and not to focus on the price fluctuations up or down.** We anticipate holding the majority of our holdings until the call date, with few exceptions. Please recall, we view risk in terms of the **probability of permanent capital loss, not short-term price fluctuations.**

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% or 23.8%. These rates are still well below ordinary income tax rates approaching 40% and may decline further if tax proposals from the new administration are enacted. It is anticipated that the 3.8% tax added to capital gains rates will be repealed and capital gains rates may also change, but we don't know what the final ruling will be.

In contrast to our conservative fixed-income holdings of only investment grade securities with yields from 4% to 8%, the high-yield segment (junk bonds) which are far riskier are offering spreads relative to comparable maturity US Treasuries amongst the lowest ever at 4.8%, as illustrated below:



These high-yield securities during the Great Financial Crisis were yielding almost 20%, providing in most cases an appropriate risk/reward scenario. Today, these securities are offering less than one quarter of that 20% yield and we do not view them as an attractive investment proposition. However, with yield-starved individual investors that need investment income to live on, combined with pension funds, endowments, insurance companies and others with specific obligations to meet, many are stretching to find yield in higher risk instruments, as higher quality securities are not providing the required yields needed. This increased risk of lowered credit quality and extended duration, are two primary ways to increase yields. We feel many investors who do so are taking excessive risks that may prove harmful down the road.

Our 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 reduce our credit quality standards or take undue interest rate risk by purchasing long maturities. With rare exceptions, we always hold our fixed-income securities to maturity.

EQUITY HOLDINGS

ABBOTT LABORATORIES (ABT) is a leading diversified healthcare company operating in the following areas: pharmaceuticals, diagnostics, nutritionals and medical products. In 2016 the company generated sales of $20.9 billion from four diverse business units: nutritionals 33%, medical products 14%, established pharmaceuticals 19%, and diagnostics 23% other 11%.

Abbott completed the acquisition of St. Jude Medical, a global device manufacturer on January 4, 2017 having paid $23.6 billion, with $13.6 billion in cash and $10 billion in Abbott stock. Abbott entered into an agreement with Johnson and Johnson to sell its optical related businesses for $4.325 billion in cash, which should close in the 1st quarter of 2017. Abbott also entered into a deal to acquire Alere, for $56 per share, however Abbott is now seeking to terminate the merger in Delaware Chancery Court.

Abbott has leading market share positions in several businesses, and in addition to a broad portfolio of products and services, is geographically diverse with 30% of sales in the U.S., 30% in other developed markets and 40% in the more rapidly growing emerging markets. Abbott's new Hepatitis C drug offers excellent potential in the years ahead, with sales estimates rising to over $3.5 billion in the next couple of years.

With the acquisition of St. Jude Medical, Abbott should generate 2017 revenues in excess of $26 billion with earnings of over $2.40 per share.

BANK OF NEW YORK MELLON (BK) is a leading trust bank with assets under custody and management exceeding $30 trillion. It is a global leader in several segments in which it operates. Few competitors have comparable global reach and scale. Approximately 80% of its revenues are reoccurring and fee-based, being focused on institutional services and less reliance on the higher credit risk from lending.

In 2016, BK generated operating revenue of $15.2 billion and pre-tax income of $4.7 billion, representing a 31% pre-tax operating margin with $3.15 in earnings per share. Low interest rates continue to negatively impact results as they have over the past few years, while the bank continues to work diligently on its initiatives to cut expenses and selectively raise prices on many of its products. We believe the bank can earn $3.40 to $3.50 in 2017, representing a multiple of 13x earnings, while paying a 2% dividend yield.

BB&T (BBT) is a leading, financial services holding company based in Winston-Salem, North Carolina with $219.3 billion in assets, operating 2,196 financial centers in 15 states and Washington D.C. It offers a broad range of consumer and commercial banking services, securities brokerage, asset management, mortgage and insurance products. The company's geographic footprint includes the more rapidly growing southeastern United States with a growing presence in North Carolina, South Carolina, Georgia, Florida and Texas.

For the full year 2015, BB&T generated $7.1 billion in interest income and $4.5 billion in non-interest income for total revenues of over $11.6 billion and net income of $2.3 billion or $2.77 per diluted share. The company's solid credit culture, geographic and product line diversity provide us with a solid institution, well positioned to continue to grow organically and through acquisitions in the years ahead. We believe BB&T should earn in excess of $3 to $3.10 in 2017, representing a multiple of 15x earnings.

BROWN & BROWN (BRO) is a leading insurance broker with an outstanding corporate culture that helps generate the highest margins in its industry. Total 2016 revenue was $1.8 billion, a 6.5% increase from 2015, while adjusted earnings rose 7% to $1.82 per share.

After several years showing sparse growth, Brown & Brown has begun to grow organically while continuing to maintain the highest profit margins in the industry. In fact, during the 1997 to 2007 insurance cycle, Brown & Brown grew EPS at 20% per year but, since that 2007 earnings peak, organic growth slowed significantly. We believe the company can continue to achieve organic growth rates in the 5-9% range for the next couple of years.

LAB CORP (LH) is the second largest provider of clinical laboratory testing services in the United States. In 2016 Lab Corp, generated revenue of $9.4 billion, EBITDA of $1.6 billion, a 20% operating margin and free cash flow of $900 million. Their Covance purchase continues to progress well and significantly diversifies LabCorp's revenues, though the purchase price was certainly a full one and we believe that free cash flow will now be applied to paying down debt rather than stock repurchases, which has been a key use of free cash flow over the past several years. The company believes they can grow 2017 revenues by 5-7%, on a constant currency basis and generate adjusted earnings per share of $9.35-$9.75, a 6-10% increase from the 2016 adjusted earnings per share of $8.83.

LOWE'S (LOW), a leading home improvement retailer, generated revenues of $59.1 billion in fiscal 2015 with net income of $3.1 billion. Diluted earnings per share were $3.30 and we see that rising in 2016 to $3.75/share. The company continues to generate significant free cash flow exceeding $3.7 billion in 2015, providing for a solid dividend yield of just under 2% with continued share repurchases. While Home Depot continues to perform better than Lowe's, as measured by same store sales and operating margins, we believe that Lowe's will continue to improve its merchandising operations, raise margins to over 10% and continue to buy back significant amounts of stock. Lowe's stock price appreciated 40% in both 2012 and 2013, 39% in 2014 and 11% in 2015.

MARTIN MARIETTA MATERIALS (MLM) is the second largest domestic producer of construction aggregates and a producer of magnesium based chemicals and dolomitic lime. "Aggregates" refers to the business of selling crushed stone, rocks and sand and is an attractive business. It enjoys significant barriers to entry, including the challenges in obtaining permits for new quarries. The low value to weight ratio of aggregates creates local oligopolies that enable solid pricing power. As I mentioned in prior letters, it is one of few businesses I have ever studied that have experienced enormous volume declines yet have been able to continue to raise prices illustrating the power of their business model.

The company purchased Texas Industries in July 2014, which expanded their geographic presence and market share in several markets and provides additional products. They are on course to generate $100 million in synergies by the end of 2016, an increase of over 40% from their initial projections.

MLM remains well positioned for solid growth in its largest markets, achieving 2016 revenues of $3.6 billion a 9.4% increase from 2015 with EBITDA of $972 million and earnings per diluted share of $6.63. Aggregates pricing rose 7.3% and EBITDA increased 29% from 2015.

With the significant need for rebuilding our bridges and highways we believe that MLM is well positioned to drive strong future growth as our country begins spending the required capital on our rapidly deteriorating infrastructure. The 2016 passage of the Fixing America's Surface Transportation (FAST) Act, a five-year Federal highway spending bill will continue to help the company prosper and the new President has expressed a keen interest in investing in our country's antiquated infrastructure.

MOHAWK INDUSTRIES (MHK) is a leading manufacturer of flooring products whose revenues continue to increase as the economy and, the housing markets, in particular continue to rebound. Sales in 2016 were $9 billion with net earnings of just $930 million or $12.48 per diluted share. The company's 4th quarter operating margin of 14% was the highest in its history.

The company continues to aggressively make acquisitions, including the 2013 purchases of Marazzi Group, the fifth largest producer by volume in the ceramic tile industry. Combining Mohawk's existing ceramic division Dal Tile with the Marazzi Group creates the largest ceramic tile company in the world on a revenue basis. Currently, about 9% of U.S. flooring consumption in value is made of ceramic tiles, a much lower percentage here than in most other nations around the world. In Western Europe, tile represents 30%, and in countries like Italy tile can exceed 55-60%. In January 2015, Mohawk purchased IVC, a European based manufacturer of sheet vinyl, luxury vinyl tile and laminate sold in Europe and the U.S. The purchase price of $1.2 billion is ten times trailing EBITDA and the acquisition should be $.30-.50 accretive in the first 12 months. In January of 2017, Mohawk acquired another small tile manufacturer in Italy to complement their leadership position there.

We anticipate continued improvement in the housing markets and in the U.S. economy, which bodes well for Mohawk Industries in 2017 and beyond. Mohawk is projecting 1st quarter 2017 earnings of $2.64-$2.73 representing an 11-15% increase over the 1st quarter of 2016.

PEPSICO (PEP) is the leading global snack and beverage company that manufactures and markets a variety of salted and convenience snacks, carbonated and non-carbonated beverages, and foods. The company operates through four segments: Beverages North America, Frito-Lay North America, PepsiCo International, and Quaker Foods North America.

PepsiCo's fourth quarter 2016 earnings were $1.20 per share, a 13% increase from 4th quarter 2015 earnings. Revenues generated in 2016 were $62.8 billion with operating income of $10.4 billion and $4.85 in earnings per share, a 6.2% increase from 2015.

The company continues its focus on cost reductions forecasting over $1 billion in incremental savings per year over the next five years. We believe the company can generate in excess of $10.8 billion in operating profit in 2017, even while facing strong headwinds from the rising dollar, and slowing global economies, as over 50% of company sales are outside the United States.

PROGRESSIVE (PGR) is the fourth largest auto insurer in the country and generated earned premium revenues of $22.5 billion in 2016 with pre-tax operating income of $1.5 billion, or $1.68 per diluted share. We project Progressive's net premiums written to exceed $25 billion in 2017 will generate pre-tax operating income of $1.9 billion.

UNITEDHEALTH GROUP (UNH) is a leading diversified managed health care company serving 75 million individuals and operating through two segments: UnitedHealthcare, and Optum. The UnitedHealthcare segment serves employers and individuals, communities, states, Medicare and retirement. The Optum service businesses include Optum Health, Optum Insight and Optum RX. Overall company revenues in 2016 were $185 billion with operating earnings of $13.3 billion and adjusted net earnings per share of $8.05, a 24% increase from 2015.

The UnitedHealthcare Segment has the #1 market position in several areas including: Medicare Advantage, Medicare Supplement, and Medicaid, and is number two in commercial insurance. Furthermore, the company's geographic and product diversity serve to reduce business risk.

The Optum segment of UnitedHealth Group is a health services business serving the broad health care marketplace, including payers, care providers, employers, government, life sciences companies and consumers. Using advanced data, analytics and technology, Optum helps improve overall experience and care provider performance. Revenues for the Optum segments in 2016 were $83.6 billion with earnings from operations of $5.6 billion. Of the three Optum segments, Optum Insight is a leader in healthcare data analytics and generated revenues of $7.3 billion for the year, an 18.4% increase for the year. The company is projecting 2017 revenues of $197-$199 billion and net earnings of $8.75-8.95 and operating cash flows of $11.5- $12 billion.

US BANCORP (USB) is one of the top 10 largest banks in the country with assets of $466 billion at year end 2016. The company has an outstanding credit culture, resulting in low credit losses and generates substantial fee income providing greater stability and predictability in its earnings. In 2016, the company generated $11.7 billion in net interest income and $9.6 billion in fee income. Operating revenues were $21.3 billion and net income was $5.6 billion or $3.24 per share.

The company's financial metrics are among the best in the industry with a return on common equity of over 14%, and a return on assets of 1.4%. We believe US Bancorp is well positioned to continue to build upon its outstanding franchise both organically and through selective acquisitions in the years ahead. The company should earn in excess of $3.40-$3.45 in 2017, representing a price earnings multiple of just over fifteen times earnings-a fair valuation for an outstanding diversified financial institution. Furthermore, with a large fee income stream the bank is better able to weather low interest rate periods than most competitors who lack such a large recurring fee income stream.

WELLS FARGO (WFC) is the fourth largest bank in the country with average assets of $1.9 trillion at year-end 2016. The company generated operating revenues of $88.3 billion in 2016 with net income of $21.9 billion and diluted earnings per share of $3.99.

I want to again address the unauthorized account openings that occurred at Wells Fargo so I am including my comments from our 2016 Semi-Annual letter below.

Given the recent headlines regarding Wells Fargo and the opening of unauthorized accounts for customers over the past several years, we feel it is important to share some of our thoughts regarding one of our largest holdings.

Wells Fargo reached agreements with the Consumer Financial Protection Bureau, the Office of the Comptroller of the Currency and the Office of Los Angeles City Attorney regarding allegations that some of its retail customers received products and services they did not request. Wells Fargo's settlement totaled $185 million, plus $5 million in customer remediation.

We are extremely disappointed in these recent findings at an institution that has been one of the finest financial services firms in the world for many years. While cross-selling has been a core strategic strength for Wells Fargo (that is, having several accounts per household), it appears that there were many pockets of unethical behavior throughout the company, with bankers opening unauthorized accounts to ensure they were meeting account opening targets and goals.

To be more specific, Wells Fargo has 82 million deposit accounts and 11 million credit card accounts for a total of 93 million accounts. Approximately 2% of the 93 million accounts were opened without the consent of the customer. Based upon a third-party review from a consulting firm, $2.6 million has been refunded to customers for any fees associated with products or services they did not request. Over 5,300 employees were fired for these practices throughout the past five years. (Keep in mind that Wells Fargo has over 268,000 employees.)

We are particularly disappointed that the top management at Wells Fargo did not address these problems in 2011 in a focused and assertive way to understand the causes and immediately begin making changes to assure there would be no future unethical behavior. Unfortunately, this was not done and the unethical behavior continued for over five years.

Based upon the information that has been disclosed, we believe that several management and operating changes have been put in place, as well as better controls and protocols implemented to ensure that customers are protected and that these practices will not occur in the future. For example, Wells Fargo will be eliminating product sales goals beginning January 1, 2017 in order to ensure that customers are receiving only those products and services that they want.

The company will continue to be investigated, as new investigations have been announced by other states, and will also likely continue to remain in business headlines. However, we believe that despite these extremely disappointing findings, Wells Fargo will do whatever it takes to resolve these issues and assure that the appropriate steps have been taken to eliminate these behaviors going forward. We do not believe that the company has systemic permanent flaws that cannot be corrected and therefore we will continue to keep our holdings, while simultaneously carefully and continually evaluating all the information available to us regarding the company's resolution of these problems.

In business as well as in life, integrity is the most important quality of all, creating the foundation for building trust with customers, vendors, employees and shareholders. Wells Fargo has broken that trust with many customers and must work diligently, quickly and thoughtfully to regain that trust with its customers. We believe they will do so and over time, Wells Fargo will regain its stature as a premier financial services company serving the financial needs of its customers.

Despite the challenges of 2016, we believe that Wells Fargo's diverse business model will continue to thrive in various economic environments and will benefit when interest rates rise, augmenting the net interest margin to once again exceed 4%, a level that it has fallen well below over the past several quarters. Nevertheless, Wells Fargo remains an outstanding financial services company which will regain its form to generate among the highest returns of banks its size in the country. The company also maintains leadership positions in several businesses including a leading mortgage originator and servicer, originating one of every three mortgages in this country. We estimate the company can earn in excess of $4.15 in 2017.

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. The company provides one-stop shopping for customers in this highly-fragmented industry. The company reported disappointing fourth quarter results as the marine segment continues to struggle and the land segment experienced challenges related to integrating several acquisitions. The aviation business continues to do well.

World Fuel Services was founded in 1984 and in 2016 generated $27 billion in revenue and $127 million in net income. Despite the company's disappointing results in 2016 we continue to believe the company has a long runway to continue to grow organically by expanding its customer base, geographic reach and additional product and service offerings, as well as through acquisitions.

ZOETIS (ZTS) is a leading animal health provider serving the livestock and companion animal markets with 2016 revenue of $4.9 billion, adjusted net income of $975 million and adjusted diluted earnings per share of $1.95. The company was spun out of Pfizer in 2013 and continues to be the industry leader operating globally in both pharmaceuticals and vaccines serving the livestock market (64% of revenues) and the companion animal market (36% of revenues). The company is the industry leader in several categories as shown in the following chart.

MARKET POSITION BY GEOGRAPHY	
North America	#1
Latin America	#1
Western Europe	#2
Eastern Europe	#1
Asia	#1
Rest of world	#1

MARKET POSITION BY PRODUCT CATEGORY	
Medicinal Feed Additives (MFA)	#2
Vaccines (biologicals)	#2
Anti-Infectives	#1
Parasiticides	#3
Other pharma*	#1

MARKET POSITION BY SPECIES	
Poultry	#2
Cattle	#1
Swine	#2
Companion Animal	#2

#1 WORLDWIDE

Zoetis' leadership position in many segments, along with the company's broad diversity by product, geography, therapeutic category and species, should lead to solid long-term results for this outstanding company. The company is projecting 2017 revenues of $4.7 to $5.1-$5.2 billion and adjusted diluted earnings per share of $2.26 to $2.36.

IN CLOSING

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

We wish all our clients a healthy, safe and prosperous 2017 and beyond.

Paul J. Lountzis
President