1949 VALUE ADVISORS

QUARTERLY REPORT

SEPTEMBER 30, 2018

PERFORMANCE

	Q3 2018	*ONE YEAR*	*SINCE INCEPTION (7/31/15)*
1949 Global Value Strategy	**- 2.6%**	**- 4.5%**	**+ 27.1%**
MSCI World Index (US$)	+ 5.1%	+ 11.8%	+ 33.9%
Out (under) performance	- 7.7%	- 16.3%	- 6.8%
MSCI World Value Index (US$)	+ 4.2%	+ 5.9%	+ 27.7%
Out (under) performance	- 6.8%	- 10.4%	- 0.6%

MARKET OVERVIEW

Global equity markets generally advanced during the quarter, helped in large part by strength in the United States. Macroeconomic data in the US paints a picture of growing divergence from the rest of the globe as record-low unemployment and personal tax cuts drove US consumer confidence to an 18-year high. After-tax corporate profits in the US remain strong, helping US equities to outperform against the backdrop of slowing growth in Europe and Asia. Stocks in the US rose 7.0% during the quarter, compared with Europe (+0.4%), Japan (+2.9%) and the rest of Asia (-2.4%). Emerging markets fell 2.0% during the quarter, according to MSCI.

Investing styles have also diverged, as value investing strategies (1949 VA included) continue to underperform passive index funds and growth-oriented active strategies across multiple geographies. The MSCI World Value Index (+4.2%) underperformed its growth index complement by 1.7% during the quarter, and by 9.5% year to date. Much has been written in the press about the underperformance of value investing this year - unfortunately we have provided our investors no exception. Despite this, we remain focused on the longer term and fundamentally derived intrinsic values of the businesses in the portfolio, and we take comfort in the meaningful discounts to our appraised valuations that current share prices imply. Value investing has proven the test of time, despite occasional periods of prolonged underperformance. Our approach to global value investing is designed to deliver both safety of principal and attractive absolute returns over the long term.

PORTFOLIO COMMENTARY

LARGEST CONTRIBUTORS TO PERFORMANCE

Berkshire Hathaway….	+ 1.2%	New Gold……..………..........	- 2.3%
Birchcliff Energy.....…..	+ 1.1%	Western Digital……..……….	- 1.9%
Apple, Inc…………….	+ 0.7%	Global Brands Group..………	- 0.8%

Positions that had the largest negative impact on performance during the quarter were New Gold (-2.3% contribution), Western Digital (-1.9% contrib.) and Global Brands Group (-0.8% contrib.). Shares in **New Gold** declined by 63% during the period, following a -18% decline during the previous quarter, primarily due to worsening operational difficulties at its newly operating Rainy River mine in Ontario. The losses experienced by shareholders in New Gold belie the quality management team we aligned ourselves with at the inception of the position in July 2015. In a mechanistic business such as mining, an important consideration is the operating history and track record of personnel in the field. Although difficult to assess, we took comfort in the quality of New Gold's senior management who experienced great success with industry stalwarts Barrick Gold and Newmont Mining – the two largest gold producers globally. As each mine poses unique challenges to those designing, building and operating them, success in one project or in many projects doesn't necessarily preclude failure with another. This difficult lesson unfolded in a series of incremental changes that – each taken in isolation – did not seem as serious to us as when taken together. Ore grades can also meaningfully mask operating difficulties, as New Gold's modest mineralization at Rainy River was insufficient to mitigate the financial impact from its early operating troubles.

Shares in **Western Digital** lost 24% during the quarter on continuing concerns over hard disk drive (HDD) market share losses and deteriorating expectations for NAND flash pricing. Shares in Hong Kong-listed **Global Brands Group** (-13%) also declined during the period as investors weighed the benefits of cash infusion from the recently announced sale of its North American licensing business against the greatly diminished profitability of the remaining non-US business. The company will pay a special dividend in January 2019 after paying down most of its corporate debt from sale proceeds.

Positions that helped performance during the quarter include Berkshire Hathaway (+1.2% contribution), Birchcliff Energy (+1.1% contrib.) and Apple, Inc. (+0.7% contrib.). **Berkshire Hathaway** shares rose 14.7% during the quarter, which we do not view as significant in the absence of company-specific news flow during the period under review. **Birchcliff Energy** shares advanced by 8.5% during the period under review as western Canadian natural gas prices (AECO Hub) were 23% stronger over the same period. Shares in **Apple, Inc.** were 22% higher during the quarter on strong iPhone demand and pricing, services revenue growth and strong capital returns.

Portfolio Changes: Global

One position was initiated during the third quarter with the purchase of Canadian steel producer **Stelco Holdings**. Stelco (formerly known as US Steel Canada before emerging from its second trip through bankruptcy) was established in 1910, yet owns one of the newest and most technologically advanced integrated steel making facilities in North America. The company supplies customers in the construction, automotive and energy industries across Canada, and to a lesser extent, the US. The company is now among the lowest cost North American steel producers. This is in part due to concessions its steelworkers' union made during the bankruptcy restructuring, but also partly due to its operations in Ontario which are efficient and strategically located near raw material suppliers and end customers alike. Stelco also enjoys easy access to multiple modes of product transportation (water, rail and truck) allowing very competitive freight rates and the flexibility to adapt to changing market environments.

Post-bankruptcy equity investing can offer opportunistic investors willing to bear the potential scorn of public ridicule generous returns in cases where good companies with quality assets have suffered under the weight of too much debt, and who have subsequently resolved their debt burden through a debt-for-equity swap with its quality operating assets intact. Previous investments in other bankrupt North American steel companies came to bear in our analysis of Stelco, including International Steel Group in collaboration with WL Ross & Co. in 2002 (Franklin Mutual Beacon Fund), and with Algoma Steel in 2006 (Lazard Classic Value – Global strategy), both of which were soon after acquired by non-US steel producers eager to establish a presence in North America.

In each case, the bankruptcy process aided in renegotiating lower labor and pension costs, other post-employment benefit obligations and the elimination of corporate debt, allowing the companies to emerge from bankruptcy with a clean balance sheet and very low costs of production, ensuring its ability to survive under future stressed conditions for the benefit of all stakeholders. The stigma of corporate bankruptcy can create very attractive post-bankruptcy equity valuations despite the resolution of financial distress. Stelco was able to cut its debt and legacy obligations by more than 90% through its bankruptcy restructuring. The company now boasts industry leading margins, and from excess free cash flow generated during the first half of 2018, paid a special cash dividend to shareholders in August. The company is committed to its strong net cash balance sheet, and will benefit from approximately $883 million in tax loss carryforwards.

As Stelco continues to make progress in optimizing underutilized assets and shifting production to higher margin steel products, the 40% discount to other North American integrated steel manufacturers should diminish over time. Lastly, significant and previously unrealizable value from development of excess land and port facilities located in the Greater Toronto Area provides a free option on the latent value of these assets as well as providing downside support.

As we try to maintain adequate concentration of high conviction positions in the portfolio, sometimes we will liquidate an existing position in favor of a more compelling opportunity. This was the case last quarter as our position in **Gentex** was liquidated in favor of Stelco Holdings. Gentex is an excellent and well-managed automobile parts supplier with 90% market share of automatic-dimming interior and exterior rear-view mirrors. Although we remain constructive on the long term prospects for Gentex, the recent valuation discount was relatively narrow when compared with Stelco and other ideas

we are working on. Also, since we were unable to establish a full position in Gentex since our initial purchases in early 2016 due to share price appreciation, its impact on the portfolio has been minimal.

OUTLOOK

As a global unconstrained and benchmark agnostic investment strategy, we strive to take advantage of changing market opportunities through time. Our experience in navigating these varied environments since 1993 gives us the confidence to act in a prudent yet opportunistic fashion. We will continue to be diligent in our search for undervalued securities of quality companies that will help us to meet or exceed our investment objectives.

Thank you for your support, and please feel free to call or e-mail us to discuss anything further.

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