1949 VALUE ADVISORS

Quarterly Review – Q4 2015

Global equity markets advanced during the fourth quarter, despite modest declines into year-end. Stocks rebounded strongly in October as favorable macroeconomic data provided investors with a renewed appetite for risk following the pullback in August and September. However, concerns over a sharp slowdown in China returned to dominate investor sentiment in December, driving world markets lower to finish the full calendar year essentially unchanged. While it is important to convey to you how your portfolio compares against the performance of world equity markets over short time periods like this, our investment strategy is focused on performing well over the long term. As disciplined value investors, we are attracted to what is currently out of favor and undervalued, while avoiding what is currently very much in favor and fully valued. This contrarian approach has proven the test of time over the long term despite occasional periods of underperformance.

The recent market environment has amply rewarded companies with stable growth profiles and predictable earnings and cash flows, driving these fully valued stocks even higher, while punishing already deeply undervalued cyclical stocks with uncertain short term earnings and cash flow growth prospects. You can imagine in which of these two camps our attention has been focused in constructing your portfolio this year. We have found many deeply undervalued opportunities in various cyclical companies, including materials, energy, technology, insurance and asset management. Perhaps counter-intuitively, as the market has driven shares of the cyclical stocks that we own lower, we have added to these positions since the risk of future permanent capital loss is diminished. As the adage goes, buy low, sell high. Sounds simple, yet short term emotion can drive this anomaly further afield, as has occurred this year. Against this difficult backdrop, the 1949 Global Value Strategy fell 3.3% during the fourth quarter, underperforming the 5.6% rise for the MSCI World Index (in US$). Since inception of the strategy on July 31, 2015, the 1949 Global Value Strategy has declined by 9.9%, compared to the 4.9% decline for the MSCI World Index (in US$). We expect this short term underperformance to reverse over longer time periods in the future.

Actively managed funds performed poorly in 2015, impacted by a very narrow concentration of positive returns in relatively few stocks. This was especially pronounced in the US, with 40% of the total return to the S&P 500 Index produced by 10 stocks, with the four “FANG” stocks (Facebook, Amazon, Netflix and Google) producing 20% of the index’s total return. Whether portfolios held these stocks or not made a big difference in performance. Your portfolio did not own any of the four. The table below illustrates select valuation ratios of these “FANG” stocks against relevant benchmarks and your portfolio. While valuation ratios tell only part of every company’s story, one can see why traditional value investors shy away from these popular companies. The 1949 Global Value portfolio is priced at a meaningful discount to the MSCI World Index on these and other important metrics in an effort to mitigate downside risk and capture upside potential.

	Price/Earnings	Price/Book	EV/EBIT
Facebook	48.4	6.5	28.9
Amazon	125.2	22.5	118.0
Netflix	273.1	21.6	153.5
Google	26.2	4.1	18.2
"FANG" stocks average :	**106.1**	**13.6**	**79.6**
S&P 500 Index	18.2	2.8	17.5
MSCI World Index	18.9	2.1	17.6
1949 Global Value Strategy:	**14.6**	**1.2**	**11.2**

Source: Bloomberg, MSCI, 1949 Value Advisors LLC

Market Overview

Stocks in the US rose 7.0% during the fourth quarter as the Federal Open Market Committee (FOMC) raised interest rates for the first time since 2006 following strong non-farm payroll data in October and November. Favorable macroeconomic data provided a boost to US stocks despite generally full valuations. European stocks advanced during October and November as investors hoped that the European Central Bank (ECB) would announce further monetary policy easing. Investors were disappointed in December, however, as the ECB announcement underwhelmed expectations. Despite the Paris terrorist attacks and the ongoing migrant crisis in Europe, macroeconomic data was encouraging with the Eurozone purchasing managers index (PMI) data the strongest in more than four years.

Japan was the best performing major market in Q4, with the TOPIX Index rising 9.9% (in ¥ terms). Japanese corporate earnings results for the first half of fiscal year 2016 were generally strong, despite macroeconomic data revealing the Japanese economy in a technical recession. Asian equities outside Japan rose early in the period, but sentiment continued to be driven by developments in China. The People's Bank of China (PBOC) lowered rates in October for the sixth time in 2015 as economic data showed continuing signs of slow growth. The Hang Seng Index rose 5.0%, while Korea's KOSPI Index was unchanged during the quarter. The 1949 Global Value Strategy has exposure to Japan, Korea and Hong Kong listed securities. In general, emerging markets underperformed more mature developed markets, weighed down by a stronger US dollar and lower commodity prices.

Portfolio Commentary

As mentioned last quarter, the 1949 Global Value Strategy has limited exposure to emerging markets, focusing more on developed world markets. This bias toward developed markets helped our performance this year, but sectoral exposure to mining stocks negated much of this benefit due to the correlation between mining stocks and emerging markets, which account for more than half of total global demand for many metals. Commodities were the worst performing asset class during 2015 (Bloomberg Commodity Index fell 24.2%), followed by emerging market equities (MSCI Emerging Markets Index declined 14.8% in US$).

Portfolio positions which most negatively impacted performance during the fourth quarter were Birchcliff Energy (-2.7% contribution), Anglo American plc (-1.4% contr.) and Industrias Bachoco (-1.1% contr.). Birchcliff Energy shares declined as Canadian spot natural gas prices fell further during the quarter, impacted by unusually warm winter temperatures. The El Nino weather pattern across North America helped drive natural gas prices to new multi-year lows as increased supply greatly exceeded demand. Despite the unfavorable pricing environment, the company reported record production and record low operating costs. Birchcliff Energy's low cost production should enable the company to continue along their profitable growth path while patiently awaiting a recovery in gas prices. On each of the five previous occasions over the last fifteen years when Canadian spot natural gas prices dipped to the current level, there was a recovery in the spot price of more than 100% in the subsequent twelve month period. While inherently volatile, commodity prices are very difficult to predict, but having low cost production like Birchcliff Energy is critical to surviving the downturn, and thriving in the subsequent recovery.

Anglo American plc shares also declined on the back of falling spot prices of the commodities that they produce. As one of the world's largest diversified miners, Anglo American is a leading producer of various minerals including copper, coal, diamonds, iron ore and platinum group metals. Shares declined in 2015 to levels not seen since the depths of the global financial crisis. Mining stocks in general have been among the worst performing sectors globally this year, and since their last cyclical peak in 2011. Because of extreme negative sentiment, and the resulting share price declines, we are finding meaningful long term value in the beleaguered sector. Anglo American trades for less than 25% of tangible book value, an historic low that bears no justification on longer term commodity price assumptions. Anglo's CEO Mark Cutifani has been restructuring the company by selling non-core assets, and while the near term supply-demand picture from China is not inspiring, we believe there is compelling long term value when commodity markets and Chinese demand normalize. Anglo's indebted balance sheet and its highly cyclical cash flows compel us to manage risk by keeping Anglo's position among the smallest in the portfolio.

After posting very strong performance during the difficult third quarter, shares in Industrias Bachoco declined primarily due to profit taking and a weakening outlook for Mexican poultry prices. Bachoco's third quarter results showed gross margin contraction of more than 5%, as softer pricing and higher feed costs started to cycle in. Still a great long term story, but near term poultry cycle dynamics are likely to negatively impact Bachoco's profitability in the near term.

Portfolio positions which helped performance the most during the quarter under review include Samsung Electronics (0.7% contribution), E.ON (0.7% contrib.) and Sanderson Farms (0.6% contrib.). Shares in Samsung Electronics rose during the quarter after the company reported financial results, and announced a new and unprecedented shareholder return policy including an accelerated buyback program, as well as a three year policy to return 30-50% of free cash flow in the form of dividends and share buybacks. The initial buyback program amounts to 6.3% of their shares outstanding and importantly, these shares will be cancelled. This will mark the first time that Samsung has cancelled its shares after buybacks and illustrates the company's commitment to maximizing value for shareholders.

Shares in German utility E.ON rose during the period under review as fears of an unfavorable outcome to Germany's nuclear stress tests proved unfounded, and it was deemed that the operators in aggregate have sufficient net assets to cover projected nuclear decommissioning costs and potential long term liabilities. In addition, E.ON continued to monetize non-core assets by selling their Norwegian North Sea E&P business for consideration of $1.6 billion, further strengthening their balance sheet and crystalizing latent value ahead of their planned spin-off program in 2016.

Sanderson Farms shares advanced due to several key improvements in the dynamics of US poultry industry. After falling from May through October 2015, big bird pricing improved. This is consistent with history as poultry pricing can be seasonal, typically bottoming at the start of winter and rising into the early months of a new year. In addition, certain foreign countries have eased their import ban on US poultry products following 6+ months without any avian influenza incidents in the US. Importantly, feed costs have been trending lower with declining corn and soybean meal prices providing a tailwind for profit margins heading into 2016.

Portfolio Changes

One new position was initiated during the quarter with the purchase of Cirrus Logic. Headquartered in Austin, TX Cirrus Logic is a premier supplier of high-precision analog and digital signal processing components for a variety of audio applications. The company has a very strong intellectual property (IP) portfolio with more than 2,000 patents worldwide, providing a wide range of niche products to more than 3,000 end customers globally. The investment thesis for Cirrus Logic rests on our "four core pillars" of compelling undervaluation, clean balance sheet, solid returns on capital driven by a strong competitive position and high quality management with a track record of creating value for shareholders. While our perceived downside is limited by a 30% discount to fair value and the company's net cash balance sheet, the near term upside opportunity comes from Cirrus Logic's ability to grow content at their top three smartphone customers while expanding market share among other market leaders. Specifically, as smartphone manufacturers increase their use of sophisticated analog and mixed signal processing components in order to offer customers better quality voice and audio features, the value of their content in each premium device sold should increase accordingly. Over the medium and long term, features such as active noise cancellation and always-on voice should move beyond phones to digital headsets and other smart accessories in the coming "Internet of Things" era. With 63% and 18% of Cirrus Logic's revenues derived from their #1 and #2 customers respectively, we are keenly focused on potential changes to these manufacturer specifications and product features as both a risk and opportunity for Cirrus Logic's business. We believe the market currently underappreciates Cirrus Logic's technological advantage in key audio features that should enjoy increasing penetration among both flagship and mid-tier smartphones, providing a meaningful growth driver in the coming years. Coincident with their most recent quarterly results, Cirrus Logic announced that its Board of Directors authorized an additional $200 million to repurchase shares, a tacit confirmation of our perceived undervaluation and a testament to their focus on creating shareholder value.

One position was liquidated during the period under review, as shares in Japan's leading hospital bed manufacturer Paramount Bed Holdings were sold at a slight gain. Paramount Bed shares remain undervalued, in our opinion, but we expect demand from hospitals and other medical institutions to be subdued. Although aging demographics in Japan paint a favorable picture for demand from elderly care facilities, models marketed to these institutions have lower functionality and lower selling prices than models marketed to hospitals, adversely impacting the company's sales mix and profit margins. We will occasionally replace an existing position with a significantly more compelling idea, as was the case this past quarter with Paramount Bed being replaced in your portfolio by Cirrus Logic.

Outlook

Clearly, with a pro-cyclical bias in your portfolio, we believe that markets have grown overly cautious on the prospects for global growth. Mining stocks have arguably discounted an excessively harsh and severe environment for supply and demand. We are of the belief that generally loose monetary policy across the globe should be enough to keep the world economy growing at a modest pace in 2016. While we do not make or rely upon economic forecasts, we are confident that current valuations in the mining sector portend a long term negative pricing environment that is highly unlikely to persist. This is also true for a number of different cyclical businesses that we have exposure to in the portfolio including natural gas, oil services, property and casualty insurance, asset management and segments of technology. This disconnect between short term expectations and longer term eventual reality is a source of opportunity for the disciplined and conservative value investor. While our performance in the most recent quarter seems to belie our conservative and capital preservation-oriented investment style, we have witnessed periods of narrow market leadership like this before. We remain steadfast in our conviction in the underlying fundamental long term value of the securities in your portfolio.

As a benchmark agnostic global investment strategy, we have the flexibility 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 be diligent in our search for undervalued securities of quality companies that will help us meet or exceed our investment objectives.

Thank you for your support, and we look forward to serving your global investment needs for many years in the future.

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