1949
VALUE
ADVISORS

Quarterly Review – Q2 2016

Brexit was the dominant topic for global investors during the period under review, as the general electorate in the United Kingdom voted on June 23rd to leave the European Union. The initial knee-jerk reaction by markets was violent, causing the MSCI World Index (in US$) to fall by more than 7% in two days. Reassured by the Bank of England's pledge to provide a backstop of more than £250 billion in additional funds to support the functioning of markets, global equities rebounded just as strongly to finish the month of June only 1.1% lower. The benign performance result for the MSCI World Index (in US$) for the second quarter and year-to-date periods (+1.2% and +1.0%, respectively) somewhat belies the heightened volatility that investors have endured so far this year. We expect this volatility to persist as markets digest the potential economic and political impact from Brexit, and other market risks.

Performance

During the period under review, your portfolio outperformed the MSCI World Index (US$), appreciating by 4.0%. Our short term performance will differ greatly from the global equity index as we seek to outperform over the long term with a differentiated portfolio of high conviction undervalued stocks from around the world. We attribute our favorable performance result since inception last July to our dual focus on both capital preservation and capital growth, and our flexibility to invest wherever we see compelling value in the world, with low absolute risk.

	June 2016	Q2 2016	Year to Date	Since Inception (7/31/15)
1949 Global Value Strategy:	**+ 4.0%**	**+ 2.7%**	**+ 16.8%**	**+ 5.4%**
MSCI World Index (in US$):	- 1.1%	+ 1.2%	+ 1.0%	- 3.9%
Out (under) performance:	*+ 5.0%*	*+1.5%*	*+ 15.8%*	*+ 9.3%*
MSCI World **Value** Index:	- 1.2%	+ 1.7%	+ 1.9%	- 3.7%
Out (under) performance:	*+ 5.1%*	*+1.1%*	*+ 14.9%*	*+ 9.1%*

Portfolio Commentary

Positions which most positively impacted performance during the second quarter ending June 30th were Birchcliff Energy (+2.1% contribution), Anglo American (+0.7% contrib.) and New Gold (+0.6% contrib.). In each of these three instances, and for different reasons, a very rare and attractive opportunity to make outsized returns with limited downside risk was provided by markets obsessed with stability and predictability. We wrote about this opportunity in our 2015 year-end letter, explaining "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". As disciplined value investors, we are contrarians by definition, attracted to what is out of favor, undervalued and therefore less risky, while avoiding what is currently very much in favor and fully valued. This approach has proven the test of time over the long term despite occasional periods of underperformance. What is required for this to work consistently, is patience. In an increasingly short-term and trading oriented market environment, we believe that our long term approach and the ability to be patient may well continue to provide a lasting competitive advantage. Ideas involving corporate events, or embedded triggers to unlock latent value, are designed to create positive returns irrespective of the general trend of markets or the economy. In a low expected return environment, our conservative strategy is well suited for absolute return oriented investors.

In the case of **Birchcliff Energy** (+30% during Q2, and +70% year-to-date), shares had declined by 60% from their cyclical peak in mid-June 2014 when we initiated our position in July 2015. At that time, we described the company as among Canada's lowest cost gas-weighted producers, able to generate a profit even during 2012, which witnessed the lowest average natural gas price in more than ten years. Birchcliff's large land base enabled compound annual growth in proven and probable (2P) reserves of 27%, and compound growth in production of 32% since 2005. With a glut of natural gas supply in North America, and spot prices again near cyclical lows, shares of Birchcliff Energy seemed to offer great potential upside with minimal risk of permanent capital loss. Since our purchase, the El Nino weather pattern across North America helped drive natural gas prices to new multi-year lows as increased supply greatly exceeded demand. Shares in Birchcliff Energy also fell, hitting levels not seen since the darkest days of the global financial crisis in 2008-2009. Comfortable buying into negative short term news if the long term investment thesis is compelling, we added materially to our position in December and again in mid-January 2016. Since the mid-January low, Birchcliff shares have risen more than 125%, contributing greatly to our performance during the period under review. In the final days of the June 2016 quarter, Birchcliff Energy announced an agreement to purchase high quality natural gas producing properties within their existing Montney core area from Encana Corp. for C$625 million in cash. Financed by the issuance of C$690 million in new shares, the deal will be accretive on every important measure, while also serving to deleverage the balance sheet. On a pro-forma basis, Birchcliff will have among the largest collection of high quality gas-weighted assets in Western Canada, with lower financial leverage and still trading at a material discount to fair value. Their success during the current low pricing environment is a testament to both the quality of their reserve base as well as the management team and personnel. We have great confidence in Birchcliff's ability to create tremendous value through the cycle and in a more normal Canadian natural gas price environment.

Anglo American plc shares advanced by 31% during the period under review, and 142% year-to-date. Here again, the depressed share price of Anglo American was ignored by investors seeking the perceived safety of companies with predictable earnings and cash flows. Following a brutal multi-year bear market in commodities and mining stocks, Anglo American shares seemed to overly discount the extremely negative commodity pricing environment. While the glory days of the commodity "super-cycle" are long past, so are the profligate capital spending programs of mining companies singularly focused on growing production at any cost. Major mining projects around the world have since been scaled back, delayed and even cancelled, constricting future and near term supply of iron ore, nickel, copper, platinum group metals and other

important minerals. While Anglo American is guilty of unfettered growth aspirations during the heyday, and destroyed many billions of dollars of shareholder value under the leadership of former CEO Cynthia Carroll, the pendulum has since swung to the other extreme offering shrewd value hunters an attractive investment opportunity. In deep value situations such as Anglo American, bad news doesn't necessarily need to become good news to provide the investor significant capital appreciation. Since the market is a discounting mechanism, and oftentimes over-discounts market expectations, news only needs to be less-bad than expected in order to drive shares higher. With shares trading well below tangible book value, and an ongoing restructuring program under CEO Mark Cutifani, there exist ample corporate triggers to unlock latent value in this special situation. During the period under review, Anglo agreed to sell its niobium and phosphate assets to China Molybdenum Company for $1.5 billion. The sale is part of the company's ongoing restructuring efforts that should result in significantly lower debt on Anglo's balance sheet – a source of investor worry last year as commodity prices fell further. While we prefer to invest in companies with clean balance sheets, we will occasionally invest in indebted companies undergoing major restructuring if debt reduction is a primary goal. If the debt burden is the primary reason for the equity's extreme undervaluation, alleviating the debt burden via asset sales should result in a corresponding increase in equity value, irrespective of the underlying trend in markets or the economy. This is an appeal to investing in special situations, especially in the current low expected return environment.

Shares in **New Gold** rose 16.5% during the quarter, bringing its year-to-date advance to +75%. New Gold shares advanced primarily because the price of gold rose 6.8% during the quarter. While New Gold shares will likely decline if the price of gold declines, our investment thesis on New Gold also relates to the current development of its Rainy River gold mine in Ontario, Canada and the resulting positive impact its eventual production will have on New Gold's growth profile. New Gold is among Canada's lowest cost producers, allowing it to remain profitable if gold prices decline modestly, while creating tremendous value in a higher gold price environment. We believe that gold is likely to trend higher as we continue along the current unprecedented global monetary experiment being executed by central banks around the world. In addition, New Gold recently entered into gold option contracts to hedge their remaining 2016 production. The option contracts will increase the certainty of cash flows this year, reducing the risk of any adverse impact to Rainy River mine plans resulting from lower gold prices. The lower perceived risk to development of the Rainy River project helped drive shares higher during the period under review.

We have long held modest exposure (5 – 10%) to gold and gold equities, sometimes to the detriment of total portfolio return, which of course can be said on occasion for every type of investment held through time. Gold is unique, however, in that its appeal as an investment in your portfolio has elements of both commodity and currency. Though not mutually exclusive, it is the supply and demand dynamics of gold as a commodity that tend to determine the short term moves in price. Recent supply-demand dynamics have driven the commodity higher as investors around the world looked for a safe haven for their capital. It is gold's monetary store of value through history that provides long term insurance against an adverse monetary event that warrants secular exposure in your portfolio. Simply put, we believe that gold is the ultimate reserve currency, and will appreciate in value when presently reigning fiat currencies fail to provide safety. Fiat currencies are based upon the full faith and credit of the government, but risk losing value if that faith is broken. It is increasingly difficult to find major fiat currencies around the world where faith and credit is strong. Having modest exposure to gold as a form of financial "fire insurance" seems prudent to us. We hope that we won't benefit from any "claim" on the insurance policy, but rather consider it to be a form of risk management. Your portfolio benefited greatly from this during the period under review.

Positions which most negatively impacted performance during the second quarter of 2016 were Franklin Resources (-0.5% contribution), Apple, Inc. (-0.5% contrib.) and Michael Kors Holdings (-0.5% contrib.). Shares in **Franklin Resources** declined 14% during the second quarter, as the company reported disappointing results. Net outflows of $24.6 billion were worse than expected, its third consecutive quarter of outflows greater than $20 billion. Poor performance among key products were partly to blame, hurting gross sales to the institutional channel, exacerbated by recent market volatility. The company has tried to control expenses, targeting a 3% reduction this fiscal year excluding sales and distribution expenses. Net cash and investments of $9.5 billion represent more than 40% of Franklin's market capitalization, a staggering amount of excess capital which could be used to buy back shares, if not for nearly 70% of its cash held offshore and subject to repatriation tax. The company has consistently repurchased shares, even if at a modest pace. Shares presently trade for roughly 5x current year's estimated EBIT, an extremely discounted valuation to both the general equity market and Franklin's own historical range, nearing its previous trough of 4.5x EV/EBIT in February 2009 at the depths of the global financial crisis. We have taken the recent opportunity to add to the position. As has been aptly said before, one can have cheap stocks or good news, but usually not both. The current discounted share price, in combination with large net cash on their balance sheet, should offer investors a comfortable margin of safety against permanent loss, while the company's recent share repurchases reinforce our conviction in the long-term investment thesis.

Apple shares declined 11.8% during the period under review as the company reported disappointing quarterly results in April, including a 13% decline in reported revenue (-9% on a constant currency basis). In its release, the company gave weak guidance for the June quarter, hurting short term sentiment toward the shares. Apple will release the new iPhone 7 this Fall, for which we understand from a proprietary survey[1] that there is strong pent-up demand. Views are mixed as some analysts are expecting modest demand due to evidence of longer replacement cycles and diminishing feature differentiation. In our work, we try to take advantage of negative short term sentiment, and the opportunity to buy stock in quality companies that it typically creates, in favor of the longer term and more appropriate fundamental valuation in a more favorable environment. Despite the current mid-product cycle lull in demand, Apple continues to take share from Android devices, lending further merit to our belief in Apple's superior products and eco-system, and the attractive investment opportunity in its undervalued shares today. In addition, it was reported that Berkshire Hathaway had initiated a $1 billion position in the name, lending credence to the argument for long term value apparent in Apple shares today. With shares trading near a 50% discount to the S&P 500 Index, after adjusting for Apple's $150 billion in net cash on its balance sheet, while generating a return on equity near 40%, it seems quite reasonable to us that there is compelling long term value in Apple. Downside appears limited, while a strong iPhone 7 product cycle could catalyze the undervaluation in the medium term.

Shares of **Michael Kors Holdings** declined 13.1% during the quarter, although its shares are up 23.5% year-to-date. A string of negative news from department and specialty store retailers in the US and Europe drove the decline, exacerbated by slow foreign tourism spending in the US, an important driver for the company. To reiterate, while we agree that the retail environment is presently challenging, we are encouraged by Kors' deeply discounted valuation relative to closest peer Coach, Inc. Together with its net cash balance sheet, we believe that there is a meaningful margin of safety against permanent loss. Strength outside the US, especially in Asia where the brand is new, represents a significant growth opportunity. Women's luxury shoes and menswear should also help drive growth, offsetting declines in watches and a recent trend toward smaller handbags. The company continues to buy back its own shares, confirming our positive fundamental view of the company and the low risk opportunity in its undervalued shares today. We took the opportunity to increase your position in KORS during the second quarter.

Portfolio Changes

A new position was initiated in your portfolio during the second quarter with the purchase of shares in **Global Brands Group Holdings Ltd**. (GBG), a Hong Kong listed branded apparel wholesale company with a diverse portfolio of both licensed and owned brands. GBG develops, designs and markets products to retailers primarily in the United States. Global Brands Group was spun off from its parent, Li & Fung in July 2014. Since the spin-off, shares in GBG have severely languished, despite its dominant competitive position and world class portfolio of brands. This is not uncommon with spin-offs, especially where the entity being spun is small in relation to its parent, as is the case with GBG. What is atypical, is that the former CEO of the parent company joined the much smaller Global Brands Group as its CEO at the time of the spin-off. In addition, CEO Bruce Rockowitz started buying shares of GBG within its first week as a new entity, accumulating more than 160 million shares at an average price of HK$1.75 (as compared with its most recent market price of HK$0.68), and aggregate consideration of US$19 million. All in, the CEO now owns 422 million shares worth HK$295 million (US$38 million). The sizable open market purchases by the CEO is a strong demonstration of his confidence in GBG's future business prospects.

At the time of the spin-off, GBG set explicit targets for gross margins and core operating profit. Their target for gross margins has already been met one year early, increasing from 30.7% in 2013 to 34.2% in 2015. While core operating profit has not yet met their target, it has grown by 26% since the spin-off. Greater profitability and a significantly lower share price has created an attractive disconnect between price and value. Demand weakness in the US apparel market is to blame for negative investor sentiment toward the industry, but following a 55% decline in GBG shares since the spin-off, we believe the shares offer great potential upside and very limited downside on a multi-year view. This multi-year view is important as it affords us the opportunity to buy deeply discounted quality companies when they are most out of favor, and thus, most undervalued. Recalling famed global value investor Sir John Templeton, the best time to buy is at the point of maximum pessimism. Since GBG's main distribution channel is US department stores and discount retailers, GBG shares are highly correlated to the performance of this currently beleaguered sector. As consumer spending is cyclical, the successful investor must be willing to buy when spending is cyclically depressed, harvesting gains when spending returns to normal and the sector is back in favor. GBG shares presently trade for 6x estimated 2016 earnings, a nearly 50% discount to the Hang Seng Index average, with free cash flow poised to grow dramatically as earn-outs related to previous acquisitions expire. At the current depressed value, GBG shares seem to overly discount the negative consumer spending environment that is likely to prevail in the US over the medium and long term.

No positions were liquidated during the second quarter.

Outlook

Seemingly overnight, Brexit has added to the already uncertain environment for the United Kingdom and the rest of Europe. We were surprised by the UK's vote to leave the European Union, reasoning that the economic benefits of EU membership far outweighed the costs. In addition, in other closely contested referenda on sovereignty such as Quebec in 1980 and again in 1995, and Scotland in 2014, polls indicated voting in favor of independence, while the final tally maintained the status quo. We were wrong in assuming a similar outcome in the UK, but limited exposure to the most at-risk sectors was fortunate. The British Pound has since declined to more than 30 year lows versus the US dollar. Business confidence took an immediate hit, and the UK economy might experience a recession in the coming quarters. UK banks and real estate related shares including home builders have suffered greatly. Exporters and companies realizing the bulk of their revenues in US dollars such as Anglo American plc will be buffeted by the depreciating British currency. The impact on Asia and the Americas remains to be seen, but the risk of contagion is one that we have learned over the years to be extremely mindful of. While we don't expect broad contagion from Brexit, market valuations in certain parts of the world are near business cycle highs, implying potential

downside if economic growth falters or the perception of global risk rises. While we don't make or rely upon economic forecasts in our construction of your portfolio, we are ever mindful of the negative potential impact on markets from material changes in global economic data. Our perception of the attractive opportunity to invest in undervalued cyclical companies may have taken a step back as a result of Brexit. For this reason, we will require a greater margin of safety in the cyclical names that we own, taking advantage of recent strength to reduce position sizes in order to mitigate risk. As has been said before, there are times to make money and there are times to preserve capital – given elevated aggregate market valuations, and the degree of investor complacency that it implies, we feel that it is prudent to increase our emphasis on capital preservation.

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 in the future. 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.

Matthew T. Haynes, CFA
Chief Investment Officer, Portfolio Manager

1. Goldman Sachs & Co. conducted an online independent survey of more than 1,000 US customers, aged 18 and above, from March 31 – April 3, 2016. See report dated April 12, 2016.

This summary does not constitute an offer to sell or the solicitation of an offer to purchase any security or investment product. Any such offer or solicitation may only be made to qualified investors and only by means of an approved confidential private offering memorandum or investment advisory agreement and only in those jurisdictions where permitted by law.

This summary reflects select positions of the current portfolio of a managed account advised by 1949 Value Advisors. There is no guarantee that a commingled investment vehicle or another investment account managed by 1949 Value Advisors will invest in the same investments set forth in this summary. The investment approach and portfolio construction set forth herein may be modified at any time in any manner believed to be consistent with the managed account's overall investment objectives.

While all information herein is believed to be accurate, 1949 Value Advisors makes no express warranty as to the completeness or accuracy nor does it accept responsibility for errors appearing in the summary.

This summary is strictly confidential and may not be distributed.