



October 6, 2016

### **Third Quarter 2016 Update and Outlook**

Our contrarian value style of investing continued its strong performance through the third quarter of 2016. Cash reserves in the LSC Opportunistic Strategy (averaging 26% in the third quarter) are the primary differentiator between our two equity strategies. We believe that the U.S. focused stock market will struggle in the remaining months of the year, led by flat U.S. corporate earnings, slowing stock dividend increases and reduced stock buybacks. Many U.S. corporations have taken advantage of the historically low interest rate environment by reducing their cash balances and/or borrowing to fund stock buybacks and dividend increases. We believe this era is ending as companies struggle to raise profitability.

In the face of plateauing earnings and the particularly aggressive (ugly) U.S. presidential race, the U.S. focused markets powered ahead in the third quarter, led by technology stocks, followed by financial services and industrials. All three sectors benefit from strengthening demand and are less affected by rising interest rates (banks actually benefit from rising rates). Likewise, the interest-rate sensitive utility sector stood out as the worst performing during the quarter after a torrid performance in quarters and years past. Could this be an early signal that interest rates have bottomed, along with inflation?

During the quarter, we added three new stocks to the portfolio. Lazard Ltd. is a financial advisory and asset management company operating in 24 cities throughout the world. Lazard is known for its advisory services regarding mergers and acquisitions, restructurings, capital structure and capital raising. The firm's asset management business has a strong international focus with \$192 billion in assets under management. We regard Lazard as well positioned to benefit from increased M&A activity and an upturn in international markets. We also purchased Potash Corporation of Saskatchewan, one of the largest potash suppliers in the world, which has suffered from a world oversupply of this important crop fertilizer component. We believe the fertilizer industry is in the early stages of consolidation and related streamlining, which will eventually benefit Potash's future earnings. Just after we added Potash to the portfolios, the company announced its intent to merge with another Canadian potash producer, Agrium. The addition of the iPath S&P 500 VIX Short-Term Futures exchange traded note (ETN) is consistent with our belief that the stock market has been incredibly complacent given the rising headwinds that we foresee, especially in the U.S. focused markets. This investment is meant to follow the direction of the CBOE volatility index, which measures investors' confidence or complacency in the S&P 500 focused U.S. stock market.

Our shares in DreamWorks Animation, the maker of animated films, were purchased by Comcast Corp. during the third quarter. Comcast's film division was attracted to DreamWorks for many of the same reasons we were: the company's animated film expertise, its popular animated characters, and growing original television and online entertainment production businesses. We sold both Micron Technology (purchased in May, 2016) and Universal Corp. because these stocks reached our price objectives. We reduced our position in AngloGold Ashanti by half reflecting the sharp run up in precious metals prices in the first six months of the year.

We are pleased overall with how the quarter turned out for our portfolios. Nevertheless, within the portfolio, some stocks struggled with a negative turn of events while others benefitted from good news. Our typical equity portfolio holds between 25 and 35 issues; diversified yet focused enough to benefit from good investment choices. We strongly value the effort of getting to know our investments.

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