

### Third Quarter 2015 Client Letter

It has been an eventful quarter for investors with the S&P 500 Index and the MSCI EAFE (international) trading down -6.4% and -10.2% respectively. Meanwhile, the Barclays Aggregate Bond Index only slightly countered these returns by marking up +1.2%. With many market commenters having long described this equity bull market as "long in tooth", this quarter's market moves, with its sentiment and severity attached, has pushed the consensus view to that of a global equity market correction.

The cause of this current market correction is a confluence of events that have been developing over a long period of time, but have only now begun to significantly affect the investment landscape. The first is the US. The US economy continues to strengthen at a slow and steady pace, and as a result the Federal Reserve FOMC will likely raise short-term interest rates by the end of the year. However, the US is doing this alone as the rest of the developed and developing world loosens their monetary policies. The second concern is on China and its slowing economy. We have seen China through economic cycles in the past, but this time China has a GDP roughly the size of the US, and that GDP is shifting its makeup from an economy run on investment to one of consumer spending. We haven't seen an economy this size undergoing a developing-to-developed market transformation since the US emerged from colony to sovereignty. Although this is a long-term process investors re-rate asset values on the margin, and many fears can be extrapolated from weaknesses in this part of the world. Lastly, with the investment thesis centered on global zero interest rate policy (ZIRP) coming under threat, many investors are participating in an unwinding of the "carry-trade". The first two events are longer-term in nature and are likely signaling the end of indiscriminant broad market returns we have seen since the financial crisis. The third event is a short term (albeit painful) driver of excess market volatility.

Times like these cause most investors to pause and rethink their portfolios. Often investors (especially financial advisors) feel the need to do something in response to elevated volatility. However, more often than not the best thing to do is nothing – an easier decision when the assets you understand the fundamental value of the asset you hold. Operating with some anticipation of a corrective event we have been in touch with our partner-managers extensively, gathering any changing/new insights into economic and business fundamentals affecting our portfolios. In every instance, our partner-managers reiterated with conviction why they hold what they hold. There was little to no selling of positions in client portfolios as a result of this market correction.

Your portfolio is positioned in very high-quality companies and credits. High-quality to us does not mean "high-flyers", but rather companies that have a history over different business cycles of delivering high (and sustainable) returns on capital to shareholders. These companies are usually larger, developed-market centric, have product pricing power in their end markets and display some higher than average growth potential. Additionally, these companies do not finance the majority of their operations with debts. These companies are best positioned to extract value from uncertainty due to their stable earnings base and financial flexibility.

In a world of divergent monetary policies we expect volatility in markets to continue. In this environment, the spread of returns between the best and worst performing companies should widen. This is not a good environment for broad indices in our view. Owning a robust portfolio of the highest of quality companies should outperform the average and achieve portfolio return targets. In closing, with increased volatility comes an increase in attractive entry points in names we like. We have been holding an elevated level of cash for over a year now, and that looks to remain until equity prices are attractive enough to trade that optionality for higher rates of return.