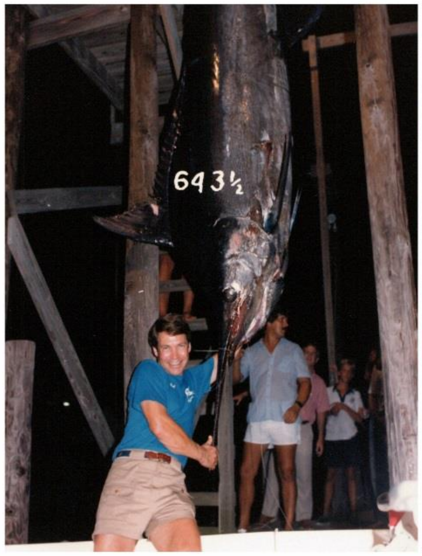
October/Fall 2016

Dear Clients and Friends:



I have discussed my dad in a past letter and how I followed his footsteps into the business. My dad, like most dads, was larger than life to me. Losing him at a young age has probably even compounded that in my memory. Dad was a titan of the investment industry, he killed big deer, caught big fish and lived a big life. Dad also drank Mount Gay Rum. Why Mount Gay Rum you ask? I have no real idea, but I assume because it tastes amazing. It is no coincidence that since Dad drank Mount Gay, I also drink Mount Gay. Let's be real, it is the oldest rum in the world. Distilled in Barbados, Mount Gay has been in production for over 300 years. Take that Fireball. It is excellent mixed with coke, ginger beer, club soda, your favorite tropical mixer or even your flask at an SEC game. What tasted amazing 300 years ago in Barbados or 30 years ago as my Dad enjoyed it still is great today. Why mess with something that works. Maybe you see where this is going, maybe it is because I have written about the detriments of significant changing before in past letters such as here, here or here. I didn't say every thought I have is an original thought right?

Benjamin Graham is considered the father of value investing. He taught at Columbia Business School starting in the late 1920s where one of his students was Warren Buffett. Warren later worked for Ben Graham and even named his son after him. The principals that Ben Graham and his disciples began using nearly 100 years ago still are used today by the world's top value investors. Essentially, look for companies trading at discounts with a built in margin of safety. What Graham taught was passed down to great investors like Buffett, Jean Marie Eveillard, Seth Klarman and even some that you have managing your portfolio. Warren Buffett and others do not look for the newest hot investing strategy nor do they attempt to jump in and out of the market. Instead they use hard research, discipline and patience along with a touch of luck thrown in.

Do not take yearly results too seriously. Instead, focus on four or five year averages.

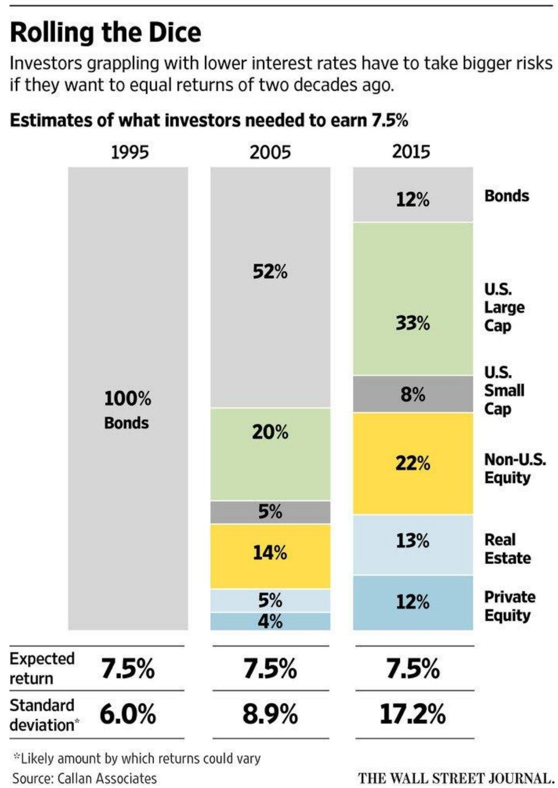
Wall Street people learn nothing and forget everything -Benjamin Graham

Behavioral finance expert and author Daniel Crosby, PhD, discusses the detriments of frequent change in his book *The Laws of Wealth: Psychology and the Secret to Investing Success*. In it, he states that the average holding period of a stock in the 1950s was 6 years, but by the 2000s that holding period had changed to just 12 months. What happened to long term investing? Dr. Crosby also discusses action bias or the tendency towards doing a dramatic effort in the face of high stakes. He uses the example of soccer goalies. In a study of goalies trying to stop penalty kicks, it was shown that goalies dove dramatically to the right or left side of the goal 94% of the time. The kicks themselves however were divided equal with 1/3 going right, 1/3 going left and 1/3 going in the middle. The study showed that the goalies who just didn't move and stayed in the center had a 60% chance of stopping the ball. Much more than diving left or right. Why is this? Doing nothing was the best strategy? The author says that the tendency is to look as if you are doing all you can to stop the ball and to "leave it all on the field". Investors are no different. When managing our hard earned money, investors rarely do nothing in periods of market distress even if research shows that is the best thing to do. Taken a step further, Fidelity examined the behavior of their best performing accounts to see what stood out. Amazingly, when they contacted the owners of the best accounts, the commonality was that those investors had forgotten about their account altogether. It is easy to do nothing, when you forget it is there.

We all remember Ron Popeil infomercials and his inventions like the Veg-O-Matic and the Pocket Fisherman, but his best was the Showtime Rotisserie and BBQ. Say it with me: You just "Set It And Forget It". It's like that tagline was invented for investing success. But, now to slightly contradict what I have been saying, I do think that strategies need to be adapted over time. Markets evolve and strategies have to be adapted to provide investors with the returns they need and the stability they want. That is not to say that following Ben Graham's value investing tenets isn't appropriate, it is and it is a large component of my portfolios, but increasingly evolving times do call for some changes. But wait……there's more.

The underlying principles of sound investment should not alter from decade to decade but the application of these principles must be adapted to significant changes in the financial mechanisms and climate.-Benjamin Graham

In fact today's markets literally call for a different portfolio to achieve the same level of return as in years past. A recent article in the Wall Street Journal showed how investors have to take bigger risks to achieve the same returns they had just 20 years ago. Estimates show that in order to achieve the 7.5% return that a 100% bond portfolio provided in 1995, investors today would have to take on nearly 3x the volatility and own significantly more stock oriented investments. Markets change over time and new products and managers become available that may fit the current market climate. 80 years ago it was difficult for everyday investors to own stocks and bonds now fast forward and investors can own mutual funds and ETFs that can provide exposure to stocks and bonds and virtually any asset class around the world. So while, set it and forget it and buy and hold are sound strategies that I do believe in, I also think that some tactical management and the ability to evolve can add significant value.



Back to where we began with rum. In the 1700s, the British Navy began serving a pint of rum to sailors each day to prevent scurvy, after some drunken results they began to water it down and add lime juice and brown sugar probably making the world's first cocktail. Fast forward to the mid 1900's and the tiki craze made rum popular again with Pina Coladas and Mai Tai's and then the ever popular Cuba Libre (rum and coke). Now fine rums (like Mount Gay Extra Old) are used to make unique cocktails or even the traditional Old Fashioned or Manhattan. Bottom line, the way it is mixed or enjoyed may have changed or evolved over the years, but the primary ingredient has remained a constant.

All of this may not matter anyway. In my collecting of interesting articles and pieces to use in this letter, I came across this gem. Do we live in the Matrix? Essentially, lots of "smart" people are saying there is a good chance that we are all living in a simulated world controlled by Artificial Intelligence. In fact, Tesla founder Elon Musk thinks there is a 1 in a Billion chance we are not living in this matrix. Maybe that explains why we have déjà vu? Some tech billionaires have even engaged scientists to work on breaking us out of the simulation. So whether this is a real world or simulated world we live in I hope it continues to be a world that includes rum. Cheers.