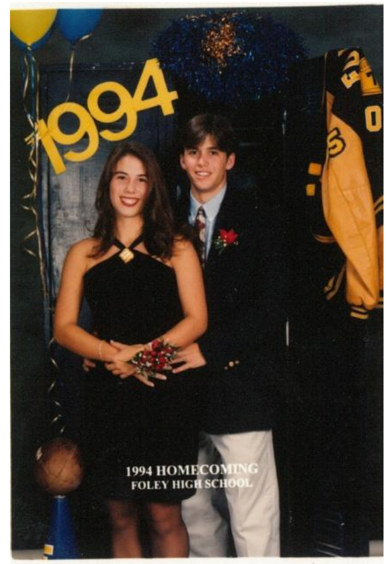
May 2015

Dear Clients and Friends:

I think it is safe to say I hate change. At the very least, I am relatively afraid of it. In my life I have only had 2 primary dentists and less than 5 people cut my hair. I have owned 5 cars in the 22 years I have been driving and 2 houses. This summer will mark my 12th visit to the BVI (you could say I am a creature of habit). I also have only worked with one company and have maintained the same email address for 15 years now. But, in the greatest feat of anti-change in my life, I started dating Amanda 21 years ago last month and we married 8 years later. Maybe I just focus on the long term and when I find something I like, I just stick with it. Most of you who know me also know that health and fitness is a big part of my life. Much of that is driven by Amanda who is a personal trainer and yoga teacher. As I am fast approaching 40, my goal is to avoid the "Dad Bod" as much as possible. That all being said, a big part of is how I eat. Abs are made in the kitchen not the gym! I eat basically the same thing, at the same time each day. When I get off of that system, even for a day, I don't feel as good. It is what works for me. Sometimes it is very tempting to eat the entire pizza or plate of cookies and I often make the decision to do just that, but time and again it fills a temporary craving, but causes me suffering later. Jimmy Buffett had a song about that called *Permanent Reminder of a Temporary Feeling.* Again, change doesn't always work in my eyes.

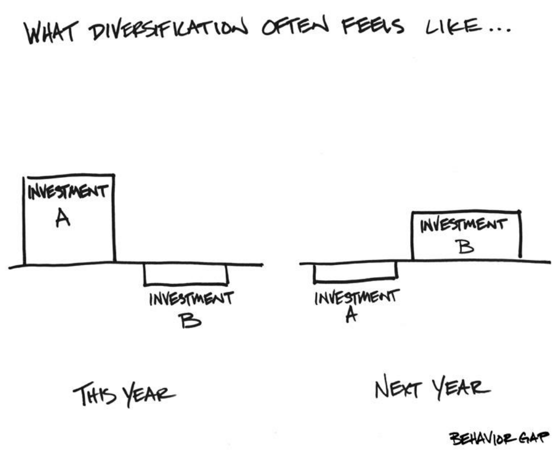


I should get her a new wrist corsage

Our favorite holding period is forever—Warren Buffett

In past letters I have written we have discussed issues related to change. Last fall I wrote about being too busy with our investment decisions and even my most recent letter in February discussed the benefits of diversification and how chasing returns can be detrimental to investors. I truly believe in active management and the benefits it can provide investors over the long term. I also believe in the value of a well diversified portfolio. Both of those strategies have not been an investor's friend in the past couple of years, but so far this year it looks like the tide may have begun to turn. Last year's big winner was US large cap stocks. As I write this on May 14th, the S&P 500 is up roughly 3.5%. The big losers last year were international stocks and commodities. So far this year international stocks are up over 12% and commodities are relatively flat. Trying to time when to be in any particular asset class is a loser's game. Where I feel the secret sauce lies is in choosing truly unique portfolio managers who have a history of adding value over long periods of time. Find a mix of these managers and build a portfolio for all seasons, all weather and anytime.

My current primary allocation model is allocated amongst 10-12 funds from 8 fund families. There is exposure to deep value stocks, emerging Asian companies, tactical bonds, managed futures, energy and infrastructure, large cap US stocks and currency arbitrage among others. There are massive fund families in there like PIMCO who manage nearly $1.5 trillion to Beck, Mack and Oliver Partners fund and Roumell Asset Management who run less than $500 million each. Not a one of the managers I use is trying to replicate an index. We seek managers with a high "active share" which is a measurement of how unique a fund is relative to its index. Studies show that high active share is in important indicator to long term strong performance.



Some of the managers I use who have extremely high active share measures have had a tough run in the past couple of years. So, do I "change" the strategy and move to a fund that has done well recently? At times the answer is yes, but that is only after thorough analysis shows that the underperforming manager has had a change in their process that might mean reduced performance in the future. Otherwise, all strategies go through periods of underperformance and specifically funds with high active share go through those periods more than others. Typically though, they are followed by periods of strong outperformance. In a perfect world, we would identify strong money managers, invest in them and never make a "change". Unfortunately that is not the real world, but there are many managers I use who I plan to hold until they retire or no longer manage money.

For investors as a whole, returns decrease as motion increases—Warren Buffett

I read an interesting article recently regarding participation in company 401k plans. A study found that participants in 401k plans that have too many options to "choose" from have a lower participation rate. In effect according to the article, the participants suffer from "choice paralysis" or "analysis paralysis". Too many options make them less likely to take action. The investment world is full of choices and options. We all see the daily hot idea from Jim Cramer on CNBC or what your favorite blogger on Twitter is saying. My job is to decipher those down to a manageable number. I constantly am bombarded and called on with new strategies I could use with my clients, but I really only look at those options when something I am using is not working like I would like it to. Otherwise, I am just adding something that may not be of value. While I would like to believe, like Warren says, that the best holding period is forever and that excess change can be detrimental I more than that realize that you have to be forward looking and proactive with allocating money in today's economy. This quote is very true.

Don't depend on what got you here if it isn't the same thing that is going to get you there

I have been fortunate to meet with a few of my top managers in the past few months. I had a good conference call with Zac Wydra who manages the Beck Mack & Oliver Partners fund. Zac's fund was a 5 star rated fund just a couple of years ago. Now he is 1 star. Did something "change" in his process or ability to identify value? I feel confident the answer is no. I also met in Gulf Shores with the head of marketing for WH Reaves. Over a cold beer and some oysters, we discussed how they have had a phenomenal run in the past couple of years as utility stocks have seen strong gains due to the low interest rate environment. He explained their plan to navigate a future rising rate environment as well as their views on the rest of the infrastructure space. I take that as adapting to a "changing" market. Lastly, I spent 3 days in Newport Beach, California at PIMCO's due diligence meeting called "Inside PIMCO". It was my 3rd visit and by far the best. Not only were we able to enjoy their new phenomenal headquarters overlooking the Pacific, they also shared very timely strategies they have to navigate this unique market we are in. I walked away with a number of new ideas. PIMCO has had to deal with a massive amount of "change" in the past year with an entire shift in their company after ousting founder Bill Gross and suffering from investor confidence issues. I have confidence that their many PhDs on staff, new consultant Ben Bernanke and their other 2500 employees will be able to adapt to that change.

PIMCO's decent conference room

Change is a part of life and we all deal with it in different ways. As I was writing this letter I began to think about all of the changes just in my life going on. A couple of months ago, Sterne Agee, who had been privately held for over 110 years, got bought out, we got a new golden retriever puppy, we are contemplating buying a new house and Finn is about to start Kindergarten. The winds of change are all around. Moral of the story may be to not let change consume you, but let it help you grow.