April, 2016

Dear Partners,

Laughing Water Capital (LWC) returned 24.4% gross from inception on February 8th 2016 through the end of the first quarter of 2016.[1] The SP500 and R2000 returned 10% and 13.4% over this period. While I am pleased by our outperformance, I remind you that LWC makes no attempt to track the indices, and thus our performance will frequently diverge, sometimes to our benefit, and sometimes to our detriment. Over short periods of time, performance of stocks is often driven by emotion, and is thus irrelevant in my view. However, I am confident that over the long run, our common sense investment style will lead to more positive divergences than negative divergences, resulting in above average investment results. For this reason, almost the entirety of my and my family's assets are invested in our strategy. Our interests are aligned.

Luck – We'll take it!

While several of our investments saw thesis confirming developments this quarter, the greatest contributor to our performance over this short period of time was luck. I had hoped to have LWC launched on the first day of trading in 2016, but a series of operational hurdles beyond my control delayed our opening until February 8th, 3 days before the indices made their lows for the year. Thus, we effectively "timed the market," something I do not believe is possible with any regularity, and not something I plan on doing in the future. I assure you, had LWC been open on January 4th as originally planned, our investments would have shown a substantial drawdown in mid-February (the Russell 2000 saw a 14% decline in the first few weeks of the year).

As it happens, our delayed opening allowed us to jump into the February market with an effective cash position of 100%. Given that as of today the indices have regained most of their February losses it is easy to forget that a scant 7 or 8 weeks ago investors were being told that a recession was almost certain as Chinese weakness would drag down the global economy, cheap oil would crush the American industrial sector, and a strong $USD would be a drag on corporate earnings abroad. It was in this environment – when the talking heads were screaming sell! - that I chose to aggressively buy and invest approximately 96% of our assets.

Behavioral Investing: Plumber's Edition

Stocks are not pieces of paper that move up and down on a screen all day. Rather, they are pieces of businesses, and the value of a business does not fluctuate all day, despite what a computer screen may say. Investors are best served by ignoring this day to day noise and asking themselves if the stock in

[1] Please see individual statements for net returns, which are what matters to investors. We report gross here due to performance results between our 2 fee options.

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question were a privately owned business, would its price change so rapidly? Fortunately for LWC, I was presented with near daily tangible reminders of this fact throughout the January and February market sell-off, which made it easier for me to act when the fund launched.

As many of you know, my wife and I recently moved away from the distractions of the city to a quiet suburb. Being value conscious and having a fair bit of construction experience personally, we decided to take on a house built in 1925 that came with a lot of charm, and more than a few projects. Some of these projects are beyond my skill level, so I did the wise thing and called in professionals. As such, we have had a series of small business owners such as plumbers, electricians, carpenters and even (unfortunately) an exterminator come to the house over the last few months. Hoping to learn some new skills, I spent as much time as possible looking over the shoulders of these professionals asking questions about their trade, and more interestingly, their business. The conversation inevitably included talk about what I did for a living, which opened the door for me to explain to these hard working people that according to the stock market, businesses were now worth considerably less than they were just a few months ago. I then asked something along the lines of, "given all the problems with China/recession fears/strong $USD/uncertain political climate, how much less is your business worth today than it was a few months ago?"

The response was typically some combination of awkward laughter and a look that suggested that I must be completely out of my mind.

Warren Buffett has commented that once you reach a certain level of basic intelligence, the difference between successful investors and bad investors is emotional. Those who are able to invest rationally despite the bad news around them do well. It is illustrative that the common sense individuals doing work on my house didn't believe that the value of their businesses changed in February, despite the fact that the fast and loud talking professionals on CNBC and elsewhere were telling the masses that the future was bleak. Exposure to the level headed thinking of my plumber helped strengthen my resolve while the "professionals" were in panic mode.

A Common Sense Strategy

The stock market is often irrational, both in its judgment of individual companies and its view on the broader economy. We spend our time seeking to benefit from this irrationality by ignoring the short term madness of crowds and taking a longer view, which allows us to focus on common sense. The vast majority of hedge funds and mutual funds are unable in invest this way, and we consider a patient, long term oriented investor base to be a major competitive advantage.

We seek to own a small collection of advantaged businesses where the near term prospects of the business are difficult or impossible to predict, but where ultimate investment success will be directly tied to the logical actions of an incentivized management team simply acting in their own best interest, regardless of what the stock market is doing. For this reason, readers of our letters will see little mention of concepts like beta, technical analysis, quarterly earnings, and other terms that Wall Street professionals use in their attempts to convince the world they know what they are talking about.

For example, consider a company with 2 segments, one of which earns $1 per share, and one of which loses $.50 per share. Being shortsighted, often times the market will focus on the negative impact of the unprofitable business line, and value the company on a multiple of net earnings ($.50). Month to month and quarter to quarter the stock will likely be volatile as the market worries about the under-performing business. However, over a longer period of time common sense suggests that the stock price will be most heavily influenced by whether or not the underperforming business is eliminated, not by any macro factors. Does it really matter if China is slowing down if reported earnings double from $.50 to $1.00 when the under-performing business is shuttered?

This situation is of course grossly simplified for illustrative purposes. In reality, a great deal of time must be spent understanding the incentives of management to act rationally within a reasonable amount of time (I typically think in 3 – 5 year blocks, which is an eternity on Wall Street), and evaluating the quality of the profitable business line to ensure that the profits will still be there in the future.[2] Of paramount importance is a low purchase price. Despite attempting to align ourselves with common sense behavior by incentivized management teams, nothing is ever certain. A low purchase price serves to protect the downside if management does not act rationally. However, if a sober assessment of the likelihood of management acting rationally and the business not degrading can be made, and the stock is cheap enough, this set-up can result in excellent long term investment results for those patient enough to <u>just wait</u>.

While I would love to own a group of excellent companies that are operating at peak efficiency, these companies are rarely priced attractively. Thus my approach frequently involves investing in companies that are faced with some sort of problem, inefficiency, or misperception, which leads to the company being mired in uncertainty. These companies are often small caps or micro caps, putting them further out of reach for most investment analysts. Unlike most investors, we prefer to travel off the beaten

[2] Understanding management incentives is typically quite a bit easier than evaluating the future prospects of a business. Generally speaking, if the management team owns a large amount of stock personally, and if they have been buying it recently, they are likely properly incentivized. Interestingly, while it seems obvious that one should be more inclined to invest alongside a management team with a personal fortune tied up in the business, companies such as these are actually punished by the indices and given a lower weighting than they would otherwise deserve. If this seems nonsensical, it is. However, despite what you may have read, indices are not designed to be the best representation of the larger investing universe. Rather, they are designed to be the best representation of the larger investing universe that is accessible to the largest amount of investable dollars. If a founder or management team owns a large portion of a business, that portion of the business is not accessible to the masses, and thus the index owns less, to the detriment of investors. Our small size allows us to find investments where others cannot.

path, and actively seek out this uncertainty, which may take a variety of forms. Some of our favorite archetypes include "good co/bad co" (demonstrated above), recent changes to a corporate structure, an inefficient corporate structure, problems associated with the vagaries of GAAP accounting, or even just a business that is grossly misunderstood by the masses.

This uncertainty is a double edged sword; on one hand it can lead to a cheap share price. It is difficult to abide by every investors maxim of "buy low, sell high" unless you are willing to accept a fair amount of uncertainty. On the other hand, this uncertainty often leads to significant volatility – common sense is uncommon on Wall Street, and investments with these characteristics can easily get cheaper before the market recognizes the value beneath the uncertainty, meaning that patience is essential. While it may be tempting to wait for signs of clarity before investing, inevitably by the time pending change is obvious, the stock price will reflect this change. The important element here is identifying situations that can be resolved by simple human decision making, not situations that require herculean improvements to a challenged business or industry.

Comments on Selected Investments

Our success this quarter was driven by a number of investments that returned 30, 40, or 50% from their February lows through quarter end. If you have any notion that markets are efficient, I would be curious to hear your view on how this is possible. Much of the success was attributable to our fortunate one-time-only timing, but several of our investments also benefitted from significant thesis confirming events during the quarter. For now I would like to refrain from commenting on these investments, and rather briefly discuss two investments which contributed essentially nothing to our quarterly performance, yet are useful illustrators of how we think about investments. The first demonstrates why the market can't be trusted in the short term, while the second is meant to demonstrate how creative thinking and patience can be rewarded with time. Both demonstrate how we look for investments that can benefit from broader weakness.

When is a Dollar Worth More Than a Dollar?

While the investing climate at the time of fund launch was such that we were much more invested than typical, we dedicated a small portion of our fund to an investment in WL Ross Holding (WLRH), which is a Special Purpose Acquisition Corporation (SPAC) controlled by Wilbur Ross, who has proved himself to be one of the world's greatest distressed investors over a long and distinguished career. Put simply, a SPAC is a cash shell formed with the intention of purchasing an operating business, and we view this investment as a cash proxy with upside potential. Ross personally invested $11 million, outside investors contributed $500 million, and the idea is that Ross would have 2 years to use this cash horde to purchase a business. If he was unable to find a suitable purchase, Ross would forfeit his stake, and investors would have their money returned to them. The downside is essentially zero. As recently as

October 2015 shares traded hands at more than $10.40, implying that investors were willing to pay a premium of $.40 per share to access Ross's investing acumen. Remember, Ross is one of the world's best distressed investors, meaning that he has profited immensely by buying businesses during times of great difficulty, such as during a bankruptcy or a recession. However, from October through February, as the world became a "scarier" place and assets became cheaper due to concerns surrounding a slowdown in China, uncertain interest rate policy, and continued weakness in the energy sector, shares in WLRH traded down to the $9.90s level allowing investors to access Ross's investing acumen for less than free. It should be obvious that a dollar in Wilbur Ross's pocket is more valuable when other investors are scared then when other investors are happy – yet the market treated WLRH in the exact opposite way, fleeing from a crowded theater as if someone had yelled "Fire!" when in fact they were yelling "Free popcorn!" WLRH has recently announced an acquisition, which we are currently evaluating.

This little vignette is only meant to show that we actively seek out investments in companies that we think will do better when the world does worse. This behavior is different than that of traditional hedge funds, who tell their investors that they will do well in good times and in bad, despite the fact that this fallacy has been exposed over and over again. Periods of difficulty are unavoidable, and in our view should be embraced rather than feared. We consider this view in two ways. At the portfolio level this means being comfortable holding cash, waiting for compelling investment ideas, even if this means missing out on short term market gains. More importantly however, we actively seek out investments whose intrinsic value per share can grow during difficult times, even if their stock price is temporarily damaged along with everything else. Being long term focused, we are happy to ignore the stock price while remaining confident that when the pendulum swings the other way – and it always does – the market's now positive view will be shining on a company who was able to better itself by taking market share, making acquisitions, repurchasing stock, or otherwise benefitting during the bad times.

When Bad News is Good

A second example of seeking investments in companies that can benefit when the world does worse is our investment in EZCorp (EZPW), one of the largest pawn brokers in the U.S. and Mexico. There is a lot NOT to like about this business – we will come to that later – but as a general backdrop, consider that pawn is a business that should improve during a recession as higher unemployment should drive people to pawn goods. Despite this obvious inverse correlation, EZPW sold off hard through the February down-turn when recession seemed to be just around the corner. Again, there are reasons for investors to be suspicious of EZPW which may explain this weakness, but taking a dispassionate view of the business reveals an attractive investment opportunity.

EZPW essentially operates in 3 segments: U.S. Pawn, Mexico Pawn, and Grupo Finmart, a Mexican based business that allows government employees to take advances versus their paychecks. Additionally, EZPW owns 32% of Cash Converters International (ASX: CCV) a publicly traded Australian pawn operation. On the day LWC opened for business, EZPW shares closed at $2.89. Together, this collection of businesses lost $1.59 per share in 2015, although $.50 of this loss was due to discontinued operations that the company wisely shut down. Additionally, the company was forced to delay the filing of their financial statements due to a past error attached to differences between Mexican GAAP and U.S. GAAP. As you can see, on the surface here we have a hated company in a hated industry that is losing gobs of money. Yucky. Way too yucky for most investors to take a deeper look, especially when most of Wall Street does nothing but fret about quarterly earnings. However, for those with a long term investing philosophy that are able to deconstruct the business, things look very different.

The financial statements show the following (in thousands):

Shares	54,838
Price Per Share	$2.89
Market Cap	$158,482
+ debt	357,131
- cash	38,938
Enterprise Value	$476,675

Now lets move past the black and white, and into the realm of common sense. First, consider the Cash Converters business, which had a public market value of about $60 million $USD to EZPW at the time of our investment. In theory this value should contribute $1.09 – or 38% of the share price - to EZPW's share price. Alternatively, the company could sell off this stake and provide that $1.09 of value to EZPW shareholders (a sale at current prices would not have tax implications). In the event of a sale, one could rightly argue that the $1.09 number is overstated because a discount might be necessary to move a block of stock this size, but one could also argue that Cash Converters itself is undervalued, so lets stick with $1.09 for simplicity sake.

Next, consider the Grupo Finmart business. On the surface, this should be a good business as the Mexican government in theory should garnish the wages of borrowers to make EZPW whole, but it hasn't worked out that way, and Grupo Finmart contributed a -$22.2 million segment level operating drag to EZPW in 2015. Importantly, of the $357 million in debt on EZPW's balance sheet, $159 million of it is attached to Grupo Finmart, and non-recourse to EZPW, meaning that EZPW could simply walk away from this business and remove a $159 million liability from their balance sheet.

So, if EZPW were to sell off Cash Converters and just walk away from Grupo Finmart, the company would now look like this:

Shares	54,838
Price Per Share	$2.89
Market Cap	$158,482
+ debt	357,131
- cash	38,938
Enterprise Value	$476,675
- Non-recourse debt	159,265
- Cash Converters	59,761

Adj Enterprise Value 1	$257,649

As you can see, by simply taking the common sense steps of shuttering a money losing business and seeking representative value for a liquid investment, the company looks quite a bit different.

Now lets consider the Mexican Pawn business, which was a slight drag on 2015 operations for EZPW. The company operates 237 stores in Mexico, and has struggled to get this business right. However, other companies – specifically First Cash Financial Services (FCFS) - have been succeeding in Mexico, and have been aggressively buying Mexican pawn shops. In August of 2014, FCFS bought 47 Mexican stores from Cash America (CSH) for $18.5 million, implying an average purchase price of approximately $400,000 per store, and a P/Net Revenue ratio of approximately 1.6x. In January of 2016, FCFS bought a portfolio of 166 Mexican stores, 32 Guatemalan stores, and 13 El Salvadorean stores for $52 million, for an average price of $250 thousand per store. This average was likely dragged down a bit by the non-Mexican stores, and by the low price of gold at the time of sale. In any case, based on these two recent sales, it is reasonable and conservative to expect that EZPW's stores could fetch in the neighborhood of $250 thousand per store, meaning the Mexican business would be worth somewhere in the neighborhood of $60 million (P/Net Revenue 1.2x) or $1.09 per share. Given that this is the low end of the range of the most recent comparable transactions, and that this low end was established when gold traded 20% lower than it does today, and that this low end represents a significant P/Net Revenue discount, significant upside is possible from this estimate.

If EZPW were to realize market value for Cash Converters, walk away from Grupo Finmart, and sell the struggling Mexican business, leaving just the U.S. Pawn business the company would look like this:

Shares	54,838
Price Per Share	$2.89
Market Cap	$158,482
+ debt	357,131
- cash	38,938
Enterprise Value	$476,675
- non-recourse debt	159,265
- Cash Converters	59,761
- Mexican Pawn	59,250
Adj Enterprise Value 2	$198,399
- recourse debt	197,866
+ cash	38,938
Adj Market Cap	$39,470
Per Share	$0.72

Now consider the U.S. Pawn business, which despite the fact that the company has been facing a mountain of problems, produced $80 million of segment level operating income in 2015. Peers frequently command high teens multiples of operating income, and U.S. Pawn pure-play Cash America (CSH) currently trades at an EV/EBIT of 21.9x. Yet in the above scenario where EZPW is essentially transformed into a U.S. pawn pure-play, the company would be trading at 2.5x segment level operating income. For patient investors, segment level EBIT is the relative metric given that it is what a strategic acquirer would be able to access since corporate level expenses could be almost completely wiped out in the event of a sale, and the industry is consolidating. CSH is a better run business with a shareholder focused management team, and EZPW is unlikely to see comparable multiples in public markets with their current dual share structure. However, at a very conservative 10x segment level operating income, EZPW would trade at $11.66, or nearly 300% higher than our effective purchase price. At 15x, EZPW would trade at almost $19, or more than 6x higher. If a potential buyer were financial rather than strategic and had to consider the weight of on-going corporate level expenses, a share price in the $9-10 range is not hard to imagine, which is less impressive than the price a strategic could pay, but it still represents a healthy upside of 200%.

All of this assumes a sale based on recent results, but the U.S. business is currently under-earning following a failed experiment to gear the business more toward retail (short version: a past CEO had aspirations of creating an EBAY like online marketplace for pawned goods, and allowed the business to drift away from their core competency of pawn lending). However, recent management changes have brought back former CEO Joe Rotunda – who ran the business from 2000 – 2010 and is widely regarded as an excellent operator – to run the U.S. Pawn business. During his first stint with the company, EZPW operated with store level margins that were better than its peer Cash America (CSH). Assuming sales stay steady and margins reach CSH levels, the U.S. business should be able to earn somewhere between $1 and $1.50 per share, meaning that if the above changes take place the stock would be trading below a P/E of 1x, while CSH currently trades at a P/E of almost 24x.

Said another way, after backing out the other pieces of the business, the market is currently saying that EZPW's 522 U.S. stores are worth about $200 million, or an average of $383,000 each. However, pawn shops regularly trade hands in the $500,000 - $1,000,000 per store range, with the wide difference being attributable to the disparity in store location, size and quality. Further, as recently as September 2015, EZPW paid $960k per store for 13 stores in Arizona and Oregon, and in February 2015, they paid $1.4M per store for 12 stores in Texas. Essentially the market is saying that EZPW is worth less than its back of the envelope liquidation value.

Interesting Theory but….

It is important to note that all of the above is theoretical, and reality is likely to look very different. Given our purchase price however, a sale of the company is not necessary for a successful investment. The future can look *very* different than the scenario laid out above, and we can *still* make a lot of money on our investment: the margin of safety is huge.

However, there are reasons to believe the above narrative may not be totally off the mark. In August of 2014, Stuart Grimshaw, formerly the CEO of one of Australia's largest banks, joined EZPW as Executive Chairman. In February of 2015, he became CEO. It seems odd that a superstar of Australian banking would leave his post in order to work in the North American pawn industry, but when one considers the stock option package he received upon joining, his motivations become clearer. Grimshaw is incentivized to focus on the share price of EZPW. Since joining, he has acted aggressively to shut down a number of underperforming business lines and simplify and streamline the business. Additionally, it has already been announced that the company is examining strategic options for Grupo Finmart, which suggests that EZPW may already be preparing to walk away from this business and erase the associated $160 million in non-recourse debt from its balance sheet.

Another reason to believe that EZPW will focus on the share price going forward is Philip Cohen, an Australian financier who owns 6% of the company's stock, yet controls all of the voting rights. Historically Cohen has abused this position by siphoning off shareholder cash to himself through a consulting agreement to the tune of $6 million per year. This behavior has rightly caused the investing community to be distrustful of Cohen. However, this agreement has recently been terminated, and it is unlikely to be re-instated. Without being able to freely siphon off this cash, Cohen's main avenue toward increasing his wealth is to focus on share price. Pulling any or all of the above mentioned levers would help clarify the underlying value of the U.S. business. Simply relinquishing his voting control would cause a re-rating of the stock as well. It is impossible to know if he has plans to eventually sell the business, but he is 68 years old, and is likely considering an exit strategy at some point. From our perspective, <u>what matters is that Mr. Grimshaw and Mr. Cohen could easily cause the price of EZPW to rocket by just acting in their own self interest</u>. We don't know when that will happen, but given the potential upside, even if it took until Mr. Cohen reached the ripe old age of 80 for the business to be stripped to its U.S. core and sold to a strategic buyer, the result would be an almost 17% per year return, assuming sales were made at the bottom end of the likely price range, and the business did not grow or improve between now and then.

However, the business *is* likely to grow and improve, meaning that if the above mentioned steps are taken in the future, $19 per share may be significantly less than what the business is ultimately worth. As we mentioned previously, Joe Rotunda is in the process of repairing the U.S. business and restoring margins. Further, it is worth examining the trends in the industry. Pawn is a business where there are benefits to scale through shared back office and pricing information, and this is becoming more true as the government increases regulation on the industry. There are approximately 13,000 pawn shops in the U.S., and approximately 90% of them are owned by independent operators. Simply stated, it is difficult, time consuming, and costly for these small mom and pop shops to keep up with government regulation, and as these small business people reach retirement age, it is often an easy decision to sell their store to EZPW or another big player. In fact, over the last 4 years EZPW's U.S. store count has increased from 433 to 522, and this was during a time when the company was not even focused on growth due to their other problems. While it is true that increased regulation may damage margins in the future, for a scale player like EZPW, the damage will likely be counter-balanced by increased volume as small players exit the industry. This is not just a theory – there is empirical evidence to support this hypothesis at the state level in Colorado, where EZPW actually benefitted from increased regulation a few years back. This means that there is room for growth in EZPW's future as the industry continues to consolidate.

While some fear that pawn will be legislated to death, I do not think this is a risk. Pawn is one of the world's oldest business models – it is very resilient, because there is always a subset of the population that needs access to alternative financing. For example, in the U.S., according to a 2013 FDIC survey, almost 8% of American households have no checking or savings accounts. 20% of Americans acknowledge that they are "under-banked," meaning they had a bank account, but also used some sort of alternative financial services such as pawn. Simply stated, while pawn may be an unsavory business, it is an essential part of life for many people. If pawn were legislated away, these consumers would be forced to turn to the world of black market loan sharks, which would be worse than the high interest rates that pawn lenders command.

Lastly, as we mentioned earlier in this letter, we look for investments that can benefit if things get worse. In the case of EZPW, this is a business that would likely see revenue go up if the U.S. were to once again plunge into recession. In fact, between 2007 and 2010, revenue at EZPW almost doubled, although it should be noted that the business looked different at the time. Additionally, pawn is levered to gold, meaning that inflationary scenarios are likely a positive as well. Given this dynamic, it is very difficult to see any lasting downside from our effective purchase price. However, in the spirit of full disclosure I should mention that I thought this stock was cheap enough to own in my personal accounts at prices significantly higher than the price the fund owns it at, proving that the market can do whatever it wants in the near term.

This is especially true in the case of a company like EZPW, which has a beta of almost 2, meaning that in recent months, the stock has moved twice as violently as the broader market. This is interpreted as "risk" by short-sighted investors (especially the ones that are robots), and in a world where the vast majority of investors are judged by quarterly or even monthly performance, it is difficult to buy a high beta company with 1 money losing business, 1 breakeven business, one underperforming business, an unsavory controlling shareholder, recent accounting problems, and regulatory uncertainty. If the wind blows the wrong way, the shares will go down in the short term, and impatient investors will say, "how could you own that dog?"

However, for long term common sense investors like us, it is hard to see risk when the business could be shut down and sold for scrap at prices higher than our purchase price. Given our patience, for us beta represents opportunity, not risk. It is completely possible – perhaps even likely – that EZPW will underperform the market in the near term, but to me, it is a simple decision to own a defensive business like EZCorp at a theoretical P/E of less than 1x rather than own the SP500 at a P/E above 20x. Although our shares did not meaningfully contribute to our Q1 performance, they have since appreciated more than 50%. In my view, they remain cheap.

Where Are We Now?

Years from now, when people look back on the first quarter of 2016 they will likely conclude that not much happened. After all, over this 3 month period, the market was essentially flat. However, for those foolish enough to have checked the market every day during this period, it was a wild ride. It seems likely that volatility will remain a theme in the coming months, and the market may once again touch its February lows. Or it may not. For long term patient investors, I suggest indifference.

Despite the "experts" that are all too willing to share their opinion on near term action, the truth is that none of them have a track record of successfully forecasting market moves. For this and other reasons, we have no plans to aggressively trim our positions to protect our YTD gains, despite the fact that we could just move to cash and call this year a great one. We were fortunate to have made our investments during a time of market upheaval when many companies were ridiculously cheap. Several of these investments have appreciated 30, 40 or 50% since that time, moving them firmly out of the ridiculously cheap arena, but in our view they remain significantly under-valued. For the most part, the recent gains have been largely a function of market emotion, and the common sense theses that drive our investments still have room to play out. It is very unlikely that our investments will ever move in a straight line from inception to conclusion; it is very likely that we will give back some gains before ultimately regaining them and cashing out. We are long term investors, so we are comfortable accepting this reality due to our belief that while this apathy may hurt our short term performance, aggressively managing positions would likely hurt our long term performance, which is the more important metric.

It is also worth noting that selling triggers tax payments, and after-tax compounding of wealth is what matters in the long run. Taxes are not necessarily a bad thing – after all, if you are paying them, then it means your investments are performing well. However, short term tax payments are especially painful as they are made at the level of ordinary income, rather than at reduced long term rates. Secondly, good investments are hard to find, and if we were to sell now just to avoid future volatility, it is possible – or perhaps likely - that I would be unable to time the market properly in order to repurchase our shares at lower prices in the future. Additionally, for many of our investments, I believe that value will ultimately be revealed by some sort of event – the closing of an under-performing division, a sale of the company, or a decision to once again focus on margins rather than volume. I have no idea when such an event may take place, but when it does, the stock price will move suddenly, and likely independently of whatever the broader indices are doing. At present, almost 25% of our portfolio is in the process of being purchased or undergoing a "strategic review," which indicates a sale of some sort is being considered. While nothing is certain, it is likely that this portion of the portfolio will be somewhat insulated from short term volatility as the market focuses on the potential sale. Lastly, as demonstrated above, I attempt to make investments in companies that will actually benefit in the long term from short term economic weakness or share price declines. This is a simple concept, but it is completely anathema to the way Wall Street typically thinks. For our portfolio, short term pain is likely to lead to long term gain as the intrinsic value of many of our investments continues to grow over time. I believe our patience will be rewarded over time.

Moving to the broader market, as explained previously, we primarily seek investments whose outcome will develop independent of the stock market when viewed from a multi-year lens. We have a long term investing horizon, and therefore believe whether the market is up or down day by day, week by week, or quarter by quarter is mostly irrelevant. However, it is worth mentioning that history has shown that in order to beat the market over the long term, you must be willing to underperform the market in the near term.[3] I feel it is my duty to mention that while our style has succeeded in the extremely short time that our doors have been open, and while I am confident that over the multiple decades I plan to operate this style it will be successful, it has been at odds with the trends that have dominated the market in recent quarters.

2015 was a year that saw investing legends including David Einhorn, Carl Icahn, Mohnish Pabrai and others suffer losses in the neighborhood of -20%. Like us, these investors who have crushed the market over many years believe that the key to generating market beating investment results over many years is focusing on the long term earnings power or asset value of a business, and then paying a price significantly below the value of this earnings power or asset value. However, unfortunately for them last year, and potentially for LWC going forward, of late the market has been more focused on the perceived safety of the crowd and "momentum investing" than the fundamental value of businesses. Many investors seem to have forgotten that great companies don't necessarily equate to great investments, and they have been happily paying expensive prices for "sexy" stocks such as NetFlix (NFLX), Facebook (FB) and Amazon (AMZN), seemingly for the simple reason that they have been going up lately. Make no mistake – these are excellent companies – but investors in these stocks seem to forget that the price you pay is immensely important, and when demand for "safety" in an uncertain world drives up the prices of "safe" investments, the result is risk in sheep's clothing. According to a recent Legg Mason study, this type of behavior has driven the performance differential between "value" investments and "growth" investments to the widest spread since the tech bubble burst as investors flock to "growth" stocks in a low growth world.

To me, boring is beautiful, and similar to the great investors mentioned previously, we are completely comfortable missing out on the trend of buying high flyers. If this trend continues in 2016, our relative performance will likely suffer in the near term. I sleep well knowing that over the longer term, the last few hundred years of stock market history have demonstrated that our style is well suited for success. Thank you for coming with me on this journey.

Sincerely,

Matt Sweeney, CFA

[3] According to a study done by Vanguard that covered the 15 year period from 1998 to 2013, nearly every active manager that outperformed the broad indices over this period underperformed their index in at least 33% of the years, and 66% experienced at least three consecutive years of underperformance during the 15 year period. This is not surprising as the key to outperformance is buying stocks that no one else seems to want. It is impossible to know when they will return to favor, and it is not uncommon for things to get worse before they get better.

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