GREFE CAPITAL MANAGEMENT
of
RAYMOND JAMES®

Investment Overview - December 2016

The largest contributors to performance in 2016 have come from the equity (Common Stock) portion of the portfolio. The gains have been broad based but some of the stronger performers have been the precious metals stocks. In our client letter in May of 2015 we stated that the gold mining stocks "remain our least successful investments to date, yet have the highest potential based on our estimates of fair value. They remain the proverbial beach ball held under water." After a longer wait than we expected the gold mining stocks have begun to demonstrate the potential previously discussed. The strongest contributors from this group included Agnico Eagle Mining and Pan American Silver.

We believe there is a strong possibility that gold and the gold mining stocks have transitioned out of their 4 year bear market and are now in the beginning stages of a new bull market. Plenty of opportunity remains and the runway for growth and corresponding price appreciation is strong. We have chosen to build/reposition this investment into a basket of companies. We have added diversification across business models, while maintaining a focus on companies that have strong financials, quality management, and have the potential to generate positive cash flow throughout the commodity price cycle.

Long term holding Agnico Eagle fits this profile and newer holding Barrick Gold exemplifies many of the characteristics we are looking for in the gold mining sector. The turnaround at Barrick began in 2012-2013 when Executive Chairman John Thornton was brought in to lead the business. Former Goldman Sachs Co-president John Thornton was credited with driving the growth in the international business at Goldman Sachs. John joined Barrick in 2012. Since his arrival, Barrick has reduced costs, improved operations, brought back a partnership/ ownership culture, and refocused the business on the core mines. In 2013, Barrick required a gold price of $1640 an ounce to generate free cash flow. Now, Barrick requires a gold price of only $1,040 an ounce to generate free cash flow and they continue to drive that lower[1]. Despite a meaningful decline in gold prices over the last few years Barrick has been able to reduce debt by $5 Billion and generate over $2 Billion in free cash flow. To illustrate the long runway previously referenced, Barrick's total market value remains approximately 60% below the peak reached in 2011-2012. Barrick is presently quite profitable and we believe it could be significantly more profitable in a higher gold price environment.

[1] The price of one ounce of gold in us dollars is approximately $1215 as of 11-17-2016

Capital Allocators Update

Here's a brief look at few of the larger investments in the portfolio:

Leucadia (LUK) – Leucadia continues to make investments into their business to grow long term shareholder value. In the last 2 years, they have deployed over $2 billion in capital into new and existing businesses. Recent investments have increased diversification, reduced cyclicality, and built a strong foundation for growth. Their two largest businesses; Investment Banking and beef processing -have been underperforming and under earning the last few years. We have recently seen a positive change in the prospects for these businesses and many of their other investments are demonstrating improved results and generating earnings. Improved cash generation will drive growth in book value. Once investors understand the earning power and capital allocation prowess of the current management team, we expect a revaluation towards book value. An improved economy or higher interest rates could also drive additional improvement. Tailwinds are building and we remain excited about the prospects of Leucadia.

Biglari Holdings (BH) - Biglari Holdings is a holding company with wholly owned operating businesses and publicly traded investments. It's primary investment and business operations remain concentrated in the restaurant industry -- primarily Steak N shake and Cracker Barrel. We expect future company investments to be opportunistic (and potentially outside of the restaurant industry) in order to increase company diversification and increase value. Since we purchased Biglari Holdings in 2014, the value of the business has continued to grow at a faster rate than the share price and the investment is progressing within our expectations.

Liberty Complex (John Malone) - We continue to like and find new investments with one key ingredient- Controlling shareholder, John Malone. From our initial investment in Liberty Media in 2014, John Malone and his team have been busy reshaping and reinventing the companies they control through spinoffs, tracking stocks and smart financial management. We have sold positions in the cable and holding company assets while maintaining the stake related to SiriusXM satellite radio. As we continue to study the web of Liberty related companies we have identified new opportunities. Businesses and industries are always going through change. The pace of that change feels quicker today than in the past. Wall street investors are quick to punish or ignore companies where the future feels "less certain." This led us to leading cable network Discovery Communications and asset light retailer QVC group. Fear of cable "cord cutting" and the changing retail landscape due to Amazon's growing presence has pressured the stock prices of both companies respectively. Both investments are controlled by John Malone, generate solid cash flow and trade at compelling valuations. We also started an initial position in recent spinoff Commerce Hub. Commerce Hub is a direct beneficiary of the growth in e-commerce and online retailing. It acts as a hub connecting retailers, distributors, and shippers to improve the e-commerce experience for all parties involved.

Asset Allocation as a Driver

Ultimately there are a few key items that will drive returns in your portfolio – asset allocation is one of those key drivers. Over the long run the proportion to common stock investments has historically increased total return. Individual security selection will also be a key driver. The last few years have reminded investors that in the short term, prices can seemingly go anywhere, but in the long run the prices paid and the results of the businesses we own will drive investment returns. We have chosen to modestly increase the number of securities we own and keep these positions smaller so that we may retain the flexibility to adjust them as prices and business results change. Today you have a portfolio of what we believe to be quality businesses at prices that are below average based on valuation metrics such as price/cash flow and price/book value. Many of these companies are run by management that have a long track record of strong returns and have a significant amount of personal wealth invested alongside shareholders.

Fixed Income

We continue to identify and invest in opportunities to drive current income in the portfolios. Despite absurdly low interest rates we believe fixed income has a place in balanced portfolio management. We have drawn down cash utilizing a blend of short and intermediate term corporate and municipal bonds. In addition to the core fixed income we have supplemented the portfolio with additional preferred securities (Longer term) and select closed end funds (higher income, additional diversification). This helps support the goal of increasing income and total return over time with a modest increase in risk. Since these positions carry additional risk beyond the core fixed income, we have kept these positions smaller. The bonds, preferred securities, and closed end funds also remain future sources of funds depending on changes in interest rates and in available opportunities in equities. In 2016, corporate bonds have outperformed municipals however both face the prospect of rising interest rates[2]. Ultimately returns in fixed income are trending downward. Due to an extended period of low interest rates, some of the return has been removed from the asset class and the risk has increased, due to the prospects of rising rates in the future. We do not know when interest rates will rise, how far or fast they may rise and what will be the cause. Rising interest rates could occur due to a change in Federal Reserve policy, an improvement in the economy, or an increase in inflation. Due to the current risk reward characteristics in fixed income, we have chosen to primarily invest in higher coupon short and intermediate maturities. Higher coupon securities offer better protection against increases in interest rates compared to low coupon bonds. The shorter maturities allow for reinvestment at higher interest rates (should they occur). This strategy also allows us the flexibility to adapt to changes in interest rates as they happen.

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[2] From 12-31-2015 to 11-25-2016 the Ishares Core U.S. Aggregate Bond (AGG) ETF is up +2.09% YTD. The Ishares National Muni Bond (MUB) ETF is down-.86% YTD. Source is Bloomberg Finance L.P. Comparative Returns

The Future

The future is unknowable and there will always be something new to concern investors. It seems today that we may have an even larger number of things to worry about. However, we believe that our philosophy and process will serve you well through market and economic cycles. The low overall price/value ratio of the common stock portfolio has positioned us very favorably and we presently have a desirable risk/reward profile with excellent growth potential. We welcome any feedback and we very much appreciate that you have entrusted us with your investment management and financial planning needs.

We hope you enjoyed this letter – Please have a safe and wonderful Holiday Season and look for our next letter in January 2017!

Respectfully,

Roger Grefe Brian Grefe Heidi Koster