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"The fundamental cause of trouble is that in the modern world the stupid are cocksure while the intelligent are full of doubt."
Bertrand Russell

January 6, 2016

Dear Clients:

Although U.S. stocks recovered in the fourth quarter, 2015 was an extremely frustrating year for most investors. The major stock market indices showed flattish performance for the year, but only because the very largest-capitalization stocks did well. In other words, the performance of the indices masked the fact the average stock struggled in 2015.

Because of this, "active" managers continued to underperform "passive" strategies, which simply attempt to mimic the performance of specific indices. We like to benchmark our performance versus two value investing stalwarts, the Weitz Value Fund (WVALX) and the Longleaf Partners Fund (LLPFX). Weitz was down 4.47% in 2015, while Longleaf plunged a whopping 18.80% for the year. Misery was widespread in 2015.

We believe strongly in "eating our own cooking "and are invested alongside you. We're tired of eating humble pie and are as frustrated as you about this ***short-term*** relative and absolute weakness. Our goal always is to generate outstanding ***long-term*** performance. We understand the long road to reaching that destination will be bumpy, but that doesn't make these periods any easier to take.

We're not Pollyannas, but take some solace stocks faced a number of strong headwinds in 2015 without suffering even greater damage. Commodity prices continued to plunge (particularly oil), decimating earnings and freezing capital spending in the sector. Strength in the U.S. dollar and China's softening economy and weakening currency also hurt U.S. manufacturers. Finally, the Federal Reserve finally raised its target for short-term interest rates.

We don't know if and when the pressures noted above will abate and neither does anybody else. We do know new challenges will arise in 2016. Plus, geopolitical risks are always front and center. We are mindful of the risks, both known and unknown. However, we can't control any of those things, so will focus our efforts on things we can control. We'll continue to evaluate stocks as if we're buying the entire business to own for 5-10 years. We'll look for companies with solid business prospects, sound financial structures and strong, shareholder-oriented management teams whose stocks are selling at a significant discount to our evaluation of intrinsic value.

It's critically important to maintain a disciplined investment approach, particularly in a headline-driven market, so we're tightening our seatbelts. We'll remain true to our value discipline and maintain a steely-eyed focus on our investment ***process***, tuning out the noise from short-term ***results***. In short, as long-term investors, we'll try to ***let volatility be our friend***. Similar to other episodes of intense volatility since the depths of the global financial crisis, instead of wringing our hands, we'll use this period of investor unease/panic to upgrade the quality of our portfolio.

Periods ending Decmeber 31, 2015
(Total Returns-Annualized*)

	Russell 3000 Index	**S&P 500 Index**
3-months	6.27%	7.04%
One-year*	0.48%	1.38%
Three-years*	14.74%	15.13%
Five-years*	12.18%	12.57%
Ten-Years*	7.35%	7.31%

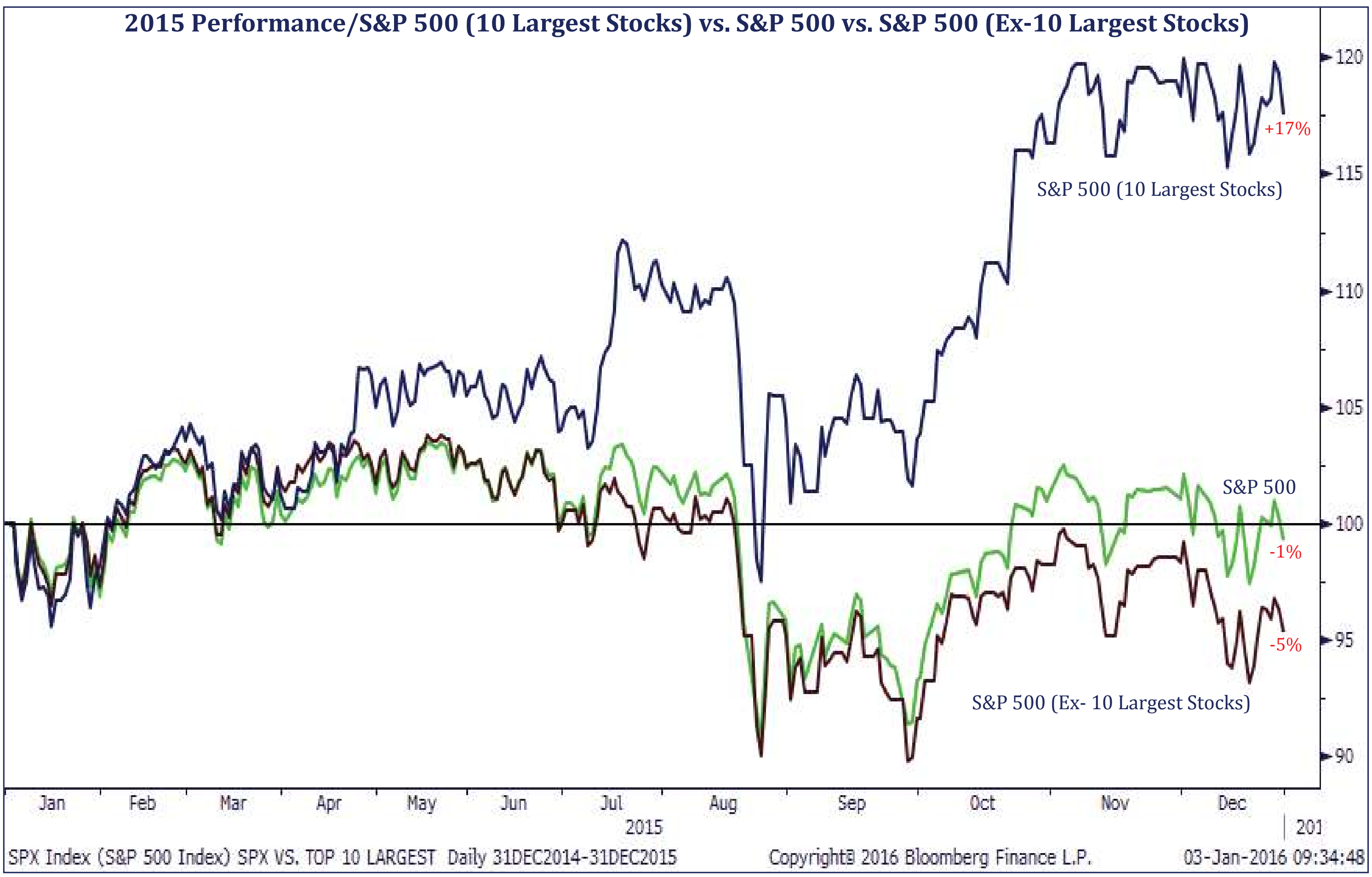
The Stock Market

We gather a lot of material for possible inclusion in our client letters. This time, one picture (and accompanying table) "paints a thousand words" of what happened in 2015.

As background, the Standard and Poor's 500 Index (S&P 500—SPX) is a *capitalization-weighted* index. Recall a stock's "market capitalization" or "market cap" is simply the stock price multiplied by the number of shares. So, if XYZ Corporation's stock is $50/share and there are 10 million shares outstanding, XYZ's market cap is $500 million. The S&P 500 contains 500 stocks, but the weighting of each stock in the index is determined by its market cap. This is why the S&P 500 (like most other indices) is *capitalization-weighted*.

The S&P 500 itself actually ***lost 15 points*** in 2015 (adding dividends led to a slight positive total return). According to our friends at Strategas Research Partners, the 10 largest market capitalization stocks (i.e. ***2% of the 500 stocks***) have a ***combined S&P 500 weighting of 18.8%***. As a group, those 10 stocks did very well in 2015 and accounted for 30.6 index points, or 304.8% of the S&P 500's points for the year.

The performance disparity between those 10 largest market capitalization stocks and the other 490 stocks in the S&P 500 can be seen in the graph below. The 10 largest stocks were up 17% in 2015. The S&P 500 was down 1% (price only). The S&P 500 without those 10 largest market capitalization stocks was down 5%. The upshot is if you did not own a significant amount of those 10 stocks, you sailed into a very stiff performance headwind in 2015.



The table below from Strategas shows A) how the 10 largest market capitalization dominated S&P 500 performance in 2015 and B) how different this was from 2013 and 2014.

Point Contribution of 10 Largest Market Capitalization S&P 500 Stocks

2015	Points	2014	Points	2013	Points
Apple	-3.1	Apple	20.7	Apple	2.7
Google	8.1	Exxon Mobil	-4.2	Exxon Mobil	7.3
Microsoft	8.2	Microsoft	7.5	Google	12.6
Berkshire-Hathaway	-3.7	Berkshire-Hathaway	6.4	Microsoft	9.1
Exxon Mobil	-6.9	Google	-0.8	Berkshire-Hathaway	5.9
Amazon	15.8	Johnson & Johnson	4.1	General Electric	8.1
Facebook	6.5	Wells Fargo	5.0	Johnson & Johnson	6.7
General Electric	6.7	Wal*Mart	1.3	Wal*Mart	1.9
Johnson & Johnson	-0.6	General Electric	-3.1	Chevron	3.7
Wells Fargo	-0.2	Proctor & Gamble	2.9	Wells Fargo	6.1
10 Largest - Total	30.6		39.9		64.2
S&P 500 Point Gain	-15.0		210.5		422.2
10 Largest - % of Total	304.8%		19.0%		15.2%

Interest Rates and the Bond Market

The yield on the 10-Year U.S. Treasury bond finished 2015 at 2.28%, up 11 basis points (0.11%) from where it started the year. Corporate credit spreads widened on fears of A) economic weakness leading to higher defaults and B) lack of market liquidity leading to train wrecks like that experienced by shareholders in the Third Avenue Focused Credit mutual fund. Though high-yield spreads have widened materially, we do not intend to increase our exposure to that sector, given the higher risk that would entail.

Now that the Fed has finally raised its target for short-term interest rates, we expect investors to remain on tenterhooks regarding the path for future rate increases. Again, this is one of those things we can't control, so will focus on finding bonds with solid financial characteristics that offer relatively attractive yields.

Summary

We're not happy with our absolute and relative performance in 2015, but have been here many times before. We'll work hard to make-up lost ground. We're invested alongside you and you can rest assured we'll continue to manage your precious assets with the same care as we invest our own.

Regards,

Kirr, Marbach & Company, LLC