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Southeast Asset Advisors, Inc.
Lanigan Wealth Management
Investment Management & Consulting

TO: Clients and Friends
FROM: SEA/Lanigan Wealth Management Team
RE: Newsletter – Commentary
DATE: July 2015

"Volatility creates opportunity for the long-term investor who has an advisor that "knows valuation" and understands his clients temperament or emotional stability and ensures the client has proper cash for any short-term needs."

- ***B. Lanigan***

"We must understand our clients' ability (cash flow needs) and willingness (temperament) to accept volatility when establishing asset allocation. If we do, the client will be able to stay with a long-term plan in times of volatility. Turning temporary market declines into opportunities instead of permanent losses of capital."

- ***M. Saussy***

"Volatility is not risk for the long-term investor who has valuation as their "North Star" and the proper temperament."

- ***B. Jackson***

Second Quarter 2015 Market Recap

- U.S. stock indices were slightly positive for the quarter, and year to date the S&P is up 1.2% through June 30, 2015.
    - Volatility is extreme (as we predicted)
    - Energy Sector is down 5% year to date
    - Commodities are in a free fall due to slowing China demand
    - Utilities (a yield stock) are down almost 6%

- A tough quarter / year for many great managers due largely to holdings in energy and very narrow market leadership, i.e., bio tech and social media (more on this below.)

- Core bonds declined 1.8% in the quarter as the yield on the 10 year T-bills increased 40 basis points. We continue to keep bond exposure at very short duration and are holding more cash (as opposed to bonds,) as we believe bonds will produce at best no return and probably lose value over the foreseeable future.

Many managers have underperformed year to date. The reasons vary by manager; however, energy holdings were a common theme among many value managers. Valuations in the energy sector have been adjusted downward, but in general, the asset quality and the leadership teams at many of these companies give us confidence that the future returns from these holdings will be meaningful in the long-term. However, it may indeed take longer for this thesis to work out.

Another contributing factor in many value managers' underperformance vs. the index is the very thin market leadership. A recent WSJ headline read: ***The Only Six Stocks that Matter***. According to the article, **Amazon, Google, Apple, Facebook, Gilead** and **Walt Disney** account for more than all of the $199 billion market cap gains in the S&P 500 this year to date. In the NASDAQ, falling stocks outnumber rising stocks this year. Additionally, the Value Line Index (an equal weighted index), which is down slightly at -0.3% year to date illustrates that the average stock has not moved much this year at all. Concentrated gains such as these often presage a pullback in the indexes (which we are seeing now). For investment managers that are "closet index funds," owning these stocks is crucial to keep up with the markets.

As you know, we always try to avoid "closet index funds," and in this type of market, we underweight true (low cost) index funds and prefer to invest with active managers who have a bottom up valuation philosophy and focus on finding individual companies that have sustainable competitive advantages, are managed by capable, honest people, and are purchased at good prices (i.e., a discount to value). Management teams who are great capital allocators are so important in increasing value per share (see book "The Outsiders" by W. Thorndike).

Berkshire Hathaway – Long time core position

Berkshire Hathaway (BRK) has been one of our favorite holdings for many, many years. In fact, we call it our "enhanced index" because it is so big and diversified, but at the same time concentrated. Warren and Charlie have taught us so much through the years, sharing their wisdom in the annual shareholder letter, at the annual meeting, in talks, books, and interviews. They helped us understand that "value and growth investing are joined at the hip," and that growing business priced at 80% of value is worth more than a non-growing one priced at 60% of value (and has less risk).

This market has not recognized the value created at Berkshire as the price has declined 9.4% through the first six months of the year; but the value has increased in our opinion. We have attached a recent Barron's article for your review. The article points out that the $16 billion in value created over the last two years in the Heinz/Kraft deal ($16 billion) is not, in our view, recognized in the current market value. In addition, BRK has a widely diversified profit base (everything from reinsurance to regulated utilities) that is growing faster than the market. While many worry about who will lead BRK after Warren Buffet (85), we believe he has built a culture that will continue. Finally, BRK offers us a very attractive risk / reward trade off with the combination of a current margin of safety as well as an implied "floor" value at which BRK will buy the stock back.

- Downside is limited. It is trading at 1.5x March 31, 2015 book value. WB has said they will buy back shares at 1.2x book and have $58 billion (and growing) cash on the balance sheet. Theoretically, they could buy back 10% of the shares.

Berkshire continues to be a core position in most of our portfolios. We believe, as Warren said about BRK, "Berkshire has the lowest chance for permanent capital loss for patient long-term shareholders that can be found among any single company investments."

Markets, Valuations and Investment Musings

- Our opening quotes really are instructive about the "temperament," "emotions," and "volatility." Today we believe markets overall are generally fairly valued if the current low interest rates continue.
    - However, we see some bubbles in "biotech and social media" as well as certain yield investments.
    - And remember that all generalizations are flawed, and bottom up valuation and qualitative work is key in this environment.

- International markets appear to offer some better values for the bottom up managers as compared to the US.
    - However, they demand a better price to value due to the increased risk: political and economic.
    - Within the International markets, our value managers are finding security specific opportunities to invest capital.

- Today's ultra-low interest rates have brought the prospective returns on cash, money market, and high grade bonds to virtually zero. Long-term (and even intermediate term) bonds are to be avoided.

- Money has been flooding to riskier assets (yield seekers) in search of higher returns, running up prices.
    - Higher prices mean lower future returns. "What is smart early is dumb late!"

- Greece fears are a nonissue due to its size, but are illustrative of what can happen with unfunded legacy costs and deficit spending.

- Interest rates are almost certain to rise. While we are a very long way from damaging interest rate levels, investor emotional reactions to the rise may cause increased volatility.

- **The key question**: Will earnings growth and wise capital allocation by great operators/managers offset the rate increase to allow individual companies to grow their per share value?
    - As discussed, "people" part (i.e., Management) is always critically important, but it is even more important when the "p to v" is higher.

Charlie Munger (Buffet's partner) said it best: *"It's not supposed to be easy. Anyone who finds it easy is stupid."*

Closing

We think that Howard Marks at Oaktree Capital explained the situation well when he recently wrote:

"Economic and company fundamentals in the U.S. are fine today, and asset prices – while full – don't seem to be at bubble levels (other than some sub sectors). When undemanding capital markets and a low level of risk aversion combine to encourage investors to engage in risky practices, something usually goes wrong eventually. Although I have no idea what could make the day of reckoning come sooner rather than later, I don't think it's too early to take today's care free markets into consideration. What I do know is that those conditions are creating a degree of risk for which there is no (or little) commensurate risk premium. We have to behave accordingly."

As discussed in this and prior letters, we expect continued volatility and possibly even a 10 – 20% drop (the market has not had a 10% correction in over 3 years, which is unusual). Looking longer (5-7 years), we believe our managers and individual stock holdings are reasonably priced to provide decent returns over the medium term as compared to cash or fixed income. We believe investors must continue to hold equity allocations at their target and higher than normal cash balances. We recommend avoiding bonds, with the exception of extremely short duration bonds (or municipals,) which provide minimal returns but can be deployed depending on individual client allocation and temperament for volatility.

It's important for investors and their advisors to reassess goals, cash needs, and temperament that impact asset allocation decisions on a regular basis. If we (and our clients) have the proper temperament, adequate cash reserves for spending, long-term discipline, and valuation as our "North Star," we should prevent permanent loss of capital. We are ultimately only as good as our clients – staying focused in the long-term.

As always, thank you for your confidence and trust. We are working hard on your behalf. Please contact any of our team at any time if you desire to schedule a personal conference to discuss your individual allocations and any changes in your goals, cash flow needs, or other personal aspects that impact your investment plan.

Enjoy the balance of your summer.

Your Investment Team,

Bernie	Brad	Mark
Bernard Lanigan, CPA Chairman & CEO	Brad Jackson, CPA, CFA President	Mark Saussy, CPA, CFP, CIMA Executive V.P. & COO

P.S. Someone left us with a great daily game plan they called "5-3-1 plan" - 5 minutes of meditation a day, 3 positive thoughts, and do at least 1 good deed daily.

Attachments: Barron's July 25, 2015 Berkshire Hathaway's Bright Future

BARRON'S COVER

Berkshire Hathaway's Bright Future

Warren Buffett has positioned Berkshire Hathaway to prosper long after he steps down as CEO.

By ANDREW BARY
July 25, 2015 2:52 a.m. ET

Warren Buffett is coming off one of the biggest investment coups of his long career with the closing of the Kraft Foods' purchase of Heinz Holdings earlier this month.

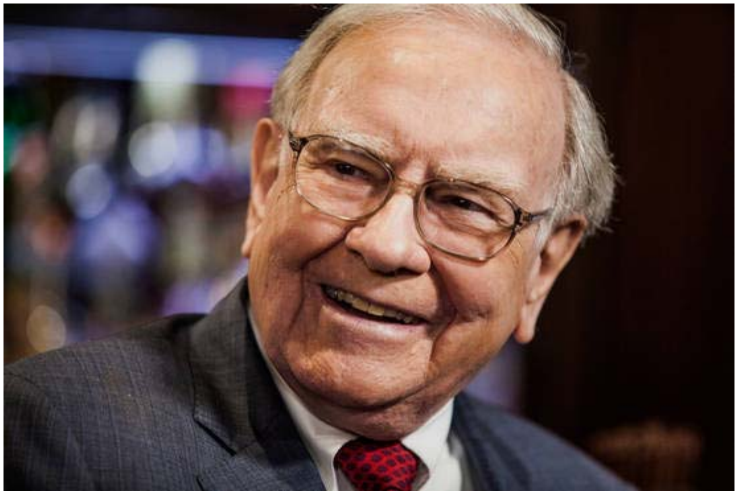


Photo: Chris Goodney/Bloomberg News

Buffett's Berkshire Hathaway invested $4.25 billion for a 50% equity stake in the $23 billion leveraged buyout of Heinz two years ago, along with a partner, Brazil's 3G Capital. Berkshire made a second $5 billion equity investment with 3G when Kraft unveiled its deal for the ketchup maker in March. Berkshire (ticker: BRKA) now is sitting on a 25% stake in the new Kraft Heinz (KHC) -- some 326 million shares -- worth $25 billion based on Kraft's recent share price of $77, resulting in a gain of almost $16 billion. That's a stunning profit in just two years. (3G has a similar gain.)

The Heinz score rivals anything ever achieved in the private-equity industry. It also demonstrates that Buffett, who is celebrating his 50th year at the helm of Berkshire this year, is still going strong ahead of his 85th birthday in August. Berkshire is his baby, and the company is better than ever despite the lackluster performance of its big equity portfolio, which is dominated by four stocks: American Express (AXP), Coca-Cola (KO), International Business Machines (IBM), and Wells Fargo (WFC).

Wall Street isn't giving Berkshire much credit for the Heinz killing and for its many attributes, notably a torrent of earnings from a widely diversified set of businesses led by insurance, railroads, utilities, and manufacturing. Operating earnings may total $19 billion after taxes this year, up 18% from 2014 and more than double the 2006 total.

Berkshire's Class A shares are down 6% this year, at $213,000, trailing the Standard & Poor's 500 index, which has gained 1%. The company's Class B shares, equal to 1/1,500 of the A, have fallen a similar amount, to $142. The stock looks attractive, trading for less than 1.5 times its March 31 book value of $146,963 a share.

"I'm scratching my head about Berkshire," says Jay Gelb, a Barclays analyst. "The earnings power is stronger than ever, the company has done a series of attractive acquisitions, and it just closed on Kraft. None of that is reflected in Berkshire's valuation." Gelb carries an Overweight rating and a price target of $259,500, 22% above current levels.

Downside appears limited, given the company's rising book value and its willingness to aggressively repurchase stock at 1.2 times book value, backed by a formidable balance sheet with $58 billion in cash, or $44 billion of net cash after subtracting $14 billion of debt. The net cash position is equal to more than 10% of the company's market value of $350 billion.

Barron's has written frequently about Buffett and Berkshire over the years, including a bullish 2012 piece when the shares fetched $128,000, or 1.1 times book value ("Buffett's Latest Bargain: Berkshire Hathaway," Nov. 12, 2012). Buffett declined to comment for this article.

BUFFETT CONTINUES to hunt for what he calls elephant-sized acquisitions that could total $35 billion or more, although he hasn't done any big deals besides Heinz in the past few years. The company wants to keep a cash cushion of at least $20 billion. Book value, which is steadily rising each quarter, may get a one-time boost from the Kraft deal of $6,000 a share, by our calculation. By the end of next year, book value could hit $175,000.

Whether the Kraft gain is reflected in book value depends on the accounting treatment, according to New York tax expert Robert Willens. Berkshire hasn't yet disclosed the tax treatment.

Berkshire historically has been valued based on book value, although Buffett focuses on what he calls intrinsic value. The challenge is that Buffett doesn't reveal his estimate of Berkshire's intrinsic value, telling investors that book value is a "crude but useful tracking device for the number that really counts, intrinsic business value." Buffett has stated that intrinsic value "far exceeds" book value because the current value of key businesses, including Burlington Northern and auto insurer Geico, is much higher than book, or carrying, value on Berkshire's balance sheet.

Buffett even offered investors guidance on purchasing Berkshire in his 2014 annual shareholder letter released in late February. He cautioned investors not to pay an "unusually high" price of nearly two times book value. Any purchase "modestly above the level at which the company would repurchase its shares, however, should produce gains within a reasonable period of time." That price is 1.2 times book, or an estimated $180,000 currently.

The last time Berkshire traded at more than twice book was in the late 1990s, and that turned out to be a bad time to invest. A purchaser in late 1998 at $70,000 a share would have seen the stock trade at the same price more than a decade later in 2009.

"Berkshire is cheap, and the risk-reward is favorable," says David Rolfe, chief investment officer at Wedgewood Partners, a Ladue, Mo., firm that counts Berkshire among its largest holdings. "Buffett is giving you a road map on valuation, and we're closer to 1.2 times book than two times."

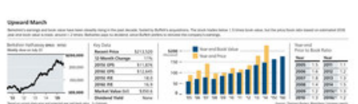
IN HIS ANNUAL SHAREHOLDER LETTER, Buffett endorsed Berkshire shares in what was probably his most expansive discussion ever about the company and what he views as its unmatched strengths. He prefaced his comments by offering shareholders the same advice he would tell his "family, if they asked me about Berkshire's future. First and definitely foremost, I believe that the chance of permanent capital loss for patient Berkshire shareholders is as low as can be found among single-company investments. That's because per-share intrinsic business value is almost certain to advance over time."

Gelb sees Berkshire's after-tax operating earnings rising to $11,924 a share in 2015 from $10,071 in 2014, an increase of 18%, and increasing another 7% next year to $12,757 a share. Burlington Northern's profits are up despite pressure on its crude-oil-by-rail business. The company is addressing service problems that plagued its network last year. Its margins are below those of its chief railroad rival, Union Pacific (UNP).

BERKSHIRE IS VALUED at 18 times projected 2015 earnings, in line with the S&P 500. But profits are growing faster than the overall market. The price/earnings ratio doesn't capture the value of Berkshire's $113 billion equity portfolio. The earnings reflect only the dividends it receives. Berkshire is also sitting on a lot of cash that is earning almost nothing. A large, cash-financed acquisition would likely boost earnings.

Why doesn't Berkshire trade higher? There are a couple of reasons. The first is Buffett's age. Even given his good health, it would be impressive if he were able to still run the company at 90. It's very rare to see a 90-year-old, which is what he would be in 2020, heading a large public company.

Buffett is irreplaceable. His combination of investment and management skills is extraordinary. He's comfortable assessing and buying a raft of asset classes, including stocks, bonds, and commodities. He also has engendered the loyalty and trust of longtime investors and of his stable of corporate managers of Berkshire subsidiaries.



Some of the investment opportunities that Berkshire has received in the past may not be available to his successor -- including the willingness of private companies to sell to Berkshire and the desire of public companies to get the Buffett imprimatur and vote-of-confidence from a Berkshire investment. Without Buffett, it's doubtful whether General Electric (GE) or Goldman Sachs (GS) would have sought investments from Berkshire during the financial crisis.

And many investors fear that the company simply is too large to generate high future returns. It will take bigger and bigger deals to move the needle at Berkshire, so the argument goes, and Berkshire is handicapped in buying companies because it won't participate in auctions. With Buffett, it's often a take-it-or-leave-it offer.

Another concern is that Berkshire, with its 80-plus subsidiaries, becomes difficult to manage after Buffett.

Berkshire's longtime vice chairman Charlie Munger addressed this in a companion shareholder letter in the annual report. He wrote that the "combined momentum and opportunity now present is so great that Berkshire would almost surely remain a better-than-normal company for a very long time even if 1) Buffett left tomorrow, 2) his successors were persons of only moderate ability, and 3) Berkshire never again purchased a large business."

"There will be big challenges," says Nomura analyst Cliff Gallant. "Buffett is the biggest CEO out there. But Berkshire is about value creation and he has positioned the company in stable businesses with competitive advantages for the foreseeable future."

Berkshire's unique conglomerate model, in which profits are recycled into new acquisitions, amounts to a virtuous circle. The company has evolved into something far greater than Buffett's investment vehicle.

"Value creation is more about the success of the operating units than Berkshire's investments," says Gallant. The equity portfolio amounts to a third of Berkshire's market value of $350 billion, which ranks it fourth in the U.S stock market, behind only Apple (AAPL), Google (GOOGL), and Microsoft (MSFT).

It's a good thing that Buffett has focused on purchasing entire companies rather than equities in the past decade, because his stock-picking skills have eroded. His portfolio is filled with winning stocks of a decade or two ago that are no longer so dominant. He has missed the boom in tech and health-care stocks in recent years.

OF BERKSHIRE'S FOUR LARGEST HOLDINGS -- American Express, Coca-Cola, IBM, and Wells Fargo -- only Wells Fargo has beaten the S&P 500 over the past three and five years (see table). IBM, a $13 billion holding, is worth less than Berkshire paid for it, mostly in 2011, and has lagged behind the market by 60 percentage points over that span. Coke is still below its 1998 peak. Berkshire liquidated a longstanding holding in Tesco (TSCO.UK), the British supermarket chain, at a loss last year. One reason Buffett may have stuck with some of these longstanding holdings is an aversion to paying capital-gains taxes.

Stuck in the '90s?

Berkshire's stock portfolio is loaded with yesterday's winners. Its only major holding that has beaten the S&P 500 in the past three and five years is Wells Fargo. Buffett missed the tech and health-care boom.

Key Equity Holdings				Total Return*		
Company / Ticker	Recent Price	Recent Value (bil)	YTD Return	1-Year	3-Year	5-Year
American Express / AXP	$78.58	$11.9	-14.7%	-14.3%	13.4%	15.3%
Coca-Cola / KO	41.21	16.5	-0.8	0.2	5.3	12.0
Int'l Business Machines / IBM	163.73	13.0	3.5	-11.8	-3.1	–**
Wells Fargo / WFC	58.00	27.3	7.2	16.7	23.0	20.1
Others				**Total Return***		
Company / Ticker	Recent Price	Recent Value (bil)	YTD Return	1-Year	3-Year	5-Year
Procter & Gamble / PG***	$81.63	$4.3	-9.0	4.0	11.1	9.2
U.S. Bancorp / USB	45.77	3.8	3.0	11.1	13.4	17.1
Wal-Mart Stores / WMT	73.02	4.4	-13.9	-2.5	2.8	10.4
S&P 500			4.1%	9.6%	18.3%	17.1%

*Three- and five-year returns annualized. **Berkshire bought IBM in 2011. ***Berkshire has swapped most of its PG stake for the Duracell battery business. E=Estimate

Sources: Company reports; Bloomberg

Berkshire has done better with a series of acquisitions, notably the Burlington Northern railroad, which is probably worth $70 billion, or twice what Berkshire paid for it in 2009.

In his annual letter, Buffett noted that the company's "Powerhouse Five" noninsurance businesses -- Burlington Northern, Berkshire Hathaway Energy (the company's large utility operation), Lubrizol (chemicals), IMC (machine tools), and Marmon (manufacturing) -- had a record $12.4 billion of pretax profits last year and could add $1 billion to those earnings in 2015.

Only one of them, the utility business, was owned by Berkshire a decade ago, and three of the other four were purchased entirely for cash; the fourth, Burlington, was largely bought for cash.

THE NET RESULT over the past 10 years has been a $12 billion increase in profits from those businesses but just a 6% rise in Berkshire's share count. "That satisfies our goal of not simply increasing earnings, but making sure that we also increase per-share results," Buffett crowed.

Buffett is obsessed with per-share profits and expanding the per-share value of the company -- an approach that all CEOs should emulate. To avoid dilution, Berkshire usually avoids the issuance of stock for acquisitions. Since he took control of a then-struggling textile maker in 1965, Berkshire's share count has risen just 60%, a tiny increase given the company's growth since then.

Then there are Berkshire's formidable insurance operations, led by Geico, reinsurer Gen Re, and specialty reinsurance operations. Fast-growing Geico, now the No. 2 auto insurer behind State Farm, could be the best-run insurer of any kind in the country. The specialty-reinsurance operation, which has long provided protection against catastrophes such as earthquakes and hurricanes, has made billions of dollars for Berkshire over the past three decades under the brilliant direction of Ajit Jain. As Buffett has written to shareholders planning to attend the annual meeting in Omaha: "If you meet Ajit, bow deeply."

"In effect, the world is Berkshire's oyster," Buffett wrote, noting that it "is perfectly positioned to allocate capital rationally and at minimal cost." Jain's catastrophe-reinsurance operation, for instance, is doing less business now because alternative sources of coverage, notably catastrophe bonds, are undercutting traditional reinsurance. Berkshire is putting its money elsewhere. The company is investing heavily in both Burlington Northern ($6 billion of capital expenditures this year) and utilities ($6 billion).

Buffett remains Berkshire's largest holder with a 19% stake worth $65 billion, even after giving away billions of dollars of stock to the Bill & Melinda Gates Foundation and other foundations.

When Buffett made his initial donation to the Gates Foundation in 2006, he called Berkshire "an ideal" investment for a foundation. Yet it doesn't appear that any major foundation or college endowment has heeded that advice. Berkshire has bested the S&P 500 since 2006, returning 10% annually, versus 8% for the index. Endowment and foundation chiefs would rather put money in high-fee investments like private equity than invest with Berkshire, whose overhead costs are trivial. Buffett still takes a salary of just $100,000 a year.

THE POST-BUFFETT LEADERSHIP structure is taking shape. Two investment managers, Ted Weschler and Todd Combs, who now oversee about $14 billion of the Berkshire equity portfolio, probably will take full control of investments. Buffett's son Howard will become nonexecutive chairman and an as-yet-unnamed Berkshire manager will become CEO.

Speculation has centered on two executives, Greg Abel, the head of Berkshire Hathaway Energy, which owns a group of electric utilities and two natural gas pipelines, and Jain. Munger even singled out the pair in the annual letter.

Our bet is that Abel gets the nod. There are several reasons, including age -- he's 53 and Jain is 64 -- and experience. He's headed a conglomerate and is comfortable in the public eye, while Jain has a relatively small staff and he's shunned the spotlight. Abel was just appointed to the Kraft board, in what may be a move by Buffett to give him experience outside the utility business and further groom him for the CEO job.

Berkshire can't possibly replicate its 20%-plus annualized performance of the past 50 years, but the next half-century should still be impressive. With its ample earnings power and strong balance sheet, it's likely to remain an above-average company capable of high single-digit annual shareholder returns for the foreseeable future. With or without Buffett, Berkshire probably deserves a place in investors' portfolios.

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