The Margin of Safety Quarterly

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member of
the LANIGAN GROUP of companies

Southeast Asset Advisors, Inc.
Lanigan Wealth Management
Investment Management & Consulting
Thomasville – Atlanta – Tallahassee – Mobile

Our Long-term Goal:
**WE STRIVE TO PROTECT AND GROW
OUR CLIENTS' CAPITAL OVER THE LONG TERM BY:**

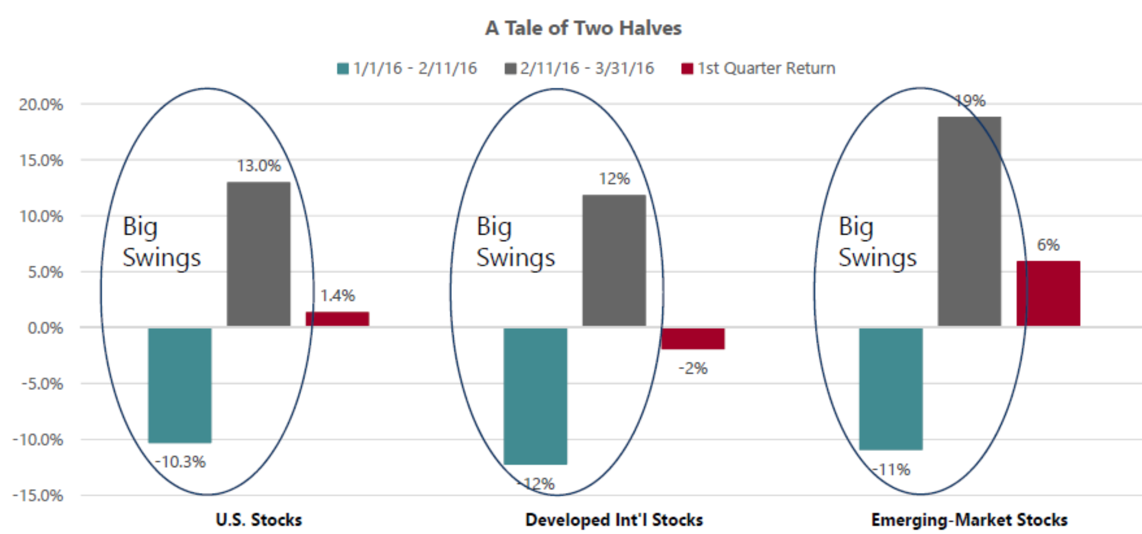
(1) Focusing on individual client goals and objectives
(2) Having the proper asset allocation to reflect each client's tolerance for volatility
(3) Stress testing short-term liquidity needs
(4) Investing with a value orientation and utilizing managers who understand the intrinsic value of a business and margin of safety
(5) Keeping a long-term focus and profiting from the manic swings of Mr. Market by using volatility to our advantage

2016 Q1 Comments

"Temperament, independent thinking, emotional stability, and a keen understanding of both human and institutional behavior are vital to long-term investment success."

In the first quarter 2016, the Market ended up ~1.4%. However, the real story was the emotional swings between highs and lows (Exhibit A below), the current swings that illustrate the potential for manic behavior from "Mr. Market" over the short term caused by reactions of undisciplined investors to the latest "news" or event.

Exhibit A



- Extreme volatility to end up slightly!
- The major global stock markets got off to a rocky start for 2016, falling 10% or more through the lows of February.
- In mid-February, global stock markets reversed quickly and rallied sharply into quarter end. The rally was led by a strong turnaround in emerging-markets stocks.

Source: Morningstar Direct. Using price and U.S. dollar returns.

VOLATILITY MUSINGS

We think volatility is the friend of the investor who understands value and has a long-term investment horizon. Stock prices move up and down in the short term based on speculators' emotions, not on the fundamental value of the underlying businesses. Time arbitrage and valuation are keys to investment success. As Ben Graham said many years ago, "In the short run, the market is a voting machine but in the long run it is a weighing machine." We would be surprised if increased volatility did not continue in this environment of economic and political uncertainty and the 24 hour news cycle reporting of same.

MARKET ENVIRONMENT (MACRO…)

Interest rates remain at historic lows, with negative rates in many developed countries around the world. The US Fed's role as "Fairy Godmother" to the stock markets (in keeping interest rates low) will eventually come to an end. This quarter the Fed noted uncertainty about global economic growth and inflation as reasons to reduce guidance on 2016 rate increases from four to two increases over the remainder of the year. Fears of U.S. recession in the short term appear to have eased, although economic growth around the world is anemic. In the U.S., job growth has shown some improvement and this has translated to lower unemployment rates. Consumer sentiment, however, has lagged expectations. The expected benefit of low gasoline prices for the consumer has not shown up fully in consumer spending or sentiment. Perhaps the windfall has gone to fund increased health care cost or to paying down debt.

The markets have been following and taking their clues from oil prices. During the quarter, the WSJ reported that the Brent oil to S&P index price movements correlated some 97%, the highest since 1990.

We continue to worry that when rates are eventually increased, there may be a negative reaction if the economy does not show signs of increased growth rates. In summary, we believe that the economy and the markets are currently very fragile.

MARKET VALUATIONS

We believe the markets (defined as the index of all companies) are probably fair to slightly over priced given the current interest rate level. However, with the belief that rates will rise, most stocks are not anywhere near bargain territory. We see little market return from multiple (PE) expansion. Any market returns will be based on earnings growth (which does not appear to be strong overall) and from good capital allocation decisions by management.

"Earnings growth" has many headwinds, not the least of which is the starting point of high profit margins, by historic standards. Eventually, the high probability of regression to the "long-term mean of profit margins" will require top line growth to offset lower margins. However, with most companies investing little capital in the expansion area and an overall low growth world, top line sales growth is likely to stay subpar for the index of companies.

Our conclusion is that from this point in the market, index returns will be low (but better than fixed income) and individual stock picking could be rewarding. Thus, we currently favor active management over passive index investing. We know how hard it is to beat the market index in the long term, and in recent years, only a few managers have actually outperformed the appropriate passive index. However, within the overall market, there are some companies that appear to be attractively valued and we believe this is the environment that a great manager can indeed outperform a passive index and achieve better risk adjusted returns. We are not abandoning index/passive investments, which are difficult to beat over the long term, but we believe in this environment, overweighting active, value managers can add performance to a portfolio. We also expect a low return world in general will be the "new normal" in all asset classes. To get the returns many need will require spotting great companies at bargain prices, embracing volatility, and having a long-term perspective.

ENERGY SECTOR THOUGHTS

We believe the energy sector will continue to have big swings, as both supply and demand are balanced over time. Energy companies continue to make reductions in capital spending (E&P, etc.) to protect their balance sheets and cash flow. Our research suggests that most production is unprofitable at today's oil and gas prices. Furthermore, our initial work concludes that many energy companies have so much leverage they cannot survive at present oil/NG prices and are not great values at even somewhat higher oil/NG prices. Most stocks in the energy space have suffered greatly over the last year (down +/- 50%) until this past quarter.

The energy sector has been in our "too hard" stack up to this point. However, we have begun detailed "bottom up" work in the energy area. We believe energy will be a growth area because in the long term, demand will continue to grow and much of our economy depends on having an adequate long-term, affordable supply of energy. We will provide more on our "drill down" on the energy sector in future letters.

OFF TO OMAHA

Many of the SEA team leaves for Omaha this week to attend the Berkshire Hathaway annual shareholders meeting. We look forward to not only 6 hours of Warren and Charlie, but also the many sessions we have with like-minded managers, CEOs, and advisors. It is also a great time for our Team to be together and reinforce our culture.

We highly recommend reading the 2015 Berkshire Hathaway Chairman's Letter (www.berkshirehathaway.com/letters/2015ltr.pdf), as it will make you feel much better and perhaps restore "HOPE" (see quote at the end) that the US will solve our problems. We are so blessed to live in the United States, compared to anywhere else in the world – even with our dysfunctional government.

This year's trip continues our 25 year streak of appearances; however, you are now able to watch the Berkshire Meeting webcast from your home on Saturday, April 30. The viewing site is https://finance.yahoo.com/brklivestream, or go to the Berkshire Hathaway website (www.berkshirehathaway.com) and follow the links and enjoy the Woodstock of Capitalism first hand.

IN CLOSING

We are concerned that the leading political candidates on both sides of the aisle will move to greatly increase tax rates and limit deductions rather than address/reform the long-term costs of entitlement programs. Regardless of how this political season turns, we think higher taxes in coming years will be a high probability for most of our clients. We continue (and encourage you) to be vocal to Congress about the dire need of a complete overhaul of our tax system, as well as entitlement reform. The current tax system is hopelessly confusing (to most), complicated, and riddled with tax expenditures that are spending by another name. Meanwhile, our corporate income tax hurts America's ability to compete in the world.

SEA is considerably different than most investment advisors – and that shows up in many areas of our practice. A significant difference is that we have a deep understanding of not only valuation, asset allocation, and investor/market behavior (psychology), but also an expertise in income and estate tax planning. Only with these combined skill sets are we able to help clients achieve the best risk adjusted after tax returns over multiple generations. Advisors having these combined skills are unique, and they will be at an even larger advantage in the coming years due to expected higher taxes of all kinds.

We encourage you to call on us, not only for your investment management, but also your multi-generational income tax and estate planning needs, as it is critical for long-term successful multigenerational family wealth management.

As always, we thank you for your confidence and trust. We are working hard to deserve that trust.

Your SEA Investment Team

President Ronald Reagan in 1986 summed up the Government's views as follows:

"If it moves, Tax it.
If it keeps moving, Regulate it
And if it stops moving, Subsidize it."

"The grand essentials to happiness in this life are….
Something to do,
Somebody to love,
And something to hope for."
J. Addison