The Margin of Safety Quarterly

member of
the LANIGAN GROUP of companies

Southeast Asset Advisors, Inc.
Lanigan Wealth Management

Investment Management & Consulting
Thomasville – Atlanta – Tallahassee – Mobile – Charleston

TO: Clients and Friends
FROM: SEA Managing Directors
RE: 3rd Quarter 2017 Commentary
DATE: October 2017

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 (i.e., temperament.)
(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 along with passive strategies as appropriate.
(5) Rebalancing portfolio holding/managers when appropriate to take advantage of underpriced and avoid overpriced assets.

Q3 2017 Market Commentary

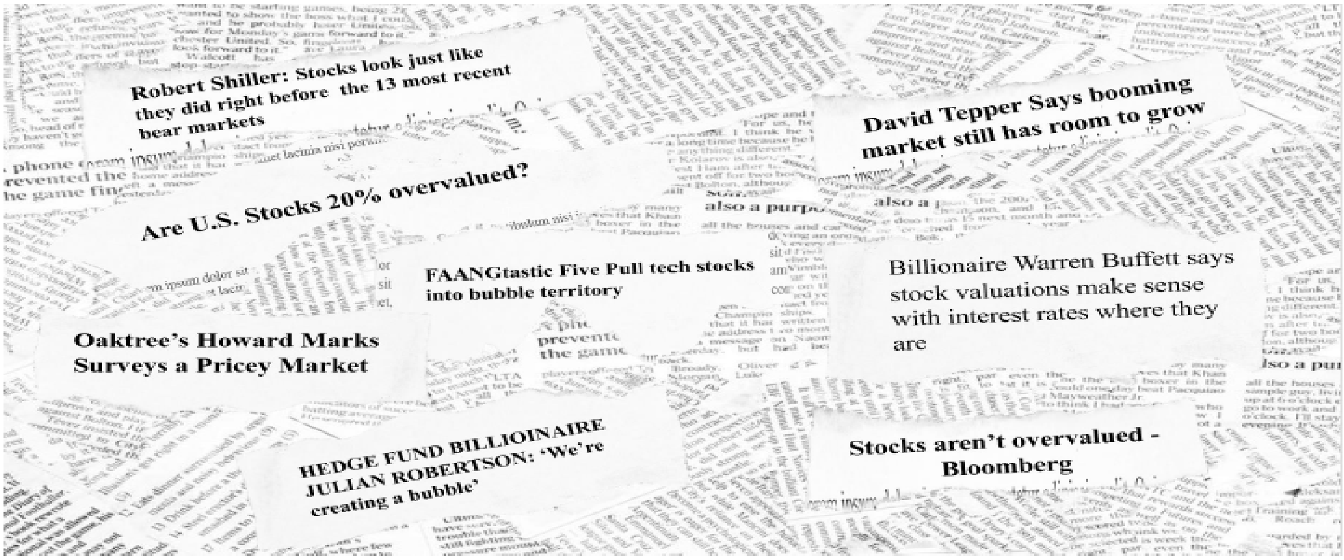
The third quarter saw continued strong performance for the majority of global markets with little volatility. For the quarter, the S&P 500 returned 4.49% bringing the year to date total return to 14.25%. Large Cap Growth has now outperformed Large Cap Value by just over 10% for the year, while the Russell 2000 (small cap) is trailing the S&P by 3.31% for the year.

International markets continued to deliver solid returns for the 3rd quarter as well. For the quarter, the MSCI EAFE returned 5.47% and is now at 20.47% for the year. International market (Developed and Emerging) valuations appear more favorable compared to the US markets. Many of our International managers are echoing this bullish international sentiment with emerging markets being their top choice.

On the fixed income side, the core bond index gained 0.70% for the quarter and 3.12% YTD.

Many of our value managers have high cash levels due to an inability to find companies with attractive valuations coupled with strict qualitative parameters. Although high cash levels have held back their returns, it also gives them ample "dry powder" to deploy if, and when, they find opportunities that qualify.

Valuation of Overall Market Comments



I would guess, a balanced portfolio of stock and bonds over the next 10 years will have a total return of 4% pretax. - Larry Fink, Chairman, Blackrock

Valuation opinions of U.S. stocks in general are unusually mixed and depend on which valuation metric is used. We believe valuation depends on future interest rates. If interest rates stay low, then the S&P seems fairly valued at an ~18x p/e ratio assuming the growth rate (LTGR) stays in the range forecasted.

So, valuation depends on…

1) Future Interest Rate Hikes
    a. Inflation and Fed policy are the determining factors.
2) Growth Rate of Earnings
    a. Tax reform and tax cuts could help earnings.
    b. Reduced regulations promised by administration should also increase earnings.

Our track record predicting macro and overall market valuations has been mixed, though better when markets are at extremes – like 2008 i.e., when valuations were historically low– and in 1999 when the market (led by Tech companies) looked very expensive. We believe that our valuation analysis has served our clients well as a general barometer to overall equity allocation and weighting. Despite what the Fed says on inflation. We believe that rates and inflation will begin inching higher and start to gather steam. The question is when?

Additionally, there are many geopolitical risks that worry us. As always, we do not think we can add value as market timers and are doubtful anyone can market time successfully over the long term.

Overall, we believe "caution" is in order from a valuation perspective as some asset classes (i.e., long-term bonds) look way overvalued. Thus, we are proceeding, but with a degree of caution.

What to do now?

In this new low return environment, investors can do several things to improve their opportunity. The first is to lower expectations and not reach for returns by taking on more risk; second is to accept the low returns as a temporary situation and increase cash positions (hold dry powder) for opportunities that will show up. The other is to find niche areas where the risk return equation is more attractive and allocate (or rebalance) some capital to these areas, without going overboard.

One area we believe is attractive is international and emerging markets. Valuations are lower (by some measures 40% lower) and appear to have more attractive growth. We understand that volatility can be higher in foreign markets and currency adds another source of potential volatility, but we feel the risk/reward is attractive for an overweight position relative to long term targets in many portfolios. Thus, we are continuing to increase our clients' weighting to these areas with managers who have this specialized area of expertise.

Tax Cuts (Reform)

Corporate and Business tax cuts are key assuming they are done in a responsible manner. Critical components include: the "tax holiday" on repatriation, reform of our international tax laws and generally lowering of the Corp/Business U.S. tax rates. Of course, with any changes there will be winners and losers.

We are optimistic that some tax cuts (reform) have a good chance of passing, but maybe not the sweeping tax reform that we once thought (in November 2016) and which is needed in our badly broken tax system. We think both tax cuts and regulatory reform are somewhat baked into the "Trump market" since the election. We anticipate the market will be disappointed if these goals are not achieved. As we go to press, the tax reform debate continues on who gets the tax cuts and the amount of the GNP growth rate that should be used to balance the budget post tax reform.

In Closing

We recently read an article asking is "value investing" dead? If that is the case what other types of investing makes sense? Of course, the future growth of FCF is one component of determining the intrinsic value of a company. Growth and value are not mutually exclusive. All investing should be valuation based, it's just how much growth one forecast and what one is willing to pay for it.

We are grateful for our clients and partners that have a long-term perspective and we are focused on earning your "deserved trust." Please contact us if you want to discuss any changes to your goals or objectives and/or your specific financial situations, rebalancing to targets or your asset allocation.

Thank you again for your continued confidence and trust.

Your SEA Investment Team