4/22/15

Dear Clients & Friends,

After dropping about 3% in January, the S&P 500 Index rallied to finish the quarter around breakeven. Investors focused on interest rate-hike uncertainty, oil price volatility, and a strong U.S. dollar. Despite the volatility, our favorite market indicators lead us to be optimistic. Low interest rates and strong equity price momentum, combined with some value found both among great global blue chip companies and off-the-radar smaller cap value stocks, gives us optimism.

A key challenge has been the recent performance disparity between “growth” and “value” Stocks. In the past 12 months, stocks with the highest P/E ratios appreciated 15.7% vs 3.9% for the cheaper stocks. A key reason for growth stock outperformance is the extra scarcity value and valuation benefit they receive from falling interest rates. This trend should reverse when interest rates rise.

With this disparity leading to some recent underperformance relative to the S&P 500, it’s logical to ask: Wouldn’t it be easier to just buy an S&P 500 index fund? We are confident that our approach is the best for growing and protecting wealth in the long run as it has been in the past.

In 1984, Warren Buffett wrote a piece called “The Superinvestors of Graham-and-Doddsville.” He wrote: “Is the Graham and Dodd ‘look for values with significant margin of safety relative to prices’ approach to security analysis out of date? Many of the professors who write textbooks today say yes. They say the market stock is efficient; that is, that stock prices reflect everything that is known and therefore there are no undervalued stocks.” Buffett would go on to challenge this view and present a group of super value investors who trounced the S&P 500 stock index over decades. Despite this group’s spectacular performance of beating the market by 8%-17% per year, this group underperformed the S&P 500 index in 1/3 of the years measured.

Similarly, the Eidelman Virant value composite has outperformed the S&P 500 by roughly 8% compounded and underperformed in 33% of the years measured since 2000. In fact, in the four years the value composite underperformed the S&P 500 by more than 1%, the value composite outperformed the S&P in 3 out of the 4 subsequent years by an average of 6% annually. What gives us confidence that the future could be so bright? In short, our portfolio.

We have constructed a diversified portfolio of companies with strong market positions, great management teams, low-debt balance sheets, and trading at below-average valuations. As I look one-by-one at our holdings, nearly every company on this list has significant market

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share in their core market or in the case of small banks, dominates their small town. We have looked the vast majority of these management teams in the eye and interrogated their business plans and made sure they "get it" when it comes to properly aligning the incentives of employees, management, and shareholders. Of our top twenty holdings, all but one company either has a stock buyback in place or has seen top management buying the stock personally within the last year. As a group, the companies have a debt/capital ratio below that of the S&P 500.

Lastly, our portfolio trades at a big discount to our calculation of intrinsic value and the market averages. Our top 20 holdings (representing 66% of the composite) trades at a median P/E ratio of 12x this years estimated earnings and 1.3x book value. This compares to the S&P 500 Index P/E ratio of 19x earnings and 3.2x book value. In other words, our holdings would have to appreciate 58% to trade at the same valuation as the S&P 500.

We are confident our portfolio's balance of business quality, management strength, clean balance sheets, and low valuations will give us the best chance to deliver superior performance going forward. Thank you for your continued business and support.

Sincerely,

Tom Eidelman, CFA