August 23, 2019

For the six months ending June 30, 2019, Broyhill generated double-digit gains with significantly less risk than global equity markets. Our performance over the past twelve months speaks for itself. We preserved capital during the fourth quarter drawdown and participated in the upside this year, generating particularly attractive risk-adjusted returns. This is what you should expect from us. Detailed quarterly reports, including account and benchmark performance, portfolio holdings, and transaction history, have been posted to our investor portal.

The plight of the value investor has been beaten to death. But it's important to note that all value investing is not created equal. To wit, while many value managers have continued to struggle this year, our return on equity capital was well north of 20% for the first six months.

Many value investors are quick to highlight that their portfolios don't look like the market. To produce better-than-average results, you need to own a different portfolio than the average. This remains true at Broyhill. What also remains true is that we don't look like the average value investor, either. This is by design. Value investing at Broyhill is more than just buying low P/E or low P/B stocks. We are actively seeking businesses that trade below fair value with catalysts on the horizon to highlight that value. We are actively seeking dislocations and working hard to understand both micro and macro imbalances.

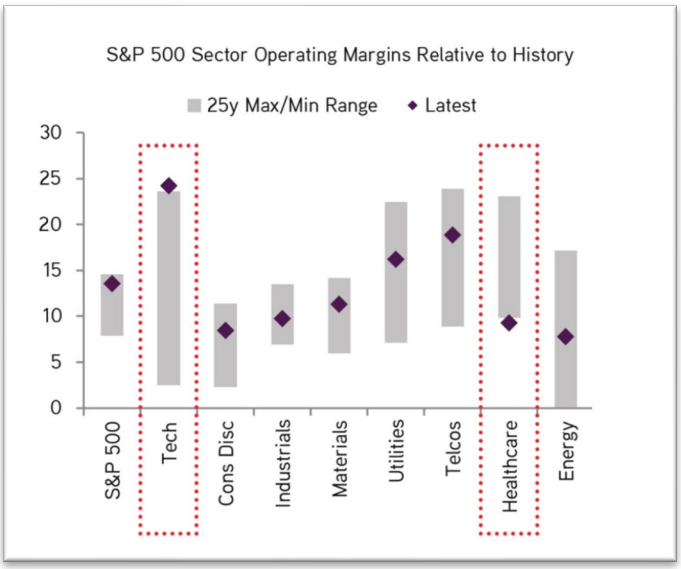
While we don't expect to generate such healthy returns every year, we do believe that the market is likely to come our way in the years ahead. We are positioned accordingly and putting our money where our mouth is, investing heavily in resources to grow our business. More on this later in our Organizational Update. But first a word on portfolio performance, new investments, and some thoughts on why history's greatest unicorn hangover may be the catalyst value investors have been waiting for.

PORTFOLIO REVIEW

The Fed's about-face on interest rates gave momentum stocks a fresh set of legs and drove growth stocks back toward record valuations. But there has also been a more subtle shift in the value landscape, which helped propel the robust returns within our equity portfolio.

This year's gains have been broad based, and our largest positions provided the largest wins. Our investments in the dollar stores were our largest contributors to performance. Shares of Dollar General (DG) and Dollar Tree (DLTR) advanced 26% and 19%, respectively, during the first six months of the year. We closed out several positions to focus on new ideas as markets rallied back toward all-time highs from the depths of December's lows. In addition to liquidating our investment in Oaktree (discussed below), we exited core holdings in Ally Financial (ALLY) and CDK Global (CDK) in addition to smaller investments in AT&T (T) and Campbell Soup Co (CPB).

As discussed in our year-end letter, shares of McKesson (MCK) have been under pressure because overly pessimistic investors focused on the company's potential opioid liabilities as well as rising political uncertainty. These risks have certainly not disappeared, but continued earnings growth and free cash flow generation have been enough to convince investors that the sky is not falling, sending shares 22% higher, year to date. Since healthcare stocks are currently trading at historically depressed multiples of depressed earnings, our investments in the industry are already discounting an extremely negative future. As such, any outcome that falls short of a worst-case scenario should drive valuations meaningfully higher.



Source: KKR

Two of our top five holdings were acquired this year, providing a nice bump to returns. When we began accumulating shares of Allergan (AGN), it wasn't clear how the thesis would progress, but we identified multiple ways to win. When you buy right, the catalyst doesn't need to be obvious in advance. In our year-end letter, we explained that, ultimately, the value we uncovered would be realized by the market—or by someone else.

At the close of the second quarter, that “someone else” turned out to be AbbVie (ABBV), who announced that it was acquiring Allergan at a 45% premium to the stock’s closing price. Given ABBV’s need to diversify away from its blockbuster drug Humira, we think the deal makes sense for both sides. Yet shares of ABBV have declined sharply since the announcement, leaving us with the potential to earn an attractive spread on our investment over the next six months.

Earlier in the year, Brookfield Asset Management (the “other” BAM) announced its intention to buy all of Oaktree’s public partnership units at a “substantial” premium to the then-current Oaktree (OAK) trading price. Management made it clear that Brookfield would pay the same price for 20% of the private units held by Oaktree’s founders and employees. What was less clear in Oaktree’s organizational announcement was that this “substantial” 12% premium was not remotely close to fair value for Oaktree shares.

Management effectively said as much in its announcement, highlighting the market’s “lack of enthusiasm” for Oaktree as a public company, thereby limiting the liquidity sought by management to “facilitate generational transfer.” Said differently, since they were not able to sell public shares at a reasonable price, they effectively cashed out 100% of public shareholders at said unreasonable price and elected to hold onto 80% of their own shares along with a "very valuable option to sell" in the future (likely at a price much closer to fair value—and a price no longer available to public shareholders).

When we took our position in OAK, we knew that one of the biggest risks was the more limited rights afforded to unitholders compared to shareholders. We were willing to assume that risk, given management's track record, culture, and history of putting clients’ interests first. This has always been “The Most Important Thing” for Oaktree. Apparently, that mantra does not apply to minority shareholders. Despite our frustrations, shares of OAK gained 30% year to date.

TENBAGGERS & BORING BOND FUNDS

In addition to the changes in our equity portfolio, we booked gains in two significant fixed income investments during the first half of the year. Our basket of closed-end municipal bond funds gained double-digits through the first six months of the year with our two largest investments in the space gaining 15%. In addition to our sizable bet on closed-end funds, we also monetized our interest rate hedges, closing out the last leg of this trade at near 10x return on our capital.

The impressive returns on our fixed income investments this year were only available because investors fled bond markets at an accelerating pace last year. This stampede caught our attention. We dug deeper to determine if this herd mentality was warranted and to explore variant perceptions. Like a good skirt steak, we are at our best cutting against the grain.

Consensus expectations for continued rate hikes, despite an increasingly shaky equity market late last year, provided an ideal entry point for investors willing to cut against the grain. In October, ten-year treasury bonds were yielding north of 3.2%, and just about every investor in the world was calling for a steady climb higher in rates. The largest bond managers on the planet were pointing to the infamous broken downward trend line, which has been intact since the bond bull market started in the 1980s.

Although we didn't have a strong view on the direction of rates at the time, we did have our suspicions. While most market participants couldn't imagine that rates would drop any lower, we believed that future rate cuts were possible due to continued equity market volatility. Although we did not expect it would happen so quickly, it wasn't a stretch to envision a scenario where a further decline in stock prices could very quickly shift investors' views on further Fed action. More importantly, options on long-term Treasuries were not at all discounting this view.

Bottom line: we saw pretty good odds of a big move in rates, but the market seemed to view it as a near-zero probability. And as a result, when that potential future became reality, those options paid off handsomely. With one rate cut already in the books, the market is now screaming for more aggressive action with the ten-year yield at 1.5% and back near all-time lows. Imagine that.

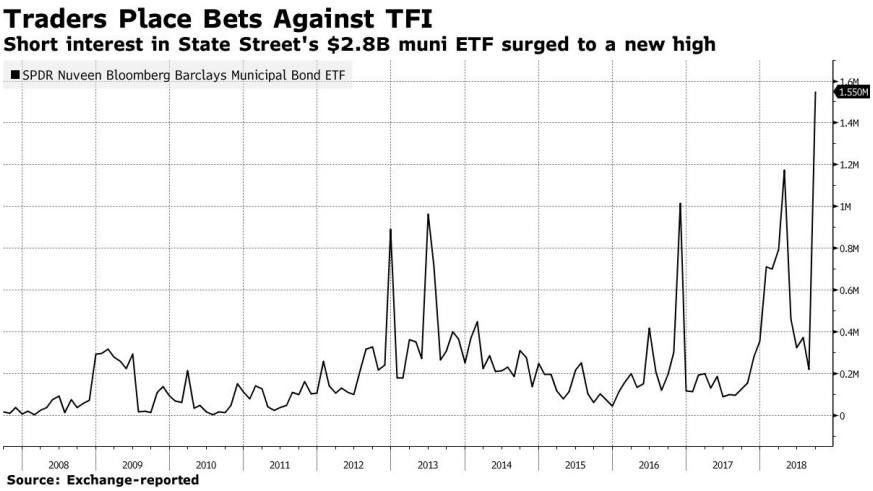
In another corner of the fixed income market, our basket of closed-end municipal bond funds contributed greatly to year-to-date portfolio returns. We've written about our interest in closed-end funds periodically over the years as we've traded in the space with consistent success. The set-up this time was identical to years past. **Closed-end funds appear to be the gift that keeps on giving in financial markets.**

Our interest in the space can be summarized as follows.

- When interest rates rise, bonds decline in value.
- When bonds decline in value, investors panic.
- When investors panic, they sell their bond funds.
- When they sell closed-end funds, the price of those funds falls even more.
- When that price differs greatly from the bonds underlying value, we buy.
- Then we wait for this process to reverse course. And we sell.

Nerd's Note: The remainder of this section will outline our thinking on these investments from the beginning to the end of the cycle noted above. Recognizing that most eyes have a tendency to gloss over when reading about interest rates and bond funds, we welcome you to skip the following detail and jump ahead to the next section, Cyclicals & The Walking Dead.

In early 2017, Congress began debating whether or not to do away with tax exemptions for municipal bonds. As a result, issuance skyrocketed, and new supply pushed municipal bonds to their cheapest levels in years. December 2017 marked the single largest month of issuance in municipal market history. It was "raining munis," according to the head of fixed-income trading at one large money manager. Throughout 2018, the threat of tax reform loomed large for retail investors. And the bad news piled on during the year as interest rates continued to rise. Short bets against municipal bond ETFs spiked, and the largest muni-bond ETF was greeted with its largest single-day outflow, almost precisely as interest rates peaked, in October 2018. **Against this widespread pessimism, we aggressively increased our position in municipal bond funds through most of 2018.**



By 2019, investors' attitudes toward these sleepy municipal bond funds began to change dramatically. Fears of a global slowdown, aggravated by the growing threat of trade wars, coupled with a more dovish Fed, provided investors the all-clear signal to return to bond markets this year. So, after dumping holdings at any price as rates rose, investors rushed back into bonds as rate fears subsided. Within weeks of the Fed's pivot, municipal funds were reporting record inflows. Investors poured more than $15 billion into municipal-bond funds in just the first eight weeks of the year—the most in over a decade. Despite initial fears that sweeping tax overhauls would depress demand in the market, municipals bonds enjoyed their strongest start to a year in recent memory. After trading at double-digit discounts to NAV through most of 2018, a number of closed-end municipal bond funds are now trading at premiums!!

To recap: most market observers expected increasing interest rates and tax changes (which cut corporate rates to their lowest since 1939 and lowered individual taxes for many households) to reduce the appeal of municipal bonds, which are exempt from federal taxes. As a result, investors sold municipal bonds en masse, pushing bond prices and discounts on closed-end funds to increasingly depressed levels throughout 2018. This extreme pessimism provided a very attractive and very low-risk entry point for prudent investors. Here's a look at how the headlines appeared along the way:

- *Tax Bill Jolts Municipal-Bond Market, WSJ, December 18, 2017*
- *The Muni-Market's Terrible, Horrible, No Good, Very Bad Year, Bloomberg, May 2, 2018*
- *Short Bets Against Muni Bond ETFs Are on the Rise, Bloomberg, October 10, 2018*

Fast forward to today, and the same municipal bonds are now wildly popular among the same investors. The same tax changes feared by the market are also responsible for capping the deductibility of state and local taxes. Translation: tax-exempt municipal bonds remain one of the few remaining tax shelters out there, particularly for investors in high tax states. After a miserable 2018, renewed demand for municipals led to higher bond prices, pushing yields lower and discounts narrower. And by the second quarter of this year, the price of state and local government bonds hit a fresh high against Treasuries, driving yields on state and local government securities to less than 74% of those on Treasuries, the lowest since Bloomberg began tracking the data.

As market sentiment has run the full course from extreme pessimism to extreme optimism, we have significantly reduced our exposure to closed-end municipal bond funds, selling as last year's dire headlines were quickly replaced by these:

- *Muni Bonds Enjoy Historic Run Despite Tax Overhaul, WSJ, March 6, 2019*
- *Tax Headaches? A Dose of Muni Bonds Might Help, NYT, April 2, 2019*
- *Muni-Bond Demand Isn't Slowing Despite Lowest Ratio in Decades, Bloomberg, April 17, 2019*
- *Investors Want Municipal Bonds, but Issuance Is Rare, WSJ, July 18, 2019*

CYLICALS & THE WALKING DEAD

Low rates have a curious effect on asset prices. At one end of the risk spectrum, bond proxies continue to be a massive beneficiary of an investment landscape starved for yield. At the other, high-beta momentum stocks have rallied alongside low-beta "defensive" stocks, as investors bid up growth at seemingly any price. The result: everything in between has been effectively left for dead.

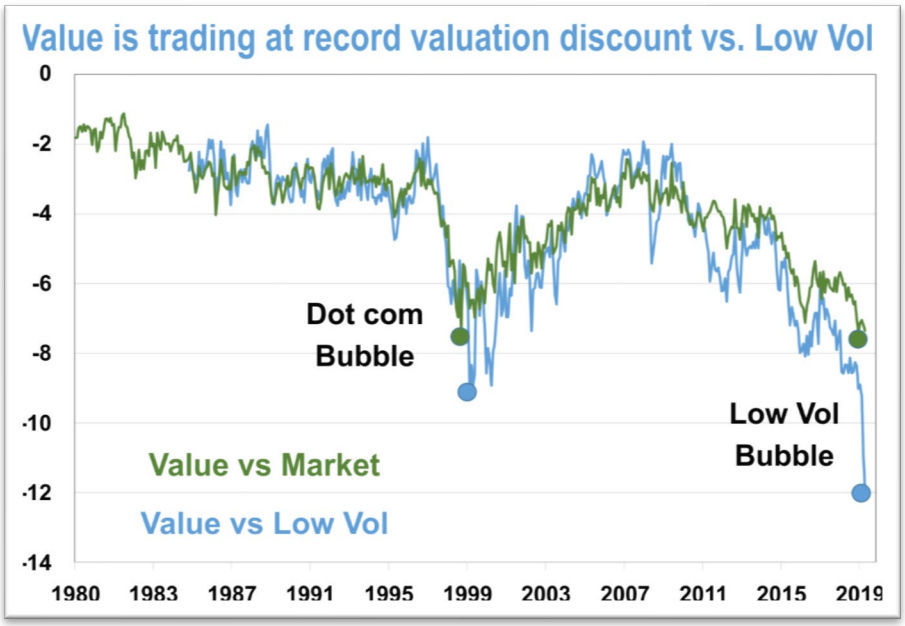
Today, value is walking amongst the dead. Through our lens, the greatest bargains are now found among the most cyclical areas of the market where the gap between perceived winners and losers has never been higher.

What do you get when you combine the risk of rapid technological change with the threat of a recession on the horizon? If you're a cyclical business, you get a really cheap stock price. And what do you get if you buy stocks trading at really cheap valuations? Well, lately, you get even cheaper stocks followed by funny looks from your unicorn-riding peers who wonder why anyone would ever bother investing in anything else. But history suggests that over time you will get above average long-term returns. Why? Because the valuations of many cyclical businesses are already deeply discounted, as if a recession were imminent.

Although some may wish to believe that modern monetary policy has cured the business cycle, we remain convinced that this record-long economic expansion will, at some point, run its course. And while an inverted yield curve, plummeting global trade, and escalating currency wars may in fact point to growing risks of an impending recession, it's not a given. It's one of a number of potential outcomes. Another is that the Fed may successfully navigate a mid-cycle slowdown with preemptive rate cuts. Or rational minds may prevail and bring the world's largest economies closer to a trade deal.

A recession in the near future certainly remains a possibility. In fact, we'd guess it's a highly likely one. But the timing of it is far from certain. And there are a number of alternative outcomes that would be highly bullish for cyclical businesses and their stock prices. Importantly, we don't think we need a "good" economic outcome to make money on these investments. With the stocks already discounting the worst, any other outcome that is incrementally better should be enough to move the needle.

But why even take the risk of owning cyclical businesses if we don't have to? Why invest in economically sensitive businesses when the odds of a recession seemingly increase daily? Because we are being paid to take the risk today. Certainty, or the appearance of it anyway, comes at an exceptionally high price. Today, that price relative to value is as extreme as it's ever been.



Source: JP Morgan

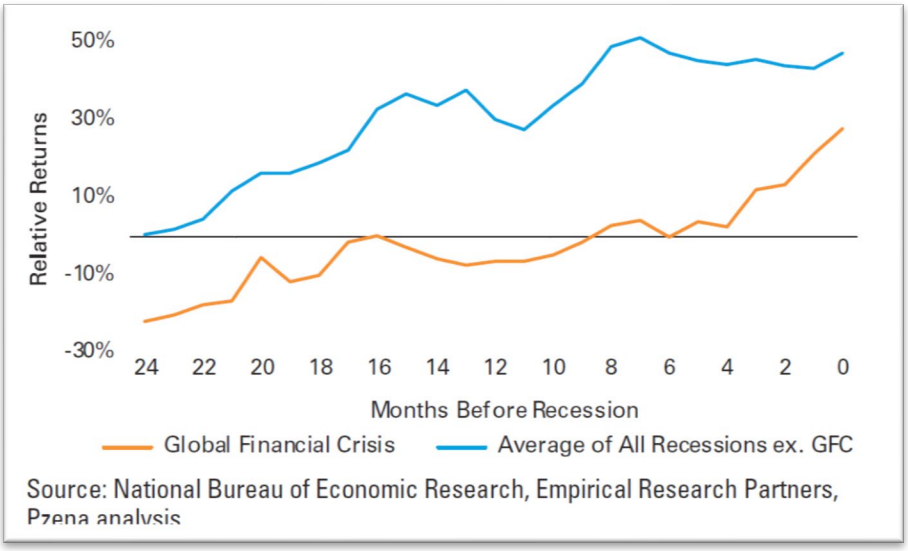
We are the first to admit our difficulties in predicting economic cycles. Perfectly calling the cycle, however, is not a prerequisite for investment success as long as the price is right. And, as it turns out, patient investors have historically been well compensated for owning undervalued cyclicals through recessions.

Investors have a knack for fighting the last battle. And during the last battle, "cheap" cyclicals got smoked if you bought ahead of the recession. So, naturally, most investors have steered far clear of cyclicals today.

It reminds me of one of the many brilliant Yogi Berra quotes, "Nobody goes there anymore. It's too crowded." It's precisely because "nobody goes there anymore" that many of these great businesses have been left for dead. Yet, a cursory look at the four previous recessions prior to the Great Financial Crisis shows that cyclicals have in fact done quite well through downturns.

The most recent recession was an incredible outlier. But because it was the most recent—and in some cases, the only recession many investors have experienced—it's the one most investors now use as their benchmark for every recession and every bear market. That's unfortunate for them as they take a pass on some very good business, but it's fortunate for us because many of these stocks are wildly mispriced today.

CYCLICALS OUTPERFORM THROUGH RECESSIONS



The auto industry is perhaps the best example of how near-term cyclical concerns have dragged down multiples and how growing secular concerns have increased uncertainty across the sector. This dynamic can create compelling opportunities for investors who can distinguish between uncertainty (which can provide attractive entry points) and risk (which can be reduced by a lower purchase price). While the changes now occurring in the auto industry may appear sudden, the truth is that transportation has been evolving for centuries. Change can happen fast. It can also take longer to play out than expected, or it could play out completely different altogether. **It's this difference in expectations that creates opportunities amidst change. Our recent investment in KAR Auction Services (KAR), which we discussed at ValueX Vail, is a good illustration of this dynamic. That presentation is available here.**

In addition to our investment in KAR, we also established a position in AutoNation (AN) in the first quarter of the year, and subsequently increased our investment as our conviction in the thesis grew. We believe that investors are so worried about new car sales, an increasingly competitive environment, and technological changes, that they aren't giving the firm's stable, high-margin, parts and service business enough attention. Gross margins on new and used vehicles have been declining for years, maybe decades. Yet, throughout this period, dealerships have remained extremely profitable businesses. These are not static entities frozen in time. They adapt. They evolve. Good management teams do this better than others. And we believe leadership at AN is best in class.

Management understands the challenges facing new and used car sales. The internet has been "a thing" for a while now. And dealerships have successfully offset increased price transparency (which is good for the consumer) with the addition of higher value services (also good for the consumer). As this transition has accelerated in recent years, so has management's attention to alternative sources of profit. And as management teams have realized how easy it is to gain share in parts and service from independents, the quicker this segment has grown. While the new car showroom is perhaps the more exciting part of the business where dealerships invest heavily in the space and in incentives for their sales team, the parts and service business is the bread earner. The back of the house doesn't look nearly as sexy as the showroom, but dealers should be happy to trade front-end sales for back-end sales. When we step back to think about it, it's just silly that the market is worried about the possibility of sales shrinking on a 4% to 6% margin business when it's being offset by strong and consistent growth in a 45% to 50% margin business.

On our math, even assuming a continued decline in new and used vehicle sales over the next five years, it's hard to see how AutoNation loses money. The analysis below assumes new vehicles, used vehicles, and finance and insurance profits (Variable Gross Profit) all decline at the same rate. While our base case assumes a steady decline in new vehicle sales, we think there's a strong case to be made that used vehicle profits and finance and insurance profits hold up better. Consider that in the most recent quarter, new car sales across publicly traded dealership groups *declined 6%* while used car sales *increased* 6% year-over-year.

AutoNation Gross Profit Growth (5 Year CAGR)

Scenario Analysis illustrating various levels of Variable & Parts and Service Growth on Total Gross Profit

		5-Year Parts & Service Gross Profit Growth					
		2.5%	3.5%	4.5%	5.5%	6.5%	7.5%
	0%	1.4%	2.0%	2.5%	3.1%	3.7%	4.3%
5-Year Variable	-1%	1.0%	1.5%	2.1%	2.7%	3.3%	3.9%
Gross Profit	-2%	0.5%	1.1%	1.7%	2.3%	3.0%	3.6%
Growth	-3%	0.1%	0.7%	1.3%	2.0%	2.6%	3.2%
	-4%	(0.3%)	0.3%	1.0%	1.6%	2.2%	2.9%
	-5%	(0.7%)	(0.0%)	0.6%	1.2%	1.9%	2.5%

Source: Broyhill Asset Management Estimates

With the market expecting *Auto Armageddon*, what's the likelihood that AN shares are valued lower in five years than they are today if gross profit grows 2% - 3 % annually over that period? We think the odds are in our favor.

Assuming continued improvement in SG&A—which fell from 74% to 72% of Gross Profit in the past six months—and continued repurchases—management has bought back half the stock over the last decade—operating profit should grow at a much better pace over the coming years. If AN posts double-digit EPS growth for the next five years, even while new car sales slow, will investors continue to reward the stock with a single-digit multiple? Probably not. Shares of AN gained 18% in the half and tacked on an additional 16% in the month of July.

DYING UNICORNS & VALUE'S RESURRECTION

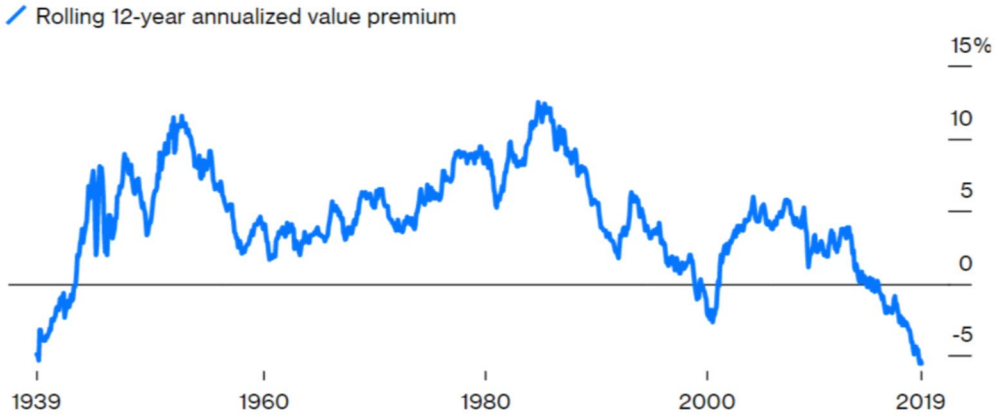
Value investing isn't dead.

It's taking a breather—like we all should from time to time.

Whatever you call it, we think there is reason to believe that the death of the mythical unicorn may very well be the catalyst for the resurrection of value.

This isn't the first time the value premium has vanished for an extended period of time. It probably won't be the last. Value's excess performance vanishes occasionally—often for longer than we'd like. But there's nothing particularly unique about this cycle. In fact, these short-term cycles of underperformance are what ultimately ensures values long term outperformance.

Similar concerns were raised during every previous cycle. And yet, each period of underperformance has been followed by exceptional outperformance. The set up today suggests we should expect the same.



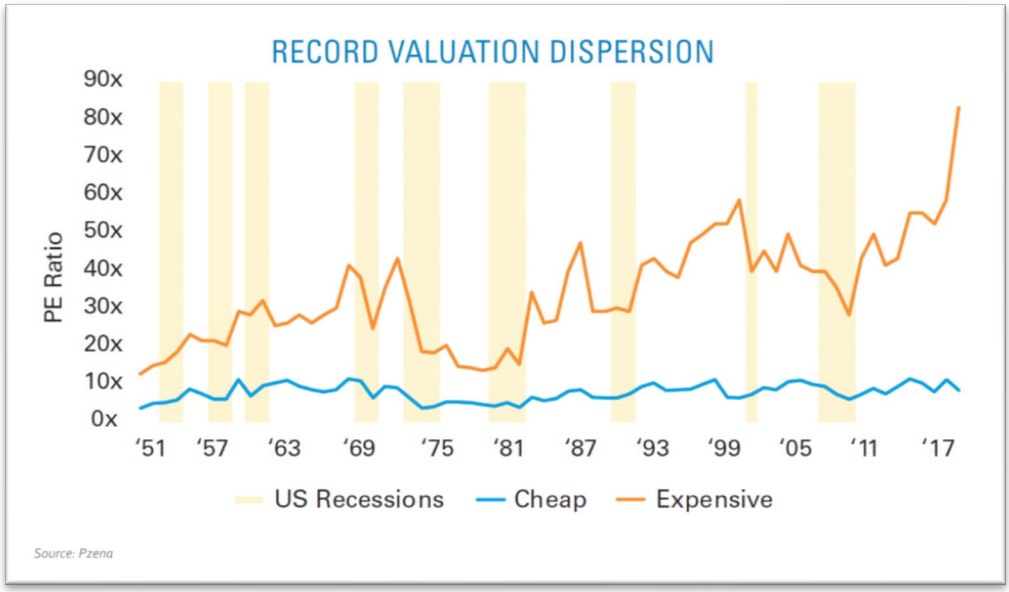
Source: Kenneth French
Note: Value premium is the excess total return from value stocks over growth, sorted using price-to-book ratio.

During the last cycle, the return of value investing coincided with the bursting of the dotcom bubble. **This cycle, we suspect that when investors grow tired of unicorn hunting, value investing will return to favor. We think that time is now.**

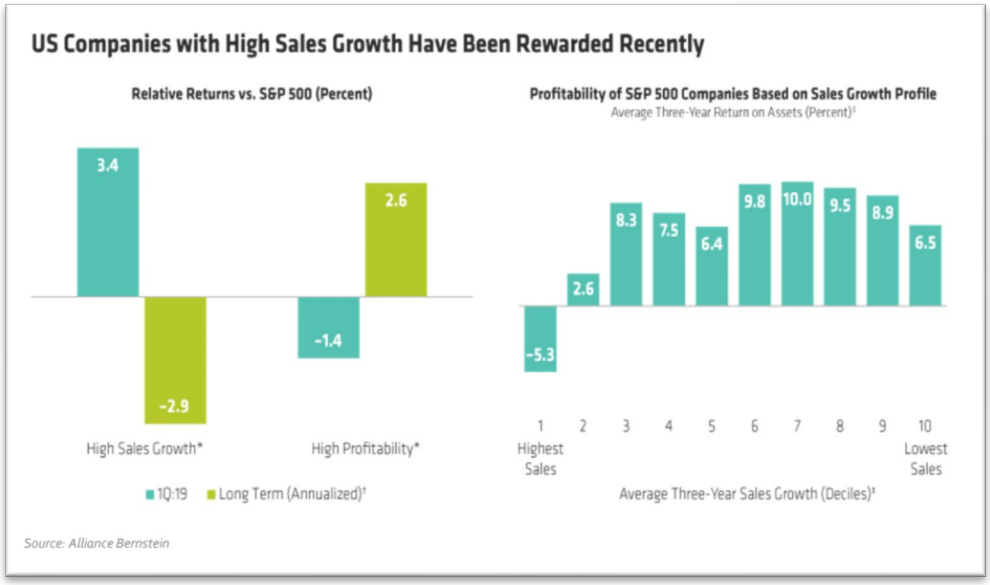
Simply put, when the hottest companies in the hottest industries come to market, optimism—by definition—is at its peak.

Sentiment can get no better.

During the current cycle, investors have paid up for the promise of growth amidst the most tepid economic recovery in history. As a result, the dispersion between the most expensive stocks and the cheapest is higher than ever.



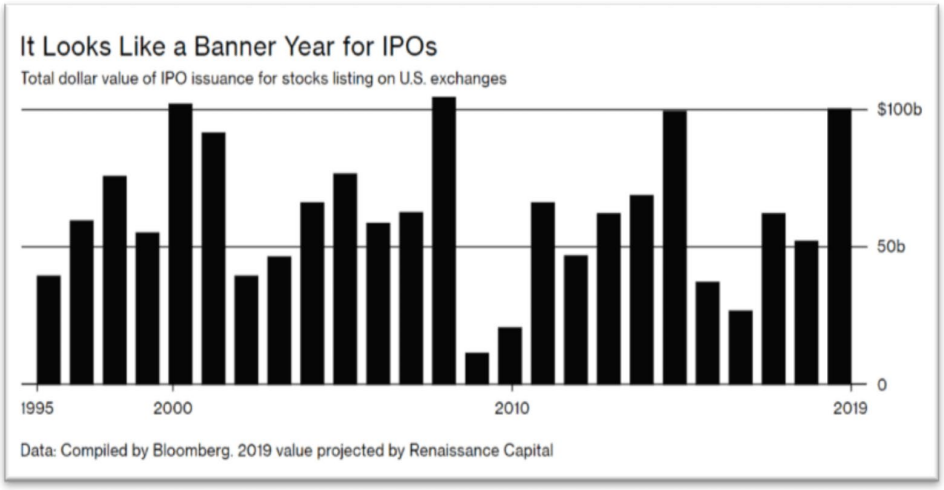
While the most expensive stocks with the most exciting growth prospects have outperformed recently, the longer term track record is less encouraging. History is not on their side. Research from Alliance Bernstein suggests that high-growth companies tend to underperform those with high profitability over time. And the fastest growing companies are usually the least profitable.



The best time to sell what everyone wants is when everyone wants it with little concern for price. This is why peaks in IPOs often occur near major market tops.

Insiders sell at the top when confidence is high.

For a unicorn looking to cash out, that's now.



A little-known secret about unicorns is that they feed on interest rates. And an appetite for low rates is something unicorns and private equity have in common. There's only one problem with low rates: there just aren't enough good investments to warrant the amount of capital sloshing around today. As a result, previously high standards are lowered at the same time that valuations rise. Not a great combination for future returns. Consider that in July 2011, a total of 161 venture capital funds was targeting $24.5 billion in commitments. In July 2019, over 1,000 funds were targeting nearly $100 billion in commitments.

Private equity deal making has also soared to its highest level since the financial crisis. A record amount of dry powder, totaling almost $2.5 trillion across private equity groups, means a growing wall of capital is chasing a shrinking number of deals, further driving up asset prices. According to Bain & Co., last year deals traded at 11x EV/EBITDA with 6x leverage, up from the 10x multiple and 5x leverage seen at the 2007 peak. While private investors have gotten used to such high multiples, it's not at all clear that equity markets will reward such high purchase prices for lower quality businesses with even lower quality balance sheets.

Leveraging up weak balance sheets to buy weak businesses at record valuations doesn't sound like a recipe for success. If the best private equity can do—after a decade-long rise in valuations, a steady decline in rates, increasing activism, and record capital flows—is generate performance in line with public market indices, imagine what performance will look like when those tailwinds reverse.

A low cost of capital works wonders for unicorns. It's the single biggest factor driving absurd valuations in the private markets. But at today's valuations, investors are playing a dangerous game. Unicorns are throwing capital at "land-grab markets" to gain share, driving tremendous revenue growth. But investors are making the collective bet that this growth at any cost will eventually become profitable growth. And that other investors will be willing to buy their shares at even higher valuations in the future. That logic is commonly known as the Greater Fool Theory for a reason.

Although this year is shaping up to set a record for the market value of new issues, in many cases, those record valuations have little relationship to the economics of the underlying businesses. Today's unicorns have acquired millions of users, but they've racked up billions of dollars of losses in the process.

Valuations, Revenues And Losses For Tech IPOs On U.S. Exchanges Over The Past Three Quarters

Company	Business	Valuation	2018 Revenue	2018 Losses
Uber*	Ride-hailing app	$64.4B	$11.3B	$3B
Tencent Music	Online music platform	$26B	$19B	Profit: $1.8B
Pinterest	Social network	$15.1B	$756M	$63M
Zoom**	Video conferencing	$18.6B	$331M	Profit: $7.5M
Lyft	Ride-hailing app	$14.4B	$2.16B	$911M
Farfetch	Online retail	$7B	$602M	$155M
Elastic***	Enterprise software	$6.3B	$160M	$53M
SolarWinds	Enterprise software	$5.9B	$833M	$102M
Anaplan****	Enterprise software	$4.8B	$241M	$131M
Beyond Meat	Meatless protein	$4.6B	$88M	$30M
PagerDuty*****	Enterprise software	$3.9B	$118M	$41M
SurveyMonkey	Survey platform	$2.1B	$254M	$155M
Jumia	African e-commerce	$2B	$150M	$195M
Upwork	Freelance hiring platform	$1.8B	$253M	$20M
Eventbrite	Event ticketing	$1.4B	$292M	$64M

*Uber's loss is operating loss, not net loss.
**Zoom's fiscal year ends Jan. 31, 2020.
***Elastic's fiscal year ended April 30, 2018.
****Anaplan's fiscal year ended Jan. 31, 2019.
*****PagerDuty's fiscal year ended Jan. 31, 2019.

crunchbase news

Impressive growth notwithstanding, many of today's unicorns have not fared particularly well as public companies. Uber and Lyft both trade well below their IPO price. We believe that, as with the railroad companies—whose massive expansion a century ago benefitted consumers for generations to come—these ride-sharing ventures (and many of their unicorn peers) will prove to be wonderful for consumers. But not so wonderful for investors.

With billion-dollar IPOs more common than presidential tweets today, the question for investors is, can the market absorb this much new stock without dumping shares of existing companies?

Call us skeptical.

BOTTOM LINE

If we were told at the beginning of the year that the consensus among investors was for at least three rate cuts in 2019, we probably would have guessed that the US had tipped into recession and that US stocks had entered a bear market. Instead, equity markets hit all-time highs, and credit spreads remain near all-time lows.

The bull case for equities from here seems to depend upon the Fed easing monetary policy and rekindling animal spirits. The obvious templates are 1995 and 1998. But is the first rate cut after a ten-year expansion really a bullish indicator?

Unlike prior, garden-variety cycles, central banks don't appear to be in the driver's seat today. Instead, the biggest threat to markets and to the global economy is simply, Deal or No (Trade) Deal?

Lower rates won't fix global trade. Monetary policy cannot address broken supply chains. Interest rates are not the problem.

The greatest unicorn hangover the world has ever seen, might be an intimidating thought for most investors to swallow. But for the rest of us, there may be a silver lining around this ominous cloud. As these mystical creatures captivated the consensus' attention, many businesses generating real profits have been left for dead. With value as depressed as it's ever been, we believe future gains are more likely to be driven by real profits than magical horses.

ORGANIZATIONAL UPDATE

A frothy market doesn't mean investors should avoid equity markets altogether. It just means that they need to identify and allocate to the pockets of value within the market where the odds are tilted in their favor. Even amidst a wildly overvalued market, compelling investment opportunities remain. It's rare for all assets prices to decline in unison. Outside of the most recent crisis, which is still ingrained in investors' memories, rolling bear markets are more common. Capital flows from the most popular crowded trades as they fall out of favor and into today's unloved and undervalued assets. That's precisely where we are focused today and precisely where we believe returns will be tomorrow.

Our portfolio has just posted its best start in more than five years, despite our extremely conservative positioning (and absent any unicorns). But we think the best is yet to come and that the investment landscape is slowly coming our way. If and when the tides shift, relative performance should look even stronger. As a result, we have made significant investments in our business over the past year. This has included bringing on Tim LeRoux as Director of Investor Relations and Caylynn Lewis as our Chief of Staff. Adding Tim and Caylynn will further enhance our clients' experience and also significantly free up my time, as well Andrea's, so that we can focus more on investment research. In addition to bringing on new people, we've also dedicated resources to refine and enhance our investment process, which is as strong as it's ever been.[1]

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[1] *Some might say it's the BEST team running the BEST investment process EVER.*

Over the years, we've occasionally gotten questions from friends and colleagues regarding our willingness to manage outside capital. Because we were founded as a single family office nearly half a century ago, it's understandable why people may be uncertain. So, let me be clear. We are open for business. Not because we need to grow the firm or because we have a desire to run a large institution. We do not. But we do believe we are incredibly well positioned for the period ahead and that this should be reflected in future performance. If you'd like to learn more about investing with Broyhill, please contact Tim at tim@broyhillasset.com.

Sincerely,

Christopher R. Pavese, CFA
Chief Investment Officer
Broyhill Asset Management

APPENDIX: INVESTORS BEWARE

Bill Gurley, a general partner at Benchmark, a venture capital firm in Menlo Park, California, wrote an article titled *Investors Beware,* highlighting the growing froth in late-stage (pre-IPO) markets. We've provided a few highlights below.[2]

> *Over the last few years, the late-stage market has become the most competitive, the most crowded, and the frothiest of these financing stages. Investors from all walks of life have decided that "late stage private" is where they want to play. These large, high-priced private financings are the defining characteristic of this particular technology cycle.*
>
> *Very few of these companies are at a point where they could or should consider being public.*
>
> *The very act of dumping hundreds of millions of dollars into an immature private company can also have perverse effects on a company's operating discipline. As these late-stage private companies digest these large fund raises, they are pushing profitability further and further into the future, as well as the proof that their business model actually works.*
>
> *Investors must realize that it is materially easier to take a company to substantial revenue if you generously relax the constraint of profitability.*
>
> *All of this suggests that we are not in a valuation bubble, as the mainstream media seems to think. We are in a risk bubble. Companies are taking on huge burn rates to justify spending the capital they are raising in these enormous financings, putting their long-term viability in jeopardy. Late-stage investors, desperately afraid of missing out on acquiring shareholding positions in possible "unicorn" companies, have essentially abandoned their traditional risk analysis. Traditional early-stage investors, institutional public investors, and anyone with extra millions are rushing in to the high-stakes, late-stage game.*
>
> *We might all do well to heed the advice of Warren Buffet who said, "there is a fool in every market and if you don't know who it is, it is probably you."*

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[2] *Investors Beware: Today's $100M+ Late-stage Private Rounds Are Very Different from an IPO*

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The S&P 500 Index represents an unmanaged, broad-based basket of stocks. It is typically used as a proxy for overall market performance. Index returns assume that dividends are reinvested and do not include the effect of management fees or expenses. You cannot invest directly in an index. For additional information about other indices or strategies mentioned here, you can contact us at info@broyhillasset.com.

Additional information is available upon request. More information on Broyhill Asset Management LLC ("Broyhill") is also available at www.broyhillasset.com.