Core Equity Commentary
Winter 2018

Market and Performance Summary

For the fourth quarter of 2017, the Kovitz Investment Group (KIG) Equity Composite[1] (the "Composite") appreciated by 5.3% and finished the year with a gain of 16.4%. For purposes of comparison, the S&P 500 rose 6.6% during the quarter and ended 2017 with a gain of 21.8%.

We are pleased with the absolute return achieved this year, particularly as it was achieved with cash balances in the Composite that approximated 8%, on average, throughout the year. The implication is that these returns were generated while employing less risk than the overall market. Late in the year, we began to put some of this excess cash to work as several companies fell to levels where we were willing to add them to our clients' portfolios (discussed in "Portfolio Activity" section below). As we said in the past few newsletters, "We will be ready and eager to deploy cash as genuine opportunities present themselves." We are pleased that the time we devoted to creating a backlog of ideas and waiting on the ups and downs of the market to provide an attractive entry point finally bore fruit. We remain optimistic about the long-term outlook for our current collection of holdings, where its valuation, in aggregate, is significantly lower than that of the overall market. The wide valuation disparities that characterize the current market offer significant opportunities for our style of active management.

Neither Hurricane Irma's 185 mile per hour winds, nor North Korea's increased movement towards developing nuclear weapons were enough to shake investor conviction during the quarter. Global equity markets continued their advance unabated, shrugging off a host of worries, not the least of which were: increasingly high valuations, near term prospects for higher interest rates and coordinated tightening by central banks, a rising terrorism threat level, numerous natural disasters, escalating geopolitical tensions, and ever-increasing partisan politics in Washington. Such has been the enduring strength of what is now the second longest bull market in modern financial history. During this run, stocks have basically gone straight up with only a few brief periods which could be considered minor corrections. The disciplined investors' best friend – volatility – has been practically non-existent. In fact, there hasn't even been a 3% pullback since November 4, 2016, the longest on record without such a decline.

Our point in stating this is not that investors should have reacted to these various concerns by selling out of their equity portfolios. Most concerns are ever-present to some degree and some are completely irrelevant to our investment decision making process (as they don't impact corporate profits), but, historically, one or two of these concerns, let alone the entire collection mentioned above, would have sent markets reeling, if only for a short period of time. Have investors finally given up the ghost of sins past and resolved to tune out the noise that litters the financial news networks and publications? We highly doubt this time is different. For the time being, however, there seems to be a focus only on the good news, such as underlying economic strength, both domestically and globally, robust earnings

[1] The returns for the equity portion of your individual account may differ from the Composite due to variations in account holdings, cash position, and other client-specific circumstances.

growth, reduced regulation for businesses, the continuation of a low interest rate environment, and, perhaps most importantly, the recently enacted 40% reduction in statutory corporate tax rates.

However, as investors concerned first and foremost with preservation of capital, we can't choose to focus on just the good stuff. Perhaps we are in the midst of a veritable "Goldilocks" environment, one that is "just right" for continued smooth sailing. Or perhaps not. As always, we don't waste time trying to predict whether the market will go up or down in the immediate future – or even where it *should* go in the immediate future. Our decision-making framework utilizes a probabilistic approach that incorporates downside elements as much as upside ones. We rely on a fundamental, research-driven process where we strive to build a diversified portfolio of equity investments through the purchase of competitively advantaged and financially strong companies at prices substantially less than our estimate of their intrinsic values. Our process emphasizes the appraisal of factors that we believe matter most to a business's long-term success. These include the franchise durability of the business, the strength of the balance sheet, the predictability of the cash flows, and the capability of the management team to allocate these cash flows intelligently and judiciously. Typically, portfolios of companies with these characteristics will perform well on a relative basis regardless of what is happening in the overall market environment. Patience, persistence, and a long-term investment horizon are essential to long-term investment success.

The chart below summarizes annualized performance over various standard time periods ending December 31, 2017 and cumulative performance results from January 1, 1997 through December 31, 2017 for the Composite.

KIG Composite[2]
Annualized and Cumulative Equity Performance (Net of Fees)

	Average Annual Total Returns						Cumulative
For Period Ending 12/31/17	**1 Year**	**3 Year**	**5 Year**	**10 Year**	**15 Year**	**Since Inception 1/1/97**	**Since Inception 1/1/97**
KIG Composite	16.4%	9.0%	12.8%	8.7%	9.6%	10.9%	770.5%

The table below lists the results for the same time periods as above for the S&P 500 and many of the other benchmarks widely held as investments via a style-box approach.

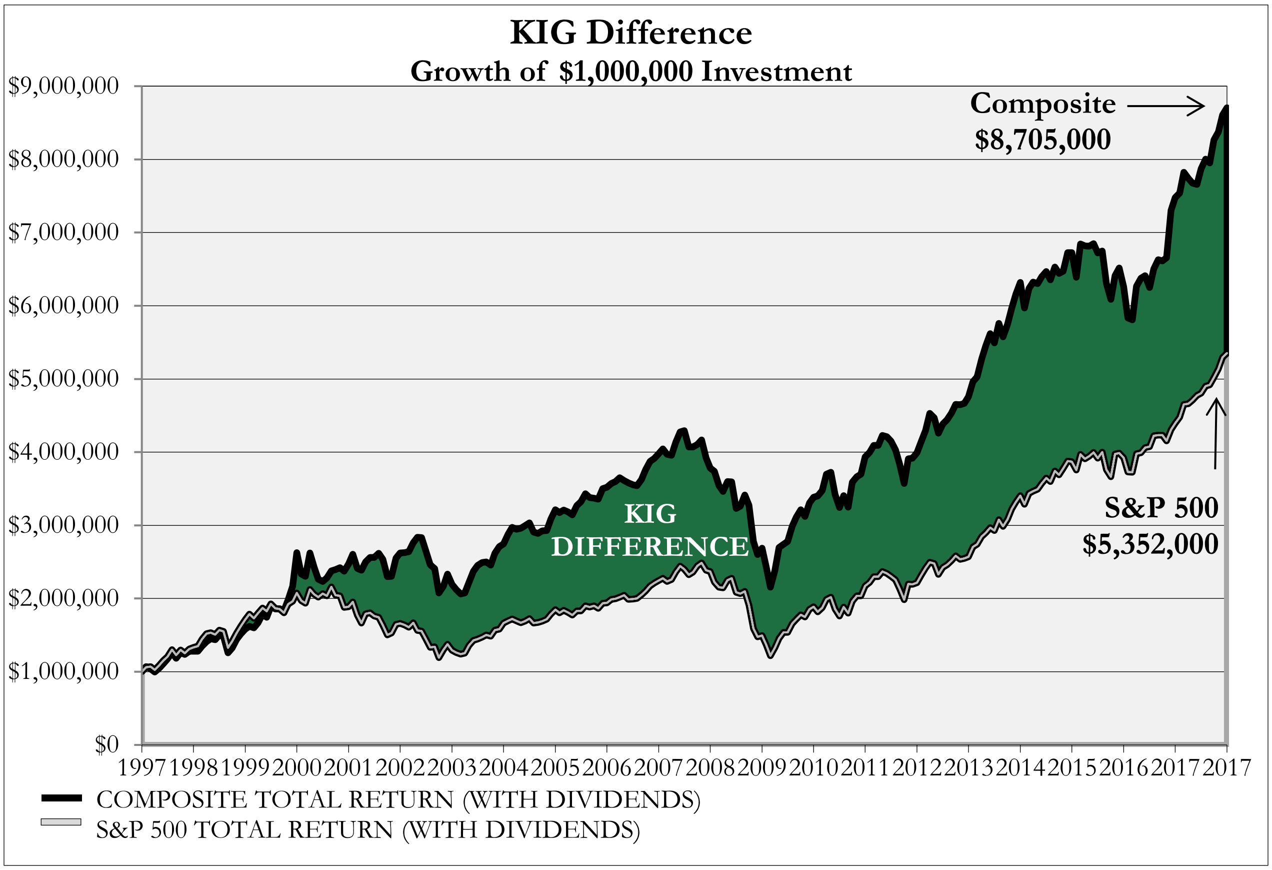
Other Market Indices
Annualized and Cumulative Equity Performance

	Average Annual Total Returns						Cumulative
For Period Ending 12/31/17	**1 Year**	**3 Year**	**5 Year**	**10 Year**	**15 Year**	**Since Inception 1/1/97**	**Since Inception 1/1/97**
S&P 500	21.8%	11.4%	15.8%	8.5%	9.9%	8.3%	435.2%
Small Cap Equity (Russell 2000)	14.6%	10.0%	14.1%	8.7%	11.2%	8.5%	459.2%
International-Developed (MSCI-	25.0%	7.8%	7.9%	1.9%	8.1%	5.1%	183.0%
International-Emerging (MSCI -	37.3%	9.1%	4.3%	1.7%	12.3%	6.5%	276.9%
Gold	12.8%	2.7%	-5.4%	3.8%	8.4%	5.9%	231.6%
Commodities (CRB)	1.7%	-5.1%	-7.8%	-5.7%	1.2%	2.1%	55.2%

[2] The returns for the equity portion of your individual account may differ from the Composite due to variations in account holdings, cash position, and other client-specific circumstances.

Below is a graph of the KIG Composite's cumulative return since inception relative to the cumulative return of the S&P 500 over the same time period. The shaded area represents the Composite's excess return over the benchmark.

Since inception on January 1, 1997, the Composite has outperformed the S&P 500 by an average of 2.6 percentage points annually. That might not sound like much. However, the extraordinary power of compounding is such that this relative outperformance over 20+ years has generated considerable rewards for our clients. In dollar terms, $1 million invested in the Composite at inception would now be worth $8.7 million at December 31, 2017. By comparison, the same investment in the S&P 500 would now be worth $5.4 million. In other words, an investment with KIG would now be worth about 63% more than if one had simply invested in an index fund that tracked the S&P 500.



Portfolio Activity

We added three new positions during the quarter.

Blackstone (BX)

Blackstone is an alternative asset manager and one of the largest asset management firms in the world with approximately $390 billion under management. These assets are roughly evenly divided among four business units: private equity, real estate, hedge fund solutions, and credit. There is also an additional $90B of committed, but undrawn, capital ("dry powder") at their disposal across all platforms. As an alternative manager, Blackstone typically raises funds from outside institutions for limited-life funds that generate both management fees and performance fees. The performance fee component of their revenue, as would be expected, is quite volatile from year to year, but we expect it to generate the majority of their revenue over the long run even with just moderate performance.

We chose to invest in Blackstone because we believe the scale of its operations has become a competitive advantage. Whether it's because of a history of good performance, the success of the "Yale Model[3]," or the proliferation of index funds, we believe institutions, pension funds, and sovereign wealth funds will increasingly seek out alternative asset managers as a source of outperformance. Blackstone has the size, breadth of offerings, corporate infrastructure, and reputation to facilitate massive fundraising efforts. In this way, even though they have funds winding down every year, we view the risk of a material decrease in assets under management as minimal.

After tax-effecting their economic net income (an adjusted earnings figure used by alternative asset managers to back out the mark-to-market effects of the fund's they manage, which are consolidated into their income statement under GAAP), we believe the units are currently trading at a low double digit earnings multiple. At this valuation we believe the market is greatly underappreciating the competitive advantages possessed by Blackstone and the potential for earnings (economic net income) to grow much faster than the market as a whole.

General Electric (GE)

Once the largest company in the world measured by market capitalization, the GE of today is a smaller, more focused industrial company. Having shed most of its finance business and its media business (NBC) in the years following the global financial crisis, GE's revenues are now derived primarily from several industrial segments. GE's primary segments include:

- Power - primarily the design, installation, and service of gas turbines used to generate electricity;
- Aviation - design, manufacture, and service of jet engines
- Healthcare - design, manufacture, and service of healthcare equipment
- Oil & Gas - services provided assist in the exploration and production of oil and natural gas
- Renewable energy - windmills and other green energy initiatives
- Transportation - locomotives
- GE Capital - legacy finance business

GE is considered a leader in nearly all of these industries, but several of them are experiencing cyclical downturns, most notably Power, Oil & Gas, and Transportation. This recently led to a significant downward revision in earnings guidance, a 50% reduction in the company's dividend, and the replacement of its CEO, all of which led to a decline of over 40% in the price of the shares this year.

GE remains a top-tier operator in its largest business lines where the company's comprehensive offerings, reputation, and integration with customers' designs make it difficult for customers to

[3] The Yale Model is a method of managing large pools of capital that emphasizes larger allocations to illiquid assets, such as private equity and real estate, over allocations to traditional equity and fixed income. It was pioneered by David Swensen and his team while managing Yale University's endowment.

switch to a competitor. We also believe that new management has a credible vision for moving the company forward. Among its priorities are:

1. Streamlining business units with a focus on the three core segments of Aviation, Power, and Healthcare, while targeting more than $20 billion of asset and business divestitures;
2. Generating roughly $2 billion of cost savings through rightsizing and restructuring actions;
3. Utilizing a more disciplined approach to capital allocation, in contrast to prior management, who did not generate appropriate returns from M&A, and divested units at prices considered too low; and
4. Improving corporate governance by consolidating decision-making, raising accountability, and increasing transparency. While more nebulous, improvement in these areas should lead to more rigorous execution and align compensation with long-term goals.

The shares still trade at a high-teens multiple of the average estimate for the next year's earnings, but we believe those earnings have minimal further downside risk. Share prices also have the potential to rebound substantially if end-markets improve over the coming years, or the company's planned reformation/restructuring proceeds as planned. By initiating with a small position, we are prepared to take it higher should the market continue to discount GE's shares while the intrinsic value of the business remains unchanged.

Henry Schein (HSIC)

Henry Schein is one of the world's largest providers of health care products and services. The company serves more than 1 million customers, including dental practitioners and laboratories, animal health clinics, and physician practices. It offers a comprehensive selection of products, services, and value-added solutions for operating efficient practices and delivering high quality care. In the three industries in which the company operates, the distribution markets are highly concentrated. Schein is estimated to account for ~35% of the dental market, ~20% of the animal health market, and ~20% of the medical supply market.

Henry Schein is a strong operator that has consistently taken market share, grown revenue (excluding acquisitions) at a higher rate than the industry as a whole, and generated high returns on capital. Its infrastructure, together with broad product and service offerings at competitive prices and a strong commitment to customer service, enables the company to be a single source of supply for its customers' needs. HSIC has over 4,000 field sales consultants around the world that are specialists in practice management. They understand how practices should run, and they help customers operate a more efficient business, which allows practitioners to focus on providing better clinical care. The company continues to advance its strategies in geographic expansion, market share growth, margin expansion, and advancing its product portfolio with products that present greater value to customers.

A longtime member of our investment universe, the company's shares have historically traded at a premium to the market, which prevented us from establishing a position at an acceptable price. However, the shares have fallen from ~$93 to ~$70 over the last five months after the firm modestly lowered forward earnings guidance, lost a large dental customer to a competitor, and has been increasingly included in chatter on the Street of Amazon entering the healthcare distribution market.

We view this as an overreaction. Earnings guidance for next year was lowered only 3% and the large customer only made up less than 1% of total sales. Most importantly, we believe Schein's customer relationships, competitive pricing, comprehensive product and service offerings, dedicated sales force, and integration into customers' operations through its enterprise software offerings are true differentiators. We believe these factors will make it extremely difficult for a no frills, online-only competitor like Amazon to take a significant amount of market share from the company in any of the industries in which it operates.

We also added to two pre-existing portfolio positions CBS (CBS) and Carmax (KMX). We pared back our positions in Leucadia (LUK) and Wells Fargo (WFC) to fund the newly initiated positions discussed above.

Key Contributors/Detractors to Results

For calendar year 2017, the individual positions that impacted Composite performance the most during the year were:

Top 5 Contributors		Top 5 Detractors	
Company	Percentage Return*	Company	Percentage Return*
Boeing	94.8%	**Halliburton**	-8.2%
Apple	48.5%	**Harley-Davidson**	-10.3%
Berkshire Hathaway	21.6%	**Walgreens Boots Alliance**	-10.5%
Bank of America	35.7%	**Schlumberger**	-17.4%
CBRE Group	37.5%	**CBS**	-6.2%

*Including impact of dividends

Largest Current Positions

As of December 31, 2017, the Composite's ten largest positions were:

Company	Ticker
Berkshire Hathaway	**BRK.B**
Apple	**AAPL**
Quanta Services	**PWR**
JPMorgan Chase	**JPM**
Bank of America	**BAC**
Alphabet (Google)	**GOOG/GOOGL**
General Motors	**GM**
CBS	**CBS**
Boeing	**BA**
CBRE Group	**CBG**

We appreciate the faith that you, our partners, have placed in us to manage your capital on a long-term basis. Your patient capital and shared long-term time horizon provides a tremendous advantage as we go about our investment decision making process. Managing other people's money is an enormous responsibility and we hope you take comfort in the fact that we are doing the exact same thing with our own money as we do with yours.