KOVITZ INVESTMENT GROUP
Intrinsic Values®

Core Equity Commentary

Summer 2018

Market and Performance Summary

In the second quarter of 2018, the Kovitz Investment Group (KIG) Equity Composite[1] (the "Composite") returned 1.8% vs. 3.4% for the S&P 500. Year to date, the Composite has decreased 2.2% vs. a 2.6% increase for the S&P 500.

We've been tracking our equity performance, via the Composite, for over twenty-one years. How have we done so far? Since inception in January 1997, the Composite has compounded at a rate of 10.5% annually vs. 8.2% for the S&P 500. When it comes to investment performance, human brains have a tendency to think linearly as opposed to exponentially. A linear mind might find these results satisfactory: 10.5% per year for the KIG Composite for 21+ years, or approximately 221% (10.5% x 21) vs. a 172% return (8.2% x 21) for the S&P 500. The ending value is seemingly about 28% higher. But this would be misleading. To analyze investment returns, one has to think *exponentially* because the annual returns compound over time. Seemingly modest differences in the annual rate of return can generate profound differences in the ultimate gain over long periods of time. Exponentially calculated, the actual gains for the period work out to be 752% for the Composite and 449% for the S&P 500. For instance, if you invested $1 million at the Composite's inception, your stake would be worth $8.5 million as of June 30, 2018. By comparison, if you invested $1 million in the S&P 500 at the very same point in time, it would be worth $5.5 million. This represents an ending value roughly 55% higher, nearly double the linearly derived result. Such is the miracle of compound interest. Harnessing this power has been our approach to wealth creation over the last couple of decades, and we plan to continue in the same vein over the next couple of decades.

Value investing requires discipline to have a realistic estimate of a stock's fair value and to not overpay relative to fundamentals. These gratifying figures reflect the power of our fundamental, value-based strategy that works well over time. Many investors with shorter time frames attempt the investing equivalent of long-range three-pointer after long-range three-pointer, but end up missing the basket badly a fair number of times. Compounding doesn't tend to work well with a high-risk approach like that. Alternatively, an approach like ours that focuses on longer bands of time and looks to attempt only lay-ups and mid-range jumpers, tends to minimize missed shots and allows the power of compounding to do its thing. The goal should never be to maximize returns at great risk, but a long, continuous march toward capital accumulation. The greatest single edge that an investor has is a long-term orientation.

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

While the absolute performance of the Composite over the last 3 to 5 years has been more than sufficient, the relative performance has been less flattering. However, if there is one indispensable lesson we have gleaned from the last 21 years, it's this: to achieve long-term investment success, we need to stick with our process through the difficult periods, through the uncertain periods, through the volatile periods, and, most importantly, through the irrational periods. This is what we have always done and what we intend to always do. So far, our track record seems to suggest that this careful, steady approach works well over time. For those like-minded and far-sighted clients taking the journey with us, we feel your patience and support will be well rewarded and we feel fortunate to have you.

The chart below summarizes annualized performance over various standard time periods ending June 30, 2018 and cumulative performance results from January 1, 1997 through June 30, 2018 for the Composite.

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

	Average Annual Total Returns						Cumulative
For Period Ending 6/30/18	**1 Year**	**3 Year**	**5 Year**	**10 Year**	**15 Year**	**Since Inception 1/1/97**	**Since Inception 1/1/97**
KIG Composite	8.2%	8.2%	9.2%	10.2%	8.7%	10.5%	751.8%

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.

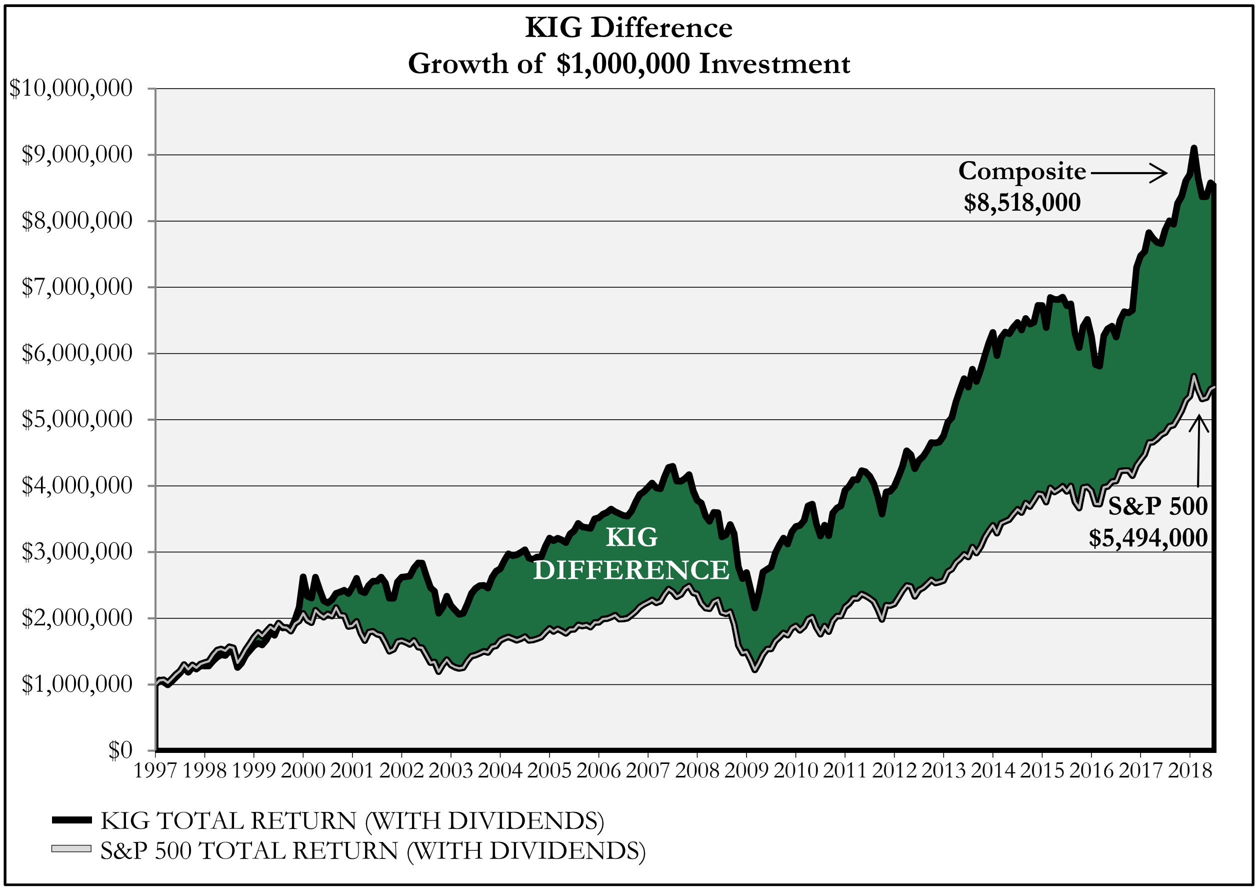
Other Market Indices
Annualized and Cumulative Equity Performance

	Average Annual Total Returns						Cumulative
For Period Ending 6/30/18	**1 Year**	**3 Year**	**5 Year**	**10 Year**	**15 Year**	**Since Inception 1/1/97**	**Since Inception 1/1/97**
S&P 500	14.4%	11.9%	13.4%	10.2%	9.3%	8.2%	449.4%
Small Cap Equity (Russell 2000)	17.6%	11.0%	12.5%	10.6%	10.5%	8.7%	502.1%

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

International- Developed (MSCI- EAFE)	6.8%	4.9%	6.4%	2.8%	7.3%	4.8%	175.3%
International- Emerging (MSCI -EEM)	8.2%	5.6%	5.0%	2.3%	10.7%	6.0%	251.8%
Gold	0.2%	1.5%	-0.1%	2.3%	8.1%	5.5%	216.4%
Commodities (CRB)	16.3%	-3.4%	-5.8%	-7.7%	1.0%	2.3%	61.8%

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.



Portfolio Activity

Today's combination of a stable economy, low interest rates, and growing cash flows due to tax reform leaves bargain priced stocks a rarity in the market. We have identified many qualified candidates, but prices would need to be lower for us to react in any significant way. We are content to be patient and wait for the "lay-ups" that we mentioned earlier. We were, however, able to find two new investments during the quarter that warranted inclusion in our clients' portfolios.

New Positions

Expedia (EXPE) is an online travel agency (OTA). In addition to their namesake website, where consumers can purchase airline tickets, book hotels, and make other travel-related arrangements, the company also operates Hotels.com, Homeaway (competes with AirBNB with a focus on whole-home rentals; includes VRBO, which was acquired a couple of years ago), hotel metasearch platform Trivago, and corporate travel management business Egencia. After a period of consolidation, Expedia and Booking Holdings (formerly known as Priceline) have emerged as something of a global duopoly in the OTA space. We believe the OTA industry is poised to continue growing at an above-market rate as more hotels and alternative accommodations are added to their platforms. Ultimately, we believe Expedia and Booking will be very difficult to disrupt as their large scale drives traffic to their sites, which allows them to vastly outspend individual hotel chains on advertising, which drives more traffic to their sites, and so on. It would also be extraordinarily difficult for a company to start from scratch and build the network of properties that Expedia and Booking already possess. A search provider like Google can show options, like Google Flights, but all the data backing those searches and the ability to actually make a purchase comes from the OTAs.

Expedia's shares had fallen about 30% from its recent highs after a couple of earnings announcements failed to meet Wall Street expectations. This was mainly due to larger-than-expected expenses related to an expanded sales force and migration of their IT infrastructure to the cloud. We believe these investments in people and systems will lay the groundwork for outsized growth in the future as OTAs continue to take share from other methods of booking accommodations and Expedia expands into more profitable business in the fragmented European and Asian hotel markets. At a valuation of around 15x forward free cash flow at purchase, we believe the shares should benefit from the compound effect of price to earnings (P/E) that are growing faster than the overall market.

Naspers (NPSNY), our next purchase, is a South Africa-based media company that operates pay TV and traditional print media platforms. One of the company's primary focuses, however, is on discovering and fostering investments in technology and e-commerce companies. In this regard, the bulk of the value of the company is derived from several investments it has made in nascent technology companies. For example, in 2001 Naspers purchased one-third of a small Shenzhen, China-based online game designer named Tencent for $32 million. In what was likely one of the best investment decisions of all time, this purchase is now worth approximately $150 billion (even after a recent partial stake sale). While they make up a much smaller amount of capital, the company's other significant investments include Flipkart, an India-based online retailer (which recently announced its intention to sell its stake to Walmart); Delivery Hero, a Germany-based food delivery company (a la Grubhub); MakeMyTrip, an India-based OTA; and online classifieds such as LetGo. We estimate these investments are worth another $20 billion.

The impetus for our investment is that Naspers currently trades at a value that is 30% below the value of just their stake in Tencent, so we're effectively getting the operating businesses and the rest of their investments for free. While some discount to the sum-of-the-parts may be warranted, the company trades at a 40% discount to what we believe is a conservative estimate of Naspers' fair value when you include non-Tencent assets in the mix. In other words, the sum of the pieces are worth far more than the current market value. This large margin of safety allows us to remain patient while the valuation discount narrows.

Increase in Position Size

We increased the Composite's position in **Amerco (UHAL)**. Revenue growth has been within our expectations but an uptick in expenses has led to somewhat of a disappointing earnings picture over the past several quarters. Our take on the expense issue is that management is continuing to invest in its business as it sees an opportunity to further distance itself from the competition in the rental truck market and to build up its self-storage business. Similar to Expedia, we believe the investments today will ultimately lead to significant future growth.

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