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Dear PVP partners and friends

The fourth quarter was a surprising one in many ways, and witnessed a return of the volatility we hadn't seen since the beginning of the year. In October, with the very contentious election just around the corner, the market turned a bit ornery in the 3Q "earnings season". Our companies generally met or exceeded our expectations, but the market would frequently draw "glass half empty" conclusions from many of the conference calls. At the same time, with Clinton deemed to be the inevitable president-elect, the concern shifted to the problematic likely loss of Republican control of the Senate, and even a possible loss of the House. In the days just prior to the election, however, the market rallied a bit as Clinton's lead in the polling seemed insurmountable.

As we now know, we will soon have a President Trump and not (another) President Clinton. Moreover, both the House and Senate will remain under Republican control. On election night, as Trump's victory became increasingly apparent, the futures market suggested equities might be off more than 5% due to the uncertainties surrounding a Trump administration. Yet inexplicably, in a matter of hours, after a gracious concession speech by Clinton and conciliatory words from Trump, the market completely reassessed the situation, and the next day US equities were up about 1.5%. Thus began a strong rally that lasted approximately though the Thanksgiving holiday.

Moreover, immediately post election there was a rapid rotation of sectors, into and out of favor, as the market began to conjecture the impact of a Trump administration on various industries. The spread-based financials were the most impacted, rallying hard and fast as the yield curve steepened based on higher expectations for economic growth, deficit spending and possible inflation. The possibility of a repeal or remake of the Dodd-Frank regulations, passed after the financial crisis of 2008, also buoyed financial stocks. Sectors that would benefit from increased infrastructure spending also gained, such as construction and basic materials.

Health care, on the other hand, lagged in the rally, primarily on account of the uncertainties around the future of PPACA ("Obamacare") in a Trump administration. Likewise, those sectors formerly deemed "safe" (consumer staples, utilities, REITs) were generally a source of funds in the rotation, as rising interest rate makes their dividend yields relatively less attractive. The volatility continued through year end as investors struggled to reconcile President-elect Trump's campaign rhetoric with the political realities, and rebalanced their portfolios accordingly. **We suspect this volatility will continue for the foreseeable future.**

The fierce sector rotation was a mixed bag for PVP. On the one hand, our long-neglected financials, mostly trading at quite discounted valuations, benefited greatly in the quarter. As a result, as we will discuss below, we recently took some profits here. Moreover, as we highlighted last quarter, we have had little representation in the staples/utilities/REIT sectors, so their underperformance did not hurt us. If anything, it might be creating new opportunities for us. On the other hand, our relatively large representation in health care, given the new uncertainties, did not help us. Nor did our underrepresentation in the more commodity-oriented industries that will presumably gain from increased infrastructure spending, which we typically don't find to be attractive investment vehicles.

Overall, the post election rally was "risk on" as we were continuing to become incrementally more "risk off", so this was not an optimal environment for PVP. Market leadership skewed toward smaller, riskier and lower quality companies, which is so often the case with a rapid upward move in the market. Nonetheless, our diversification, patience and opportunism – along with the announcement that our holding **Harman (HAR)** has agreed to be acquired by Samsung, which we will discuss below -- did lead us to post a healthy gain for the quarter. In aggregate **PVP was up 3.6% in 4Q16, and is now up 18.9% since accepting our first partner assets in early February of 2016.** [1] Regardless of how strong or weak recent performance has been, **we will always caution our partners to take a longer term view when assessing our track record.** While we obviously cannot control or even predict the overall market direction in the short run, we can say that we continue to hold a diverse portfolio of free cash flow generating companies, currently trading at a discount to the market, but with better growth, margin, return and leverage characteristics.

Actions taken in 2Q16

Buys in the quarter

We were relatively active in the quarter. PVP generally does not consider itself to be a "thematic" investor. Rather, we tend to construct portfolios from the bottom up, on a stock by stock basis. There are times, however, when our research insights are more broadly applicable than to just one stock. For example, recently we have developed some conviction that, at long last, the US may be on the verge of a housing recovery. Many companies are exposed to the housing sector, but (so far) we have found two stocks in particular -- Weyerhauser (WY) and Whirpool (WHR) -- that should benefit if we are right, at valuations that we find highly attractive, and with a substantial margin of safety.

Weyerhauser (WY), the lumber company, is another operating company that in recent years has elected to become a REIT, and currently boasts a 4.1% dividend yield. First, the company will benefit from a boost in demand if we are right about housing. Moreover, WY has struggled recently to compete with Canadian importers, whom it believes are being given an unfair advantage via a subsidy from the Canadian government, and has petitioned the Dept. of Commerce for relief. The late 2016 expiration of a "pro Canadian" lumber trade

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[1] *Performance figures are net, and assume a 1% annual management fee. Assumes PVP partners, all of whom hold the same portfolio, were fully invested as of the beginning of the time period.*

pact, combined with the prioritization of "fairer" trade deals for American business, were of course major campaign platforms of President-elect Trump, and any relief WY might get on this front would hugely benefit the company.

Whirpool (WHR), the manufacturer of washers, dryers and kitchen appliances, is another company that has struggled with the lack of a housing recovery thus far. As a result, the company has a plan in place to take significant costs out of its expense structure in the coming years. If housing starts do pick up, and demand kicks in, while expenses are reduced, the growth in profits will be powerful. WHR is currently trading at attractive multiples of 13x P/E and 7x EV/EBITDA on 2016 earnings.

Crown Castle (CCI), one of the largest owners of cell phone towers, is a company that offers a 4.4% dividend yield and enjoys strong growth prospects. Cell phone towers are a highly attractive asset in the mobile phone service value chain - both essential and scarce, owing to the difficulty of zoning in dense markets. As a result, cell phone tower owners have been able to enjoy strong rent growth historically. With mobile video the fastest growing segment in telecommunications, we believe the market is undervaluing CCI's prospects for future rent increases and commensurate dividend growth.

NextEra Energy Partners (NEP) is an alternative energy independent holding company, in which NextEra Energy (NEE) holds a substantial economic position (and incentive to grow). NEP has a 5.5% dividend yield, and the dividend has been growing 12-15% annually. Today, the market seems to be valuing NEP as if that growth, which is driven by NEE's prodigious investments in alternative energy, is about to stop. Our analysis of NEE's investment backlog, which is both funded and completed through the end of this decade and beyond, indicates that NEP's yield should be lower (and share price higher), reflective of NEP's highly visible long term growth prospects.

Palo Alto Networks (PANW), the leader in cyber security, is the kind of stock we are rarely able to "afford", given our valuation discipline. The company has been growing revenues by more than 30% annually, but due to a shift in the company's business model coupled with somewhat longer cycles, there is some current skepticism about the company's ability to continue to grow. We disagree, and believe in time the recent pullback will prove to have been a great opportunity. PANW is currently trading at an attractive 2016 FCF yield of 5%.

In addition, we added opportunistically to a number of our holdings during the quarter. For instance, **Booz Allen (BAH),** which we initially purchased in 3Q16 and discussed in our last letter, had an unfortunate situation recently in which an employee allegedly stole classified national security information. The stock quickly fell materially, the company dealt with the situation appropriately, we added to our position, and the stock has recovered nicely. From a bottom in early October after the news, the stock was up about 21% through yearend. In the case of **Maximus (MMS),** also purchased and discussed last quarter, the stock dropped precipitously the day after the election on a rather misleading research report suggesting that a large portion of the company's business would disappear if PPACA ("Obamacare") were repealed. We believe there is a very low likelihood of this scenario playing out. Furthermore, even if PPACA is repealed, the government health insurance landscape would quickly get very confusing, and in fact Maximus's business typically thrives in times of policy uncertainty. So we added to our position, and the stock recovered 23% from its bottom the day after the election through yearend. It is for these kinds of opportunities that we frequently carry extra cash. We also added to a number of positions in which our holdings were temporarily out of favor for reasons that we expect to be transitory, most notably **Alphabet (GOOG)** and **Amazon (AMZN).** We don't understand why Alphabet, parent of Google, is now trading at approximately a market multiple in spite of its enviable business model, dominant market share and terrific growth prospects, so we have made it our largest position.

Sells in the quarter

To fund these purchases, we were also active sellers in the quarter. In the case of **Principal Financial (PFG)** and **Alexandria Real Estate (ARE)**, the companies' performance continued to exceed our expectations, and each of these stocks blew through our price targets. In addition to their own strong results, PFG had also benefited from increased expectations of a Fed rate hike, and ARE from the ongoing strong performance of the REIT group. True to our discipline, we sold each of these stocks at a healthy profit. PFG and ARE returned 33% and 27%, respectively, in 2016.

Not all the sales of our financial stocks were victories, however. As you probably have read, it was recently revealed that in recent years a large number of **Wells Fargo (WFC)** employees have engaged in truly egregious behavior in furtherance of the company's sales initiatives – in many cases opening client accounts without permission. Since Wells has long prided itself on its ability to "cross sell", we believe this widespread behavior calls into question the company's management, strategy and competitive advantages, and jeopardizes customer relationships and future growth prospects. We sold the stock shortly after the news broke, prior to the post election rally in financials. Fortunately WFC was not a large position, and so it was not overly detrimental to performance.

In the case of **Landstar (LSTR)**, **IBM (IBM)** and **Emerson Electric (EMR)**, the stocks have performed well notwithstanding relatively poor current fundamentals. In these cases, rather than waiting for business to turn, and risking that the stock market may grow impatient, we decided to take profits and redeploy the capital elsewhere. LSTR, IBM and EMR returned 46%, 25% and 21%, respectively, in 2016.

Staples (SPLS), the retailer of office supplies, had been a relatively small position for us. We bought the stock on the premise that there would be tremendous synergies from its planned acquisition of Office Depot (ODP), and that eventually positive job creation would bolster the company's stagnant top line. The valuation was quite compelling as well; however, when federal regulators began the process of blocking the ODP acquisition on antitrust grounds, the deal was terminated. While the stock remains very cheap, we believe there are better opportunities elsewhere. Staples stock was approximately flat in 2016.

Finally, in a risk we referenced last quarter, midway through the quarter **CBS (CBS)** appeared increasingly likely to acquire Viacom (VIAB). While we believe there is substantial risk in a transaction like this, we were delighted that the market has disagreed, pushing up CBS stock. This provided us the opportunity to reduce risk and also reap profits by selling CBS. CBS returned 37% in 2016.

We also trimmed a number of our positions when the stock movements made their investment case less compelling. For instance, in the case of **West Corp (WSTC),** on the 3Q call the company, frustrated with the stock price, revealed that they have hired an advisor to explore a potential sale of the company. The stock moved up rapidly, and we sold part of our position, locking in some profits and also removing some risk in the event a transaction doesn't occur. After the major post election rally in the financials, we also took some profits in several of our holdings, including **Goldman Sachs (GS), BankAmerica (BAC), JP Morgan (JPM), Citizens Financial (CFG) and Voya (VOYA).** All these stocks were up significantly after the election. While we still like these stocks, and their business prospects indeed look more promising now, we believe a good deal of that optimism has already been reflected in the stocks, so we trimmed these positions.

Strong performers in 4Q16 [2]

As referenced above, our financials were generally our best performers in the quarter. **Goldman Sachs (GS)** had a very impressive quarter in difficult market conditions, posting an impressive 11% return on equity (ROE). Even more importantly, as noted above, the Trump victory led to expectations of higher interest rates, a steeper yield curve and a potential modification of Dodd-Frank. As mentioned previously, we did take some profits, but maintained a core position. GS returned 49% in the quarter.

Harman (HAR), the provider of car audio and infotainment electronics, a holding we have highlighted in previous letters, agreed to be acquired by Samsung. The transaction is expected to be completed by mid-2017, and the stock was up 32% in the quarter.

Citizens Financial Group (CFG) is a Providence, RI-based "super regional" commercial bank, formerly owned before the 2008 financial crisis by Royal Bank of Scotland. Citizens continues to do an exemplary job of improving itself since its independence, and will also benefit from many of the same factors that are favoring our other banks. CFG returned 45% in the quarter, and, as noted previously, we did take some profits.

Voya (VOYA), the life insurance/retirement company, is another financial stock that will benefit greatly from the rise in long term interest rates. VOYA returned 36% in the quarter, and, as with many of our other financial holdings, we did take some profits here.

At the risk of repeating myself, **BankAmerica (BAC)** also benefited from the same factors that buoyed so many of our financials. Higher interest rates, and a steeper yield curve, will have a major effect on BAC's net interest margin, the main driver of profitability for most banks. BAC returned 42% in the quarter, and again here we took some profits.

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[2] *Top and Bottom Five performers in the quarter defined as the most value added or subtracted, in basis points, relative to the Russell 3000. Top and bottom stocks are presented, respectively, in descending and ascending order of value added/subtracted.*

<u>Weak performers in 4Q16</u>

As referenced previously, health care struggled in the quarter. **Allscripts (MDRX),** the health care IT provider, has been a perplexing and frustrating stock for us. Although we have seen tremendous progress in recent years, and we anticipate a bright future for the company, the valuation just continues to become more compelling as the stock gets cheaper. MDRX was off 22% in the quarter.

Biogen (BIIB) had another news-filled quarter. Importantly, in terms of pipeline development, the company announced that its new drug (nusinersen) for Spinal Muscular Atrophy (SMA) has been approved by the FDA, and also released promising results from its Phase 1B study of aducanumab for Alzheimer's Disease. Unfortunately, these positives were overwhelmed by the failure earlier in the quarter of Eli Lilly's Phase 3 study of solanezumab for Alzheimer's, as well as the Board's decision to elevate the company's Chief Commercial Officer to the CEO role, making a sale of Biogen less likely in the near term. Moreover, like the rest of the pharmaceutical and biotechnology sectors, Biogen has come somewhat under fire for its drug prices. BIIB was down 9% in the quarter.

Allergan (AGN) had a rare 3Q "miss" due mostly to a slowdown in some of its more mature products, which, coupled with the aforementioned pricing/regulatory cloud that hovers over the industry, brought the stock down 9% in the quarter. Allergan, best known for Botox, has perhaps the most robust pipeline in the industry; is currently executing a very large share buyback, with still more likely to go after the divestiture of its generics business to Teva; and trades at a 7+% FCF yield. Recall also that about a year ago Pfizer (PFE) offered to buy AGN for $363/share, and AGN now sits at $210.

Palo Alto Networks (PANW), which we discuss above, was admittedly not our most timely purchase, as the company's 3Q results were modestly disappointing and the stock sold off 18% in the quarter. Although demand remains very strong, and Palo Alto appears to be gaining share, as it gets larger the company's sales cycles are extending somewhat. Moreover, while the company's shift from a transaction-oriented to an annuity-like business model should bode well for revenue visibility and thus valuation, as well as customer relationships and cash flow, this transition is not exactly seamless. We recognize the short term challenges but believe the opportunity is compelling, so we added to the position in the quarter.

Liberty Global (LBTYA), despite being purchased after the "Brexit" vote, which we believed at the time to be a timely entry point into this growing and highly FCF generative European cable company, was down 10% in the quarter. We attribute this partially to currency effects, as 2/3 of LBTYA's business is in the UK, with the Pound depreciating during the quarter; partially due to some investors, who had been anticipating a "quick gain" from a possible Vodaphone acquisition of LBTYA, selling their positions. Net of expansion CapEx, we estimate LBTYA is trading at approximately 9x FCF, is growing, and is managed by a highly shareholder-friendly and financially astute management team, which has been aggressively buying back shares as the stock has pulled back.

Setup

We continue to like the positioning of the portfolio. PVP owns a **diverse portfolio of high quality companies, operated by shareholder-friendly management teams with a proven track record in deploying capital.** While we are normally reluctant to rely much on benchmark data in the short term, some context can occasionally be helpful. Similar to previous quarters, as shown in the table below, the PVP portfolio remains cheaper than the Russell 3000, yet PVP's holdings have grown revenues and eps faster than the Russell 3000, with less leverage. PVP also has higher margins and greater returns than the Russell 3000.

	PVP [3]	Russell 3000
Free Cash Flow yield (2016)	6.2%	4.3%
Price/Earnings (2016)	18.2x	19.7x
Debt/Total Capital	41%	44%
Debt/EBITDA	2.5x	3.1x
2016 revenue growth	5.9%	0.8%
2016 eps growth	8.9%	7.6%
2016 EBITDA margin	29.1%	18.6%
2016 Return on Equity	15.4%	14.2%
2016 Return on Invested Capital	9.6%	6.3%

To put PVP's 2016 FCF yield of 6.2% into perspective, we must also consider the still quite low 30-year US Treasury Bond at 3.0%. This suggests an Equity Risk Premium (ERP) of 3.2% (6.2-3.0). In other words, **we believe we are being appropriately compensated to bear the risk of equities.** Since we expect recent volatility to continue, and possibly increase, as always we will strive to position ourselves to take advantage where possible.

Finally, as we have previously discussed, for the first year since the 2008 financial crisis **"value" began to outperform "growth"** investing in 2016. As a reminder, from 2009-2015 the growth indices outperformed their value counterparts by 3-4% per year. In 2015, in fact, the Russell 1000 Growth index returns exceeded the Russell 1000 Value by a whopping 9.5%. In 2016, however, the dynamic has reversed, with large cap value (Russell

[3] *Data for both PVP portfolio and Russell 3000 are generally via FactSet. In a few instances, we have made minor adjustments.*

1000 Value) outperforming large cap growth (Russell 1000 Growth) by 9% and small cap value (Russell 2000 Value) outperforming small cap growth (Russell 2000 Growth) by 19%.

As always, we are so appreciative of the confidence you have shown in PVP, and we promise to work tirelessly to make you pleased with that decision. We also strive to be as transparent as possible. Please let us know if you have any questions, or if we can help in any way.

Sincerely

J. Kelly Flynn

Chief Investment Officer

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