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Britain's vote to exit the European Union has led to significant uncertainty across global markets. We believe market impact of this uncertainty, though severe, is more of a shorter-term phenomenon which will provide an opportunity for long-term investors. We think the market's current extreme reaction is overdone, as ultimately the effect on long-term cash flow streams for most of the companies we own will not be impacted significantly.

We must accept the fact that periods of long-term macro tranquility are actually quite rare. In 1987 there was a global stock market crash. In fact, the Hong Kong market was hit so hard that it was closed for days before it regrouped and reopened. In the early '90s there was the first Gulf War, followed by Latin America's "Tequila Crisis" in 1994. The next couple of years were fairly quiet, but then came the Asian Crisis in 1997, followed by a full-blown panic in most emerging markets by mid-1998. Asia began to slowly recover in 1999, but then in 2000, the tech bubble popped and 2001 brought the terrorist attacks of 9/11.

Especially since the financial crisis of 2008-2009, investors have been obsessed with macroeconomic themes and distracted by various worldwide circumstances including deflation in Japan; the state of global banks; financial instability in Greece, Cyprus and the European Union; and the challenges facing the BRIC economies (Brazil, Russia, India and China). These investor distractions have resulted in a persistent cloud of fear that has depressed equity market valuations while inflating valuations in investments deemed as "safe": cash and other fixed income instruments.

While today's economic environment is not robust, our opinion is that it is suitable for long-term value creation. We do not believe today's Brexit is a fair comparison to 2008's Lehman moment. The financial system has recapitalized and banks are in a better position to deal with uncertainty. With low energy prices, low interest rates, near full employment and less indebtedness, the global consumer is in a stronger position to weather this uncertainty. The global economy has removed most of its excesses and is doing okay, growing at 3%.

We believe conditions are best for long-term value investors to buy quality companies on the cheap when the markets think macro conditions are at their worst. We have a consistent approach to the integration of macro events: determine how the event impacts a specific company's value over the long-term, if at all, and make adjustments to specific business valuations, if needed. Recall that we value a business based on the present value of all future cash flows. Because the stock market reacts mostly to short-term information flows, we seek to exploit market inefficiency.

Keep in mind many companies domiciled in the United Kingdom are multi-national corporations earning income and generating free cash flow worldwide. For companies that are outwardly focused – many of which are "dollar earners" with a lot of exposure outside of the United Kingdom and Europe – the depreciation of their home currency may actually prove to be beneficial, both in terms of competitiveness and the impact on operating income. All else being equal, earnings are going to be substantially higher if these companies have significant revenues outside the United Kingdom whereas we believe their costs, in their home currency, will be lower. This recent volatility has provided us with several buying opportunities in the United Kingdom, and in Europe in general, as well as in Financials and other cyclically exposed sectors specifically. In all of these areas, there is a common thread: We are discovering companies that we believe are high quality and managed intelligently, but their stock prices have been hit for reasons unrelated to their intrinsic value.

As we wade through this uncertain time, we have been moving at a judicious pace in making portfolio changes. One thing we have learned is that you don't rush in all at once when things look cheap. It takes a while for these things to get digested. As such, we like to gradually increase exposure to those companies we own that we think have been unfairly hit; their share prices have weakened significantly more than the corresponding change in intrinsic value.

Though we cannot control price movement, we can apply the principles of disciplined value investing with the goal of growing our shareholders' capital over time.

David G. Herro, CFA
Chief Investment Officer - International Equity, Partner and Portfolio Manager

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