JRW Financial LLC

Letter to Clients and Interested Parties
1st Quarter 2016
April 28, 2016

Dear Clients and Interested Parties,

The first quarter of 2016 showed the virtue of our Long-Term Investing[1] approach. Broad market declines from Q4 2015 continued into Q1 2016, and the beginning of the year was one of the worst on record from a market price perspective.

The usual suspects (declining oil prices, China, strong U.S. dollar, and central bank policies) were blamed for the turmoil. Fortuitously, large cap, stable, dividend-paying equities proved to be the safe haven and the path to outperformance (fortuitous for us because we rolled out the JRW Income Focused Strategy during the second week of January).

Fast-forward through the remainder of the quarter and broad market indices did a full about-face, making up the dramatic losses in equally dramatic fashion. Q1 ended with the broad markets slightly higher than they were at the quarter's beginning.

One of the important messages I try to convey in these letters is the importance of taking the long view. I will always remind you that we invest for the long-term, we buy ownership interests in businesses based on business performance and potential for compound growth, and we ride out periods of heightened volatility and uncertainty with resolve. We have a process and we adhere to it regardless of market conditions. So far, these tactics have served us well. It's certainly the process that best fits our and our clients' investment needs.

Had we panicked and sold our holdings during the market's decline, we would have missed the right time to reenter and our investment operations would have suffered. Market timing is a game we choose not to play. Perhaps others may succeed weaving in and out of markets based on guesses as to where prices are headed next, but I am certain such efforts on our part would be futile.

[1] Our blog of the same name can be accessed at http://www.long-term-investing.com

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Declining share prices breeds fear, but we are not beholden to fear in our day-to-day operations. We invest in best of breed (BOB) companies at reasonable share prices and allow the power of compounding to do the leg work. Lather. Rinse. Repeat.

Margin of Safety

Warren Buffett has referred to the words "Margin of Safety" as the three most important words in the investing profession. Seth Klarman wrote an investment book with that title. I believe that our investment operations are worthless if we do not always pay mind to the concept of margin of safety.

There are a number of ways in which margin of safety can factor into the investment process. Paying a significantly discounted price for shares relative to conservatively estimated per share business value incorporates a margin of safety. Even if you are wrong about the per share business value, paying significantly less builds in a buffer zone. This concept is very important to value investors, and it is the reason we always are mindful of the price we pay.

We think of margin of safety in another way too. In last quarter's letter, I wrote a section called "Our Focus on Quality," where I offered some insights into the type of high-quality businesses we prefer. I highlighted that most of the businesses in your portfolios are "stable" mid and large cap companies with a predictable path for continued compounding. The reason we focus on these types of businesses is for the margin of safety they provide.

As your investment manager, my number one goal above all else is to protect the money you've entrusted to our care. We are stewards of your investment capital, first and foremost, and we devote a considerable amount of time to making sure that your money is protected from permanent impairment.

As an investment firm, we are hard-wired to despise losing money. We believe fundamentally, deep within our core, that the only way to grow wealth over the long-term is to ensure that wealth is protected as well as it can be. "One step up and two steps back," a line from a Bruce Springsteen song, is a sure fire way to capital impairment.

The businesses we invest in are exceptional in some way. They have giant moats protecting their core operations from competition. They enjoy competitive advantages built into the very fabric of their businesses. This allows those businesses to continue earning high returns on capital with little to no threats to future profitability. The built-in protections of these BOB businesses

provide our investment capital with a satisfactory margin of safety and minimal risk of permanent capital loss. Putting your money to work any other way is not worthy of the term "investment."

Our Investment Operations Practically

How does this work in practice? The quest for superior businesses is one we undertake constantly. We read broadly. We keep track of businesses that have in the past or may in the future exhibit the characteristics we believe show the existence of competitive advantages. Our study is both qualitative and quantitative. We look for businesses we can understand and for businesses where the next 3, 5, and 10 years seem forecastable. We try to find "equity bonds[2]," which are businesses with stable and predictable cash flows and earnings over a long period of time that offer coupon-like returns to equity owners.

When we find a business that seems to have a moat and high returns on capital consistently with a visible path for compounding value over the long-term, we next turn to the business operators. We try to get a feel for management and how they run the business. Are we certain that our clients' interests are best served by investing their capital with these operators? Are they capable operators with a detectible sense of integrity and honesty? Would we feel comfortable purchasing the entire company and keeping current management in place?

If the business and the managers check out, we next turn to the quantitative assessment. Can we reasonably forecast cash flows and earnings in such a way as to conservatively estimate per share business value? If our models are too speculative based on highly uncertain and potentially volatile future business performance, we cannot have confidence in our assessment of intrinsic value. In those situations, we cannot adequately protect client capital with a margin of safety.

Once we've found a business with a strong moat, excellent management, and a conservatively estimated and predictable assessment of per share business value, we compare value to price to see if there is a reasonable case for purchasing shares. The stability and predictability of the business largely dictates the price-based margin of safety we seek. The more stable and predictable the business, the smaller the required difference between price and value for an investable stock.

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[2] A term we quite enjoy and attribute to Larry Sarbit of Sarbit Advisory Services, who believes Warren Buffett stated the term in a 1970s article from Fortune.

I hope this gives some insight into how we try to serve your interests daily in our investment operations. Our primary purpose is to ensure that your money is protected from permanent loss, and once we are confident in that pursuit, we then try to grow your money over the long-term. Our spin on this tried-and-true method of investment has served us well since inception, and we hope to continue serving you, our partners, well into the future.

Portfolio Activity

While we intend to own businesses for a very long time, there are important portfolio management considerations that lead us to interim transactions. These transactions serve as adjustments to the optimal risk/reward tradeoff within our portfolios. There will be times where existing holdings meet or exceed our estimate of per share business value while others develop a larger margin of safety between share price and value. Such is the nature of inefficient markets.

From a portfolio management perspective, we seek to optimize internal rates of return in the portfolios we manage in each of our broad strategies. We do so by allocating investment capital away from overvalued and into undervalued businesses.

In future letters, this section will detail portfolio activity for both the JRW Core Equity and JRW Income Focused Strategies. Since the Income Focused Strategy began during the quarter, we will not update interim transactions until next letter.

In the Core Equity Strategy, we added three new positions, trimmed three existing positions, and sold out of two positions completely (though these businesses were transferred to the new Income Focused Strategy). Other than these infrequent, small transactions, we remained largely inactive in the face of extreme volatility during the quarter.

New positions in the Core Equity Strategy were taken in **The Priceline Group (PCLN), Cullen/Frost Bankers (CFR), and Amazon (AMZN)**. We hope to provide some insights into these positions on our Long-Term Investing blog, so please be sure to check in periodically.

We made no net additions to portfolio holdings. We trimmed our positions in **Apple (AAPL), Mondelez International (MDLZ), and Gilead Sciences (GILD)**. These transactions had more to do with making capital available for higher conviction businesses than with our general assessment of each company's quality, as we are happy to remain owners of each. The two holdings we deleted from the Core Equity Strategy, **Philip Morris International (PM) and**

Aflac (AFL), are two of our most favorite companies to own, and we are glad to do so in the Income Focused Strategy.

Income Focused Strategy

Last quarter I wrote to you about plans to introduce a Strategy focused on generating current income at a high level, while still being faithful to our investment mandate of BOB businesses at fair prices. Specifically, I wrote:

> In discussions with current and prospective clients, we learned of the strong desire from many people to generate at least some semblance of current income from their portfolio holdings. Whether with people dissatisfied with the return on normal savings accounts or certificates of deposits, or with people closer to retirement age who want to ensure that there is a regular stream of income on which they can rely, we've had many discussions in the past few months about dividend paying stocks and tweaking our Core Equity portfolio to include more income generation.

This effort led to our launch of the JRW Income Focused Strategy on January 12, 2016. Our purpose in launching this Strategy was to offer interested clients a way to generate current income from their portfolio holdings, while still benefitting from our overall investment philosophy of owning BOB businesses for the long-term.

Many of the Core Equity businesses are businesses reinvestment opportunities and capital expenditures are favored over distribution of capital to shareholders. I believed that we could build a portfolio that remained true to our unending devotion to high-quality businesses, while at the same time, offering interested clients a higher yield from their portfolios.

We launched the Income Focused Strategy on January 12, 2016. As I alluded to earlier, stable, dividend-paying stocks became a safe haven in the market, and our Income Focused Strategy was up over 9% at quarter's end. **This will not be the norm**. Further, we will not sacrifice business quality for dividend yield. That is important to know. We could build a portfolio of the highest yielding stocks in the market if our primary goal was generation of the highest current income possible from equity positions. The goal of this strategy, however, is to generate income, focus on dividend growth, and apply the fundamental, value-oriented, businesslike principles with which we approach our investment operations.

The strategy will likely outpace the market in share price returns in volatile down markets and trail the market during euphoric gains. Still, we believe we have found an exceptional mix of income generating businesses that will provide clients who desire income from their holdings substantial risk minimization and highly satisfactory total returns over the long-term.

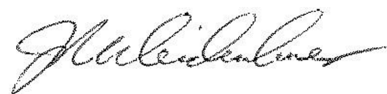
The following businesses were purchased for the strategy on January 12, 2016, and no interim transactions took place within the quarter: **AmeriGas Partners (APU), Cummins (CMI), Emerson Electric (EMR), Ventas (VTR), Philip Morris International (PM), Time Warner (TWX), Wal-Mart (WMT), Verizon (VZ), Altria Group (MO), International Business Machines (IBM), Aflac (AFL), Apple (AAPL), Chevron (CVX), Procter & Gamble (PG), Union Pacific (UNP), Paychex (PAYX), Diageo (DEO), Pfizer (PFE), U.S. Bancorp (USB), and Wells Fargo (WFC).**

Conclusion

Margin of safety is the concept with which we manage your investment accounts towards our ever-present goal of protecting your capital from permanent loss. Whether markets are up, flat, or down, we will always remain on the lookout for wonderful businesses to add to your portfolios at reasonable prices.

As always, it is a true honor and privilege to manage your investment capital, and I take pride in building relationships that last a long time. If you know of anyone who is not familiar with us but may be benefited by our services, please feel free to send them our way. And as always, please feel free to call or write at any time.

Warmest regards,



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April 28, 2016