IN THIS ISSUE

OBERMEYER WOOD **NEWS**

SUMMER 2016

MARKETPOINT

After a volatile start in 2016, the U.S. equity market stabilized during the second quarter. In late June, however, Britain's unexpected vote to exit the European Union created turmoil in stock markets worldwide. This difference may be explained in part by American companies generating only 14% of their revenues in Europe, while European companies generate a much larger 49% of their revenues in Europe. In other words, American companies have much lower direct exposure to disruptions and a general slowdown in Europe.[1] U.S. equities also benefitted during the quarter from reduced concern about China, higher oil prices, and better-than-expected earnings at some U.S. companies.

For many Britons who voted to exit the E.U., the chief concern was a perceived reduction in British sovereignty and self-determination as the E.U. grew in bureaucratic reach and enacted increasingly burdensome regulations. Concerns over immigration and its impact on public resources, housing, and wages also played a role. Regardless of the reasons for exit, the region must now work through the complex process of legal withdrawal from the E.U. The exit necessitates establishing new rules surrounding tariffs, import quotas, and transfer payments —and the final agreements cannot be predicted with confidence. Despite some alarmist headlines, we don't believe this unexpected development will push the global economy into a severe recession or threaten the financial system. Markets are averse to uncertainty, and it is this more than any known quantity that seems to be driving market volatility at present. Given that the timeline for negotiations is two years after Article 50 is invoked, uncertainty over the outcome may remain a headwind for global growth. As such, we expect markets to remain volatile.

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For domestic growth, however, the economic impact of European uncertainty on the U.S. should be modest. American exports to Western Europe and the UK are just 2% of U.S. GDP. China's contribution to the U.S. economy is similar: total exports to China are just 2% of U.S. output. As for the impact of all overseas activity on the U.S., we note that exports are 13% of GDP.[2] In other words, domestic demand—the consumption of households and businesses within the U.S.—is 87% of the economy. Domestic conditions are key to the U.S. outlook.

Economic data in the U.S. continue to indicate a moderate expansion. Employment growth, an important ›

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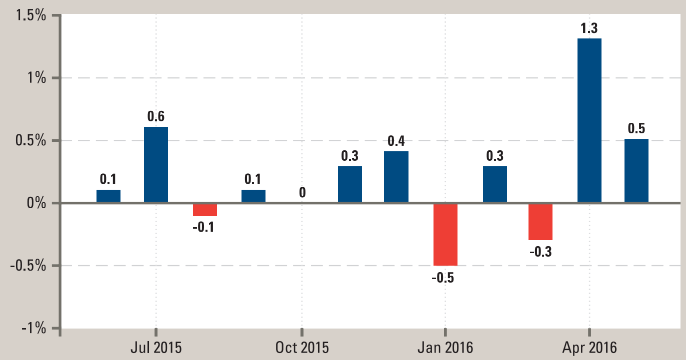
indicator of economic strength, is emphasized by the Federal Reserve in its consideration of when to raise interest rates. The U.S. employment report for April was fairly strong, as it has been for most of the last few years, but May's report fell short of expectations. The government's employment numbers, however, are known to be volatile, and other employment measures suggested stronger growth. Data gathered by a nationwide payroll company, ADP (Automatic Data Processing) usually tracks the government's number, and in May it was still showing the strong trend of the preceding months. Also pointing to an improving economy are strong retail and existing home sales (see chart below). If the current pace of economic growth is sustained, we would expect the Fed to continue with modest rate increases later in the year. However, those increases may be postponed in deference to the current uncertainty created by the British vote.

U.S. Retail Sales



Source: www.tradingeconomics.com | U.S. Census Bureau

The U.S. presidential election is drawing increased attention from investors and politicians around the world. It is an unusual race, with the candidates presenting extremely different backgrounds and allegiances. Similar to the Brexit vote, the outcome of this election cannot be predicted with confidence. Indeed, in some ways it is difficult to know how a given candidate will govern once sworn in as President. From an investment perspective, leaders of U.S. companies have historically proved their ability to adapt to change, both economic and political.

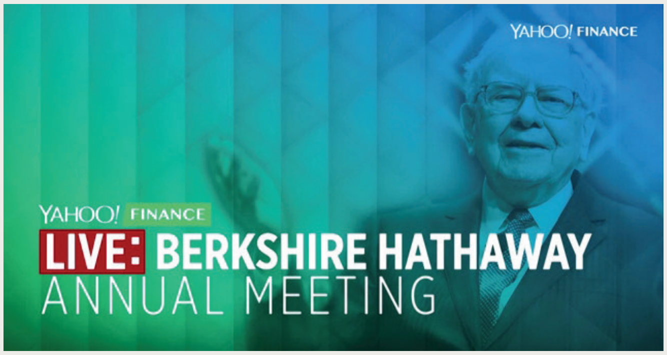
Currently, investor sentiment has become more cautious with measures of expected volatility having risen in recent weeks. Brexit and, to some degree, the U.S. election are contributing to uncertainty. Also creating volatility is capital invested in short-term trading strategies and formula-driven computer trading. This type of activity can cause irrational declines in stock prices that are unrelated to company fundamentals. In this environment, we believe it is important to maintain a balanced view and resist reacting to short-term events while adhering to our philosophy of investing in quality companies at attractive valuations. With this approach, volatility can be viewed as providing selective opportunities for long-term investments in good companies whose stock prices are temporarily under pressure.

Today's uncertainty reminds us of the old adage, "a rising market climbs a wall of worry." It suggests that widespread concern is an opportunity. Conversely, widespread enthusiasm suggests a warning: markets fall from clouds of optimism. When most investors are confident and willing to pay high prices for stocks, it is often time for extra caution. Current markets appear to reflect a healthy degree of skepticism.

Overall, the U.S. continues to be the strongest of the developed-world economies. It will likely continue to benefit from more favorable regulations, innovation, and abundant natural resources. Our long-term investment approach remains focused on finding strong companies whose prospects we believe are not being fully recognized and whose stocks are undervalued. While broad stock market valuations remain somewhat higher than average, individual company valuations are more varied, and we continue to find new compelling investments. We believe our patient search for undervalued, superior businesses will generate attractive returns for clients over time.

[1]Source: S&P Dow Jones Indices.
[2]Source: World Bank National Accounts Data.

REPORTING FROM OMAHA
FROM OUR HOME COMPUTERS



As we highlighted in our last newsletter, Berkshire Hathaway's annual meeting offered a new twist this year: it was streamed live on Yahoo! Finance. We took advantage of the new format and watched the broadcast from our home computers, securing front-row seats for Buffett and Munger's unscripted, five-hour-plus Q&A session. The broadcast barely dented attendance, with around 40,000 investors showing up for the event.

For those who didn't have a chance to tune in to the broadcast, we wanted to share some of the key takeaways:

- Buffett and Munger's renowned humor and quick comebacks remain intact. Opening the meeting, Buffett (85) introduced Munger (92), and then referred to himself as "the young one."
- Several comments reiterated their long-held view of buying businesses led by extraordinary managers. Since these leaders tend to stay with Berkshire after acquisitions, it is a key consideration in their due diligence of any opportunity.
- One question noted that Berkshire's recent acquisitions have been of more capital-intensive businesses (e.g., Precision Castparts). Buffett agreed that an "ideal business...takes no capital," but this is largely a "problem of prosperity" and these assets tend to be much smaller and wouldn't move the needle at Berkshire. Additionally, capital-intensive businesses in regulated industries can be solid holdings as they can be more stable. Buffett said they were "happy with a satisfactory result."
- One of the more detailed answers was on the contentious political environment and its potential impact on business. Buffett believes that Berkshire will be fine: "we've operated under price controls, we've had 52% federal taxes applied to our earnings… we've had regulations come along...In the end, business in this country has done extraordinarily well for a couple hundred years."
- Buffett reminded the audience to look at stocks as shares of a business and that any sensible analysis should focus on what the business itself is worth—not short-term considerations or other noise; they advised to not fixate on the day-to-day, saying, "don't get into a stupid game just because it's available."
- Buffett remains concerned about low rates (which he has commented on for several years now). It is "no fun" to hunt for investment yields, and "having a lot of money around" is a problem for companies and retirees, he said.
- Berkshire's succession plan remains on shareholders' minds; while it is clearly being discussed at length amongst the Board, Berkshire isn't inclined to provide details as no one knows when succession will take place, and of the short list, personal situations may change between now and then.
- No meeting would be worth tuning in for if there weren't a few heated moments. Buffett and Munger both took aim at Valeant Pharmaceuticals and highly paid hedge fund managers—and found themselves in the hot seat defending their Coca Cola holdings.

Buffett and Munger responded to several questions by bringing the discussion back to investing basics. Their ultimate advice is timeless: keep it simple and avoid doing stupid things.

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Associate, Client Services

Kaitlin Ryan
Assistant, Client Services

FIRM UPDATE

NEW TEAM MEMBER: BRIDGET BOYLE

We are pleased to announce the addition of Bridget Boyle to the Obermeyer Wood team. Bridget joins us in our Aspen office in the area of client services and general support. Bridget has been in the Roaring Fork Valley for almost seven years, working with several great companies in the hospitality industry. She received her MBA/BS in Accounting, *cum laude*, at the University of Dayton. Please make sure to say hi to Bridget the next time you stop by our office. She will be happy to help you with whatever you need.

MEETING THE NEXT GENERATION

Clients occasionally ask us if we would be willing to help their kids or younger relatives. The answer is a resounding "yes." One of our key tenets is the value in extending our client relationships to the larger family. We bring this up as we know many people have family visiting during the summer holidays. We invite you to call and arrange a time for them to come by one of our offices as we would love the opportunity to meet them in person. Our team enjoys these broader family discussions, and we often gain interesting insights from the younger generation's experiences and perspectives.

CONFERENCE LINEUP

Several of our Investment Committee members attended industry conferences this winter and spring, listening to well-seasoned investment practitioners, exchanging ideas with peers, and evaluating new companies and ideas. A few other conferences are on our summer calendar, including the CFA's annual Financial Analyst Seminar in Chicago this July. These gatherings are incredibly valuable as they further our team's knowledge and help us better advise clients. We were also honored that both Ali and Wally were asked to participate on panels at Barron's series of Top Independent Advisor conferences in recent months. We recently posted a video of Wally being interviewed at one of these events on our website (*Thinking like Buffett: Three Stocks for Volatile Times*); you can find it in the "News" section at www.obermeyerwood.com.

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