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DEEP VALUE INVESTING
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To: Investors

Gaining ground! Following poor performance in 2015, year-to-date results show substantial improvement. This year's sharp sell-off culminating on February 11th created an attractive investment opportunity for our deep value strategy. We acted aggressively to adjust the portfolio. Since year-end 2015, ten new positions have been added, representing a 30% change in portfolio composition. While stock market valuations in general appear full, our three-year upside potential remains noteworthy, and a simple return to 52-week highs would provide a gross (before fees) return of 54.5%.

Near the end of the quarter, Brexit produced elevated volatility in the Towle portfolio and throughout worldwide financial markets. The initial two day shock was followed by several strong days, recovering a substantial portion of the two day loss. Brexit brings considerable uncertainty to financial markets and the prospects for global growth. And the path to fully understanding its wide-reaching impact is many months away. While the Towle portfolio is not immune to the effects of Brexit, with limited direct exposure to Europe, we feel the long-term impact on our companies' revenues and profitability will be minimal.

Provided below are historical results compared to our standard benchmarks. Periods greater than one year are annualized.

Periods ending 6/30/16	Towle Composite *(Gross of fees)*	Towle Composite *(Net of fees)*	Russell 2000 Value	S&P 500 Total Return
3 months	6.60	6.43	4.31	2.46
6 months	16.01	15.62	6.08	3.84
1 year	-2.86	-3.54	-2.58	3.99
3 years	8.76	8.00	6.36	11.66
5 years	10.10	9.34	8.15	12.10
10 years	7.41	6.61	5.15	7.42
20 years	13.13	12.31	9.13	7.87
Inception (1982)	16.12	15.29	11.84	11.43

The second quarter 2016 investor letter segments as follows: **Portfolio Review**, **Howard Marks,** and **Investment Outlook**.

Portfolio Review

This section has been removed for compliance reasons to exclude discussing specific securities transactions.

Howard Marks

Viewed by some with the ability "to see around corners," Howard Marks provides practical insight and stimulating commentary to thousands on a regular basis. Howard is Co-Founder and Co-Chairman of Oaktree Capital Management, overseeing $97 billion in assets with a world wide staff approximating 900.

Howard's observations and tidbits of wisdom are available to all. Here are some of our favorites:

- When things are going well and prices are high, investors rush to buy, forgetting all prudence. Then when there's chaos all around and assets are on the bargain counter, they lose all willingness to bear risk and rush to sell. And it will be ever so. (*Barron's* March 11, 2013)

- Risk control is the best route to loss avoidance. Risk avoidance, on the other hand, is likely to lead to return avoidance as well. (*Barron's* March 11, 2013)

- As Ben Graham pointed out, the day-to-day market isn't a fundamental analyst; it's a barometer of investor sentiment. You just can't take it too seriously. (Letter to clients, January 19, 2016)

- It seems clear to me: the market does not have above average insight, but it often is above average in emotionality. Thus we shouldn't follow its dictates. (Letter to clients, January 19, 2016)

- There is only one intelligent form of investing: figuring out what something's worth and seeing if you can buy it at or below that price. It's all about value. (Letter to clients, January 19, 2016)

Prior to the Great Recession of 2008-09, Howard foresaw the rumblings of financial dislocation. Then, on December 1, 2010, he wrote, "The bottom line is that for whatever the reason, some asset prices have risen again, risk bearing has returned, and the risky transactions of 2004-2007 are once again doable." In the following year of 2011, valuations adjusted accordingly and asset prices declined. In early 2015, Howard cautioned of stress in the high yield debt market eventually resulting in lower equity prices for cyclical companies with more leveraged balance sheets in the back half of the year. Howard's sensitivity to the ups and downs of financial markets is remarkable.

Investment Outlook

While we believe the Towle portfolio possesses significant three-year appreciation potential, prospects for rapid price gains for the *overall* stock market appear limited. Headwinds to a sustained, broad-based U.S. market advance are commonplace:

- ✓ **Equity prices are full** based on most historical measurements.

- ✓ **Corporate profit margins approach all-time highs**.

- ✓ **Global growth slows** due to aging demographics, lower productivity, and weak business investment.

- ✓ **Total debt to GDP ratios hit record levels** as many governments commit to unsustainable spending plans.

- ✓ **Extreme central bank policies** hurt savers and cast a shadow of uncertainty across worldwide markets.

- ✓ **Brexit befuddles financial markets** threatening prospects for global growth.

- ✓ **Collapsing commodity prices degrade living standards for millions** as raw material production shrinks.

Brian Rogers, Chairman of money management firm T. Rowe Price, highlights the underlying problem. "Growth is challenged all over the world. In the second half, we could see more of the same. It is hard to see what leads to an acceleration of the U.S. economy." (Barron's June 13, 2016)

Despite the aforementioned concerns, here's why we remain constructive on the Towle portfolio:

- **Global economic progress is at hand**. "…the fact remains interest rates are low, gasoline prices remain cheap, home prices are up and wages are starting to tick higher. People are loosening their purse strings, too: Consumer spending recently advanced to the fastest pace in nearly seven years." (*Wall Street Journal*, June 10, 2016) Capital Economics, a well-respected economic forecasting firm, states the following, "We expect the pace of global growth to be similar this year to last and to accelerate slightly in 2017." (June 20, 2016)

- **Investor sentiment remains too cautious**. Institutional and retail investors are perplexed by slow global growth, central bank decision making, and worldwide political uncertainty. In the U.S., the capital withdrawal from equity mutual funds and ETFs exceeds $92 billion since 2014. Investor apathy and risk aversion are rampant.

- **The Towle portfolio valuation gap is too wide**. In light of remarkably low interest rates and a dearth of attractive investment options, the high earnings yield of our portfolio should attract investment capital. We expect equity prices for the Towle portfolio to advance in order to narrow the valuation gap. Of course, this assumption must be backed up by continuing fundamental progress within the portfolio.

Naturally, actual results for the Towle portfolio can vary from our targeted projections. Unanticipated events and conditions may disrupt or delay expected progress. For sure, future equity prices will surprise us all, up or down. Regardless of short-term market swings, our mandate is to prudently and effectively execute our deep value strategy. We push ahead because our time-tested process works and the long-term results have been beneficial to our investors.

Thank you for investing side-by-side with us. We are committed to creating capital that, over time, will bless and support others in countless ways. Please do not hesitate to call or email with your comments and questions.

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