TOWLE & CO.
DEEP VALUE INVESTING
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To: Investors

Continued progress! During the third quarter, equity prices moved higher for the Towle portfolio. This advance was predicated on improved earnings, low portfolio valuations, and global economic stability. While broad stock market prices in the U.S. appear fully valued, the Towle portfolio is undervalued and possesses above average appreciation potential.

Returns for the Towle Deep Value Composite are noted below with periods greater than one year annualized:

Periods ending 9/30/16	Towle Composite *(Gross of fees)*	Towle Composite *(Net of fees)*	Russell 2000 Value	S&P 500 Total Return
3 months	12.19%	12.00%	8.87%	3.85%
9 months	30.12	29.46	15.49	7.84
1 year	34.97	34.06	18.81	15.43
3 years	8.62	7.85	6.77	11.16
5 years	19.16	18.36	15.45	16.37
10 years	9.14	8.33	5.78	7.24
20 years	13.46	12.63	9.51	7.91
Inception (1982)	16.37	15.55	12.02	11.46

Our third quarter 2016 letter breaks out as follows: **Deep Value Revisited**, **Portfolio Overview,** and **Portfolio Outlook**.

Deep Value Revisited

The ultimate goal at Towle & Co. is simple: to maximize the long term rate of return on invested capital. Over five, ten, and fifteen years, our performance relative to the overall U. S. stock market demonstrates the accomplishment of this challenging objective.

	Cumulative Returns		
	Towle (Net)	Russell 2000 Value	S&P 500
5 years	132.2%	105.1%	113.4%
10 years	122.6	75.4	101.1
15 years	544.1	283.9	181.7

This time-tested record of success has been accomplished through a strategy that reflects the remarkable insights of three value investing greats: Warren Buffett, Benjamin Graham, and John Templeton. Their principles of successful investing have been well-documented and fully demonstrated. The Towle Deep Value strategy varies from traditional value investing by emphasizing stocks with earnings cyclicality, particularly low valuation metrics, and usually smaller market capitalizations.

The following key investment concepts capture the essence of Towle Deep Value:

Contrarian View
Investing against the "crowd" is a critical concept in the deep value investment process. Deep value enters an arena where few wish to reside. Most analysts and investment practitioners view deep value as too risky, a threat to capital preservation. We take the opposite stance. It is the inherent risk and volatility in the space that creates the opportunity we embrace. John Templeton states it best, "It is impossible to produce a superior performance unless you do something different from the majority." (*The Templeton Touch*, Doubleday & Co.) We strive to select attractive stocks where the majority of others experience apprehension and discomfort.

Three Year Time Horizon
When evaluating a security's appreciation potential, the investment community typically looks out 6-18 months. This view is unnatural and constrained. Corporate managements need an extended period of time in order to accomplish their strategic goals. Each and every business day, the Towle investment team looks at the portfolio in the context of a three-year investment horizon. We ask ourselves, based on what we know today, should we delete, trim, or add a position to the existing portfolio? Looking out three years to determine a company's future equity value is a highly fluid and dynamic process, but this approach provides a proven framework for deep value investors.

Price is King

For sure, there are many variables in picking that right purchase point. At Towle & Co., three key factors standout for identifying a bargain purchase:

1. **Low Price to Sales**
   For every dollar of investment, we seek to purchase a noteworthy stream of sales or revenue. In other words, we wish to buy an inordinate amount of economic activity at a discounted price. Commonly measured by **Price to Sales** and/or **Enterprise Value to Revenue**, this investment technique is central to our strategy. At quarter end, the non-financial companies in the S&P 500 had a weighted average Price to Sales ratio of 1.97x. Conversely, the non-financial companies in the Towle portfolio showed a Price to Sales ratio of just 0.30x. This powerful metric means that for every dollar invested, the Towle strategy owns over 6 times more revenue than an investment in the S&P 500. While this investment approach pushes the portfolio into lower margin companies, it provides the opportunity for a *modest* margin improvement to magnify profitability.

2. **ROMV**
   An appropriate entry point and sell target rest with our ROMV calculation (Return on Market Value). Prior to purchase, the investment team must feel confident that, within three years, the company will generate a trailing twelve month after tax return of 15% on the original purchase price. (A $10 stock must generate annualized earnings of $1.50 per share within our three-year holding period.)

3. **Earnings Advance**
   Over the long term, stock prices are driven up or down by earnings. Ideally, at the time of stock selection, a company's earnings will begin to advance materially. While an earnings inflection point may be difficult to identify, it is highly important that, at the point of purchase, expectations for earnings are either flat or trending modestly higher. Declining earnings will likely bring selling pressure to stock prices. The stock market relishes companies with advancing profitability.

Steadfast perseverance and process discipline have been highly important to Towle & Co. For sure, mistakes in stock selection and judgment have been plentiful. Nevertheless, the positive portfolio decisions far outweigh the disappointments. Hence, we continue on our journey, seeking to create capital at a rate that merits your trust and confidence.

Portfolio Overview

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

Portfolio Outlook

In analyzing the road ahead, investors must not ignore key economic issues and worries confronting planet earth.

- Since the Great Recession, global economic growth has been tepid, undercutting confidence in the benefits of capitalism.
- The rich are getting richer while the middle and lower economic classes have struggled to advance economically.
- Global trade has selectively helped some nations but has brought severe economic challenges to others.
- Most governments throughout the globe have failed to resolve social ills and are mired in a debt crisis of historic proportions.

Contrary to this gloomy perspective, we feel the Towle portfolio can run counter to the mood of many. Our enthusiasm for upside performance is based, to some degree, on the following assumptions:

Global growth will continue. The World Bank and the IMF (International Monetary Fund) both indicate a continuing pattern of expansion.

Real GDP Growth	2016	2017
World Bank	2.4%	2.8%
IMF	3.1	3.4

"…the world economy may be on the brink of an economic bounce." (James W. Paulsen, Wells Capital Management, Inc., August 8, 2016)

Investor sentiment is cautious, not confident. Weak bullish readings from three investor surveys are as follows:

Surveys	*Current*	*10 Yr High*	*10 Yr Average*
AAII	24.0	63.3	37.0
Market Vane	60.0	74.0	58.3
TMI Group	51.9	87.7	53.1

Economic recessions and financial disturbances typically commence when the investing public and professional investors are enthusiastic.

> **Pent-up demand builds in the U.S.** Big ticket spending on housing, durable goods, and capital goods remains well below the trend line of the last 60 years. (James W. Paulsen, Wells Capital Management, Inc., August 17, 2016) At some point consumers and businesses will likely enhance their spending patterns.

While our outlook is upbeat, risks still remain. Historically low interest rates have led to overleveraged borrowings by many investors. U.S. equity market valuations, broadly speaking, are fully valued. The Value Line Index pushes to the high end of its range with a P/E ratio of 18-19x. The narrowing of the valuation gap between the S&P 500 and the Towle portfolio may not occur. Nevertheless, we conclude that the portfolio's strong earnings profile and low valuation will bring satisfactory results to our investors in the coming three years.

We welcome your questions and comments and are most appreciative of your continuing support and confidence.

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DISCLOSURES

Past performance is no guarantee of future outcome. The Deep Value composite results are time-weighted total returns, dollar weighted for the size of each account, including cash reserves and reinvestment of income. Performance figures are calculated after the deduction of all transaction costs, commissions, and other portfolio expenses. Returns are subject to adjustment at any time, and the Deep Value Composite is not audited. Although Towle & Co. makes no attempt to manage against the composition of a specific benchmark, the Firm provides the Russell 2000 Value Index as a readily accessible indicator of comparative performance as well as the S&P 500 Index as a general indicator of the market at large. Investments made by Towle & Co. differ in comparison to the Russell 2000 Value Index in terms of security holdings and industry weightings. Towle & Co. invests in considerably fewer companies than the index with lower average multiples to book value, sales, earnings, and cash flow, and as a result, the volatility and returns of the benchmark index may be materially different from the individual performance attained by a Towle & Co. investor. We urge investors to carefully compare the enclosed appraisal reports from Towle & Co. with your account statement received directly from the custodian, in the case of separate accounts, or from the third-party administrator, in the case of the two limited partnerships. Results for specific holdings highlighted in this communication represent the gross returns of those positions in Towle & Co.'s model portfolio and may not be indicative of an individual investor's actual experience.