TOWLE & CO.

DEEP VALUE INVESTING

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To: Investors

Modest pullback! The Towle Deep Value Composite (DVC) declined 6.05% net of fees during the second quarter. As excitement surrounding the Republican pro-growth agenda waned and short term interest rates advanced, investors pivoted from economically sensitive value stocks to a handful of large cap growth stocks in the technology sector. During the quarter, the S&P 500 made 11 new all-time highs propelled by the upward movement in this narrow subset of securities. Money manager Scott Black stated clearly the disparity in performance, "Value stocks have been left in the dust." (*Barron's* June 12, 2017).

We view this downturn as a long term positive. The mild sell-off in our space resets investor expectations, increases the upside potential of our existing portfolio, and broadens the opportunity set for new positions. Overall, we remain comfortable with the earnings power and conservative sell targets of our current holdings.

Short and long term performance results are noted below. Periods greater than one year are annualized.

Periods ending 6/30/17	Towle DVC *(Gross of fees)*	Towle DVC *(Net of fees)*	Russell 2000 Value	S&P 500 Total Return
3 months	-6.05	-6.22	0.67	3.09
6 months	-1.98	-2.34	0.54	9.34
1 year	32.84	31.90	24.86	17.90
3 years	9.14	8.36	7.02	9.61
5 years	20.71	19.86	13.39	14.63
10 years	7.90	7.10	5.92	7.18
20 years	13.28	12.45	8.98	7.15
30 years	13.55	12.74	10.32	9.60
Inception (1982)	16.56	15.73	12.19	11.61

The second quarter letter of 2017 segments as follows: **Investment Environment**, **Portfolio Review,** and **Onward**.

Investment Environment

The ups and downs of financial markets produce varying thoughts and opinions regarding the complex world of investing. Oh, how the cross currents of diverse data impact the many millions of investment decision makers! At Towle & Co., we are truly blessed with a proven investment strategy that is rock solid and timeless.

To support our portfolio management process, we actively monitor the investment environment through a weekly review of indicators including ACME, our internal framework for measuring the state of the economy and financial markets. At the present time, we conclude that satisfactory economic conditions exist for *discriminating* equity investors. Here's why:

- **Interest rates, commodity prices, and inflation remain low**. These three economic inputs facilitate pro-growth behavior by consumers and businesses.

	Interest rates % (10 yr Treasury)	Commodity prices (S&P GSCI Index)	Inflation % (CPI Annualized)
6/30/17	2.31	372.4	1.9
12/31/15	2.27	312.3	0.7
12/31/10	3.30	631.8	1.5
12/31/05	4.39	431.7	3.3
12/31/00	5.12	246.9	3.4
12/31/95	5.58	203.5	2.5

- **St. Louis Federal Reserve Bank Financial Stress Index (STLFSI) suggests financial stability.** The STLFSI comprises 18 data points including interest rates, yield spreads, and bond indices. Readings below zero imply reduced financial stress.

	12/31/95	12/31/00	12/31/05	12/31/10	12/31/15	6/30/17
STLFSI	-0.44	0.22	-0.69	0.16	-0.60	-1.51

- **Current data indicates economic growth ahead**. The long term economic expansion since the Great Recession may well continue. Dozens of economists suggest satisfactory times ahead, forecasting slow but meaningful GDP expansion for the U.S. On a global basis, the World Bank predicts improving GDP growth, advancing to 2.9% in 2018. Synchronized global expansion has been discussed by many market strategists, an event not experienced since 2009.

Nevertheless, all is not ideal. Many in the investment community discuss the “rolling recession” currently underway in autos, energy, and retail. Further exacerbating investor sentiment is the uncertainty surrounding central bank policy. While the U.S. stock market has effectively absorbed the Federal Reserve’s initial rate hikes, investors are nervous about the ramifications of ending today’s historic, easy money policy.

Although shifting Fed policy and muted GDP growth weigh on investor behavior, we believe economic growth will persist both in the U.S. and abroad. In fact, moderated global growth may prove beneficial by curbing economic excess associated with overinvestment and speculation.

However, valuation multiples for most stocks remain elevated. The Rule of 20 is a closely watched indicator at Towle & Co. Compared to historical year end data, the current reading of 21.6 hints at a fully valued equity market and helps to explain today’s limited opportunity to purchase deep value stocks.

Rule of 20

(Value Line P/E + Inflation)

12/31/11	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	6/30/17
17.8	17.2	19.7	20.0	17.9	21.5	21.6

Yet, these high market valuations do not alter our mission of investing in mispriced, overlooked equities. We remain fervently committed to our process, knowing full well that circumstances change quickly and opportunities emerge unannounced. Should we fail to find attractive investments, we will not hesitate to hold additional cash.

Portfolio Review

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

Onward

Disappointments and declining stock prices are always a possibility when investing in equities. An abrupt, negative change in investor perception can take place at any time. Given the nature of securities in which we invest, the Towle portfolio is more susceptible to short term volatility than other investment strategies. Consequently, we urge our investors to embrace a long term, multi-year view when allocating investment capital to our deep value offering.

Most importantly, investors must understand that, at times, the inherent volatility of deep value investing will lead to mispriced and undervalued equities. Our mission at Towle & Co. is to accurately measure and manage valuation discrepancies, seeking to refute false perspectives or uncertainties regarding companies under purchase consideration. In this process, our investors must be comfortable with the variability of equity prices.

Risk comes in many forms. Worldwide economic growth has been less than robust; U.S. stock market valuations are lofty; short term interest rates push higher in the U.S.; central bank policies are unusual and unprecedented; global geo-political uncertainty is rampant; the long awaited U.S. recession has yet to arrive. Yet, with all these concerns, we stay committed to our deep value discipline, knowing that long term economic advance will endure. We simply wish to participate financially in this likely trend of continued progress.

Warren Buffett speaks to the remarkable achievements realized within the U.S. during his lifetime. “Americans have combined human ingenuity, a market system, a tide of talented and ambitious immigrants, and the rule of law to deliver abundance beyond any dreams of our forefathers.” (*Berkshire Annual Report* 2016)

With patience and persistence, Towle & Co. stays focused on the progress yet to come, managing capital in a manner that benefits others.

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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. 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 small-cap performance as well as the S&P 500 Index as a general indicator of the market at-large. Towle & Co. invests in considerably fewer companies than the index with lower average multiples to book value, sales, earnings, and cash flow, and with different industry weightings. 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.