

TOWLE & CO.

DEEP VALUE INVESTING

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To: Investors

Onward! The year of 2017 ended on a positive note with the Towle portfolio advancing 4.86% net of fees in the fourth quarter. Following a good start to the year, second quarter results declined modestly as investment capital shifted away from value stocks in favor of growth companies such as Facebook, Amazon, Netflix, and Google. A meaningful valuation gap ensued but subsequently narrowed in the third and fourth quarters after strong economic data and prospects of corporate tax reform buoyed investor sentiment.

As we enter 2018, elevated equity valuations persist. The Towle investment team will not hesitate to take profits as portfolio holdings approach our three year sell targets. That said, we fully recognize that the underlying conditions for equity investing remain supportive. The market's upward trajectory of the last nine years may continue on account of low interest rates, low commodity prices, low inflation, and improving economic growth. But, again, valuations are stretched.

Our short and long term performance is provided below. Results are annualized for periods greater than a year.

Periods ending 12/31/17	Towle DVC (Gross of fees)	Towle DVC (Net of fees)	Russell 2000 Value	S&P 500 Total Return
3 months	5.04	4.86	2.05	6.64
1 year	15.95	15.15	7.84	21.83
3 years	15.45	14.64	9.55	11.41
5 years	20.54	19.70	13.01	15.79
10 years	12.69	11.87	8.17	8.50
20 years	13.02	12.20	8.62	7.20
30 years	15.53	14.71	11.57	10.70
Inception (1982)	16.85	16.02	12.22	11.77

The year end letter segments as follows: [Timeless & Enduring](#), [2017 Portfolio Update](#) and [Outlook](#).

Timeless & Enduring

Since our founding in 1981, three great practitioners of value investing, Warren Buffett, Benjamin Graham, and John Templeton, have guided us with their written word and strategic thought. Their comments are timeless and enduring.

In 1980, Warren Buffett stated to Jack Train in *The Money Masters* that successful investing is comprised of six characteristics or traits:

1. You must be animated...and fascinated by the investment process.
 2. You must have patience.
 3. You must think independently.
 4. You must have the security and self-confidence that comes from knowledge, without being rash or headstrong.
 5. Accept it when you don't know something.
 6. Be flexible as to the types of businesses you buy, but never pay more than the business is worth.
- (*The Money Masters*, Harper Collins, 1980)

Towle & Co. learns and relearns from the extraordinary insights of Buffett, Graham, and Templeton.

Portfolio Update

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

Outlook

Wow, stock prices are high! For most segments of the U.S. equity market, valuations have reached full to excessive levels. At Towle & Co., we closely monitor the investment environment and now believe the pristine conditions of today's stock market may be vulnerable. We list three possible threats:

1. Too good for too long. Since year end 2011, the Towle portfolio has advanced by 194.6% net of fees. These results equate to a six year annualized return of 19.7%. Stock markets don't go straight up.
2. Monetary tightening and inflation. Short term rates will increase, and inflation will likely advance. Invariably, higher interest rates and inflation result in lower valuations as price/earnings ratios compress. This is a particular concern since the current Value Line P/E is lofty at 20.5.
3. Synchronized global growth may not last. The International Monetary Fund notes that only six of 192 countries will likely experience an economic contraction in 2018, a record few. (*Wall Street Journal*, December 4, 2017) Yet, long term synchronized growth may not be sustainable in light of rising, short term interest rates and global geopolitical uncertainty.

Jim Paulson, a highly regarded stock market strategist at the Leuthold Group, states it plainly, "The news can't get any better." (*Barron's*, December 11, 2017) Paul Ashworth of Capital Economics is more specific for 2018, "a good year for the economy, but not equities." (*U.S. Economic Weekly*, January 2018) For sure, one should anticipate a more volatile and uncertain stock market in the period ahead. Then again, the "ideal" economic characteristics of today may continue. This favorable outlook is conveyed by well-known Gavekal economist Anatole Kalatsky when he states that the economic story, "...is maturing into a structural expansion of economic activity, profits, and employment that probably has many more years to run." (*Barron's*, December 4, 2017)

In any case, the mission at Towle & Co. will not change. Our only objective is to create capital at a rate that exceeds the performance of the major stock market averages. And we will continue to purchase equities that meet our deep value characteristics as long as the investing environment appears steady and the opportunities exist.

All of us at Towle & Co. are most appreciative of your support and confidence in our deep value approach to investing. One should anticipate that realized gains for 2018 may well exceed those registered in 2017. Please be in touch with any questions or comments.

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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.