April 2015

Markets are contemplating the potential for a tighter domestic monetary policy. As this would be the first such shift experienced in a decade, the recent increase in volatility should not come as a surprise. The table below illustrates each of the cyclical peaks and troughs in the Fed funds rate and the magnitude of changes since 1919. As shown, the last time the Fed took rates to zero, they stayed there for over two decades. If history were to repeat, investors might be nervously digesting a shift toward tightening for some time.

Low	Date	Change	Period	High	Date
3.96%	Oct-19	1.92%	14	5.88%	Dec-20
1.92%	Jul-24	2.88%	64	4.80%	Nov-29
0.00%	Sep-32	2.09%	251	2.10%	Aug-53
0.65%	Jun-54	2.94%	40	3.59%	Oct-57
0.88%	Jun-58	3.69%	18	4.57%	Dec-59
2.27%	Jul-61	3.32%	62	5.59%	Sep-66
3.33%	Jun-67	4.75%	30	8.08%	Dec-69
4.00%	Feb-72	7.00%	28	11.00%	Jun-74
4.75%	Dec-76	11.75%	39	16.50%	Mar-80
11.00%	Aug-80	8.00%	9	19.00%	May-81
8.00%	Nov-82	3.44%	21	11.44%	Aug-84
5.88%	Oct-86	3.87%	31	9.75%	May-89
3.00%	Sep-92	3.50%	99	6.50%	Dec-00
1.00%	Jun-03	4.25%	50	5.25%	Aug-07
0.00%	Current		?	?	?

Source: Bridgewater Associates

It has been said that time heals all wounds. Zero percent interest rates may have bought the Fed time, but many economic wounds remain hidden by scar tissue just beneath the surface. With the passage of time, investors quickly forget the lessons learned during previous bear markets. Cash becomes a drag on performance as stocks march steadily higher. The longer the advance, the more willing investors are to seek relative bargains rather than hold cash earning nothing.

With equities priced for perfection, the search for value has become more challenging. There are always things to do in the market, but that doesn't mean we should do them. Sometimes, doing nothing is everything. As it turns out, doing (almost) nothing worked rather well for us in the first quarter, as our managed accounts outperformed global equity and bond markets.

A NOTE TO NEW INVESTORS

We've been fortunate to have added a number of new clients over the past year which has kept us (i.e. Nancy) incredibly busy. Since we construct each portfolio from the bottom up based on the opportunities then available in the market, the dispersion of returns across our accounts has grown as new investors have transferred cash and legacy positions. While this makes a discussion of our "portfolio" more difficult in the near term, we believe that building individual portfolios thoughtfully and adding investments opportunistically is ultimately in the best interest of our clients.

This dispersion should narrow over time as new positions are purchased across accounts and others are exited. In the interim, we thought this was important for you to understand as some of the investments discussed in our letters may not be held in each of your accounts. The positions discussed are those which had the greatest impact on the portfolio in aggregate. It would be much easier for us to just "buy the portfolio" when a new account is funded but in doing so, we would be purchasing a number of securities that have appreciated substantially since our initial purchase and that no longer offer the same upside potential today. Consequently, we invest each account in the same manner that we invest our capital – by patiently seeking bargains and demanding a wide enough margin of safety to part with our cash.

Meticulously constructing a portfolio in this manner takes time. Consequently, we may decide to slow the inflow of new clients beyond what is currently in the pipeline to ensure that the vast majority of our time is invested in the research process rather than the onboarding process. We will surely have greater capacity once the current inflow is digested but see no reason to grow for growth's sake. We like the size and composition of our current team and intend to keep it that way. Warren and Charlie have done just fine for investors over the years without spending a small fortune on a team of investment banking analysts building exquisite models.

INVESTMENT REVIEW

It has become more challenging to find investments trading at a wide discount to intrinsic value today (although we did manage to find a couple in the first quarter which we discuss below). Consequently, we are spending more time stress testing current holdings and considering the sale of all or a portion of those that are more fairly priced today. There is value in patience particularly when it is in short supply. We read voraciously while we wait. Most investments don't meet our requirements and as a result, we pass and go back to scanning the markets until something turns up. When it does, we dive in.

During the first quarter, this focus worked in our favor. Our equity portfolios gained about 3% on average with individual account performance ranging from 1% to 5% despite holding roughly 40% of assets in cash and short-term investments. The performance and range of returns for the *Broyhill Portfolio*, which is a more broadly diversified mix of assets and external managers, performed similarly. We provide a brief discussion of contributors and detractors to performance below in addition to recent portfolio activity.

Performance during the quarter was driven by several core holdings. Fiat Chrysler (FCAU) gained over 40% in anticipation of the pending spin-off of Ferrari, the company's crown jewel. Cedar Fair (FUN) rallied over 20% as investors bid up the price of companies with domestic revenue sources. And IRSA (IRS) advanced nearly 30% despite continued uncertainty in advance of upcoming elections in Argentina. Each of these businesses continues to trade below our estimate of fair value.

Awilco (AWDR) was once again the largest detractor during the quarter. The only silver lining is that we have resisted the urge to increase our position during the stock's decline and, as a result, the impact on the portfolio has shrunk along with the company's market value. Awilco remains our only exposure to the energy industry outside of a single investment in an oil refiner with little correlation to the price of crude. Although a 50% success rate in the sector leaves much room for improvement, our investment in NTI has returned more than 50% on our cost.

Other detractors – Proctor & Gamble (PG), Arcos Dorados (ARCO) and Coca-Cola FEMSA (KOF) - had one thing in common: significant operations outside of the United States. While a surging dollar has convinced the consensus to limit investment in foreign operations, there is little empirical evidence that extrapolating currency trends improves stock selection. Rather, exchange rates are just one small piece of the much larger picture. Value is of far greater importance.

Conventional wisdom usually sounds right, but tactical calls of this nature often prove harmful to long-term performance. Coca-Cola, which derives two-thirds of its sales from abroad, provides an interesting anecdote. Coke's returns were positively correlated with the dollar rally in the 1980's but the opposite was true during the dollar's rally in the 1990's. The bottom line is that operating fundamentals and competitive positioning are the primary drivers of performance, and the price you pay is the best predictor of returns.

NEW INVESTMENTS

One of the most challenging aspects of investment is training the mind to tune out the noise as the adrenaline rush that accompanies exciting new ideas can quickly lead you astray. There is no shortage of ideas in this business; however, excellent ideas are few and far between. Consequently, one must be meticulous in allocating our most precious resource - time.

We are often asked how we allocate our time and how an idea moves from being an idea to an investment. There is no magic formula, but doing the work up front so that we are prepared when an opportunity presents itself is a big part of turning research into profit. During the quarter, we reviewed dozens of ideas brought to our attention from various sources. We spent considerable time on only a handful of these by focusing our resources on the following opportunities:

- **Our Circle of Competence:** We deepened our understanding of businesses within our circle of competence and sharpened our work on a number of companies in the financial sector. While no action was taken here, we are well prepared should Mr. Market offer us a better entry point. Since quarter end, we've gotten a little closer.
- **Oil Related Weakness:** After passing on many direct oil investments in the fourth quarter, we moved on and began to examine ancillary businesses suffering from energy-related weakness. Price declines in several high-quality industrial businesses piqued our interest but upon closer inspection do not yet provide a wide enough margin of safety.

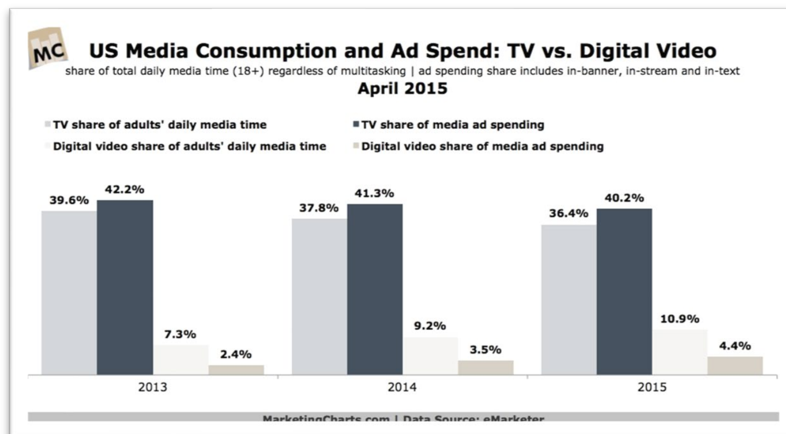
- **Special Situations:** The combination of growing cash balances on corporate balance sheets and activist war chests make for an eventful investment landscape. We ramped our efforts and refreshed our work on several previous investments in the technology sector recently put back in play. This may well be a source of opportunity during the year and one we continue to monitor closely.

- **Maintenance Research:** The best opportunities often arise from continued work on existing holdings. So far in 2015, this has been the case as our two new investments this year have been sourced from existing ideas. We discuss the evolution of our research below.

CUTTING THE CORD

Since our initial investment in Time Warner (TWX) discussed here, we've continued our analysis of the media sector. We believe the shifting industry dynamics are misunderstood as new distribution models have resulted in growing uncertainty. In addition to the launch of HBO Now, Dish Networks introduced Sling, which, coincidentally, does an excellent job highlighting the value of Time Warner's assets. While a number of other networks have launched over-the-top "me too" products, the biggest threat to the bundle is scheduled to arrive this fall according to Apple's plans to offer an online television service.

We believe exaggerated threats to the stability of the cable bundle have created an opportunity to purchase high-quality assets in the media sector at very attractive valuations. While TV's share of media consumption has shrunk in the past couple of years, television continues to pull in over 40% of total ad spending. And while consumption of digital video has been rising quickly, digital is expected to pull in just 4% of ad spending this year. The reality is that increasing consumer time and attention increases the opportunity for owners of content as on demand services have been complementary to traditional offerings.



During the quarter, we increased our investment in the industry with the purchase of Discovery Communications (DISCK). Domestic advertising concerns and significant international exposure have weighed on the stock in the short term, but are offset by the company's low-cost, fully owned content, global distribution platform growing at double-digit rates, and abundant cash flow in the hands of astute owner-operators buying back significant stock at a discount to fair value.

DISCOUNT AUTO SHOPPING

Warren Buffett has said, "When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact." Brilliant reputations are difficult to come by in the auto industry. Bad economics are much more common. That being said, some of the greatest opportunities for investment arise when cyclically depressed assets are trading at cheap multiples of trough earnings. This has been the case as the auto sector has slowly recovered from the depths of the recession only recently reaching pre-crisis unit sales after years of production below trend.

We made our initial investment in the industry early last year as recurring front page headlines eventually caught the attention of Congress who jumped at the chance to fault General Motors (GM) for ignition switch failures. Trading at nearly half the multiple of its peers, with largely restructured operations and an overcapitalized balance sheet, the company had a variety of operational and financial levers at its disposal. Shares of GM gained 8% during the quarter. Since quarter end, some of those levers have been pulled for them.

Our next investment in the sector was CDK Global (CDK), a business we have discussed in previous letters. We purchased CDK, which provides mission critical technology to auto dealers, shortly after it was spun out of ADP in September 2014. The company's Digital Marketing business claims GM as its most significant client, creating additional synergies in our internal research efforts. CDK advanced 15% in the first quarter after a powerful rally post-spin.

Other corporate actions in the auto industry proved to be equally compelling. We had been following Fiat Chrysler (FCAU) for some time as the company progressed towards its merger as one holding company and moved toward a US listing. We leveraged ongoing conversation with auto dealers while exploring CDK's competitive moat to better understand the value embedded in Fiat brands like Maserati and Ferrari. We ultimately made our investment at a price we felt represented little downside risk given the value of the company's luxury brands and parts business. Assuming CEO Marchionne comes anywhere close to his long-term goals for Jeep and the company's other core brands (an assumption the street is unwilling to make) the upside is very compelling. Shares of FCAU rallied over 40% during the quarter.

As our investment in Fiat appreciated, and Chrysler continued to set new records for sales gains, we began to question the level of incentives at play in driving top line growth. Around this time, questions around subprime auto lending began to arise. Given our general skepticism for lending practices in the financial system, we decided to take a closer look. We doubled back on our conversations with auto dealers and dug into the data ourselves. Which brings us to Ally Financial (ALLY).

By way of background, Ally is the artist formerly known as General Motors Acceptance Corp, a name that should probably make you wince when you say it. The old GMAC collapsed under the weight of massive mortgage losses and auto loans largely dependent upon a failing General Motors.

The transition from GMAC to Ally Financial was a long, treacherous process and as a result, investors have been slow to recognize the value in the new company today. After receiving billions in equity from the US Treasury, Ally shed its mortgage business, became a bank holding company with a rapidly growing online bank, and refocused on its core competency of auto lending while diversifying away from GM.

In January, GM "assisted" the company's diversification efforts by announcing its plans to use the new GM Financial as its exclusive provider of the manufacturer's leases. We believe the market overreacted to the GM loss which provided an attractive entry point for our investment in Ally. We expect management to execute on their multi-year plan to increase normalized earnings power through balance sheet optimization given the easing of regulatory constraints after exiting TARP last year. Ally has already begun reducing its high-cost funding which should allow for greater flexibility from its rapidly growing online bank. We expect a continued reduction in funding costs this year.

Today, Ally is trading at 70% of tangible book value. Even assuming no asset growth over the next few years and cumulative losses on par with the financial crisis, book value should remain well in excess of the current price, providing ample downside protection. Given the higher quality of Ally's current book, low-hanging fruit in the form of high-cost debt and rapid growth in non-GM originations, we view this scenario as quite extreme. We believe Ally is poised to grow its capital base and the returns it earns on that capital, and if successful, the stock should trade at book value or higher.

The upside case is quite clear and far more likely in our view. Assuming management is successful in its plan, which we believe is very achievable, and the company continues to grow per share book value at the current pace, Ally's book value should approach $40 over the next few years. If the stock were to trade back to book value, this would represent a 2x return on our investment.

If I had more time, I would have written a shorter letter. But since this one has already run longer than intended, we'll save our discussion of subprime auto lending for the appendix, which can be read (or discarded) on its own.

Sincerely,

About Broyhill

Broyhill Asset Management is a boutique investment firm, initially established as a family office in 1980 and guided by a disciplined value orientation. Founded in the foothills of North Carolina's Blue Ridge Mountains, we operate outside of the fray and invest with a rational, objective, long-term perspective.

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Performance is calculated using time-weighted rates of returns, net of fees. Since these platforms report returns to Broyhill gross of fees, in order to report net returns, a 1.5% annual management fee has been subtracted from gross reported returns. This methodology has also been applied to the extracted attribution returns. Average position size is calculated from the average capital invested divided by the average portfolio capital in fully invested accounts.

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