ACR
alpine capital research

That Giant Sucking Sound

Equity values for the US market, international markets, and ACR holdings were essentially flat in 2015.

2015 Total Return

EQR Net 1.25%[1]	-0.4%	**S&P 500**	1.4%

ACR's portfolio companies paid dividends, and the ACR investment team estimates that the overall intrinsic value of the portfolio grew, even though the value creation failed to register in this year's market return. A far longer period than a year is necessary to be sure that market prices and intrinsic values have had sufficient time to converge.

Full Cycle Total Return

	EQR Net 1.25%[1]	S&P 500
Since Inception (4/3/2000 – 12/31/2015)	10.8%	4.0%
Most Recent Full Cycle[2] (1/1/2008 – 12/31/2015)	9.2%	6.5%

While a year is too short to draw conclusions about market and intrinsic returns, we still find it useful to track intrinsic value changes yearly. Intrinsic results are more stable and ultimately determine market returns. ACR estimates that the EQR portfolio intrinsic value increased 6.5%[3] last year. Adding a dividend yield of 2.2%, the total increase in value was 8.7%[3]. Given an inflation rate of 0.7%, 2015 was a satisfactory year for EQR's companies, if not their stocks.

Even though 2015 was a flat year for market returns and a pedestrian year for intrinsic values, much was going on underneath the surface. The giant sucking sound of declining demand coming out of China drove a collapse in major commodities and a recession in emerging market (EM) economies. In the US and EU, the security prices of companies with exposure to commodities and EM economies declined precipitously.

[1]EQR (Net 1.25%) is the annualized total return (dividends and capital appreciation) of the Equity Quality Return Advised SMA Composite calculated net of a 1.25% hypothetical annual fee. The EQR (Net 1.25%) return calculation is supplementary information based on the average recommended fee schedule across our client/partner base. Please refer to our full composite performance presentation with disclosures published under the performance section of our web site at www.acr-invest.com. Actual fees may be higher or lower than 1.25%.

[2]A "Full Cycle" refers to the most relevant time horizon for a definitive investment performance evaluation period, generally a full economic cycle of expansion and contraction in economic output and equity market prices.

[3]The EQR portfolio intrinsic value is based on ACR's weighted average estimate of the intrinsic value of each portfolio company. Appraised intrinsic values and returns are estimates. Actual returns may vary widely from those estimated. Past returns are not indicative of future results.

8000 Maryland Avenue, Suite 700 | Saint Louis, MO 63105
t 314.932.7600 | f 314.932.1111 | 877.849.7733 | acr-invest.com

an alpine investment management, llc group

Please see page 4 for additional important disclosures.

What was going on underneath the surface in 2015 has bubbled up in 2016, or should we say down. Broader financial markets in the US, EU and Japan have declined significantly and have become more volatile. The contagion appears to be psychological, as all indications so far this year indicate that the broader US economy has not entered a recession. Yet the direct and indirect effects of a hard landing in China could conspire to produce a global recession.

The ACR investment team is observing these effects at the company level. As demand for natural resources plummets, so does the demand for train carloads of freight, valves and pumps for processing liquids, new loan demand of impacted companies and so on down the supply (and demand) chain. At the same time, stretched US and EU consumers have not yet responded to lower commodity prices with expected increases in consumption.

The specific circumstances are always different, but the general storyline remains the same. Economic turmoil has reared its head multiple times in every generation since markets have existed. As the economic historian Charles Kindleberger remarked, financial crisis is a "hardy perennial." The ACR investment team finds it helpful to consider several concepts when contemplating the inevitable financial crisis or the more mundane recession: acknowledged unpredictability, advance preparedness, patience, opportunity and prosperity.

Economic events seem predictable with hindsight. For example, the US housing bubble was no secret. Pundits and real economists warned us many times over (including our very own macroeconomic advisor Steve Fazzari). Same with the China bubble. The problem is that a bubble cannot be truly confirmed until it pops. Even those who properly spot the bubble in advance do not know the precise timing nor the magnitude of the economic tsunami to follow. Timing and transmission are unpredictable: we simply have not figured out the economics, and human behavior is itself unpredictable. Investors would do better to be clear about what they do not know and waste neither time nor money speculating about unpredictable events.

Rather than speculating, we are more like Noah preparing for the flood which will someday come. ACR's investment Ark is built of two materials: quality and price. The enterprise or government cash flows to which we have attached our financial claims must be durable, and the price we pay for the stocks and bonds which have a claim on those cash flows must secure a satisfactory absolute return. When such returns cannot be secured, we sit on cash. ACR may adjust the quality of our holdings depending upon the values we find, yet we never compromise a base level of quality capable of withstanding a 100 year economic flood.

Price is our ultimate weapon, value our compass. Seeking securities with the lowest prices relative to values is the best way to navigate economic turbulence. Patience is the key. For example, our purchases in 2008 declined still further in early 2009 when we bought still more. Despite the short term declines, our purchases in early 2008 were profitable by the end of 2010. When a sound return can be secured at a specific price, we do not wait for additional short term price declines. Anticipating short term price movements is in our opinion nearly impossible. "Don't catch a falling knife" is a catchy

Please see page 4 for additional important disclosures.

phrase, but poor advice. "Strike while the iron is hot" would be more apropos, even if it gets a little hotter.

Recent declines are presenting opportunity. Our primary on deck list of approximately 500 companies has gone from a paltry half dozen or so at the end of 2014 to over 70 today. For the first time since 2012, the ACR investment team is beginning to find more to buy than to sell. The slow process of accumulating our cash pile in EQR by selling 14 stocks and only purchasing 9 since 2012 is reversing. And almost all securities under review are significantly lower in price than they were over the past few years as our cash position grew.

Yet we will not jump at every opportunity. In 2008 when investment banks began to register as statistically cheap, ACR went on record saying we would not bite. In January of that year we wrote: "Alpine will avoid some investments regardless of how attractive they look. Looks can be deceiving. Today, many financial institution balance sheets are like black boxes. A massive casino of esoteric financial instruments has developed in recent years to which all major banks have exposure. The underlying risk and value of these instruments cannot, in many cases, be reliably assessed." Today the US financial system is on solid ground. It's not the investment banks that are looking inordinately cheap, and possibly dangerous, this time around.

China's investment-lead demand is today's culprit. China is not going away, but its roughly $6 trillion per year of capital investment is unsustainable. The exact level is difficult to quantify. We will not purchase companies whose revenues and profits mostly rely on a source of demand which is unsustainable and difficult to reliably assess. As for oil, gas and other commodity related companies, we are sifting through the rubble. The ripest area for opportunity in our opinion consists of cheap industrial companies with modest exposures to Chinese investment demand and commodity sensitivity. In our opinion completely indiscriminate selling has not yet taken hold. We hope it does, as such an environment generally presents the very best opportunities.

The great irony of investing is that major price declines create opportunity. Short term pain produces long term gain; assuming one has the cash, flexibility and valuation acuity to capitalize upon the malaise. The other pillar of opportunity is the continued rise in standards of living which market based economies have enjoyed for the past few hundred years. ACR is concerned about current economic conditions, yet we believe that nothing has changed in the long term outlook for the US and world economy. The goose which laid the golden egg of human prosperity in the early days of the Industrial Revolution – that is, market economies and the rule of law – is alive and well. Healthy free market economies have always produced market turmoil; our job is to protect and profit from it.

Nick Tompras
January 2016

As of November 4, 2022, we have provided this supplement to accompany the commentary and satisfy changing regulations: https://acr-invest.com/commentary-supplement/

Please see page 4 for additional important disclosures.

IMPORTANT DISCLOSURES

Past performance is not indicative of future returns. Data in this Commentary represents past performance and investors should understand that investment returns and principal values fluctuate, so that when you redeem your investment it may be worth more or less than its original cost. Performance has been calculated on a total return basis, which combines principal and dividend income changes for the periods shown. Principal changes are based on the difference between the beginning and closing values for the period and assume reinvestment of all dividends and distributions paid. Adviser's fees are disclosed in the Firm Disclosure Brochure, ADV Part 2A. All applicable expenses such as advisory fees have been included in calculating performance. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the examples discussed. You should consider any strategy's investment objectives, risks, and charges and expenses carefully before you invest. The volatility of the Indexes portrayed may be materially different than the composite presented. Investors cannot invest directly in an index.

This information should not be used as a general guide to investing or as a source of any specific investment recommendations, and makes no implied or expressed recommendations concerning the manner in which an account should or would be handled, as appropriate investment strategies depend upon specific investment guidelines and objectives. This is not an offer to sell or a solicitation to invest.

This information is intended solely to report on investment strategies implemented by Alpine Capital Research ("ACR"). Opinions and estimates offered constitute our judgment as of the date set forth above and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. Under no circumstances does the information contained within represent a recommendation to buy, hold or sell any security, and it should not be assumed that the securities transactions or holdings discussed were or will prove to be profitable. There are risks associated with purchasing and selling securities and options thereon, including the risk that you could lose money. All material presented is compiled from sources believed to be reliable, but no guarantee is given as to its accuracy.

The Equity Quality Return (EQR) Advised / SMA Composite consists of equity portfolios managed for non-wrap fee and wrap fee clients according to the firm's published investment policy. The composite investment policy includes the objective of providing satisfactory absolute and relative results in the long run, and to preserve capital from permanent loss during periods of economic decline. EQR invests only in publicly traded marketable common stocks. Please refer to our full composite performance presentation with disclosures published under the performance section of our web site at www.acr-invest.com.

The Index Benchmark is the S&P 500 Total Return (TR) Index. The S&P 500 TR Index best represents the quality of the composite holdings. The S&P 500 TR Index is a broad-based stock index including reinvestment of dividends and is widely regarded as an indication of domestic stock market performance. The S&P 500 TR index is unmanaged and cannot be purchased by investors.

Please see page 4 for additional important disclosures.