"Because passive funds take no view of business fundamentals or valuation, they bear significant and unnecessary investment risks, in our view. For example, investors buying a global index fund in 1989 would have had the bulk of their investment (44%) in Japan at the absolute worst time to buy Japanese stocks. A decade later, they would have had nearly 25% of their investment in technology companies that were grossly overvalued."

—— Franklin Templeton Investments, February 2015

October 28th, 2016

A Look Back at the Third Quarter and a Peek at Q-4

As discussed in our previous client letter, volatility has returned to the market with a vengeance. September, for example saw 12 of its 21 trading sessions rise or fall by more than half of a percent according to FactSet Data.

The moves on the last two trading days of the quarter serve as a case in point. On Thursday, September 29th, the S&P 500 fell as much as 1.2 percent when midway through the trading session a Bloomberg News report spooked investors when it revealed that a relatively small number of hedge funds were pulling money from beleaguered Deutsche Bank. This immediately brought back images of the 2008 financial crisis. On Friday, September 30th, the market rose as much as 1.1 percent intraday as a more bullish round of Deutsche Bank headlines surfaced.

There were other headlines that contributed to the volatility during Q-3.

(1) Angst as to whether or not the Federal Reserve would raise interest rates;
(2) The OPEC announcement that it would curtail output;
(3) Unease about the fallout from a scandal over sales tactics that has engulfed Wells Fargo & Co.;
(4) The contentious U.S. presidential race

Despite these uncertainities, the S&P 500 climbed a wall of worry and advanced 3.2%.

Looking back over the last 20 years, October has on average been a reasonably good month with stocks increasing in value ~70% of the time. For example, since 1996 the S&P 500's average price increase during the 10th month of the year has been 2% with the best return being an increase of ~10% and the worst return being a loss of ~19%.

October has also seen a disproportionately large number of exogenous events occur. In October of 1929, the stock market declined over 20% in two trading days. On October 19, 1987 the stock market fell ~20%. In October of 2008 in the midst of the financial crisis the S&P dropped by ~19%. On a brighter note, November and December in a presidential election year have historically been good for the stock market, particularly in years when October's performance was not stellar.

6 East 32nd Street • 7th Floor • New York, NY 10016 • P. 212.995.8300 • F. 212.995.5636
www.BoyarValueGroup.com

With the S&P finishing the third quarter up 7.84%, the beginning of the year when the S&P 500 fell almost 11% by February 11th seems like a distant memory. From March 2009 through September 2016, the S&P 500 has increased by 220%. The market as a whole is selling at 16.8x forward earnings.

This is neither particuarly cheap nor expensive from a historical perspective. In March of 2000 immediatley prior to the tech bubble bursting and the S&P 500 subsequently decling by 49% in ~1.5 years, the S&P 500 traded at 27x earnings.

BLACK TUESDAY

THE STOCK MARKET CRASH OF 1929

However in 2007 prior to the financial crisis, the market sold at a modest 15.7x earnings before declining 57%. As bottom-up stock pickers, we try not to let such statistics influence our investment decisions, but this is information we believe that is at least worth monitoring.

In our opinion, the most important thing we should focus on are uncovering individual businesses that are selling below their intrinsic or private market value. Currently media names, the financial sector, and consumer disrectionary stocks are fruitful hunting grounds for finding such companies.

"All the News That's Fit to Print"

The New York Times

Late Edition

NEW YORK, TUESDAY, OCTOBER 20, 1987

STOCKS PLUNGE 508 POINTS, A DROP OF 22.6%; 604 MILLION VOLUME NEARLY DOUBLES RECORD

U.S. Ships Shell Iran Installation In Gulf Reprisal

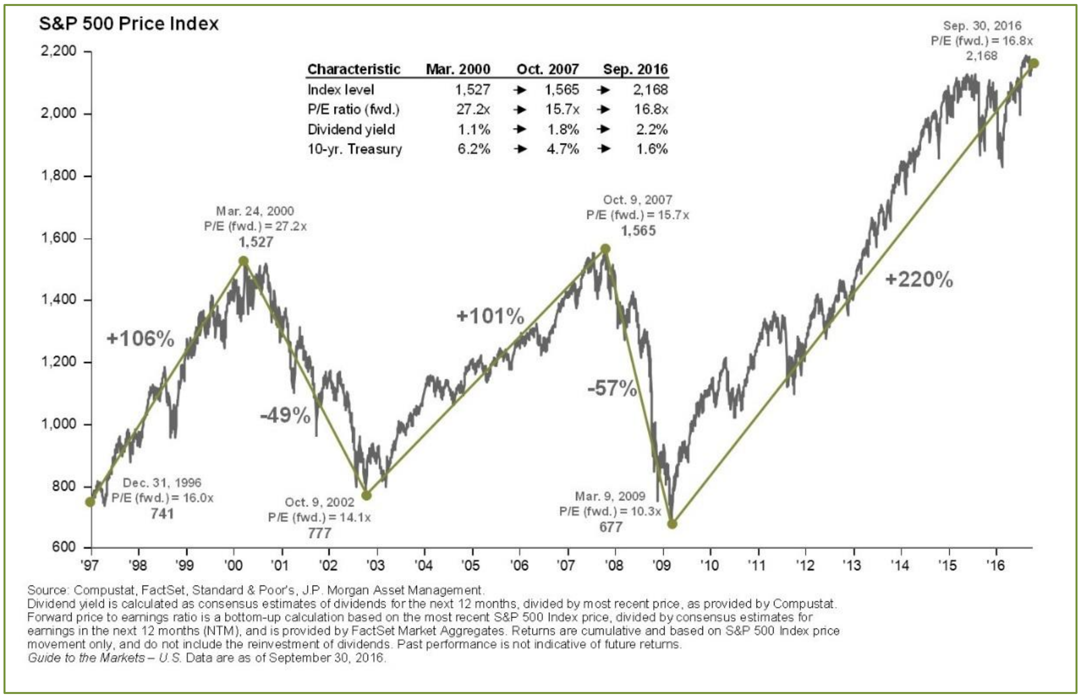
Offshore Target Termed a Base for Gunboats

A Huge Blow to the Five-Year Bull Market

Dow's Record Fall

WORLDWIDE IMPACT

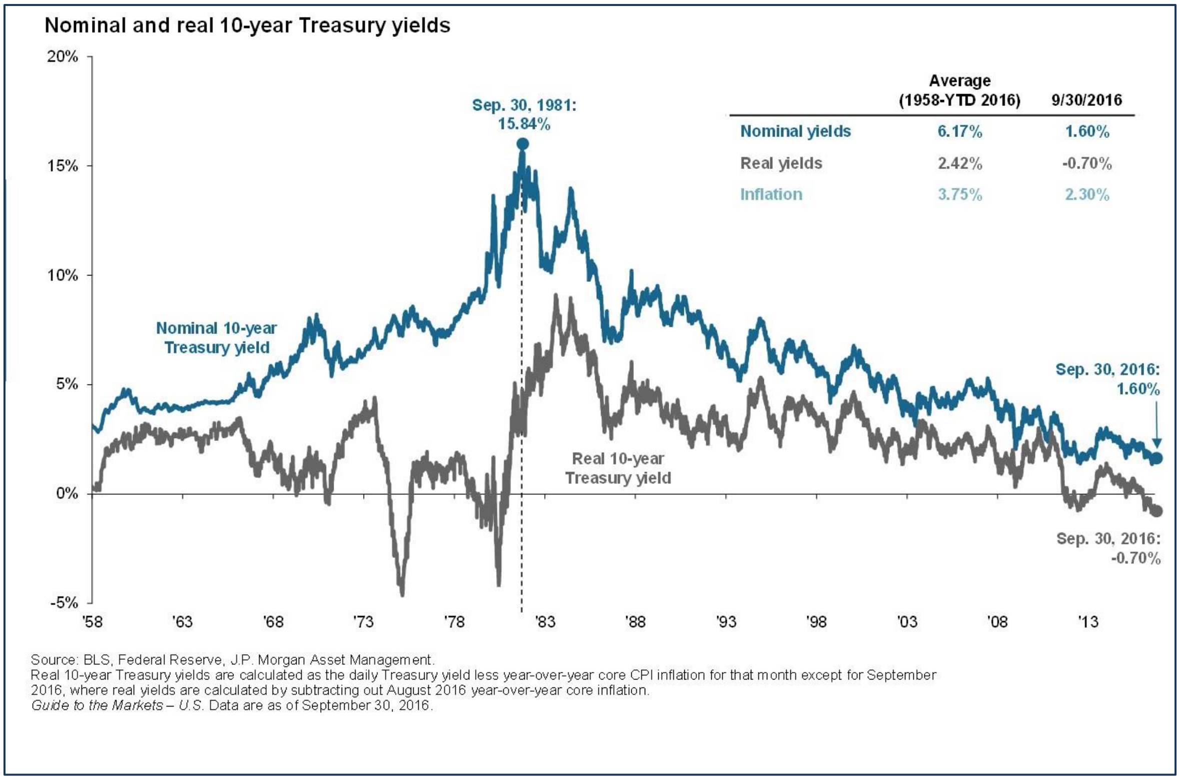
Frenzied Trading Raises Fears of Recession — Tape 2 Hours Late



Source: J.P. Morgan Asset Management

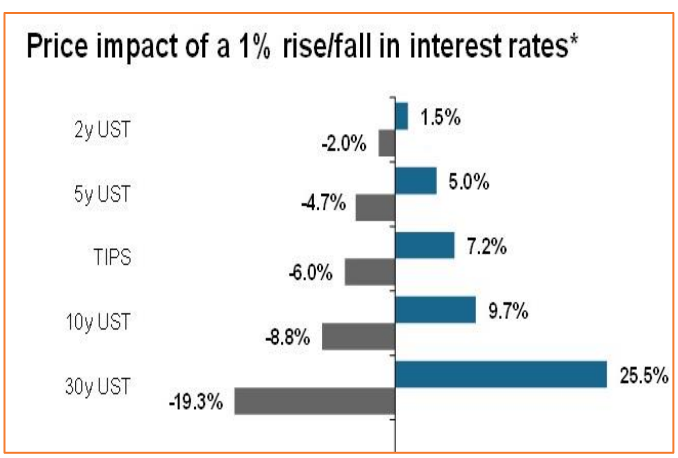
As we have discussed numerous times in these letters, interest rates have been at historically low levels for quite some time. When interest rates will finally rise is anyone's guess (and we are the first to admit that we have been wrong about rates rising for quite some time), it is worth pointing out how abnormlly low rates are from a historical perspective.

The average yield of a ten year Treasury since 1958 has been 6.17% compared to the 1.6% yield as of 9/30/2016. As the chart on the next page illustrates, interest rates peaked in September of 1981 at over 15%! While we are by no means predicting rates will reach that level for a very long-time (if ever), forecasters tend to extrapolate recent trends as if they will continue unabated when making their predictions. Investors contemplating purchasing long-dated bonds should remember from 1958-1981 Treasury yields increased virtually every year (with a few exceptions) and our bet is during that time frame no mainstream market forecaster predicted that one day yields would ever reach 1.6%. We are in a world full of distruptive change and making truly long-term predictions on almost anything **(including interest rates)** is a fool's errand. In the early 2000s, who would have predicted that Blackberry and Nokia would no longer produce their own phones and Samsung and Apple would be the market leaders?

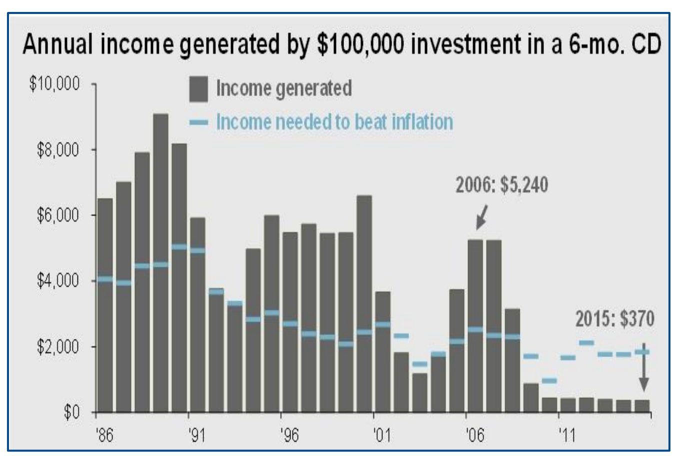


Source: J.P. Morgan Asset Management

While we have displayed a similar chart in previous letters, we think it is worth re-printing as many clients frustrated by the lack of yield have asked us our opinion on purchasing long-dated bonds in order to capture yield. For an individual investor, we continue to believe this is the wrong course of action. As the chart below demonstrates, investor's in "safe" 30 year US Treasuries would stand to lose 19% if rates increased by just 1%. In our opinion, to take that type of risk to capture a 2.32% (pretax) yield is a horrible risk/reward proposition. Investors looking for yield are better off either leaving their money in cash and waiting for rates to rise or buying dividend paying stocks that have the capability of growing their dividend over time that are selling at reasonable valuations.



Source: J.P. Morgan Asset Management

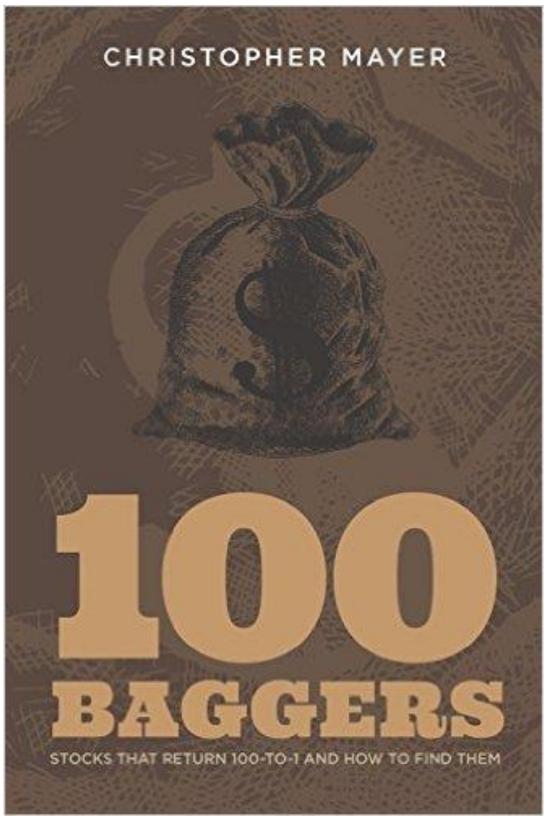


Source: J.P. Morgan Asset Management

<u>Sacrificing Short Term Outperformance in Favor of Potential Future Outsized Gains</u>

This mission of Boyar Asset Management is to purchase a great business at a significant discount to its intrinsic or private market value and hold it for many years. There are times when the price of companies we own shares in have soared, and other times when they fell precipitously for non-fundamental reasons. There are also prolonged periods of time when these stocks have just languished. Sometimes, even more frustrating is when the shares drop in value while the leading averages are ascending in price.

A friend of the firm, Chris Mayer in his book <u>100 Baggers: Stocks That Return 100-to-1 and How To Find Them</u> points out that watching stock prices on your computer screen on a daily basis is detrimental to your long-term financial health as seeing these moving prices is a call to action. He continues by saying that if you pay too much attention to stock swings in all likelihood you'll be scared out of even the best stocks.



Chris did a study of all the stocks that returned 100-to-1 from 1962 to 2014. The ups and downs are incredible. From the time it went public in 1980 through 2012, Apple was a 225-bagger. A $10,000 investment turned into $2.25 million. But you had to suffer through two 80% declines and several 40% plus drops. If you held off on buying Apple because you did not like the current stock market environment, or if you sold shares after the large above-mentioned price declines, you missed out on a spectacular opportunity. The point being is investors should tune out the short-term noise and focus mainly on the price you pay for a stock and the quality of the underlying business. If you do that, over the long-term, good things usually occur. But you need to be patient!

For most accounts that have been with our firm through an investment cycle a significant portion of your portfolio is represented by unrealized gains. We have effectively postponed paying taxes and allowed your capital to grow at a better rate then if we turned over the portfolio more rapidly. Remember, your partner Uncle Sam takes his cut each time we sell one of your holdings. Sometimes our short term performance can be negatively impacted by utilizing this approach but over the long-term it has served us well. We see no reason why this should not continue.

The majority of our accounts for the first nine months of 2016 have underperformed. Our underperformance relative to the leading indices was directly attributable to us not having any exposure to the best performing sectors within the S&P 500. Energy advanced by 18.72%, telecom services 17.86% and utilities 16.13%. Last year energy was the worst performing sector tumbling 21.12%. This year's best performing index, the Russell 2000 gained 11.46% during that time frame. Last year it was the worst performer declining by 4.22%.

Unlike many managers who attempt to mimic the leading stock indices in terms of sector weightings, we believe that over the long-term you are better off structuring a portfolio on a best ideas basis. This approach results in our portfolios looking quite different in terms of sector weightings than the major indices. One outcome of this contrarian style is "lumpy " results that seldom match any of the stock indices. Over the long term, however, we believe a well-researched portfolio of high quality undervalued businesses will lead to superior long-term appreciation potential with reduced risk. **Remember, patience is the key to successful investing.**

A Must Read Article from Chris Mayer

Over the years we have been fortunate to become friendly with Chris Mayer, Chief Investment Strategist of Bonner Private Portfolio. We enjoy reading his articles, as they always contain valuable pieces of financial wisdom and he has the unique ability of taking a complicated concept and explaining it in such a way that both a professional investor finds it useful, and a layperson understands. Chris was kind enough to share a piece he recently published illustrating one of the most important lessons we believe an investor can learn. In our quarterly letters we normally feature excerpts from multiple articles but we believe the lesson Chris is demonstrating is so important we are printing it in its entirety and not including other articles.

I'm going to tell you a remarkable story…

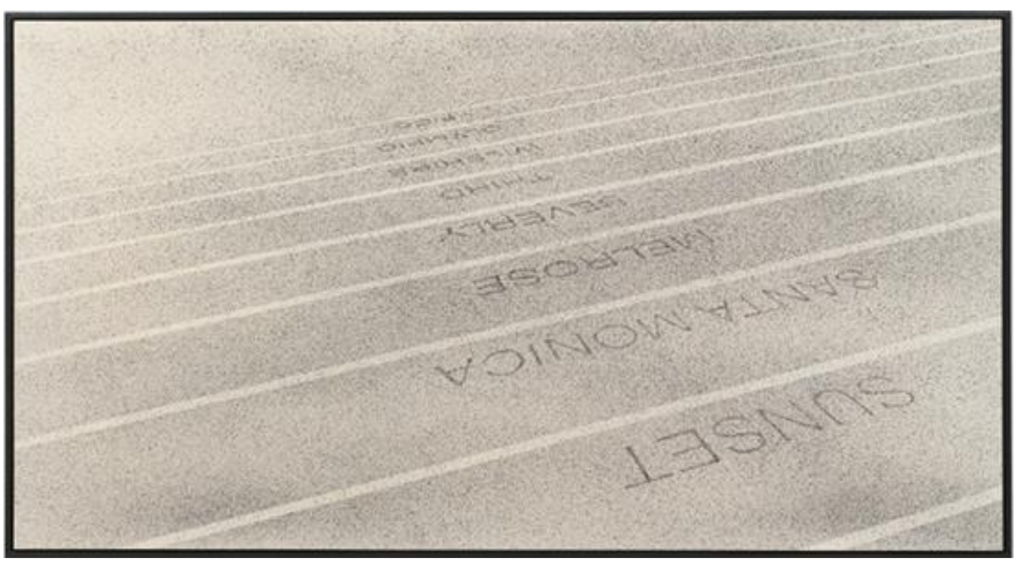
It illustrates the two key factors that go into a successful investment. And they apply to just about any asset, regardless of what the economy is doing.

I was in New York City recently having breakfast with Ken, a longtime reader and friend. Ken is a sharp-tongued New Yorker who tells you exactly what he thinks, good and bad. He runs a small hedge fund in Connecticut. And made a lot of money in the 1980s and 90s riding stocks like Home Depot and Wal-Mart.

But his best investment ever wasn't in stocks…

In 1999, Ken bought an acrylic painting by Ed Ruscha (Sunset to Pico) for $150,000.

His wife thought he was nuts. She pointed out that they could have bought a few nice cars with that money. Nonetheless, Ken was fond of the painting. Sunset to Pico shows nine parallel lines running diagonally across the canvas, as if seen from a bird's-eye view. Below each line is an upside down street name – the nine most recognizable east-west thoroughfares in Los Angeles.



Ken hung it in his home and mostly forgot about it. He simply enjoyed having the piece.

Fast forward to 2015. He's older now. He's thinking he might sell some art and pay off his mortgage. He knows the value of the Ruscha painting has gone up over time, but he has no idea how much. He gets Sotheby's to appraise it. They say they can sell it for $1 million to $1.5 million. At the high end of that range, it's a ten-bagger… Remember, he paid $150,000.

So Ken decides to put it up for auction. He puts a reserve on it of $850,000. Meaning, he won't sell it for less than that. Bidding starts at $500,000.

On the day of the auction, Ken arrives with his wife and daughter. It's a big event with high expectations… like having a horse in the Kentucky Derby. They settle in and the bidding starts. It doesn't take long for the bidding to hit $850,000.

Ken breathes a sigh of relief. He's sold the painting. Bidding climbs higher. It hits $1 million. Ken's ecstatic. He takes a picture of the million-dollar bid. He thinks to himself: "Wow, I've sold a painting for a million dollars."

But the bidding keeps climbing higher… and higher.

It hits $1.5 million. Then the bidding stalls. The auctioneer is working the room and ready to hit the gavel, but another bid comes… $1.6 million… and they keep coming. $1.7 million… $1.8 million…

When the gavel finally falls, Ken sells his Ruscha for $2.3 million.

Even if you never buy a painting in your life, there's a lot to learn from this story…

<u>The Art of Buy and Hold</u>

I'm not advocating that you buy art. I'm always amused when I hear some financial "guru" warn about stocks, and tell you to buy art instead. What they don't seem to get is that art prices are highly correlated to stocks. When we are in bubbly stock markets, we also tend to see bubbly prices for art and collectibles. Conversely, the bids for both stocks and art disappear in times of despair – like 2008. Don't believe that owning art makes you diversified.

But I do recommend buying a great asset and forgetting about it.

One of the first things I said to Ken after he finished his story was: "You'd never ride a stock that long." Do you think Ken would've been able to hold on to that art piece if he had the price of the painting blinking on his computer screen every day for 16 years?

There would've been times when it soared. There would've been times when the price dived. There would've been long stretches where it did nothing, or maybe drifted lower. He might've sold it out of boredom to get something that seemed to be moving. If it were a stock, he might've sold it after it doubled. Those blinking prices on your computer screen are like little siren calls to action.

This is why I tell people not to watch stock prices. Otherwise, you'll surely get scared out of even the best stocks. I did a study of all the stocks that returned 100-to-1 from 1962 to 2014. The ups and downs of these stocks are incredible. From the time it went public in 1980 through 2012, Apple was a 225-bagger. A $10,000 investment in turned into $2.25 million. But you had to suffer through two 80% declines and several 40%-plus drops. Netflix was a 60-bagger from 2002 to 2014. Yet it lost 25% of its value in a single day on four different occasions. There was also a four-month stretch where it fell 80%. Sometimes it's not the decline that will cause you to sell, but the sheer boredom of nothing happening…

Warren Buffett's Berkshire Hathaway has earned a compounded annual return of 20.8% over the past 42 years. But if you bought it in 1997, for example, you had to sit with it for five years before you saw any positive return on the stock. Odds are – if you're watching stock prices and not paying attention to the business

– you'll probably dump it for something more exciting. To enjoy really big, life-altering gains in the stock market, you have to learn to sit on your hands. You have to learn that stock prices can diverge wildly from underlying business values.

And you have to learn to screen out the junk…

You Can't Hold Everything

Ken has a filter he uses before he buys any art for investment. First, he only buys when there is already a market for the artist's work. Second, he only buys artists who've had their work on display at the Museum of Modern Art in New York City. And finally, he only buys art that has been sold at Sotheby's.

These are quality filters. They help screen out stuff that could go to zero or lose huge chunks of value. Still, there are no guarantees in art… or stocks. In the stock market, there are a number of quality filters you can use. I recently finished a book called Quality Investing: Owning the Best Companies for the Long Term (2016) by Lawrence Cunningham, Torkell Eide, and Patrick Hargreaves. The latter two are portfolio managers at AKO Capital, a London-based investment partnership. It has delivered double the market's return since its inception in 2005.

The focus of AKO is to own quality assets, defined by these three characteristics: Predictable cash flow generation: You want to own a business that generates a lot of cash. Companies like Apple and Berkshire Hathaway generate a lot of cash. Mining companies generally don't. Sustainably high returns on capital: You want a business that earns a high return on the money invested in it. If you put $100 in a business and it generates a profit of $15, that's a great 15% return on capital.

Attractive growth opportunities: This is what propels value over the long term. Imagine owning McDonald's when it had only 300 stores. Or imagine owning a cellphone company when cellphones were only 5% of the market. You want to see that the business can be a lot bigger in the years ahead. The book goes into quality in much more detail. But the key takeaway is this: You can't hold junk for the long term and expect great results. Buy the best assets.

Two Factors for Investing Success

The two things that drive long-term success as an investor – in stocks or art or probably anything – are time and quality. You need to give your ideas time to work. And you need to own high-quality assets. If you do that, there's no need to worry about the crazy ups and downs of the markets… or what the Fed is doing… or the state of the economy.

You'll be like Ken, holding on to his painting all those years. And one day, with a little luck, you'll discover you have a fortune.

If you have any questions or comments, please do not hesitate to call.

Best regards,

Mark A. Boyar

Jonathan I. Boyar

IMPORTANT DISCLAIMER

Past performance is no guarantee of future results. Investing in equities and fixed income involves risk, including the possible loss of principal. *The S&P 500 Index is included to allow you to compare your returns against an unmanaged capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of the 500 stocks representing all major industries. The Russell 2000 is an index measuring the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The NASDAQ Composite is a market-capitalization weighted index of the more than 3,000 common equities listed on the NASDAQ stock exchange. The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ. The volatility of the above-referenced indices may be materially different from that of your account(s), and the holdings in your account(s) may differ significantly from the securities that comprise the above-referenced indices. Your results are reported gross of fees. The collection of fees produces a compounding effect on the total rate of return net of management fees. As an example, the effect of investment management fees on the total value of a client's portfolio assuming (a) quarterly fee assessment, (b) $1,000,000 investment, (c) portfolio return of 8% a year, and (d) 1.50% annual investment advisory fee would be $15,566 in the first year, and cumulative effects of $88,488 over five years and $209,051 over ten years. This material is intended as a broad overview of Boyar Asset Management's, philosophy and process and is subject to change without notice. Account holdings and characteristics may vary since investment objectives, tax considerations and other factors differ from account to account.*