CAIRN INVESTMENT GROUP

Newsletter and Quarterly Update

December 2015

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Important Reminders:

- NYSE Closed:
  1/18/2016 MLK Day
  2/15/2016 President's Day
  3/25/2016 Good Friday
  No Checks/Deposits
  No Settlement

Tax Forms and Dates:

- Form 1099-R—Late January Mailing
- Form 1099—Mid February Mailing
- Schedule K-1—Various

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Greetings from the Northwest.

I hope nobody is reading this letter for the weather information. Our usual focus is on economic information and investments. But this is an unusual weekend, the weekend of January 1, 2 & 3, and we have an eye on the New Year, while reflecting on the past year. Lara and I live near the top of Cornell Mountain, about 1000 feet above downtown Portland. This December we had 17 inches of rain; that's a bunch. Right now we have about 4 inches of snow, and for the last several hours we've experienced a consistent sprinkling of rain that is causing us to have a nice thick sheet of glassy, wet ice, while the temperature outside is 25 degrees. So, with that said, for those of you who are going to join me in the trip into Portland tomorrow, good luck. I'm going to leave early. For those of you who are out of town, enjoying someplace sunny – nice choice.

2015 was a remarkable year. I've heard it referred to as a "Stinker." So many things changed and yet so many things stayed the same. Interest rates changed for the first time in years. Oil prices continue to change, getting sliced from $120.00 / barrel, down to $35.00 / barrel, at a couple of different times late in the year. The oil and gas markets have swung so wildly: expensive, restricting the economic expansion of our country and globe; reasonably priced, where people could afford to purchase energy to expand their businesses; cheap, causing a slowdown in the amount of exploration, development, and transportation of energy around the world. At such a low price, oil has put the brakes on a great number of companies, including several companies that we own.

In a nutshell it might be said that 2015 was the year when oil, interest rates, job growth and personal spending marked the majority of the significant economic events. Oil was a little too expensive, and then just-about-right, and then not expensive enough. Interest rates, low forever, apparently are now going to move higher. For those of you who have followed me over the years, increasing interest rates don't cause me much concern. Companies can do well when they have to pay a little bit more than nothing when borrowing money. It is intriguing to see the evidence that we have a growing economy, with an expanding number of jobs. It is frustrating that many of the jobs that are being counted as new jobs don't have the same impact as in the past, because many of them are at lower pay. This causes the overall spending rate of people across the country

Photo by: Noel G.

to be lower. That is a problem, and it's a problem not only in this country but around the globe. Of course that's a gross generalization, but please allow me that generalization. We need to have an environment where there is a little less supply of a couple of key things, and a little more demand. So with a little less supply of energy, and a little more demand by people being well employed, we would have a much more robust economy than we have right now. What this means, more than anything, is that we have seen a slowdown in corporate earnings. At the root of all company valuations are earnings, and the earnings that we've seen reported as the year chugged on have, in general, again a gross generalization, waned. As you have heard me say, many times over the years, earnings do matter, but they matter more to the specific company and less to "the markets." So 2016 for the first time in a long time will be the type of year when individual stock selection, individual bond selection, and a careful eye to changes are going to be more important than during the last few years. Newspaper articles over the New Year's weekend read like this: "Up, down - market just spun its wheels," or "When the S&P Is Nearly Flat, What Happens Next?" Or this one: "Stocks Post Worst Year Since 2008." Let's try to get this into perspective; these statements seem rather alarming, depending on what you're looking at and how you measure it. The 2015 Dow Jones Industrial average gained about 0.21% total return including dividends, while the much broader S&P 500 gained 1.38% with dividends. This is not bad and certainly doesn't deserve "Stocks Post Worst Year Since 2008." As we look around and see that there is one more thing that is being nailed to our wall of worry, it is a worry about corporate earnings, and that is a reasonable topic to be concerned about.

Many of you have noticed that during this last year several of our best and most intriguing companies have been purchased. Purchased by organizations that in most cases have taken them private. This is sad for those of us who have invested in some of these companies for a long period of time. I hate to see them go. It happened primarily because new acquirers looked deeply at these companies and realized that the companies had soft earnings, and the current stock price was undervalued, making them a takeover candidate. Not all, but nearly all of our investors were affected by a merger, acquisition, or a company being taken private - out of our publicly traded arena. We have to pay attention to company valuation, and we have to pay attention to the businesses and the sectors they operate in.

Over the last half of 2015 you may have had a chance to meet Patrick in our office or on the phone. You'll be seeing more and more information from Patrick; he is specifically charged with the effort of helping Tim and me understand relative valuation of an enterprise and whether or not a company should continue to be held or discharged from our group. I am particularly excited about how we really focus on individual companies, dismissing much of the noise that is the news cycle barrage of information that hits our senses every day. We don't own the market; we own individual companies, whether that is an ownership position or a loanership position. Research is a key to this process, and as we go forward I'd love to be able to show and explain more of the things we are working on to expand our capabilities at Cairn. In the last couple of months of 2015 we worked hard to capture capital losses that can be used to offset capital gains now and in the future. It's not our habit or desire to do such a thing, but it is certainly logical, and puts us in a good spot to help offset some of the 2015 gains that many of you received when some of our investments were acquired and taken private. The largest company in this group was Sigma-Aldrich, followed by MWI Veterinary Supply, and the list goes on. We've had nine or ten companies bought out and taken away. In most cases the transactions produced capital gains for our investors. Rite-Aid, a company that a few of you own, is being acquired by Walgreens. This is not an approved deal yet, as it must go through regulatory processes.

Patrick is going to pick up the pen in a moment and will have a chance to expand on some of the things he's been looking at. But I want you to hear it from me: As we go forward, we are listening to the drum beat of a good investment philosophy and working through a multiple-year strategic plan that is fundamentally about continuing our portfolio investment programs and service to our investors. The model that we have been using is constantly being modernized; it is scalable, and it is relevant to you, our investors, because it is your money, your future, and our joint prosperity.

Patrick Mason, CFP :: Investment Analyst

The big headline for the fourth quarter, and for 2015, was that the Fed decided to raise short-term interest rates by .25%. It takes numerous months (6+ historically) for rate hikes to move their way through the economy, so we don't view this as an immediate positive or negative for the economy. For stocks in general there are some more abstract ramifications. Primarily, companies that have a lot of debt will be refinancing at higher borrowing costs over the next couple of years; this will result in higher interest expenses on their income statements.

These matters will be of high priority as we slide into the new year: seeking opportunities, monitoring existing positions, taking the pulse of the economic landscape, considering the amount of debt a company has, and the effects of that debt on a company's profile. 2015 was the year of strong-momentum companies carrying the torch for the broader market. The S&P 500 finished the year essentially flat, but when you look underneath the hood many stocks have entered bear market levels. We feel this trend will eventually reverse itself, as valuations and fundamentals become more of an important consideration. Since this is our main focus when evaluating potential investments, we feel that we are well positioned heading into 2016.

Last quarter we wrote about finding value in some select consumer discretionary stocks and technology stocks. We did not make any changes to the portfolios during that time, as we continued to focus on year-end tax loss harvesting and new opportunities to add to portfolios in the coming weeks or months. We will continue to be vigilant and focused on risk management while continuously scouting for opportunities.

"The Stuff You Need Out Here"

Thanks, Patrick. Speaking of being vigilant and focused on the companies many of you own, like Tractor Supply: While in Idaho for Thanksgiving we found good food grade buckets at the local Tractor Supply store for the Parr annual sauerkraut pounding.