CAIRN INVESTMENT GROUP

Newsletter and Quarterly Update

September 2016

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Important Reminders

- **Bank Holidays Oct. 10 & Nov. 11 No Checks or Settlements**
- **NYSE Closed for Thanksgiving**
- **NYSE Early Close Nov. 25**

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Greetings from the Northwest.

We have entered that lovely time when the Northwest glows with fall colors and abundant harvests. The rains are beginning. In pauses between showers the curious sunshine peeks around the clouds and warms you, yet when the sun shutters back behind the clouds it's cool enough to pull on a sweater. I find fall to be the most stimulating time of the year. There is much to be done, a winter to prepare for, and, of course, wonderful bounty coming out of the fields, forests, and farms to enjoy. Already I've had a crisp, luscious apple pie. And yes, a dollop of ice cream on top of that pie was just enough to send me into "I love fall" spirits.

As we look forward to the remaining three months of 2016, we're contemplating all kinds of events around the world. Later in this letter, Patrick will discuss some of the most important and subtle changes we're seeing in the overall global economy. We are still very pleased to see that the economy is strengthening, although it is slow. With that slow strengthening it seems the Federal Open Market Committee, the Fed, missed a logical time to begin increasing interest rates. Yet a series of increases must be somewhere over the horizon.

Fall is the season to prepare for cooler weather that's on the way. At home, it means bringing in firewood, and making sure that our houses are secure and ready for the cold winter. We are also preparing at Cairn: Brie will illustrate one of the preparations we're doing with computer protection, and some suggestions she has for you to keep the bad guys from your personal information.

Hardly a quarter goes by when we don't talk about our wall of worry. This may sound a little silly, but maybe in the back of our minds there truly is a corkboard where we pin up various issues that might turn into worries. One worry the markets have worked their way through over the last several years has been the aftermath of the bank disaster of 2008 & 2009—what is now firmly called the "Great Recession." And yet, here we are with one of the world's strongest banks and strongest countries, Deutsche Bank of Germany, called to answer questions. It appears that Deutsche Bank may have been involved in a scheme to provide information which was used to create false data that has to do with mortgage securities. The punishment, in the form of monetary fines, is so great that it calls into question Deutsche Bank's viability. Well, that's an embarrassing situation. The German government has been very clear that they don't want to bail out banks. They certainly haven't had any stomach for bailing out banks of other countries, and here they find themselves in a situation where they may have to do that for themselves. A post on our wall of worry.

Cape of Good Hope, South Africa — *Jennifer E.*

A different kind of current worry is "What is going to happen as we work our way through the U.S. Presidential election?" Well, my answer is (no surprise to any of you), I don't know. But we do have a tremendous amount of confidence that this kind of question—one formed in clear view, with everyone focused, listening, watching and paying attention to the evolution of this election, where everyone's ears are open and eyes are wide—is typically NOT the type of event that causes great market upheaval. So the election posted on the wall of worry is certainly there, but fairly low on the wall, lower than Deutsche Bank. And of course those worries at the top are the worries that will affect us most: the unknown, or unforeseen. We at Cairn hope we won't have any of these events in the near future.

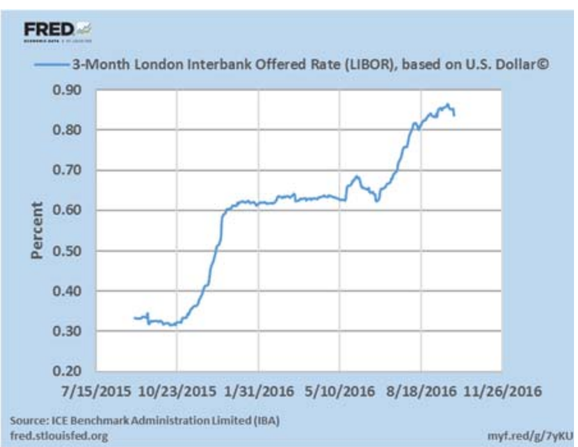
Some of our investors have been exploring the corners of the globe, if a globe has corners, and have sent back wonderful images where cairns helped them along a path, as we certainly intend to help you along your path. I'm going to turn this to Patrick, then Brie, and in the end close with my regular encouragement.

Patrick Mason, CFP :: Investment Analyst

As the third quarter came to a close, the U.S. Fed decided to hold short-term rates unchanged. If you have been listening to any of the financial press, I'm sure you have witnessed the never-ending opinions and thoughts about how this is either positive or negative for the global economy. We at Cairn have long taken the view that the Fed is behind the curve when it comes to a clear path of normalizing/increasing interest rates. Global imbalances have led the Fed to delay unwinding their unconventional monetary policy past the point that would be considered normal, based on what the economy was producing here in the U.S. The issue arising now is that over the last year growth trends in the U.S. have started to slow, limiting policy actions available to the Fed if the trend continues. What is important to us is how these macro events affect the companies and investments we hold or look to hold in your portfolios.

In previous letters we discussed how we view the U.S. broader market indices as being lofty from a valuation perspective, and this view has not changed. Our task is, and always has been, to find companies that are high quality and trade at attractive prices. The benefit of this value philosophy is that, even as the market gyrates, we can be patient and wait for investments that offer compelling growth potential, while trying to limit the loss of capital by "over-paying" for future expectations that the market has placed on the company.

We have a wall of worry topic that we want to touch on surrounding the current investment landscape. A couple of quarters ago we wrote about focusing on high quality companies that fund operations via cash flow and not debt. We believe this to be a vital consideration at this point in the business and credit cycle. Many companies over the last 6 years have been able to fund operations, dividends, and share repurchases via debt, as interest rates (both short and long term) were at an historical low level. We are witnessing a shift in this environment as short term funding rates have increased over the last 9 months (as measured by 3-Month LIBOR). This could potentially put pressure on some firms' profits as interest expenses and borrowing costs increase (not to mention company valuation from outside analysts). We are trying to protect against this possibility by focusing on the makeup of a company's debt distribution, quality of their debt, ability to cover an increase in borrowing costs, and their management around interest rate changes. The chart illustrates some of our concern; it shows that the noticeable increase in 3-Month U.S. Dollar LIBOR, which is the rate most widely used to determine variable rate debt, has gone from 0.30% to 0.87% over the last year. It will be interesting to see how the broad market reacts if this trend in increased borrowing costs continues.



There are always some types of risks that are present across the equity and fixed income markets. Know that we remain vigilant in monitoring the potential risks while always keeping a keen eye open for new opportunities presented by the market. We are certainly living in interesting times so if you ever want to discuss how the topics in the newsletter affect our thinking, please drop in or give me a call. The door is always open.

Brie Valant :: Investor Services Manager

Recently, I had the opportunity to attend a cyber security seminar that emphasized the importance of bolstering passwords to strengthen the key to your online world. The seminar provided an enlightening perspective on password hacking and reasonably implementable solutions to help deter hacks. I thought I would pass the information along to you.

In a hackers' world, length + complexity = strength. Using the technology available today, it takes 15 minutes to hack an 8 character password; but 3 weeks to hack a 13 character one. While the prospect of thinking of and remembering a 13 character password feels daunting to most, the seminar presented some simple tricks and habits you can utilize to make the process easier.

- Phrases: "TheMostAwesomeBrie"
- Password Padding: "Brie$$$$$$$Valant"
- Chunking: "BrieABCDAwesome"

It's good practice to add a few numbers or characters interspersed or at the end of your password. And always…don't use your name—I just did that for the laughs.

Passwords are the keys that open the door to your online world and, as such, they should be as strong as your first line of defense against intruders. We've taken these instructions to heart at Cairn and have implemented a very stringent password policy, along with a two factor authentication for our transaction system.

We enjoy hearing from you, so please, give us a ring, mail a letter, send a pigeon, or if you are in town, come on by. The coffee is always on.

Happy Trails,

Jim

Jim Parr, Principal
Cairn Investment Group, Inc.