IBV CAPITAL

Q3 Partnership Letter
October 2016

Dear Partners,

"It's never been this bad!" At least that's what the two United States Presidential candidates would have you believe as they race towards their dream of living at 1600 Pennsylvania Avenue. This rhetoric and demagoguery is usual for any political race in any country because it grabs headlines and fosters fear and anger within the "disenfranchised" electorate. While typical, we find it ironic that the path to achieving the pinnacle of power - being the President of the United States of America - candidates feel compelled to tell an entire nation that they'll never be able to amount to much, unless they vote for them, of course!

What we do find unusual in this instance is that economic thought leaders, namely central banks, are also repeatedly warning of the negative potential of numerous global risk factors. This narrative, by this group (we've been desensitized to political rhetoric for some time), is especially troublesome and creates a somewhat counter-intuitive outcome. By persistently warning of poor global economic conditions and highlighting the constant threat of global risk factors, market participants are constantly on edge and taking steps to prepare themselves for poor conditions, which ultimately leads to the very economic conditions they're being warned about. It's a very harmful feedback loop.

For central bankers, this outcome shouldn't come as a surprise, as they use this precise expectation mechanism to achieve their inflation targets – to great effect. This repetitive cautious tone, coupled with the deep scarring from the last recession, is having a tangible impact on businesses. We find evidence of it in the level of cash being held on corporate balance sheets, now near 11% of assets up from around 4% in the early 1990's. We also see it in muted business investment and dramatic reactions to even the slightest sign of a change in economic conditions.

In the United States, and arguably globally, this dour attitude is far from warranted. As we stated in our first quarterly letter, if global growth persists on its current trajectory, nearly $29 trillion of GDP will be created over the next ten years – a great outcome. However, we do acknowledge that despite broadly positive economic growth, there are pockets of weakness. For instance, Canada *is* struggling, and it's increasingly difficult to see how this will improve in the near term without the aid of *effective* fiscal spending. South of the border, in the United States, economic growth is good – though not as excellent as some seem to feel entitled to. It's prudent to remind everyone that since 1870, the United States' annual GDP growth has averaged approximately 2.0%, much worse than last year's 2.6% reading.

Moving forward, we're encouraged by continued signs of a healthy economy that are present in new home sales and home price growth, unemployment levels, wage growth, and core inflation numbers. These positives are despite the impact of a huge pullback in energy infrastructure spending and related job losses, as well as a fall in government spending from 20.9% of GDP in 2010 (when GDP was growing at a similar pace of 2.5%) to 17.6% today. Imagine what GDP growth could be if these headwinds abated.

Today, broadly speaking, stock market valuations can only be justified if meaningful earnings growth were to occur - hardly a certainty. Similarly, bond markets, in many instances, are trading at levels that make little to no investment sense (negative yields). It's clear that this investment market reality dramatically conflicts with the poor rhetoric of the presidential candidates, negative tone of central banks, and today's economic growth. When such divergence exists, we seek comfort in our established process of only buying a select few investments (new and old), that we know extremely well, and only when a huge margin safety exists. If we didn't take this approach, as the last few paragraphs illustrate, it would be very difficult to move forward in any discernable direction.

Closing the Gap

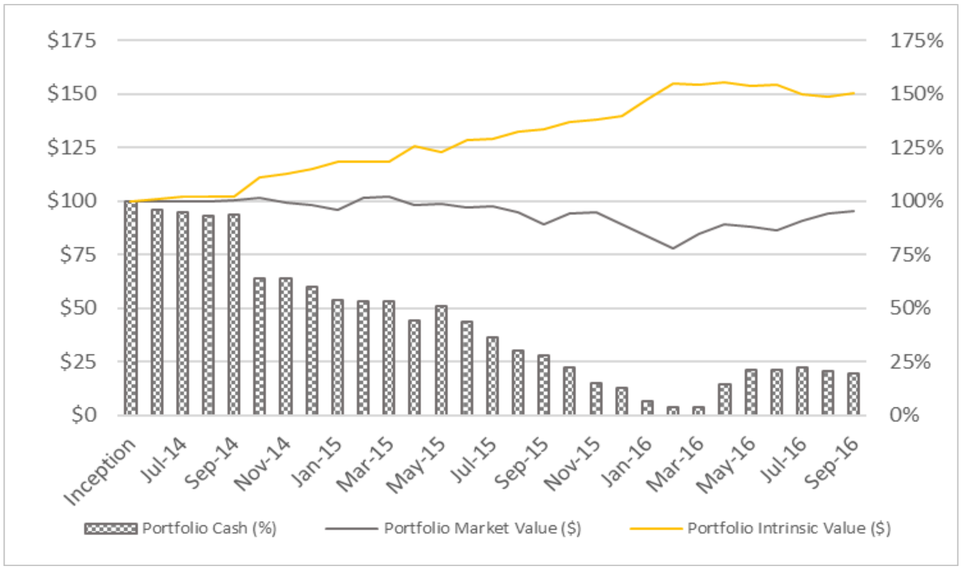
The market value of our investment portfolio increased by 10.8% in the third quarter, and we are now up 7.1% year-to-date. At the same time, the intrinsic value of our portfolio decreased by 2.4% in the quarter and increased 7.7% year-to-date. During the third quarter and year-to-date, the MSCI World Index increased by 4.9% and 5.6%, respectively.[1]

We should note that the improvement in the value of our portfolio is not because we did something differently this summer; it's actually a result of our patience, steady hand, and disciplined investment process which we exhibited in the first quarter of this year. These are three core qualities of IBV Capital and we are able to execute them largely because of the detailed research we conducted.

As a reminder, in the first quarter, while the investment world was in great turmoil, we put a considerable amount of our cash to work in Bank of America and Citigroup – companies we've known intimately since 2011. Further, it was our view that the long-term fundamentals of the companies we owned at the time were largely unchanged (even though the market thought otherwise) so we actively decided to remain invested in them.

At the time, the impact of our decisions were only being reflected in the increase of our portfolio's intrinsic value, mainly from deploying cash into undervalued investments. With rationality prevailing as the year progressed, the strong fundamentals of our companies came into focus again, ultimately leading to an increase in their market values. As a result of these recent market value changes, and the growth of our portfolio's intrinsic value since the beginning of the year, our margin of safety gap now stands at 57.4%.

[1] IBV Capital Global Value Fund LP - Class M units and are shown in US dollars, gross of management fees and performance allocations and net of all other expenses. Inception date of this class (and of the fund), is June 2, 2014.
The MSCI World Free NR Index is a widely known free float weighted equity index representing large and mid-cap companies in 23 developed market countries. The index referenced provides a comparison to the returns and volatility present in the broader market. IBV does not invest in all or necessarily any of the securities that compose these respective



We would like to reiterate the importance of the current intrinsic value (and its changes) of our portfolio. It is our view that this intrinsic value represents the true value of our portfolio – and it has a history of being extremely stable. Our partners should focus intensely on this number, with our expectation being that the market value of our portfolio will gravitate towards it over time – in the same way gravity pulls Newton's apple towards earth.

Portfolio Update

In addition to rational markets prevailing, we continue to benefit from the improving fundamentals of the companies that make up our portfolio. Some notable changes occurred in National Oilwell Varco, Helmerich & Payne, Trinity Industries, Bank of America, and Citigroup.

The deal OPEC announced to cut production by up to 700,000 barrels from present levels lifted two companies we have an interest in - National Oilwell Varco and Helmerich & Payne. While we fully anticipate, these companies enjoying success over the long-run, largely due to anticipated oil and gas demand volume increases (not oil price increases), a supply response that expedites the shift to a rational and stable price environment that promotes conditions for desperately needed infrastructure investment is helpful. We see an OPEC freeze of this nature as especially helpful to us because it will shift production away from the Middle East, where our two companies have limited business operations, to producers in the Gulf of Mexico and North America's conventional and unconventional oil and gas fields where our firms dominate. It is nice to see the investment thesis we've talked extensively about in previous letters begin to play out – though we're still in the early innings.

Our investment in Trinity Industries is becoming reminiscent of an investment we made in The Timken Company in 2013. Timken had two businesses, a struggling steel manufacturer and a thriving ball bearing business. At the time, we noticed the impact these once complementary businesses were having on each other and made an investment on the basis that the ball bearing company would eventually prevail – and it did. With the encouragement of the late Ralph Whitworth of Relational Investors, who accumulated a large stake in Timken, the company was separated into two publicly traded companies, unlocking considerable shareholder value that we enjoyed in full.

Trinity, who owns numerous quality businesses, enjoys far more positive attributes than the combined Timken. However, this was more difficult for us to uncover because of Trinity's relatively larger size and greater diversity. While they're very different companies, our investment in them enjoys similarities because on July 29th, Jeff Ubben of ValueAct announced a 6.8% position (later increasing it to 7.9%), with the aim of changing the composition of Trinity's board and unlocking shareholder value - a potentially positive development.

As is the case with all our investments, we identify changes that could be made to improve the business. However, as a course of our conservative valuation practice, we do not incorporate these improvements into our intrinsic valuations if management has not displayed a long-track record for making the required changes, or communicated that they're currently taking steps to make the improvements. Instead, as was the case with Trinity, we envisioned the improvements we identify as being wonderful potential upside opportunities, but don't predicate our investments on them.

It's evident ValueAct has aligned themselves with our thinking, as Relational Investors did with Timken, seeing the benefits of the base case investment scenario for Trinity, as well as hidden upside opportunities. While ValueAct's presence does not constitute a change in Trinity's fundamentals, it does increase the probability management makes the value-enhancing changes we identified. We're eager to hear more about ValueAct's plans and any progress they make with management.

Our positions in Bank of America and Citigroup have performed extremely well after we added to them in the first quarter of the year. While our investment thesis is aided by short-term rate increases, the timing of which eludes nearly everyone, it's not dependent on them. Instead, we think both firms have other ways of increasing earnings and book value per share. One area we're encouraged by, that appears to be largely overlooked by the market, is how technology will be a distinguishing factor and a meaningful benefit moving forward.

Interestingly, what the market deems as technology that's "disruptive" to large financial institutions, we see as being complementary and value-enhancing. We take issue with the notion that the banking business model is broken and point to the problems LendingClub and Paypal have recently encountered as case in point. LendingClub does precisely what banks do - match borrowers with savers - though less reliably because they have little control over either group in the transaction. Paypal enjoys an entirely different problem. It provides customers with wire transfers for a fee, a service most banks now provide to many of their customers for free, making it difficult to understand their value proposition. More concerning, for the stability of the financial system at least, is they hold "deposits" in their customer's Paypal accounts, without offering deposit insurance or being a regulated financial institution.

Technology has long been used by "conventional" banks to eliminate costs (ATMs replacing tellers and now mobile banking replacing branches) and drive revenues (providing wealth management to the masses). For instance, last week, Bank of America disclosed that the cost of a mobile deposit, which now represents 18% of their deposit transactions, is 1/10th the cost of a deposit made through a teller. Citigroup enjoys similar cost-saving benefits, especially in their Asia franchise. These two organizations (the largest fintech companies you've never heard of), will continue to innovate, as they have always done, and use their well-established global reputations to widen their economic moat and benefit their shareholders.

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In November, I have been invited to speak on a wealth management panel at the Calgary Business Transition Forum, an exclusive conference for business owners and their executives. This panel will focus on the evolution that business owners experience when they begin to consider exiting their family business. The change from a business owner to their own wealth manager can be a daunting task, and I look forward to sharing my personal and firsthand family office insight on the topic.

Ensuring a family's legacy and financial success remains, for future generations, a responsibility that each of our investors task us with, and is a responsibility that we, as a firm, do not take lightly. This responsibility is what fuels us on a day-to-day basis and is the driving force behind our focus on capital preservation and long-term wealth creation.

Sincerely,

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