IBV CAPITAL

Q1 Partnership Letter
April 2016

Dear Partners,

In the past, I've written letters semi-annually. The infrequency of these letters has left some of our Partners wanting more. During these tumultuous global markets, understanding how we're positioned for the years ahead is especially important, as is articulating our recent investment activities and sharing our views on the investment world at large. I'm not often short of words or thoughts, so increasing the frequency of our letters to quarterly shouldn't be a problem. We look forward to spending more time communicating with our Partners.

Setting Sail Without Tailwinds

We find ourselves in an interesting - perhaps unprecedented - time to be investing. Global GDP growth is low, interest rates are abnormally low (about 29% or $7 trillion of the outstanding debt in Bloomberg's Global Developed Sovereign Bond Index was yielding less than zero in February), and stock valuations are at or above their historical averages when compared to earnings. This presents a conundrum when trying to maximize portfolio returns and leads us to believe that return expectations must fall in line with today's reality.

Our portfolio returns, like many of our Partners' personal investment portfolios, come from three distinct areas: stocks, bonds, and cash. Historically, each of these investment options held the promise of a reasonable rate of return for the investment risk that was being taken. Today, the future return profiles of each segment has been meaningfully altered. Let's look at each of them to see what we mean.

We have had several years of easy global monetary policy. The by-product of this has been an incredibly powerful and sustained reach for yield. This is putting remarkable and increasingly concerning downward pressure on interest rates that is impacting everyone's fixed income portfolio - suppressing future returns. For an extreme example of the ultimate impact, we look to Germany, where the 10-year government bond yield is 0.094%. For investors in these particular bonds, if the price moved lower by a mere 1%, it would effectively wipe out all 10 years of the interest that one was expecting to earn. We question whether these bond investors, and many others, are being paid for the risks they are taking. We don't think so. Instead, we think these types of investments are akin to running onto a busy highway to pick up nickels.

On the short end of the yield curve, the cash we hold in the fund earns minimal returns. In fact, last fall, our custodian, Bank of Montreal Nesbitt Burns, informed us (and their other clients) that they will be charging us interest for holding US cash in our futures account. This means we must hold a security, such as short-term US government bonds, to avoid being charged interest. This scenario has been commonplace in Europe for some time now. Our shift towards short-term bonds has been happening en-masse across developed markets, which has been leading investment firms and companies alike to adapt their formerly typical financial planning decisions in meaningful ways.

Attractive stock investments are also increasingly more difficult to find. Over the last 92 years, taking us back to the earliest form of today's S&P 500, stocks have traded at 16.3 times earnings and provided long-term buy and hold investors with annual returns of 10.3%, including dividends. Today, the S&P 500 and MSCI World Index trade at 19.0 and 19.9, respectively. Couple these high earning-multiples with earnings growth that is increasingly difficult to obtain, and wide-spread stock price increases will be harder to come by. We are no longer sailing with tailwinds at our backs.

While this is beginning to sound grim, it's not meant to be. Instead, we're simply enlightening our partners to the very real possibility that returns over the next few years will not be as easy to come by as the returns we've experienced over the past five years. However, we stand ready and able to try and buck this trend.

Fact-based Optimism

The topic of global economic growth is particularly interesting to us and was at the top of most investors' minds in the first quarter of 2016. Today, global GDP is $80 trillion and grew an estimated 3.1% in 2015, with advanced economies growing 1.9% and emerging and developing economies growing 4.0%. This growth rate, according to global investors, is unattractive. We disagree. We do so because if global growth continued at its present 3.1% pace for the next 10 years, $29 trillion of incremental GDP would be created - this is equivalent to the present day economies of the United States and China, combined - and nearly everyone would benefit in some way.

What prompted the investment community to question global GDP growth is the slowing of China's economy. We are of the opinion that the heightened level of concern is misplaced. For one, China saves much of what it earns - the gross savings rate nears 50% relative to the United States' less than 20% savings rate - and once converted to a nation of consumers, future growth is reasonably assured. Further, China's economic activity is a mere $7,590 per capita, relative to the United States $54,629. In short, there is still considerable room for growth, but like any economy, there may be bumps along the way.

Beyond China, we see many other areas around the world where growth can be derived from. Today, approximately 700 million people live on less than $1.90 per day, down from two billion in 1990. For social reasons, this is a rather depressing statistic. However, for the eternal optimist in us, this large demographic of the economically less fortunate represents remarkable growth potential – and they desperately need it. Much of China's financial success has been its ability to lift 791 million people (2.4 times the US population) out of abject poverty between 1981 and 2012. This is a wonderful accomplishment. While China and the rest of the world's work isn't done on this front, while hopeful, I suspect this chasm of income inequality will never be closed. Global GDP growth has left many behind and "catching" them up will be very rewarding.

Surprisingly, nearly 17% (172 million of the aforementioned 700 million people) of this exceedingly poor portion of the globe's population call India home. This partially explains why India's GDP is only $2 trillion per annum, not much more than Canada's, even though it has 36 times the population. India's infrastructure is in desperate need of repair and aggressive expansion, much like China's not too long ago. Reversing this infrastructure deficit will boost current economic activity while improving future growth prospects.

Africa, like India, has a largely untapped population of 1.1 billion. While many of the continent's economies are closely tied to commodities and related industries, my trip to Morocco last November showed that a vibrant consumer and manufacturing based economy can exist there as well. Look to India and Africa as the next economies that will have an insatiable appetite for all the consumer goods and infrastructure that we take for granted in the West.

These three economies, to name but a few, have all the ingredients needed for remarkable global growth stories, but their promise is being overshadowed by both China's slowdown and developed markets' moderate GDP advancements. Global economic growth will march forward - at exactly what pace, no one knows - and many companies will benefit handsomely from it. Consider us eternal optimists about the world's economic future.

Economist versus Weatherman

This brings me to our economist versus weatherman analogy. A weatherman's job is difficult, but we think an economist's job is darn near impossible. On a day-to-day basis, we're not confident in anyone's ability to precisely predict where the economy will be in one, three, or five years' time – but that won't stop many intelligent individuals from trying. In our humble view, most economies are simply too complex with too many unknown variables to get a firm enough grasp on the many factors that determine precise long-term growth. Add to this complexity the possibility of unforeseen events (financial, political, or other) and the proverbial crystal ball becomes far too cloudy for anyone to peer inside of. This is a tough critique, considering I am a trained economist.

Instead of predicting where the economy is going, we spend our time and efforts deciphering where it currently is. What we do is more akin to the weatherman telling its viewers each morning whether to leave the house with or without an umbrella and jacket. Now, everyone is keenly aware that their trusted weatherman is not accurate all the time. Sometimes, they predict rain that doesn't come or a temperature that's off by a few degrees – a margin of error, if you will – but rarely do they mistakenly suggest you wear a winter jack during a summer heat wave.

Having a sense of the "economic weather" today gives us a benchmark to gauge the financial statistics of the companies we're researching and the price we should pay for them. If the skies are clear and temperatures are hitting record highs - in other words, the economy is pumping on all cylinders and stock prices relative to earnings are reaching all-time highs - we'll start preparing for a possible storm.

Coincidentally, in our annual letter, we spoke about our concerns for private technology company investment prospects following years of smooth sailing. We're unsurprised to report that clouds are already forming above them. Conversely, in that same letter, we extolled the return possibilities in US financials, energy companies, and industrials - all of which have experienced a long and chilly period. The sun will shine on these investments once again. It always does.

Baseball is 90% Mental and the Other Half is Physical

In theory, long-term value investing is quite simple. Purchase great companies at great prices and hold them, sometimes for a significant period of time, until they reach their intrinsic value –

then sell them. In practices, the strategy is much harder. The challenge is that markets move in both directions, up and down, and everyone has their own definition of long-term. In the end, when markets turn bad, most cannot handle the psychological discomfort of losing money, regardless of how long their planned investment horizon was in advance. Unfortunately, this usually results in an emotionally charged sale of many of their investments to protect themselves from further losses. The idea of buying during these times is almost impossible to comprehend.

We understand - the recent volatility we have experienced has been discomforting. Our Funds' negative performance since inception should humble any self-reflecting investment manager. It certainly humbled us. However, I was once told that changing your investment strategy based on market conditions isn't a strategy at all. While adapting to market conditions is important, when it comes to changing strategies entirely, I agree with this sage advice. So, we have stayed the course and invested heavily throughout the market turmoil at the start of this year, bringing our cash position to just 6%, down from 52% just one year ago.

The new investments we made, coupled with holding our existing investments throughout the turmoil, resulted in March being our best one-month performance ever, up 9.0%. The lesson here: if we sold, realized our losses, and failed to return to the market, our performance year-to-date would be much different.

Our Extended Family

We often speak about our history managing the private investment accounts for IBV's co-founders. It's due time we revealed more details about our past and present investment performance that our co-founders have enjoyed. Especially since we still work closely with them on their various financial management needs.

Below are two columns, one that displays the financial performance for our IBV Capital Global Value Fund and the other detailing the aggregated private investment accounts which we manage:

	IBV Private Investment Accounts (1)	IBV Global Value Fund (2)
2016	-14.0%	-4.9%
2015	+0.9%	-9.0%
2014	+9.2%	-1.9%
2013	+36.1%	N/A
2012	+23.4%	N/A
2011	-0.6%	N/A
Annualized Since Inception	+9.1%	-8.5%
Average Monthly Cash Position	17.2%	47.3%

Note: Gross investment returns; (1) In CDN with inception at January 1, 2011. (2) In USD with inception at June 2, 2014.

You'll note that the performances between the two, while they were both in operation, deviate from one another. This is for a few select reasons, namely legacy investments and functional currency differences.

When we started the fund, we did not indiscriminately mimic the family office portfolio. Instead, we essentially built the fund from scratch, borrowing only a few past investment ideas. This was done because our family office portfolio had some legacy investments that were not suitable for the fund, due to risk reward dynamics. We have since sold many of these legacy investments as they have matured, leaving the fund and family office with nearly identical investments and weightings. Over time, the impact legacy investments will become immaterial because all the investments we make are for the fund and family. However, what will not change is the difference caused by our functional currency being US dollars for the Fund, and Canadian dollars for the private family office accounts. This will have a lasting impact on relative performance.

Year-to-date and annualized since inception, our fund's performance is -4.9% and -8.5%, respectively. It's taken much longer than I would have anticipated for the strength of our investments to shine through. While short-term performance is important to us, our long-term performance is what we're ultimately focused on. We take a multi-year perspective on performance, a rolling five-year perspective to be precise, that drives our investment decisions. Should our five-year performance be underwhelming, we will be as disappointed as our investors.

Cable Bill too High? If You Can't Beat Them, Join Them

In the fall of 2015, we began investing in Scripps Networks Interactive (SNI). SNI owns television networks that viewers have proven they cannot live without. Its core franchise networks include HGTV, The Food Network, and The Travel Channel. While not big TV watchers, my wife and I enjoy watching a variety of shows on their channels. While I enjoy the occasional show, it's my wife that SNI is truly after. Women, between the ages of 25 and 54, are extremely loyal to these channels and, importantly, these women heavily influence the spending decisions of most households. This fact makes SNI networks an advertiser's dream.

SNI creates original quality content and a lot of it. Its content is also incredibly inexpensive to make when compared to smash hits such as HBO's Game of Thrones or AMC's Walking Dead - two very attractive features that are unique to SNI. It has taken time, but they've mastered the Lifestyle media space in North America and are now taking their show on the road with the purchase of TVN, Poland's premier multi-platform media company. This investment, made in March 2015, represents the platform from which SNI will continue to build their international business on. This expansionary strategy is driving expenses in the international segment to abnormal levels at the moment. While this is suppressing today's underlying earnings, it has placed the company at the precipice of a tremendous amount of growth.

The media industry has come under some pressure of late due to the feared impact skinny bundles and cord-cutting will have on companies. Everyone, myself included, would like to see a drop in their cable bills. However, the idea of cutting my cable altogether seems too extreme a measure to accomplish this. I suspect many others share my sentiments. Instead of cord-cutting, it's more likely we see a shift towards skinny bundles, base cable packages with fewer more high-quality channels, to reduce cable bills. In the case of SNI, most of their networks are so popular that TV carriers must include them in their basic skinny packages, to entice customers to join or stay. So, if you cut down the number of TV channels you subscribe to by purchasing a skinny bundle, you can still enjoy Chopped or Property Brothers, or whatever your vice may be. Reducing your cable bill won't necessarily impact SNI the same way as it would, say, the owner of a niche channel such as the World Fishing Channel.

Over the coming years, we anticipate that SNI will continue to lead its category by creating high-quality content for the most desirable advertising demographic, while growing their viewership internationally. We suspect shareholders will reap the rewards of this well-executed strategy.

A Bigger and Better IBV

Earlier this year, we received a large investment that catapulted us over the $50 million in assets under management mark. An investment of this nature during such tumultuous markets was a true show of faith in our investment strategy. As I said to the investing partners at the time, when the markets are down, we have more ideas than money.

Now, I should disclose, the partners I'm speaking about have had the benefit of getting to know us and our strategy over many years. They appreciate that we think in terms of years, not months or quarters, when it comes to making investment decisions. Our transparency and sharing of thoughts has given them incredible comfort with how we operate. We encourage potential and existing partners to get to know us better so they can enjoy the same comfort these partners have in us. We're just a phone call away.

While new partners are always welcome, it's important to note how encouraged we are by our investors whom have been with us for a long time during these market gyrations. I've spoken with many of you personally about our positions and strategy and the response has been overwhelmingly positive. My enthusiasm for our positions is at an all-time high – so let's stay the course.

Sincerely,

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