



The Narwhal Letter
Fourth Quarter 2016
January 24, 2017

Dear Reader,

A year that began with the worst 10-day stock market open in history and was later dubbed by many (at least on social media) as “the worst year ever” turned out surprisingly well for investors. While asset classes weren’t unanimously “up,” most American investors made money in 2016—at least that’s what we would postulate.

The S&P 500, quite remarkably in some regards, finished the year up 11.96% on a total returns basis. The “Trump Bump” or perhaps a conveniently timed rally helped contribute to a 3.82% return for the equity index for the fourth quarter alone. But for us, the more impressive story was the strong rebound from early-year lows and an eighth consecutive “up” year. We didn’t read too much into the sharp downward open to 2016. As we observed on our blog back in January, there was “nothing conclusive to glean” from a few decades worth of early-year trading data. Nonetheless, it was something of a pleasant surprise to see the S&P rally from a low of 1,810 in early February to a 2016 closing price north of 2,238.

Equally appreciated was the positive return for gold, a position widely held by Narwhal clients. Though absolutely hammered in the fourth quarter (the precious metal declined 12.56%), gold managed to post a respectable gain of 8.63% for the entirety of the year.

Meanwhile, challenges in the fixed income asset class persisted. For the year, the Barclay’s Aggregate Muni Bond Index eked out the slightest of gains (+0.24%) but that weighed on balanced accounts. Further, with the same index declining by 3.63% in the fourth quarter alone, more conservative accounts saw late-year equity runs negated (at least to some extent) by challenges with bonds.

Nevertheless, we remain committed to disciplined asset allocation and exposure to multiple asset classes. Anecdotally, we recently had a conversation with a non-client, neophyte investor who asked why we would own bonds when equities were running up so much late in the year. At the risk of sounding like a smart aleck, the reason is two-fold:

1. We can’t predict the future. We’d all prefer to own an asset class that appreciated 3.82% (which the S&P 500 did in the fourth quarter) than an asset class that declines 3.63% (which the bond index did in the fourth quarter). But we’re not in the wizardry business.
2. We are long-term investors. Our time horizon was never simply October 1, 2016 – December 31, 2016. We’ve bemoaned this in newsletters before, but one of our largest frustrations is dealing with the turning over of a calendar. We don’t tear up portfolios and start from scratch each year. Therefore, it’s at times hard to see the broader picture at the end of the somewhat arbitrary time period of performance measurement.

We remain committed to identifying undervalued investments and holding them to maturity. Along those lines, here are some recent activities we’ve taken in equity portfolios. As a reminder, we make all investment decisions based on client risk tolerance and investing objectives. These recent buys and sells are a sampling and not intended to be comprehensive. Further, *none* of them took place in every single client portfolio.

Last quarter we mentioned a recent investment in Flowers Foods (ticker: FLO). We felt negative headlines regarding contracted labor was disproportionately pushing the stock down. We took a number of positions in the high \$14 and low \$15 range. When a settlement with drivers was reached in mid-December, the stock rallied and we exited entirely and sold all positions for more than \$19.

We have continually acquired positions in NXP Semiconductors (ticker: NXPI) ahead of a buyout tender offer from Qualcomm. The offer will give NXPI shareholders \$110 per share in cash and we believe the deal is likely to go through. Therefore, we initiated and added to positions in the high \$90s during the fourth quarter and we continue to add positions ahead of the February 6 tender deadline. For what it's worth, we like NXPI as a standalone investment opportunity. And if for some reason the deal doesn't go through we expect some downward price volatility, but this isn't solely a "buy-out story."

We also reinitiated positions in Oracle (ticker: ORCL) based on attractive valuation and continued to pick up Royal Bank of Scotland (RBS) for some of our more risk-tolerant clients.

We significantly trimmed exposure to TEVA at a number of different price points during the fourth quarter as bad news seemed to pile up. But we haven't exited the position entirely and we continue to monitor the company as a suppressed share price may present value.

Additionally, we put a large emphasis on minimizing capital gains in the fourth quarter, which is customary for us. Obviously, a strong year for the market and a prolonged bull run made harvesting losses something of a challenge, but wherever possible we strove to reduce gains on portfolios. With that in mind, you may very well have seen a wide array of trades that don't align with the notes above. To be frank, it would take too many pages to individualize every loss-harvesting strategy we employed during late in the year.

As always, we appreciate the opportunity to work alongside you. Matt Burton sent out an email update on Narwhal and the trajectory of the firm earlier this week, and we encourage you to read his commentary from a firm-wide level. In the meantime, please let us know if you have any questions.

Sincerely,



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