

South Atlantic Capital Management Group, Inc.

Investment Management

December 31, 2016 Portfolio Review

COMPOSITE PERFORMANCE SUMMARY

South Atlantic Capital (SACMG) versus S&P 500 Annualized as of 9/30/2016

	QTD	YTD	1 Year	3 Years	5 Years	7 Years	10 Years	Since Inception*	Total Return Since Inception*
SACMG Core Equity ¹ (Net)	0.74%	(2.40%)	1.87%	1.85%	9.08%	9.11%	6.57%	11.46%	1,363.47%
S&P 500 ²	3.85%	7.84%	15.43%	11.15%	16.39%	13.17%	7.27%	9.09%	759.06%

*Inception date of South Atlantic Capital's composite is 1/1/1992.

South Atlantic Capital is an independent investment adviser registered with the State of North Carolina and the Commonwealth of Virginia. South Atlantic Capital claims compliance with the Global Investment Performance Standards (GIPS®). The firm maintains a complete list and description of composites, as well as GIPS® compliant presentations, which are available upon request by calling (910) 763-4113, or emailing info@southatlanticcap.com. Ashland Partners & Co., LLP, our independent verifier, has verified South Atlantic's compliance on a firm-wide level for the period of January 1, 1992 to September 30, 2016. All returns are net of management fees and include reinvested dividends and interest. Past results are not indicative of future investment results.



MARKET COMMENTARY

Core Equity Composite returns through September 30, 2016 were (2.40%) year-to-date versus 7.84% for the S&P 500, and 11.46% annualized since inception versus 9.09% for the S&P 500.

Composite returns for the fourth quarter are not available yet but performance from representative accounts for the fourth quarter and full year compared to the S&P 500 are outlined below. Representative returns for South Atlantic Capital are preliminary and not verified.

	<u>Representative Accounts*</u>	<u>Total Return S&P 500</u>
Fourth Quarter	13.35%	3.8%
2016	10.75%	12.08%

* Representative accounts performance is shown as supplemental information to the GIPS annual disclosure presentation which can be found on the last page.

Looking at our best 5 and worst 5 positions for the 4th quarter, it's clear the rally in bank stocks helped our year to date returns as bank stocks were revalued by the market.

As of 12/31/2016			
Best 5 Positions		Worst 5 Positions	
PNC Warrants	108.9%	Moody's	(12.6%)
JP Morgan Warrants	79.7%	Oaktree	(10.2%)
Wells Fargo Warrants	70.9%	CVS Health	(11.0%)
Bank of America	41.7%	Enterprise Product Partners	(0.5%)
CF Industries	30.6%	Tenga	(0.3%)

Bank Stocks

We believe Wells Fargo, our largest bank position, remains considerably undervalued as it trades at a lower price earnings ratio than other banks due to the phony account scandal. At 11x our expectation for 2017 earnings, it trades at a 36% discount to the forward multiple for the S&P 500, a bigger discount than lower quality banks and larger than the historical 20% discount for banks despite industry leading expense control, credit management and returns on equity over time for Wells Fargo.

The market's reaction to the former CEO's half-hearted response to the scandal is understandable. However, despite management's inattentiveness to employee compensation incentives that were causing problems, the extremely unethical behavior by 2% of their employees discovered after much digging by Wells Fargo is minor compared to the size of the bank. The current CEO is dealing with the problem straight on and thoroughly and we don't expect any significant long term erosion in Wells Fargo's considerable competitive advantages. Customer satisfaction rates have recovered to pre-scandal levels and the reduction in the growth rate in new customers stemming from the scandal appears to be moderating.

Our view that banks were good investments was a minority opinion three months ago but is becoming market consensus. Minority opinions that become market consensus require additional buyers and translate into nice returns. The market consensus three months ago was banks should trade close to book value because returns would remain subpar given the regulatory environment and interest income growth would be hard to come by.

Our view for the banks and specifically for Wells Fargo was that net interest income would begin to grow in line with or above “core earning asset growth” as (1) the home equity loans inherited from the Wachovia acquisition which were in runoff and slowing earning asset growth became a smaller piece of the pie and (2) artificially low rates were bottoming out and margins would increase as rates normalized.

Finally, in the 4th quarter net interest income was up 7% versus last year due to earning asset growth and a net interest margin which was down marginally versus last year but increased nicely versus the 3rd quarter. If interest rates continue to normalize as we expect, margins will increase and net interest income will grow faster than earning asset growth leading to operating leverage as net income growth exceeds operating expenses.

The regulatory environment had plenty to do with the subpar returns and valuations for the banks but we felt much of the problem with returns was due to artificially low interest rates and returns would improve as rates normalized. Outlined below is a comparison of returns on tangible equity assuming margin increases. We don’t expect margins to reach 2007’s pre-financial crisis levels.

	9/30/2016		
	<u>Wells Fargo</u>	<u>JP Morgan</u>	<u>Bank of America</u>
Current Net Interest Margin (NIM)	2.82%	2.24%	2.23%
Current Return on Tangible Equity	13.96%	13.00%	10.31%
NIM up 0.25% >> Return on Equity	16.20%	15.21%	12.07%
NIM up 0.5% >> Return on Equity	19.30%	17.41%	13.84%
2007 NIM	4.72%	2.03%	2.60%

If Wells Fargo’s net interest income increased to 3.07% or 3.32% it would remain well below 2007 levels but would increase earnings approximately 16% and 38% respectively. If higher margins are achieved, that would also lead to more excess capital generation and increased share buybacks.

We did not anticipate the election would result in a change in the bank regulatory environment but we’ll take it. Without commenting on changes in profitability for JP Morgan or Bank of America’s trading desks or changes in compliance costs, bank balance sheets from before the financial crisis compared to today outlined below illustrate the effect the regulatory environment has had on the banks’ ability to generate returns.

We don’t expect or want capital requirements to change drastically but liquidity requirements could and we think should change. As individuals and companies vested in a healthy economy fund banks by making deposits, we think it’s doubtful that the optimal outcome for depositors or the economy is for banks to hold 17% of their earning assets in cash equivalents versus making more loans.

	<u>Wells Fargo</u>	<u>JP Morgan</u>	<u>Bank of America</u>
Percentage of earning assets in cash 2007	3.5%	3.7%	0.9%
Percentage of earning assets in cash today	16.2%	18.0%	17.1%
Tangible equity to assets 2007	5.9%	4.8%	3.8%
Tangible equity to assets today	7.6%	7.3%	7.8%

In the fourth quarter, Wells Fargo earned .56% on cash equivalents and 4.2% on loans outstanding. Reducing cash equivalents from 16% to 8% of earnings assets and lending that money out would add about 17% to net earnings. Like normalized interest rates, reshuffling the balance sheet this would also lead to higher returns and higher share buybacks. If banks return on equity jumps that would lead to higher valuations for their shares.

Being A Contrarian

We agree with Edgar Wachenheim who has an outstanding investment record and recently wrote an excellent book called Common stocks and Common Sense. He describes the need to be contrarian. Since at any point in time the price of a stock is determined by a majority of investors, when we see a stock as undervalued we are in the minority. We try to limit our holdings to companies where, after doing our analysis, our view of value is higher than the current stock price and hope that prices for these stocks rise by more than the market as our view becomes closer to market consensus.

He makes several points we agree with that make it easier to take contrarian views. One is to avoid being influenced by the media by realizing negative news sells. The more information you have the easier this is to do. In addition, very often Wall Street analysts are focused largely on a company’s short term problems and ignore their long- term potential. It’s difficult for them to embrace companies suffering from poor short term results or impaired reputations. This is brilliant—he tracks Wall Street reports not for information but to see where the consensus is hoping that it is contrary to his view creating as large a gap as possible between value and price. Lastly, he has a theory that he admits he can’t prove that it’s difficult for most people to take contrary positions including many people smarter than he, try as they might. Again creating opportunity. His theory is therefore this inability to go against the crowd must be partially hard wired and genetic based on the 200,000 years of history before human beings were civilized. During this time, people were hunter gatherers traveling in bands looking for food and shelter. To be successful, the bands needed to have one leader so through survival of the fittest many leadership genes were killed off leaving the clear majority of hunter gatherers as followers rather than potential rivals. Scientist say that the

genetic composition of present humans is almost identical to the genetic composition of these hunter gatherers. So, according to this guy, take this into account when you listen to the media or analysts and realize that the next time you go to a party you are basically hanging out with a herd of sheep.

I couldn't resist all that but the main point is we try not to be disturbed by the media or analysts disagreeing with our position. Although in no way do we expect returns similar to the recent returns in bank warrants, we are hopeful and optimistic that market consensus on additional positions in the portfolio could approach our view of value in the coming year.

Passive Investing

There is much discussion in the media about the virtues of passive investing, an investment option which certainly has its merits. We have been able to outperform passive indexes overtime but most consistently through a cycle, from peak to peak in the market. We feel much of this is because our style of active investing emphasizes downside protection. We try to avoid permanent loss by focusing on companies with strong balance sheets and look for an additional margin of safety by attempting to buy stocks below our view of value.

Passive investing doesn't incorporate downside protection. Thus, there can be long stretches where there is little appreciation in an index fund and investor returns are limited primarily to a 1.5% to 2% type dividend since valuations can get ahead of earnings growth. From March 1, 2000 to October 1, 2007, the S&P 500 went from 1,379 to 1547, an annual return of 1.53%. By trying to avoid overvalued companies we tend to avoid stretches like this. Including dividends, the total annualized return for the market from March 1, 2000 to October 1, 2007 was 3.1% versus the annualized net return for our core equity composite of 11.1%.

For many investors in the real world of passive investing, they need regular distributions from their account that are higher than the dividend income from the index fund. This means they suffer through significant drawdowns in account values during these lean stretches and are forced into a position to sell shares in the index fund regardless of whether they're getting a good price. Second, since we have held more than 5% in cash on average, clients typically have access to that along with dividend income throughout the year to avoid selling at a bad time. To say you could just sell the S&P in 2007 is much easier said than done since that is really market timing and not passive investing which studies have shown the great majority of people fail at doing successfully.

The S&P 500 has had four down years in the twenty -five years we have been in the business. Our composite returns net of fees during these four years as verified by Ashland Partners are outlined below. We don't know when to expect a downturn in the market and don't expect this level of outperformance in the future but we do expect to outperform the S&P 500 during down years. You should also be aware that we don't expect to outperform the market in the later years of a market cycle when valuations tend to be more expensive.

	Performance in Down Years	
	<u>Core Equity Net</u>	<u>S&P 500 Total Return</u>
2000	12.86%	(9.10%)
2001	4.14%	(11.89%)
2002	(4.22%)	(22.10%)
2008	(26.68%)	(37.00%)

Past results are not indicative of future investment results.

An investor should further understand that future results may result in losses for account holders.

Please feel free to contact me if you would like to discuss this further.

Best regards,

Eddie Nowell

DISCLOSURES

¹**Core Equity Composite** contains all fully discretionary accounts invested in equities excluding accounts that use significant leverage. For comparative purposes it is measured against the total return for the S&P 500. It includes accounts managed for capital appreciation as well as accounts managed for a combination of capital appreciation and current income. The equity securities are typically mid cap and large cap value oriented U.S. equities and ADR's of similar capitalization. The portfolios also include equity securities that provide higher current income such as master limited partnerships, real estate investment trusts and similar securities that "pass through" most of their cash flow as distributions. The portfolios may from time to time invest in

fixed income securities and various hedges such as gold backed ETF's as conditions warrant. The portfolios are typically invested in 15-25 positions but have held fewer than 15 positions in the past.

²**S&P 500 Index** has been widely regarded as the best single gauge of the large cap U.S. equities market since the index was first published in 1957. The index has over U.S. \$4.83 trillion benchmarked, with index assets comprising approximately U.S. \$1.1 trillion of this total. The index includes 500 leading companies in leading industries of the U.S. economy, capturing 75% coverage of U.S. equities and includes the reinvestment of dividends of companies in the S&P 500.

Returns are presented net of management fees and include the reinvestment of all income. The U.S. Dollar is the currency used to express performance. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request, as is GIPS compliant presentations and lists and descriptions of South Atlantic Capital's composites, by emailing Info@SouthAtlanticCap.com or calling (910) 763-4113. Portfolio composition is subject to change at any time and references to specific securities, industries, and sectors referenced in this letter are not recommendations to purchase or sell any particular security. Current and future portfolio holdings are subject to risk.

The discussion of our firm's investments and investment strategy (including current investment themes, the portfolio managers' research and investment process, and portfolio characteristics) represents the firm's investments and the views of the investment adviser, at the time of this letter, and are subject to change without notice.

Past results are not indicative of future investment results. An investor should further understand that future results may result in losses for account holders.



EDWARD D. NOWELL

Edward D. Nowell is President, founder and sole portfolio manager of South Atlantic Capital Management Group, Inc.

Mr. Nowell has over thirty years of experience in the finance business. Prior to founding South Atlantic Capital he worked in the structured finance department of Bankers Trust Company, New York as an Assistant Vice President. His primary responsibility was arranging bank financing for leveraged buyouts led by Kohlberg Kravis Roberts & Company. During graduate school, he interned with Merrill Lynch's Capital Markets Group in New York. Later, he served as an institutional fixed income sales representative for Carolina Securities/Prudential Bache Securities and worked with Fox, Graham, and Mintz, Securities. Mr. Nowell graduated from the University of North Carolina with a B.S. in Economics and received his M.B.A. from the University of Virginia.

©2017 South Atlantic Capital Management Group, Inc.

SOUTH ATLANTIC CAPITAL MANAGEMENT GROUP, INC.
CORE EQUITY COMPOSITE
ANNUAL DISCLOSURE PRESENTATION

Year End	Total Firm Assets (millions)	Composite Assets (USD) (millions)	Number of Accounts in Composite	Annual Performance Results Composite		S&P 500	Composite Dispersion	Three Year Annualized Ex-Post Standard Deviation	
				Gross	Net			Core Equity	S&P 500
9/30/2016	32.7	25.7	70	(1.67%)	(2.40%)	7.84%	0.89%	NA*	NA*
2015	42.0	22.1	67	(4.40%)	(5.35%)	1.38%	1.14%	11.53%	10.47%
2014	40.7	26.8	67	8.19%	7.16%	13.69%	0.98%	7.99%	8.97%
2013	37.2	23.1	55	26.97%	25.77%	32.39%	2.15%	9.88%	11.94%
2012	28.6	17.3	46	13.02%	11.94%	16.00%	1.69%	11.19%	15.09%
2011	25.3	15.2	42	3.63%	2.59%	2.11%	2.48%	15.55%	18.71%
2010	22.0	14.4	40	20.19%	19.00%	15.06%	3.42%	17.94%	21.85%
2009	18.6	13.0	36	46.20%	44.76%	26.46%	5.32%	17.26%	19.63%
2008	12.4	8.4	38	(25.98%)	(26.68%)	(37.00%)	2.30%	12.59%	15.08%
2007	17.4	11.9	37	(1.90%)	(2.82%)	5.49%	3.03%	9.31%	7.68%
2006	22.4	12.6	36	12.11%	11.12%	15.80%	2.52%	8.75%	6.82%
2005	12.4	10.8	33	0.78%	(0.16%)	4.91%	3.12%	11.08%	9.04%
2004	12.3	11.1	30	20.38%	19.25%	10.88%	3.37%	12.60%	14.86%
2003	9.2	8.5	23	35.31%	33.93%	28.68%	4.38%	13.67%	18.07%
2002	6.9	6.4	21	(3.21%)	(4.22%)	(22.10%)	6.43%	14.21%	18.55%
2001	7.6	6.7	17	5.18%	4.14%	(11.89%)	2.36%	14.06%	16.71%
2000	7.1	5.9	14	13.89%	12.86%	(9.10%)	3.77%	13.65%	17.42%
1999	6.4	5.4	13	8.94%	7.89%	21.04%	10.61%	12.67%	16.52%
1998	6.5	5.4	13	6.11%	4.93%	28.58%	5.60%	12.07%	16.01%
1997	5.1	4.7	11	41.04%	39.60%	33.36%	5.15%	11.12%	11.14%
1996	3.6	3.3	8	23.65%	22.40%	22.96%	3.34%	11.76%	9.58%
1995	2.9	2.7	6	48.47%	47.05%	37.58%	3.31%	10.46%	8.22%
1994	2.0	1.9	5	7.76%	6.69%	1.32%	8.02%	11.05%	7.95%
1993	1.8	1.7	4	23.26%	22.05%	10.08%	3.33%		
1992	1.3	1.2	3	13.88%	12.87%	7.62%	0.00%		

*Three Year Annualized Ex-Post Standard Deviation provided for full year-end periods only.

Core Equity Composite contains all fully discretionary accounts invested in equities excluding accounts that use significant leverage and for comparative purposes is measured against the total return for the S&P 500. It includes accounts managed for capital appreciation as well as accounts managed for a combination of capital appreciation and current income. The equity securities are typically mid cap and large cap value oriented U.S. equities and ADR's of similar capitalization. The portfolios also include equity securities that provide higher current income such as master limited partnerships, real estate investment trusts and similar securities that "pass through" most of their cash flow as distributions. The portfolios may from time to time invest in fixed income securities and various hedges such as gold backed ETF's as conditions warrant. The portfolios are typically invested in 15-25 positions but have held fewer than 15 positions in the past. The minimum account size for this composite is \$50,000.

South Atlantic Capital claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. South Atlantic Capital has been independently verified by Ashland Partners & Company LLP for the periods January 1, 1992 to September 30, 2016.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Core Equity

Composite has been examined for the periods January 1, 1992 to September 30, 2016. The verification and performance examination reports are available upon request by calling (910) 763-4113, or by emailing info@southatlanticcap.com.

South Atlantic Capital is an independent registered investment adviser registered with the State of North Carolina and the Commonwealth of Virginia. The firm maintains a complete list and description of composites, as well as GIPS® compliant presentations, which are available upon request by calling (910) 763-4113, or by emailing info@southatlanticcap.com.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Composite policy requires a three month, temporary removal of any portfolio incurring a client initiated external significant cash inflow of at least 25% of portfolio assets. The temporary removal of such an account occurs at the end of the prior month in which the external significant cash flow occurs and the account re-enters the composite at the end of the second full month after the cash flow. In 2014, South Atlantic Capital switched to a new database reporting software and switched our composite fee calculation methodology to using the highest fee in the account, 1.0%, effective 7/1/2014. Additional information regarding the treatment of significant cash flows is available upon request. Composite returns represent investors domiciled primarily in the United States. Past performance is not indicative of future results. As of December 31, 2014, less than 1% of composite assets represent non-fee paying accounts.

The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Returns are presented after trading expenses but before any applicable taxes. The annual composite dispersion presented is a size-weighted standard deviation calculated for the accounts in the composite the entire period. The annual dispersion and the standard deviation were calculated based on net returns prior to 12/31/2014, and gross of fees beginning 1/1/2015. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request, as is GIPS compliant presentations and lists and descriptions of South Atlantic Capital's composites, by emailing info@southatlanticcap.com or calling (910) 763-4113.

South Atlantic Capital's management fee schedule for accounts with assets up to \$5,000,000 is generally set at 1.0% per annum, and is negotiable for accounts with assets over \$5,000,000. Actual investment advisory fees incurred by clients may vary.

The Core Equity composite was created on March 1, 2011.

Independent Accountant's Verification Report

Mr. Edward D. Nowell, President
South Atlantic Capital Management Group, Inc.:

We have examined whether (1) South Atlantic Capital Management Group, Inc. (the "Firm") has complied with all the composite construction requirements of the Global Investment Performance Standards (GIPS® standards) on a firm-wide basis for the periods from January 1, 1992, to September 30, 2016, and (2) the Firm's policies and procedures are designed to calculate and present performance results in compliance with the GIPS standards as of September 30, 2016. The Firm's management is responsible for compliance with the GIPS standards and the design of its policies and procedures. Our responsibility is to express an opinion based on our examination.

Scope of Work

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about the Firm's compliance with the previously mentioned requirements; evaluating the design of the Firm's policies and procedures previously referred to; and performing the procedures for a verification required by the GIPS standards and such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Opinion

In our opinion, in all material respects,

- the Firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis for the periods from January 1, 1992, to September 30, 2016; and
- the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards as of September 30, 2016.

This report does not relate to any composite presentation of the Firm that may accompany this report, and accordingly, we express no opinion on any such performance.



Ashland Partners & Company LLP
November 29, 2016