January 26, 2016

Dear clients and friends,

Re: LCM Annual Letter December 31, 2015

In LCM's eighth annual letter I will discuss the markets in 2015, review our results, and shed some light on how we make the decision to sell or trim a position.

Year in Review

2015 was not an easy year to make money in the stock market. Oil and gas prices were particularly weak and contributed to about half of the decline in the Canadian market. The U.S. stock market was close to flat, with the best performance coming from the technology sector which, frankly, looks expensive. The only tailwind for Canadian investors this year was a benefit from appreciation of the strong U.S. dollar on their U.S. investments.

Strangely, a number of American investors can blame Canada for their poor performance this year. Valeant, a Canadian growth-by-acquisition drug company, was the #1 position in the portfolios of at least six large, highly respected U.S. investment firms, and these managers were hurt as the stock unraveled. Valeant has never been a holding of LCM, but the surprising popularity of this eclectic Canadian company is probably a good indication of the limited number of bargains available in the market, and why many investors have strayed further afield to try to find opportunity.

In terms of research, this year I interviewed the senior management of 27 companies, toured two plants, travelled to meetings in New York and Nebraska, and attended a conference on decision-making in California. The majority of activity in the portfolio involved selling, which was done as warranted, on a case by case basis. We added to one holding early in the year, trimmed three positions during the strong markets in the spring and sold a significant amount of one position this fall. The selling brought our cash position to 47% of the portfolio at year end, which is on the high side. In last year’s letter I discussed our perspective on holding cash. To briefly recap, LCM does not target a specific cash weighting as a macro call on the direction of markets; rather, it is a residual of our process. If we cannot find enough attractively valued, decent quality investments we hold cash rather than lower our standards. Cash should be viewed as a valuable option to take advantage of future bargains rather than as something burning a hole in one’s pocket. We will deploy our capital with the same patience and discipline that we have since inception, and we are optimistic that the market will continue to offer up opportunities.

Results[i]

In 2015 our focused approach enabled us to earn a return of 9.3%. We had 3 outperforming investments this year and this more than offset the drag from 2 underperformers. This is a decent level of absolute return and beat a simple average of the Canadian and U.S. stock markets. Canadian stocks were down 8.3% and the U.S. stock market gained 1.4% (in Canadian dollar terms U.S. stocks were up 20.9% due to the stronger U.S. dollar).

LCM has earned a cumulative total return of 204.5% since it was founded in 2008, or 16.0% per year on an annualized basis. We have accomplished our long-term goal to earn in excess of 7%

annually, and LCM has beaten the market by 8.2% per year relative to a simple average of the Canadian and U.S. stock markets since inception. We are pleased with these results and view them as a product of our patient and disciplined approach.

The Sell Decision

As we have done more selling than buying this year I thought it might be useful to discuss some of LCM's reasons for selling or trimming a stock position. One might assume that the hardest part of investing is figuring out what to buy and how to buy it cheaply. Certainly the buying process is not easy and involves considerable due diligence and an inordinate amount of patience, but the process of continually assessing one's current holdings and determining what and when to sell is often harder. Conventional advice, such as "you'll never go broke taking a gain," can result in missed opportunity. Selling based on a short-term forecast for the stock market has a low probability of success. Even the adage "be fearful when others are greedy" is hardly a roadmap to smart sell decisions. What, then, are some good reasons for selling? LCM's five reasons are set out below.

1. Investment Thesis is Incorrect

If an investment thesis is fundamentally incorrect, then a sell decision should be made quickly so that if losses result, they are manageable. The quick identification and sale of a losing position is necessary to protect downside in a portfolio. This may sound simple, but it requires a high degree of intellectual honesty and the investor must keep his or her ego out of the decision. One reason LCM does not champion its investments publicly is that it can cloud one's judgement and make it harder to reverse course if the occasion demands.

2. Change in Business Model or Management

Change in a business model can sometimes be highly value-destructive and necessitate a sale. Most of these types of changes are gradual and, by their nature, can be hard to identify. For example, the cumulative effect of poor capital allocation over several years, introduction of new competitors, or an emerging new technology can all lead to significant degradation of a business over time. Sometimes, however, changes can occur quickly due to a merger or acquisition and an immediate sell decision is required. Changes in management can also lead to the sale of a position although this tends to matter more for smaller companies where the effect of one individual can be most impactful. Regardless, changes in management are always worth paying attention to.

3. Deterioration in Fundamental Outlook

An imminent decline in fundamentals, such as the earnings power or free cash flow of a business, can be a compelling reason to sell an investment. For long-term investors, changes in fundamentals are often the most important driver of value creation as the earnings power of a business can collapse or multiply many times over a five-year period. Estimating the earnings power for a company or sector can be difficult and requires a lot of work, but it is often easier to be more precise about the direction, magnitude and timing of changes in fundamentals than determining what valuation is appropriate.

4. Valuation is Excessive

Valuation can be a reason to sell, but it is probably the most over-used reason for selling by the

investment industry. Valuation is a critical aspect at the time of purchase, but being overly focused on valuation as a reason for sale can be misguided. Changes in the valuation multiple might cause a stock to rise or fall by 50% in any given year, but these moves can just be noise relative to the moves driven by changes in long term fundamentals. Furthermore, it is difficult to determine the correct valuation with precision because − unlike a bond − the intrinsic value of an equity is an estimate based on a range of assumptions, which is why buying at a discount (or margin of safety) is sensible. It is easy to lose sight of what is important if one is overly focused on valuation. Just as selling a great business with an attractive, high-confidence, long-term fundamental trajectory for a small increase in price does not make sense, neither does buying a terrible business even if the price is dirt cheap. Given the high failure rate of businesses over time, in our view many businesses should never be bought at any price.

5. Portfolio Management Considerations
If a position has grown too large or better ideas have been identified, then sometimes a sale is warranted. Generally I am a fan of letting winners run as espoused by Philip Fisher, but to manage risk there should be an upper limit for each position given its attributes.

In conclusion, there are many factors we consider before selling and certainly there are benefits to long holding periods including compounding gains from our best ideas and deferring taxes for as long as possible. This is something we strive for, and we can envision holding some of our investments for many years given a long runway for potential earnings growth and a strong competitive position. However, worthwhile gains can also be made from buying businesses that one day should be sold as we describe below.

LCM's selling activity in 2015
The three trims we did this spring were based on a combination of the reasons outlined above: peak fundamentals, high-"ish" valuations, and position sizes that had grown too large. In the fall we reduced one position in an industrial company by 70% due to concern about changes in its business model, as well as potential risk to its fundamental outlook. During the 5 ½ years since our first purchase in 2010, this stock beat its peers and the market with an annualized total return of just under 40%. (This has been LCM's 3rd best performer – with these sales we realized a gain of about 6.5 times our initial investment). Most of these returns were due to increases in fundamentals (as opposed to valuation) as the earnings power increased 5.4 times over this period. For this company, the organic opportunities for fundamental earnings growth had been mostly realized such that any future increases would most likely come from acquisitions, a proposition that, while likely, is also much riskier. Also, the sales mix had shifted over the years putting less emphasis on the unique competitive advantage which initially attracted us. Valuation was still reasonable at 14 times earnings with no debt, but a lower position size was warranted given the changes outlined above.

What can clients expect going forward?
In every letter we caution that losses on an annual basis are unavoidable from time to time. Despite conservatism, rigorous due diligence, greater selectivity and the ability to hold cash, investing in the stock market entails enduring some bleak periods along with the good ones. Given that owning shares in a company is analogous to being a part owner of a business, just as no business owner can expect to increase his or her net worth in a straight upward line, neither

can an investor in stocks. Despite this fact, investing remains one of the best ways to protect and grow one's capital. Being emotionally prepared in advance for the inevitable setbacks that will occur, and considering one's investment results over the long term are useful ways to stay the course and reap the rewards that the market can offer. Although we expect our performance to be different from the market from year to year, we continue to anticipate generating returns in excess of 7% annually over the long term.

I wish you all the best for 2016. If you have any questions please call me at 604-558-0070.

Sincerely,

Daniel Lewin CFA
President

P.S. We are grateful for referrals to friends where our approach might resonate. Due to our segregated model we have minimum of $5 million in investable capital for new clients.

[i] All stated returns are gross of fees. We take pride in ensuring that our fees are fair and reasonable for the service LCM provides. If you would like a copy of LCM's Investment Management Agreement that outlines our fees and services in more detail please contact us. Returns for LCM are from a representative account as all client assets are held on a segregated basis. Small differences will occur between accounts due to rounding and the timing of cash flows. The S&P TSX Composite Total Return Index is used to represent the Canadian stock market returns, and has returned 1.6% per year over the seven and a half years ended December 31, 2015. The S&P 500 Total Return Index translated into Canadian dollars is used to represent the U.S. stock market returns, and this index has earned 13.3% per year in Canadian dollar terms over this same period. Thus LCM's total portfolio return of 16.0% per year has beaten the Canadian and U.S. Stock Markets by 14.4% per year and 2.7% per year respectively since inception. "Since inception" refers to the seven and a half year period from June 30, 2008 to December 31, 2015.