January 8, 2016

Dear Clients and Friends,

We are pleased to comment on the events of the year just ended and to offer a few thoughts on the year ahead. For our clients, we enclose your December 31, 2015 reports, including your portfolio appraisal, performance history and realized gains and losses.

Last year at this time we noted the widespread sense of optimism in financial markets, reflected in buoyant stock and bond prices and consensus forecasts for another strong year. We took a more sober view, advising clients to preserve gains achieved since the depths of the 2008-09 recession. As it happened, stocks treaded water for the year, with the S&P500 and Dow Jones Industrials down marginally in price (-0.7% and -2.2%, respectively, excluding dividends). Even this lackluster result required extraordinary horsepower from a handful of the most widely loved growth stocks, including Amazon, Google (Alphabet) and Netflix, which returned an average of +99% for the year. By contrast, most stocks fell, paced by precipitous declines in pipeline MLPs, energy and industrial stocks and emerging market equities. Oil continued its supply-driven de-scent, closing just above $37/barrel and rattling commodity-dependent emerging market econ-omies. China's economy slowed more than expected and the U.S. dollar strengthened, making U.S. exports more costly. With organic growth hard to find and an era of Fed induced cheap money nearing an end, companies turned to mergers and acquisitions to defend market share or enter new markets. Several DWA portfolio companies were active sellers or buyers in 2015 including Precision Castparts, which was acquired by Berkshire Hathaway, and DirecTV which was sold to AT&T. JM Smucker made a strategic acquisition to enter the pet food market and AB Inbev agreed to buy SAB Miller, enhancing the company's global footprint.

Valuation matters, eventually

Observing financial markets at the start of 2016, there seem to be two opposing and mutually incompatible views among investors. On the one hand, investors in investment grade bonds are willing to accept paltry yields for the promise of safety. High quality bonds appear overval-ued, especially now that the Fed has raised rates for the first time in nearly a decade. A 10-year Treasury note yielding 2.2% will return its owner's principal at maturity in nominal terms but is unlikely to provide an adequate return after inflation, fees and taxes. Investors who chased yield in junk bonds are facing the unhappy fallout of that strategy, enduring soaring yields, falling prices and uncertainty of repayment, especially in the energy sector; at least one large high yield mutual fund has frozen its investors' assets. Seven years after the collapse of Lehman Brothers, fear still stalks the bond market. By contrast, equity investors are nonchalant, at least with respect to the fastest growing companies. Private technology companies with in-novative but unproven business models are raising capital at eye-popping valuations in hopes of a splashy public offering, while in the public market many of the most successful large cap growth stocks trade in excess of 30x reported earnings – and higher multiples of GAAP (or generally accepted accounting principles) earnings. Value stocks are lagging mega cap growth stocks and the chasm between the two is widening.

This bifurcation in the stock market between the most widely owned growth stocks and many other less flashy but still high quality companies is creating our kind of investing environment. Quality, defined by wide economic moats, shareholder oriented management, abundant rein-vestment opportunity and bulletproof financial attributes, is our center of gravity. When valua-tions also favor our approach to investing, we are active buyers. During 2015 we added several new positions and increased our exposure to our largest holding, Berkshire Hathaway. As this position represents a material commitment for many clients, it is useful to comment briefly on our thinking with respect to the company's valuation and prospects.

Berkshire Hathaway: An Unloved Compounding Machine

Berkshire's share price fell last year by -12%, underperforming the S&P500. Book value actually increased marginally, resulting in a decline in Berkshire's price/book value multiple to 1.3x. Put-ting this valuation in context, over the past several

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decades Berkshire has traded at an average multiple of 1.6x book value and the board has communicated its willingness to repurchase shares at 1.2x, a level Warren Buffett believes dramatically understates the company's intrinsic value. One reason book value understates intrinsic value is that, under GAAP rules, insurance float must be recorded as a liability on the balance sheet as these funds are, in theory, cash temporarily held by an insurance company but earmarked to pay claims. Classifying float as a liability reduces shareholder equity even when, as in the case of Berkshire, float is essentially permanent and costs roughly zero.

Putting aside this accounting debate, the operating businesses and asset values of Berkshire support a higher share price, in our judgment. Berkshire's class B shares, which are economi-cally equivalent to 1/1,500 of a single A share, traded recently at $130. Consider that Berkshire had cash and securities worth $100/share at September 30 and estimated 2015 operating in-come per share of $7.65. Assuming the collection of operating subsidiaries, including BNSF Railway, Lubrizol, Berkshire Energy, McLane, Benjamin Moore Paints, Marmon Industries and Net Jets, are collectively worth 10x operating income (a conservative multiple, in our view), the intrinsic value per share, excluding the network effect of Berkshire and the capital allocation talents of its management team, is at least $176 (investments of $100 + operating subsidiaries of $76.50), or 35% higher than the current price. Consider too that Berkshire will soon add Precision Castparts to its arsenal of operating subsidiaries and that its free cash flow earnings power, currently exceeding $1 billion per month, is likely to grow as Berkshire's largest busi-nesses regain footing.

Those betting against Berkshire cite Warren Buffett's probable retirement, the impact of weak commodity prices on BNSF and an "old economy" public equity portfolio. While acknowledging Berkshire will be different post-Buffett, we believe he has successfully transitioned Berkshire from an investment vehicle into a powerful operating business with sustainable free cash flow, wide economic moats and a team of talented managers. Berkshire today is an undervalued compounding machine with more than $25 billion in cash available for acquisitions or share repurchases, after deducting the purchase price of Precision Castparts and the $20 billion Berk-shire cites as minimum cash on hand.

A Hopeful View for the Global Economy

In these letters we highlight economic and market themes we feel are important for our clients to consider. Earlier, we noted the apparent contrast between the views of fixed income and equity investors, which roughly correspond to fear and greed, respectively. A similar divergence is apparent in international affairs with important implications for long term investors.

A look back at 2015 must note the terror attacks in Paris and the wider chaos in the Middle East, in which four countries are engulfed in civil wars and the world's largest refugee crisis since World War II threatens to destabilize countries outside the region. Tensions between Saudi Arabia and Iran could light an even wider conflict with uncertain consequences. The root causes of extremism in the region are hard to fathom and impossible to counter. What seems clear is that a protracted conflict between a liberal set of values including free trade, free exchange of ideas and tolerance is deeply opposed to an alternate view espoused by large numbers of peo-ple in the Middle East. How this conflict is resolved in the years ahead will bear directly on whether the economic system in which our portfolio companies exist can endure. It is tempting to despair of the challenge ahead and easy to adopt a pessimistic view.

And yet, against the nihilism splashed across headlines, three international agreements com-pleted in 2015 mark a reason for optimism for those, including ourselves, who welcome open markets, rule based global trade and the free exchange of ideas. Two of these – the normali-zation of relations between the U.S. and Cuba and the Trans Pacific Partnership ("TPP") – are aimed squarely at extending trade and investment in our hemisphere and in Asia, and at pre-serving a global economic system largely established and enforced by the U.S. Indeed, the TPP codifies a framework for trade among the eleven largest Asian nations (excluding China), preserving a central role for the U.S. in setting the terms for trade in the region and eliminating tariffs on thousands of goods and services. Similarly, the U.N. climate accord signed last month in Paris commits countries to enact plans to reduce emissions, outlines a system for mitigating climate change in developing countries and establishes a timetable for countries to tighten cli-mate policies over time. The agreement, involving nearly 200 countries, is the first to include China and India, two of the world's largest emitters of carbon. Among other effects of the climate deal is the likelihood that capital will be committed to new opportunities in renewable energy, water conservation, food security and sustainable forestry. We believe the potential for innova-tion in these areas is immense and that thoughtful investors will have significant opportunities.

We are committing capital to companies that will prosper from global trade and innovation in new markets. Ours is an optimistic view, dependent on a free and durable economic system and expressed by our investments in companies such as Novartis, MasterCard, Nestle and AB Inbev. We invest in innovative companies, including Apple, where Tim Cook and Lisa Jackson are retooling Apple's supply chain to conserve forests, Unilever, which is financing its growth in part by issuing innovative green bonds and Ecolab, which is addressing the growing market for water purification and conservation.

Housekeeping

Always on the lookout for exceptional people, we are delighted to announce that Tom Loizeaux agreed to join us in New York from Fiduciary Trust International to lead our business develop-ment effort. We are a tightly knit group, proud to serve our clients and ever grateful to you for giving us the chance to do work we find challenging and meaningful. Thank you for your confi-dence in our firm, and best wishes for a happy and prosperous 2016.

Sincerely,

Douglass Winthrop Advisors LLC