



Poplar Forest Partners Strategy Quarterly Update

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March 31, 2016



Dear Partner,

Thirty six years ago, in the spring of 1980, I bought my first stocks – 10 shares of IBM and 20 shares of American Medical International (AMI). I was in the 9th grade. It didn't take long before I was hooked on investing. I looked up the prices of IBM and AMI in the newspaper and plotted them on graph paper. The up and down movements led me to ask: "Why?" I was fortunate to be working with Dave Basten, then a broker at Legg Mason. Dave took me under his wing and started explaining concepts like price/earnings ratios, price/book value multiples, and dividend yields. I loved it!

When I think back to those first equity purchases, I realize that my excitement about the treasures I was discovering in the stock market wasn't typical. At the time, investor uncertainty was high – and for good reason. In November 1979, Iranian revolutionaries had taken over the U.S. embassy and were holding Americans hostage. Watergate and Vietnam were still fresh memories. Oil prices were high, inflation was a big problem and there were worries that a recession was coming (and it did). The country was in a real funk and looking for change. A former actor (and two-term California governor) was running for the White House (after failing to win a contested convention in 1976).

I was recently reminded of an article by Warren Buffett in the August 6, 1979 issue of *Forbes* magazine. Mr. Buffett offered these observations (emphasis added):

*An "argument is made that there are just too many question marks about the near future; wouldn't it be better to wait until things clear up a bit? You know the prose: 'Maintain buying reserves until current uncertainties are resolved,' etc. Before reaching for that crutch, face up to two unpleasant facts: the future is never clear; you pay a very high price in the stock market for a cheery consensus. **Uncertainty actually is the friend of the buyer of long-term values.**"*

Despite concerns that led many investors to shun stocks, the market rewarded those who saw opportunity in the uncertainty. In 1980, the S&P 500 rose over 30% despite all the negativity. In the seven years of 1980 to 1986, the S&P produced compound annual returns in excess of 20% per year. **Today, I feel very much like Warren Buffett did back then: uncertainty has created what I believe are great bargains in the stock market.**

Value investing is hard. Not many have the courage to invest in uncertain times, but there can be substantial rewards for those willing to go against the crowd – to use fundamental research to identify bargain-priced securities that others may be anxious to sell.

While value investing has a long history of market-beating returns, it doesn't win every year. From 1965 to 2015, Mr. Buffett, arguably the most famous value investor in the world, generated a compound total return of 20.8% per year for shareholders of Berkshire Hathaway versus 9.7% for the S&P 500. But it was at times a bumpy ride – his results lagged behind the S&P 500 in 16 of 51 years. And the bad years were rarely near misses. In 2015, for example, Berkshire Hathaway shares fell 12.5% as compared to the 1.4% total return of the S&P 500.



VALUE PEAKED IN 2007

Exhibit 3
Value Long Term Performance in the US (long short cumulative return)



Source: The Ken French data library, available at <http://mba.tuck.dartmouth.edu>

As you can see in the graph above, value investing's great long-term results include long stretches of underperformance. The last eight years has been one of those stretches. The Russell 1000 Value Index, which measures the performance of the cheapest half of the 1,000 largest companies in the United States, can help us gauge how challenging the environment has been for value managers. From the end of 2007 to the end of 2015, the S&P 500 generated a total annual return of 6.5% while the Russell 1000 Value index grew 5.1%.

Why might the last eight years have been difficult for strategies that emphasize discounted stock valuations? Perhaps it has been the rise of passive investing – an inherently “anti-value” strategy. In passive investment strategies, like many Index and Exchange Traded Funds (ETFs), when new money comes into the strategy, the portfolio is replicated proportionately. In practical terms, that means that the strategy buys twice as much of the stock that recently doubled and half as much of the stock that fell 50%. This is a momentum strategy: buy more of what's doing well in the belief that it will continue to do well. It is the opposite of what we do - we prefer to buy low and sell high.

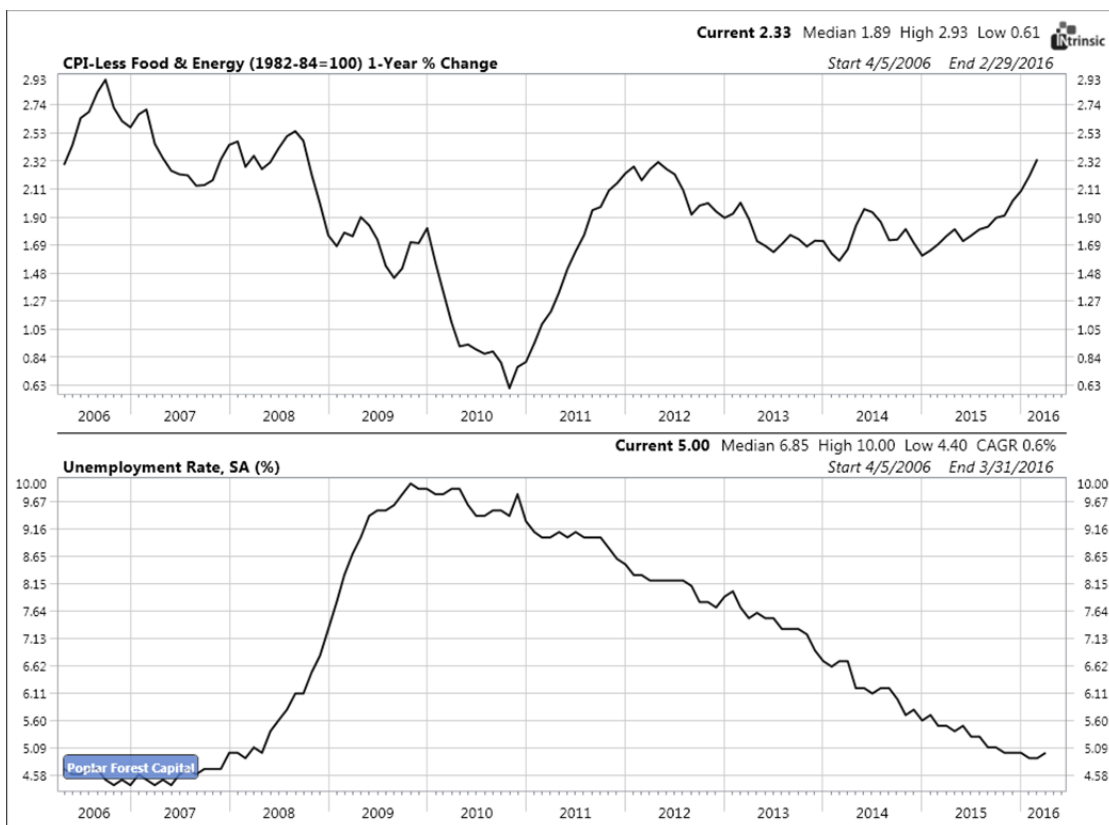
Another potential explanation for value strategy struggles is that, after a great run in the eight years after the bursting of the tech bubble in 2000, it became difficult to find bargains. In the period from the end of 1999 to the end of 2007, the Russell 1000 Value Index compounded at 6.8% - more than 5% a year better than the S&P 500's 1.7%. It's possible that there simply wasn't as much value in value stocks. That's not the case today.

Maybe the problem has been weak macroeconomic fundamentals in the aftermath of the financial crisis and the accompanying Great Recession. In response to the bursting of the housing bubble in 2007, financial authorities began what has become an extraordinary monetary policy experiment by cutting interest rates to zero in an effort to fend off the deflation they feared would result from deleveraging of the financial system. Central banks cut interest rates to encourage borrowing, which was expected to be used to expand businesses and, thus, the economy as a whole.



While cutting rates was an appropriate response in the immediate aftermath of the financial crisis, conditions no longer demand such action. Keynesian policy seems to have been transformed from a tool used in emergencies into a perceived cure for all economic ills. Despite a historic level of monetary intervention, global economic growth remains anemic. There appear to be diminishing returns from debt funded growth. I am hopeful that we will soon enter a new phase of monetary responsibility where policies that have piled new debt on top of the old are replaced with lessening of central bank intervention in markets and a gradual rise in interest rates. If we don't head in this direction, I worry that we will be forced to live with the costs of misallocated societal resources and, potentially, much higher inflation in future years.

In the United States, the stage appears set for this potential policy evolution. As you can see below, unemployment and inflation, the key metrics the Federal Reserve is charged with managing, are moving in a direction that suggests a need for normalization of monetary policy in coming months and years. In a recent speech at the National Association for Business Economics Economic Policy Conference, Stanley Fischer, Federal Reserve Vice Chairman, said "we may well at present be seeing the first stirrings of an increase in the inflation rate – something that we would like to happen."



The situation looks less rosy overseas. In Europe and Japan, authorities remain concerned that economic weakness in China will pull their already moribund economies into recession. Despite a lack of evidence that cutting interest rates will do the trick, they keep trying. I am reminded of the definition of *insanity* attributed to Albert Einstein: "Doing the same thing over and over again and expecting different results." Cutting rates hasn't worked as expected. Yet to a hammer, every problem is a nail,





and many central bankers around the world don't seem to know what else to do, but they believe they must do something. In our globally connected financial markets, the pull of negative interest rates in Japan and Europe are putting downward pressure on U.S. interest rates. In time, I believe rates will be forced higher given continued low but steady growth in the U.S. and declining unemployment. I don't know when rates will start moving materially higher, but I believe our portfolios are well positioned for that outcome.

Financial Services – A Potential Beneficiary of Higher Rates

One area where we continue to see great value is in large cap financial service companies. From my vantage point, these stocks remain among the most eye-catching values in the market and they continue to be the largest commitment in both the Partners and Balanced Strategies. As you can see on the graph below, **the banking and insurance companies in which we are invested are currently being valued at just 74% of book value – a roughly 50% discount to the valuation they have been accorded over the last 20 years.** While I acknowledge that new regulatory burdens have lessened the attractiveness of the business, I believe investors, still scarred by the devastation in the '07-'08 financial crisis, are unwilling to accord these businesses the valuations they deserve, particularly given that their balance sheets look stronger than they have in a generation.



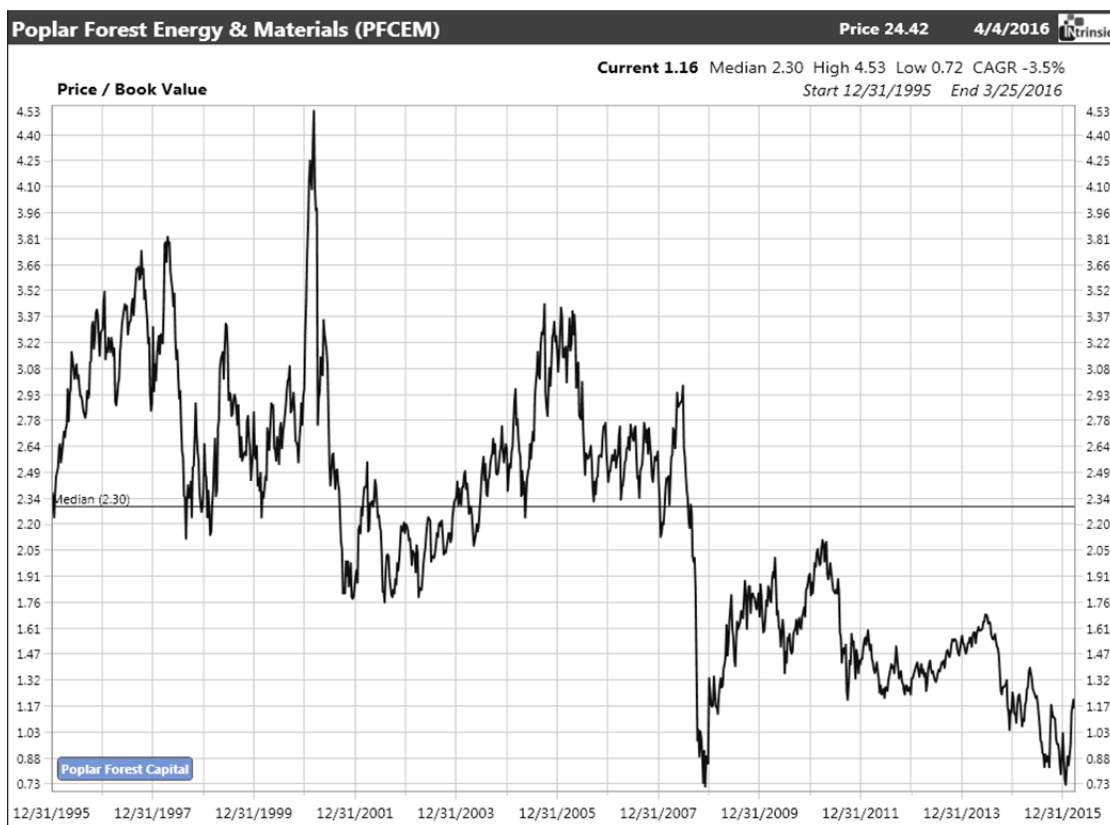
In the short run, the downward pressure of global interest rates has kept U.S. interest rates at levels that I simply do not believe are justified by U.S. economic fundamentals. The profitability of financial service companies is dependent on the level of interest rates, and in recent months, globally



influenced low interest rates have been a major headwind to our banking and insurance investments. In addition, fears of recession have led to increased worries about potential credit losses at banks and write-downs on the energy bonds held by insurance companies. We believe these concerns are overblown and that the companies have more than sufficient reserves and capital balances to avoid a repeat of the financial crisis meltdown.

Energy – A Classic Opportunity to Buy Low

It is probably no surprise that we have a keen interest in energy and materials companies. The fall in the price of oil, natural gas, copper and many other commodities has resulted in material declines in the stock prices of companies associated with these goods. While investors appear to believe these low prices will result in permanently lower returns and/or major asset impairments that will lead to falling book value for these businesses, we see opportunities.



First, we see the potential for higher commodity prices over our investment horizon. Investors have largely underappreciated the sharp supply correction underway in many of these commodities as new investments have been curtailed. In the U.S., for example, oil and gas rigs are down approximately 75% from the peak and 30% YTD, while new capital investment is down more than 50%. Oil and gas wells require ongoing investments as reserves become depleted with production. Without new investments, current production begins to decline. This decline is ~5% globally and more than double in the U.S. due to a high mix of shale production. Shrinking long-term supply and growing demand is setting the stage for more balanced markets and higher prices. Second, we focus on well capitalized companies that we



believe have staying power at lower commodity prices. The companies we are focused on are diversified, have balance sheet flexibility (e.g. limited covenants, unsecured debt structure) and ample liquidity. Third, these companies are lowering their cost structures (down 20-25% on average) and taking advantage of the current environment to high grade their assets. These actions could result in higher returns long-term. Finally, valuation is attractive on both current and future metrics. As you can see on the preceding page, **the companies in which we are invested are trading at only a slight premium to book value – 50% less than they have traded, on average, over the last 20 years.** For these companies, we see limited risk of major asset impairments.

As the opportunity set has grown, we have increased our exposure to energy and materials companies from nothing in the first five years of Poplar Forest's existence to roughly 20% of the equity exposure in both the Partners and Balanced Strategies today.

In the early years of my career, I was an analyst focused on the energy sector. The current cycle reminds me of the mid-1980s – a time of great stress for energy companies. That stress created multi-year, market beating results for the companies that survived the cycle. At Poplar Forest, a key focus of our analytical work involves understanding each company's cost position as well as its financial constraints. I'm delighted to report that our efforts in this area were enhanced in early February when Akash Ghiya joined Poplar Forest's research team. Previously, Akash was part of a successful hedge fund team at Pimco where he had focused on energy and industrial companies. Before that, Akash worked for a small investment firm in Boston where he developed an expertise in energy and energy infrastructure while investing in both debt and equity securities. With Akash on board, we have a fresh set of eyes to review our investments in this area and his expertise and 11 years of financial service experience are a real plus. Please join me in welcoming Akash to Poplar Forest!

The Value Opportunity - It's Bigger than Financials and Energy

At the sector level, there appear to be great opportunities in financial service and energy and materials companies, but bargain shopping doesn't stop there. As the chart on the next page demonstrates, valuation spreads within industries are approaching levels last seen in 2000: the starting point for a terrific period of performance for value investors. As a practical matter, I am having a much easier time finding stocks whose price looks attractive relative to our assessment of the underlying value of the business. In the last six months, we have made new investments in the consumer, healthcare and technology sectors. **It has been several years since the environment looked this good to me. This evidence leads me to believe that we may be on the cusp of a multi-year period of market-beating results for value strategies like those pursued at Poplar Forest.**



Exhibit 12
US Industry neutral price/book factor valuation (median long/median short)



Source: MSCI, Factset Bernstein analysis

In Closing

I realize there are many things for investors to worry about: economic weakness in China and its impact on the global economy, worries about recession here at home, and a presidential race unlike anything I remember. I am particularly thankful to our founding fathers for creating a system of government that balances power between the executive, legislative, and judicial branches. The U.S. economic and political systems are messy and sometimes create disquieting feelings but, as Winston Churchill said, “Democracy is the worst form of government, except for all those other forms that have been tried from time to time.”

Markets have certainly been volatile over the last year with the S&P falling 12% between May and August followed by a strong rally into November; then a second decline to a new low in February followed by yet another strong rally into early March. Sentiment seems to be shifting back and forth between optimism given decent economic conditions in the U.S. and worries that Chinese economic weakness will drag the world into recession. As long as investors remain uncertain about the future, this volatility may continue. With a shopping list of potential investments that exceeds our cash reserves, we are positioned to take advantage of additional bouts of investor nervousness. As Buffett said: “*Uncertainty actually is the friend of the buyer of long-term values.*”

From my vantage point, equity valuations aren’t stretched, economic fundamentals look solid, and investment opportunities appear abundant. The bond market doesn’t look as attractive, but corporate spreads have opened a little and we recognize that carefully chosen bonds can play an important defensive role in portfolio construction. In the Partners Strategy, we have been roughly 97% invested in equities for the last several months with cash reserves of 3%. In the more conservatively managed Balanced Strategy, we’ve maintained a 65% exposure to equities with another 35% in cash and high quality bonds that we believe should cushion the downside if economic fundamentals unexpectedly disappoint. While we think the Partners Strategy will do better in strong equity market years, the more



defensive posture of the Balanced Strategy should be a benefit in lean periods. Since inception on Nov. 1, 2007, the Partners Strategy has generated a total net return of 6.05% per year.

I remember well the excitement that my 14-year old self felt when buying those first stocks in the early 1980s. I feel that same delight today as I sift through the opportunities created by the current bout of uncertainty. We appreciate the patience of our client partners who understand that even great investment processes don't beat the market every year. We will continue to do what we've done from the beginning: invest alongside you in our strategies with the goal of generating market-beating, long-term returns by building portfolios of high conviction investments that we believe are only temporarily unloved or underappreciated.

Thank you for your continued confidence in Poplar Forest.

A handwritten signature in cursive script that reads "Dale".

J. Dale Harvey

April 4, 2016





Contrarian Value- Partners Strategy

Poplar Forest Capital Contrarian Value - Partners Strategy Average Annual Total Returns

	1Q 2016	Calendar YTD	1 year	3 year	5 year	Annualized Since Inception (11/1/2007)
Composite Gross	3.07%	3.07%	-2.69%	10.94%	11.41%	7.22%
Composite Net	2.82%	2.82%	-3.66%	9.84%	10.24%	6.05%
S&P 500	1.35%	1.35%	1.78%	11.82%	11.58%	5.73%
Russell 1000 Value	1.64%	1.64%	-1.54%	9.38%	10.25%	4.31%

Past Performance is not indicative of future results and individual account performance may vary. Please see additional disclosures at the back of this document.

The first quarter was a period of great volatility, but little net progress. After starting the year at 2044, the S&P 500 fell almost 10% to a mid-February low of 1829 before rallying back to 2060 at quarter-end. Including dividends, the S&P produced a modest gain of 1.35%. In this environment, we are pleased with the Partners Strategy's 2.82% return in the quarter ending 3/31/16.

The biggest headwind to our results this quarter came from our financial service investments (Lincoln National Corp, Bank of America, Citigroup, American International Group, JP Morgan). In the short run, the downward pressure of global interest rates has kept U.S. interest rates at levels that I simply do not believe are justified by U.S. economic fundamentals. The profitability of financial service companies is dependent on the level of interest rates, and in recent months, globally influenced low interest rates have been a major headwind to our banking and insurance investments. In addition, fears of recession have led to increased worries about potential credit losses at banks and write-downs on the energy bonds held by insurance companies. We believe these concerns are overblown and that the companies have more than sufficient reserves and capital balances to avoid a repeat of the financial crisis meltdown.

One of the biggest positive contributors to our results this quarter was a gain in Freeport-McMoRan, a producer of copper, gold, oil, natural gas and other commodities. As I said last quarter: *"Freeport has been in the cross hairs of investors who believe that slowing growth in China and other developed markets has resulted in a permanent reduction in prices of the key commodities produced by Freeport. In recent months, the company has taken steps to improve its balance sheet and cash generating ability as it works through the challenges of the current macro environment. We continue to believe Freeport will produce solid future investment gains when this cyclical decline in commodity prices reverses."* Commodity prices did reverse in the first quarter and Freeport shares recovered a portion of their losses incurred in 2015.

Other energy and materials related companies that helped our results included Reliance Steel & Aluminum and MSC Industrial Direct, a distributor of industrial goods. Both stocks had been dragged down in the commodity downdraft last year despite having variable cost business models that should



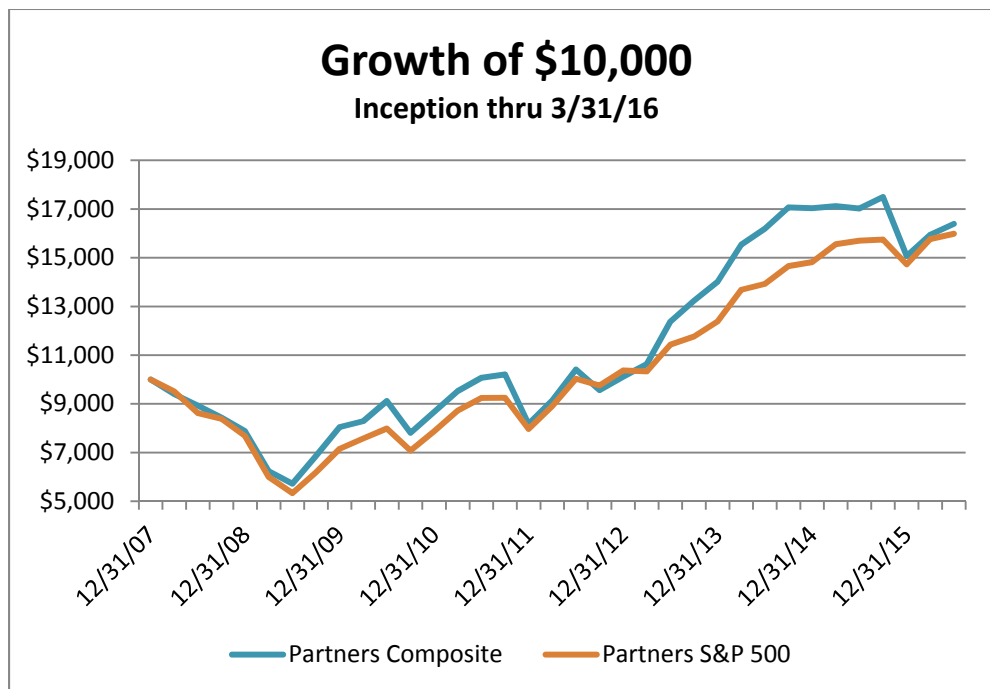


result in less downside during tough times. Also benefitting results were investments in Mattel and Avon, both recognized consumer companies undergoing operational turnarounds that should result in higher operating margins over time.

I'm particularly excited about the value I see in the portfolio today. The companies in which we've invested offer proportionate free cash flow equaling more than 7% of their market value (excluding energy & materials), they trade at a more than 30% discount to our appraisal of fair value, and at close to a 50% discount to the S&P 500 on our assessment of normalized earnings. We believe that investing in financially strong companies when they are out of favor, and thus trading at heavily discounted prices, can offer very compelling prospective returns – particularly in the current low yield investment environment.

Given our focus on long-term investing, we pay most attention to our long-term results. The recent performance of the Strategy has resulted in cumulative results that have not kept pace with the S&P 500. While we are disappointed in current comparisons, this has happened before and we believe that by sticking to our investment discipline, we can deliver on our goal of market-beating returns over full market cycles.

The chart below is a hypothetical representation of how \$10,000 would have grown had it been invested in either the Strategy (to \$16,394) or in the S&P 500 (to \$15,981). If we are successful, the gap between the lines on the chart will widen over time.



Past performance does not guarantee future results. This chart illustrates the performance of a hypothetical \$10,000 investment made in the Strategy since the Strategy's inception on 11/1/2007. It assumes reinvestment of dividends and capital gains, but does not reflect the effect of any applicable sales charge or redemption fees.





Disclosures

Investing involves risk. Principal loss is possible. Investments in medium-sized companies involve additional risks such as limited liquidity and greater volatility. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities.

Opinions expressed are subject to change at any time, are not guaranteed, and should not be considered investment advice. Discussion of a particular security should not be considered a recommendation to purchase or sell that security. There is no assurance that any security discussed will remain in our portfolios for any particular length of time. Securities discussed do not represent an entire portfolio and in the aggregate represent only a small percentage of a portfolio. It should not be assumed that any securities discussed were or will prove to be profitable.

As of March 31, 2016, the Contrarian Value Partners Strategy's 10 largest holdings accounted for 41.72% of total assets. The Strategy's 10 largest holdings at March 31, 2016:

MSC Industrial Direct – 4.92%
Reliance Steel & Aluminum – 4.70%
American International Group – 4.25%
AECOM – 4.18%
Chevron – 4.15%
Quest Diagnostics – 4.07%
Microsoft – 4.05%
Dun & Bradstreet – 3.97%
Mattel – 3.74%
TE Connectivity – 3.72%

The Price to Earnings (P/E) Ratio reflects the multiple of earnings at which a stock sells.

The S&P 500 Index is a market-value weighted index consisting of 500 stocks chosen for market size, liquidity, and industry group representation. It is not possible to invest directly in an index.

Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The annual percentage change in a CPI is used as a measure of inflation.

Dividend Yield is a financial ratio that indicates how much a company pays out in dividends each year relative to its share price. Dividend yield is represented as a percentage and can be calculated by dividing the dollar value of dividends paid in a given year per share of stock held by the dollar value of one share of stock.





Free cash flow is revenue less operating expenses including interest expenses and maintenance capital spending. It is the discretionary cash that a company has after all expenses and is available for purposes such as dividend payments, investing back into the business or share repurchases.

An index fund is a type of mutual fund with a portfolio constructed to match or track the components of a specific Index, such as the S&P 500 Index.

The Russell 1000 Value index measures the performance of the Russell 1000's value segment, which is defined to include firms whose share prices have lower price/book ratios and lower expected long-term mean earnings growth rates.

Price/Book is the ratio of a firm's closing stock price and its fiscal year end book value per share.

Earnings Growth is not a measure of a company's future performance.

Composite Specific Disclosures

Contrarian Value – Partners Strategy Composite contains fully discretionary contrarian value accounts that will generally hold 25 to 35 companies with (i) an investment-grade debt rating, (ii) a history of paying stock dividends, and (iii) a market capitalization among the top 1,000 companies in the United States. These accounts are managed using a long-term approach to security selection. We define value investing as buying businesses at a discount to our assessment of fair value. We believe fair value is a function of sustainable free cash flow and the growth of that free cash flow. This perspective leads to an investment process that considers both valuation and growth. The balance between these two metrics will vary over time based on where we see opportunity. As no single benchmark is constructed in a manner consistent with our process, we present two indices: the S&P 500® Total Return Index with its balance of growth and value and the Russell 1000® Value Index which is comprised of companies with lower price-to-book ratios and lower expected growth rates.

Poplar Forest Capital LLC is an independent SEC-registered investment advisor that commenced operations in October 2007.

Poplar Forest Capital LLC claims compliance with the Global Investment Performance Standards (GIPS®).

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. Net-of-fee performance is calculated using the monthly fraction of the highest annual management fee incurred, applied monthly: for the period from composite inception through March 31, 2013: 1.15%, and for the period April 1, 2013 through current: 1.00%. Past performance is not indicative of future results and individual account performance may vary.

The investment management fee schedule is as follows: for pooled investment vehicles management fees are 1.00% with breakpoints outlined in the specific offering documents; for separate accounts it is





1.00% on the first \$25 million and 0.60% on the remainder. Actual investment advisory fees incurred by clients may vary.

The compliant presentation and a list of composite descriptions are available upon request by calling Patty Shields at (626) 304-6045.

