Poplar Forest Partners Strategy Quarterly Update

December 31, 2015

Poplar Forest Capital

Dear Partner,

Years ago, a love of good food led me into the kitchen. In 1996, I started trying to perfect North Carolina style, hickory-smoked barbeque here in Southern California. One of my newer culinary endeavors is baking bread. I've been pursuing better bread for three years now and I'm generally pleased with the results, though it still isn't as sour as I'd like it to be. I think that as my starter ages, it will take on more character and that will yield an even tastier loaf.

I find it quite satisfying to get up on a Saturday morning and mix together the ingredients: sour dough starter, flour, water, eggs, salt, butter, honey and a little yeast. I can read the paper while the dough rises. While there is a bit of variability in the rising process, once the loaves are ready for the oven, they get 10 minutes at 450 degrees and another 19 minutes at 400. This process produces two golden loaves of fresh bread every time.

If only investing were as predictable as baking. I know of no investment "recipe" that produces a winning result every year. This challenge is compounded by the reality that while people say they want to buy low and sell high, they often do the opposite. Investment advisors with great short-term records generally have a much easier time attracting clients than do advisors with weak records. In my experience, the best time to invest is often when short-term results are at their worst. Investing is cyclical, and historically, great results often follow weak periods. Baking isn't cyclical, but as my not-yet-sour-enough starter reminds me, it still requires patience. To get that perfectly sour loaf, I may need to wait months or years for my starter to mature.

2015 – A Year of Fear

While there are eight ingredients in my bread recipe, there are three key forward-looking variables in investing: inflation, uncertainty and growth. **Given the difficulty of forecasting the future, it is no surprise that people most often start by extrapolating the past. Thus, the economic environment of low and uneven economic growth that we've lived with for several years now is projected to continue into the future.** If anything, investors appear to be worried that the lackluster economy will get worse, not better, as the Fed starts to normalize interest rates. Given this outlook, inflation isn't a major worry while certainty and growth are highly valued.

At its core, investing is about deferring consumption today in the hopes of having more to consume in the future. Our expectations of future prices figure prominently in this calculation. The more prices are expected to rise, the more an investor needs to be compensated for the potential loss of future purchasing power. Government bonds are the investment most closely tied to inflation expectations given that they are perceived as being risk free. Current Treasury bond yields suggest investors are not overly concerned that inflation will rear its head any time soon. For example, someone buying a 10 year Treasury bond at current prices is effectively saying they are comfortable getting paid approximately 2.25% per year for ten years. If inflation averages more than 2.25% per year over the next decade, the bond holder will be able to buy less with their money in the future than they can today.

While the current prices of long term government bonds don't appear to offer much value to me, there are plenty of people who are willing to buy them. I think this is due to the second key variable in investing: uncertainty. Given that the Federal Government owns printing presses, the chance of not being paid back when Treasury bonds mature is deemed to be close to zero. In other words, Treasury bonds are often viewed as the safest place to invest: "The yield may be low, but I'm confident I'll get my money back at maturity." Corporate bonds are a little less predictable, hence the need for companies to offer higher yields relative to Treasury bonds of similar maturity. In recent weeks, the yields of high yield "junk" bonds have increased; investors have grown more worried that their principal won't be paid back in full due to economic growth that may be disappointing.

Finally, stock prices are driven by the earnings and free cash flows generated by the businesses they represent. Those financial streams are far less predictable than the contractual payments that come with fixed income investments. As a result, stocks prices typically reflect a so called "equity risk premium" as compensation for that uncertainty. In the years since the 2008 market crash, the equity risk premium has remained at historically high levels. This is yet another indicator of either expected slower than normal growth or higher than normal uncertainty. In short, there are multiple indications that investors are not confident in the future.

I believe this fear of the future can best be summed up as fear of the Fed. After seven years of EASY money, the U.S. Federal Reserve's Open Market Committee recently decided to increase interest rates by 0.25%. In my opinion, a 0.25% increase in short-term interest rates is apt to be as impactful as a butter knife trying to slice a loaf of bread. If the U.S. economy is so weak that 0.25% will make a difference, then we have much bigger problems than anyone currently imagines. I disagree with those commentators who have scared investors into believing that increases in interest rates will lead to recession in the short term. I would not be surprised to see short-term interest rates of 1% or more a year from now given the strength in employment and what appear to be nascent increases in wage pressure. From my perspective, this is good news; rising interest rates can be viewed as an indicator that the economy is stronger than it has been in many years.

Even if short rates were set at 1% in an economy with roughly 2% inflation, monetary policy would still look stimulative, just less so. The Fed is simply starting the process of normalizing rates; they aren't trying to slow an over-heated economy. While there will come a time to worry about interest rates, it's too early to worry. In the last cycle, the Fed first raised rates in June of 2004. They continued to raise rates by 0.25% at each of the next 17 meetings before holding firm in June of 2006. In the three years starting June 30, 2004, the S&P 500 grew from a level of 1141 to 1503 – a gain of over 30% excluding dividends despite an increase in short-term interest rates from 1.00% to 5.25%.

While I'm not worried that the Fed's actions will tip us over into recession, I recognize investor nervousness given that short-term interest rates have basically been at 0.00% for seven years. As we move forward, I believe investors will grow more confident the Fed won't spoil the party, but until then, they may continue to worry about disappointing economic growth.

In an uncertain, low growth environment, companies with seemingly rock solid growth are in even greater demand than normal. Basically, if the value of an investment is determined by the amount of cash it produces in the future, then a company growing its cash flow faster than average should be accorded an above average (or premium) valuation. The challenge for investors is to determine the appropriate premium to pay given the uncertainty of future growth. Today, the premium being accorded the market's darlings looks too high.

Good Companies Don't Always Make Good Investments

From time to time, a small handful of stocks is accorded special status. Today, one such group is FANG: Facebook, Amazon, Netflix and Google (aka Alphabet). I am a satisfied customer of all four of these companies and they have been able to grow rapidly because they are meeting consumers' needs for, among other things, information, entertainment and the ability to shop from home. These companies are all well managed and they appear to have a bright future. That said, consumers can be fickle and lofty growth expectations sometimes lead to disappointment.

In a year when the S&P 500 fell 1%, owners of FANG stocks were quite happy as those stocks enjoyed a roaring bull market. While these are great businesses, at current prices the stocks do not look attractive to me.

In addition to being drawn to the rapidly growing FANG companies, investors have looked to the biggest companies in the market for security. Of the ten largest companies in the S&P 500, only Exxon Mobil and Apple dramatically underperformed this year. These stocks, given they are the largest holdings in S&P index funds, have also benefitted from the incremental demand created by investors shifting from actively managed mutual funds into passive index and exchange traded funds.

	Market Cap (Billion)	Stock Price 12/31/14	Stock Price 12/13/15	Price Change	P/E Ratio 2015E
FANG Stocks:					
Facebook	$296	$78.02	$104.66	+34%	48x
Amazon	317	310.35	675.89	+118%	358x
Netflix	49	48.80	114.38	+134%	545x
Google (Alphabet)	535	530.66	778.01	+47%	27x
Remaining S&P Top 10:					
Apple	$539	$110.38	$105.26	-5%	11x
Microsoft	443	46.45	55.48	+19%	20x
Exxon Mobil	325	92.45	77.95	-16%	20x
General Electric	294	25.27	31.15	+23%	24x
Johnson & Johnson	284	104.57	102.72	-2%	17x
Wells Fargo	278	54.82	54.36	-1%	13x
JPMorgan Chase	243	62.58	66.03	+6%	11x
S&P 500		2058.90	2043.94	-1%	18x

Source: Capital IQ and Poplar Forest calculations

Outside of the current market favorites, results have been far less rewarding. Over half the stocks in the S&P 500 declined in price during 2015 and 120 stocks fell by 20% or more. Many of the stocks that suffered most last year either participate in or are indirectly connected to the cyclical energy and materials sector.

The aforementioned tendency of people to extrapolate the recent past when projecting into the future has, more often than not, created opportunity for patient and long-term value investors to exploit. This is Poplar Forest's sweet spot. Value investors buy stock in companies whose future is not currently deemed to be bright while avoiding the currently fashionable parts of the market, for example the FANG companies. Over long periods of time, value investing has been shown to produce results that beat market averages like the S&P 500, but this approach can have periods of underperformance. We appear to be living through one such period right now.

Our Recipe For Investment Success

When I look at today's economic environment, I'm not surprised that many investors feel most comfortable with Treasury bonds and growth stocks. Provided nothing changes, the prevailing wisdom will continue to look smart. However, it is my belief that change is inevitable; Poplar Forest's investment philosophy is predicated on other investors incorrectly extrapolating the recent past too far into the future.

I don't know how long this particular market phase will last, but I believe that this is a particularly attractive time for investing with the strategies employed at Poplar Forest. We use great ingredients and a recipe that focuses on the price we pay relative to normalized earnings and free cash flow. The ingredients: high quality companies that are, in our opinion, undeservedly out-of-favor. We invest primarily in companies that have an investment grade balance sheet as we believe this should minimize downside in a recession. We seek out businesses that consistently generate free cash flow, even at the bottom of their respective cycles, as additional downside protection. We prefer dividend paying companies. Combining high quality with low prices has generally been a rewarding recipe for investment success and we believe it will be going forward.

I recently read a report comparing the returns provided by stocks with the lowest ratio of price to earnings (the P/E ratio) to those with the highest P/E ratios. The low P/E bunch soundly out-performed the high P/E group when looked at over many years. This particular study examined rolling five-year phases starting in 1968. While low P/E stocks did better in over 80% of the periods examined, they produced disappointing results several times: 1986-1991 (which included the '87 Crash and the first Gulf War), 1995-2000 (the inflating of the tech bubble) and 2010-2014 (the weak recovery from the Great Recession). The '86-'91 and '95-'00 underperformance episodes saw back-to-back five year periods of growth success. While no one can predict the future with certainty, it is worth noting that 2015 likely produced the second sequential five year run of disappointing value strategy performance. (Please see Appendix for more information.)

The most difficult time to be an investment professional is when their strategy isn't working. I was a portfolio manager in the '95-'00 period and it was exceedingly painful. I know how the pressure to perform can get to investors, and those who didn't have the confidence of their conviction got sucked into what, in hindsight, was a dangerously inflated technology and super large cap stock bubble. The situation today isn't as extreme as the late '90s, but there are certainly parallels. I think it is as imperative today as it was then to stick to time-tested, contrarian value strategies because I believe they ultimately offer market-beating, long-term returns for those who are willing to live through the weak periods.

As we look at the investment landscape today, the areas that appear most out of favor are energy and materials. We understand that demand growth from China has slowed, but we believe the price decline for many commodities has been more extreme than is warranted by fundamental changes to supply and demand. While we understand that prices may fall further in the short term, we believe current values are unsustainably low and that they will recover.

Evidence of Our Confidence

The business of managing other peoples' money is challenging. When the opportunity to "buy low" may be most available, a manager's weak short-term results may make prospective clients nervous to invest and may lead existing clients to start to worry that they've made a mistake. We've seen this industry-wide this year: according to Morningstar, in the twelve months ending September 30, 2015, investors redeemed a net $150 billion from their actively managed equity mutual funds. Value funds were among the areas witnessing particularly high redemption rates. Will these redemptions prove prescient or ill-timed? We'll only be able to answer that question with the benefit of hindsight, but from my vantage point, now is the time to be investing with active managers, not reallocating away from such strategies – particularly strategies with a value bias.

Investor redemptions put pressure on the revenue of active investment management firms. For many, these revenue challenges have been reason to pull back and/or to be restrained in their spending. At Poplar Forest, we are taking a different tack. In addition to being invested alongside you in our strategy, we are investing in the business given our confidence that the Poplar Forest investment recipe could produce market-beating returns for our client partners. We've added to our marketing and operations team and we're looking to hire two new analysts in order to expand the depth and breadth of our research efforts. I had hoped this letter would include information about a new member of our investment group, but given that we're as picky about our people as we are about the stocks in which we invest, that announcement will have to wait. With all the new hiring, we needed more space and we've recently completed an expansion of our office. If you are ever in Pasadena, please stop by to check out the new space and to say hello.

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 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.

J. Dale Harvey
January 1, 2016

Appendix

S&P 500 Lowest vs. Highest P/E Stocks (1968-2014)				
Rolling 5-Year Periods	Top 20% by P/E (Growth)	Bottom 20% by P/E (Value)	Value Outperforms	Growth Outperforms
1968 – 1972	6.03%	9.66%	3.62%	
1969 – 1973	0.29%	0.00%	--- flat* ---	
1970 – 1974	-4.31%	1.11%	5.42%	
1971 – 1975	2.71%	12.44%	9.73%	
1972 – 1976	2.44%	17.81%	15.38%	
1973 – 1977	-3.27%	17.02%	20.29%	
1974 – 1978	1.35%	24.71%	23.35%	
1975 – 1979	14.38%	34.30%	19.91%	
1976 – 1980	15.37%	24.67%	9.31%	
1977 – 1981	9.93%	18.20%	8.27%	
1978 – 1982	18.87%	22.18%	3.31%	
1979 – 1983	22.54%	24.53%	1.99%	
1980 – 1984	15.30%	26.07%	10.77%	
1981 – 1985	12.43%	26.46%	14.03%	
1982 – 1986	17.23%	27.63%	10.40%	
1983 – 1987	12.20%	18.92%	6.72%	
1984 – 1988	9.77%	18.22%	8.45%	
1985 – 1989	16.75%	16.29%	--- flat* ---	
1986 – 1990	8.57%	6.14%		2.44%
1987 – 1991	11.67%	10.53%		1.14%
1988 – 1992	11.90%	15.37%	3.47%	
1989 – 1993	12.34%	14.54%	2.20%	
1990 – 1994	7.09%	10.10%	3.00%	
1991 – 1995	14.98%	23.17%	8.20%	
1992 – 1996	12.46%	17.92%	5.47%	
1993 – 1997	14.35%	22.01%	7.66%	
1994 – 1998	16.19%	17.79%	1.60%	
1995 – 1999	21.84%	18.23%		3.61%
1996 – 2000	16.42%	13.91%		2.51%
1997 – 2001	8.73%	13.27%	4.54%	
1998 – 2002	-0.27%	4.74%	5.01%	
1999 – 2003	2.61%	12.15%	9.53%	
2000 – 2004	1.52%	16.02%	14.49%	
2001 – 2005	2.99%	15.38%	12.39%	
2002 – 2006	9.25%	15.97%	6.73%	
2003 – 2007	16.35%	17.29%	0.94%	
2004 – 2008	-5.01%	-2.31%	2.70%	
2005 – 2009	-2.07%	1.98%	4.05%	
2006 – 2010	0.96%	2.10%	1.14%	
2007 – 2011	-5.51%	-1.51%	4.00%	
2008 – 2012	-0.17%	1.99%	2.15%	
2009 – 2013	19.61%	24.67%	5.05%	
2010 – 2014	15.80%	14.45%		1.35%
	ANNUALIZED RETURNS		AVERAGE OUTPERFORMANCE	
(47 Years) 1968 - 2014	**8.68%**	**14.80%**	**7.65%**	**2.21%**

Flat = less that 1% difference

Source: S&P Corp/ FactSet Research/ Schafer Cullen Capital Management

<u>**Contrarian Value- Partners Strategy**</u>

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

	4Q 2015	Calendar YTD	1 year	3 year	5 year	Annualized Since Inception (11/1/2007)
Composite Gross	6.05%	-5.90%	-5.90%	15.60%	12.04%	7.05%
Composite Net	5.79%	-6.85%	-6.85%	14.45%	10.86%	5.88%
S&P 500	7.04%	1.38%	1.38%	15.13%	12.57%	5.73%
Russell 1000 Value	5.64%	-3.83%	-3.83%	13.08%	11.27%	4.23%

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

Our 2015 results were disappointing on both an absolute and relative basis. Being a disciplined value investor can be frustrating when that approach is out of sync with the market, as has been the case this year. As I explained in my last report to you, strength of the U.S. dollar relative to other currencies and the collapse of oil and other commodity prices dramatically impacted our portfolio. While those macroeconomic trends continued in the fourth quarter, we appear to be moving into a phase where at least some stock prices have stopped tracking movements in commodity prices.

For example, we made an investment in Chevron in late August at a price that we simply found too hard to resist. Since then, the stock has moved steadily higher and it was one of the top three positive contributors to the strategy's composite performance in the fourth quarter, despite oil prices falling further to levels last seen in late 2008/early 2009 in the midst of the Great Recession. Likewise, Rowan Companies, an offshore oil driller, was one of the top three contributors in the fourth quarter. These bright spots were offset by falling prices for WPX Energy and Baker Hughes. Unlike Chevron and Rowan, WPX continued to closely track the decline in oil prices and was one of the three largest negative contributors in the fourth quarter. In the case of Baker Hughes, another of the three largest negative contributors in the fourth quarter, the stock declined on worries that the Department of Justice will prevent Halliburton from completing its planned acquisition of the company. We remain positive on the combination but recognize that we are living in an era of stringent scrutiny of mergers. At current prices, we'd be happy to own Baker Hughes even if the merger does not get consummated.

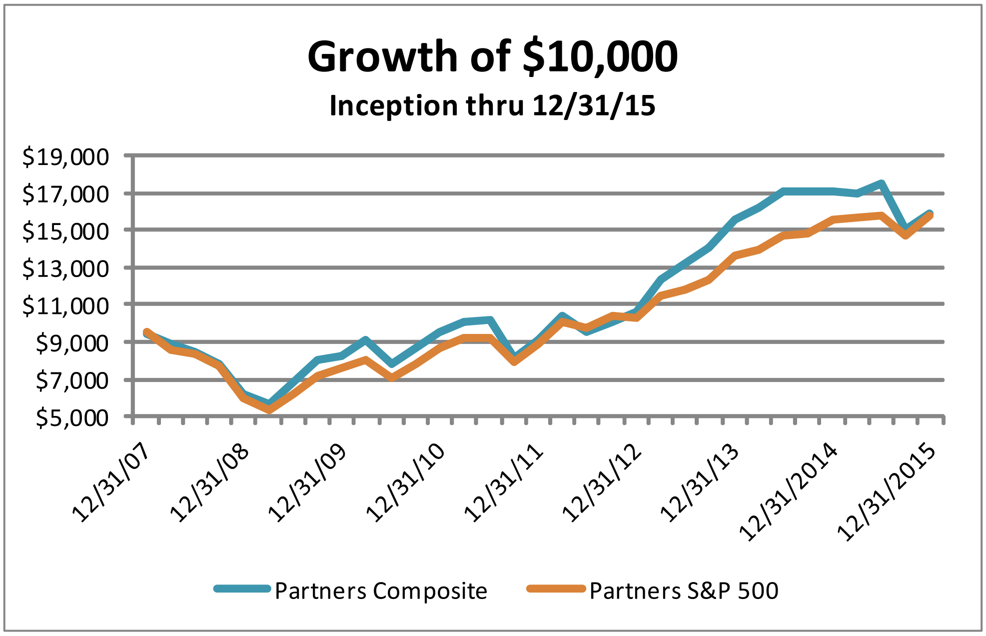
Avon is another investment that appears to have changed course. While the stock has remained one of our biggest disappointments this year, it rebounded in the fourth quarter. A new management team installed three years ago hasn't yet been able to demonstrate a lasting turnaround in the company's operations and this has been compounded by the strengthening U.S. dollar, which dramatically cut the value of Avon's profits, all of which are earned overseas. We continued to see great potential in Avon, but had waited to see some fundamental progress before adding to our position. In mid-December, two different investment groups began agitating for change. The company ultimately agreed to sell its money-losing North American operations to Ceberus Capital Management, a successful private investment firm. Ceberus also made a substantial investment in Avon and has pushed to have half the board changed as part of their deal. I believe Ceberus's influence will have a very positive impact on the company. As a result of these changes, Avon was one of the top three positive contributors to our results.

More than offsetting the 4Q gain in Avon was a continued decline in Freeport-McMoRan, a producer of copper, gold, oil, natural gas and other commodities. Freeport, also among the three largest negative contributors to the strategy in the fourth quarter, 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.

Periods of weak results are frustrating, but I believe they provide opportunity. 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 hope to 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 the Strategy (to $15,947) or in the S&P 500 (to $15,768). 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 December 31, 2015, the Contrarian Value Partners Strategy's 10 largest holdings accounted for 44.16% of total assets. The Strategy's 10 largest holdings at December 31, 2015:

Mattel – 5.07%
American International Group – 5.02%
TE Connectivity – 4.52%
Microsoft – 4.40%
Lincoln National – 4.30%
Quest Diagnostics – 4.26%
Eli Lilly – 4.20%
AECOM – 4.17%
Metlife – 4.11%
Reliance Steel – 4.08%

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.

Active investing has higher management fees because of the manager's increased level of involvement while index investing has lower management and operating fees. Investing in both actively managed funds and index funds involves risk and principal loss is possible. Both actively managed funds and index funds generally have daily liquidity. Actively managed mutual funds may have higher portfolio turnover than index funds. Excessive turnover can limit returns and can incur capital gains.

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.