White Brook Capital LLC
220 N Green Street
Chicago IL 60607
Tell: (312) 889-9022

2016 Fourth Quarter Commentary

As of December 31, 2016	Q4 2016	YTD	Inception
WBCMP gross	1.97%	6.00%	6.00%
WBCMP net max fee (1.25%)	1.66%	5.35%	5.35%
iShares Core S&P 500 ETF (Total return)	*3.82%*	7.81%	*7.81%*

Portfolio Commentary

For the 4th quarter White Brook Capital's Model Portfolio ("Portfolio" or "WBCMP") returned 1.75% net of fees vs. 3.82% for an easily investable S&P500 ETF. At the quarter end, the Portfolio held 20 positions with the 10 largest positions comprising 56% of the portfolio. As always, the Portfolio is somewhat concentrated and may not track with the S&P500 over short time frames.

Community Health

Let me start this quarter's letter by saying that I'm displeased with the permanent impairment of capital incurred to the Portfolio by the Community Health (CYH) investment. This investment ultimately contributed approximately 140% of the difference between White Brook's performance and the S&P500 this quarter and detracted from performance during the 3rd quarter as well. Clients received a post-mortem the day the position was exited. Whenever a meaningful permanent loss occurs, clients will hear from White Brook immediately after it occurs and then again with any additional learnings given the clarity and perspective that time brings.

In performing the post-mortem, I wanted to be able to point to a specific avoidable error in the investment and a lesson learned. With the Community Health investment, however, that isn't the case. The investment's success was highly dependent on the management team executing on a cost savings program that entailed bringing an acquired and lagging hospital group up to legacy standards - while preserving the cost structure and operational excellence of the group. Other parts of the thesis were working out as anticipated, but despite confirmation of the availability and readiness of those cost savings, the company proved unable to achieve them on a fleetwide basis. Other investors were suitably surprised and disappointed and, enhanced by the leverage the company had taken on for the acquisition in the first place, the stock declined precipitously.

The result is disappointing - especially so that it happened during only the second quarter of White Brook's existence, and even more so that it happened in a quarter filled with days where the Portfolio outperformed. The nature of the mosaic process of investing is that by an accumulation of non-material, public information, focused investors can derive meaningful takeaways about the likely performance of a business. The key is that it is the "likely" performance, and while White Brook works to drive down the probability of a negative outcome, there is always possibility that one occurs. In the case of Community Health, it did.

An additional question I've considered is whether the position was too large given the risks inherent in the leverage and the prior stock performance. If I divorce the outcome from the fact pattern before the preannouncement, I'm forced to conclude that the size of the position was appropriate. The day before the announcement, based on the research, I believed Community Health to be amongst the stocks with the most potential upside in the Portfolio, measured in hundreds of percent over time with 15 to 20 percent potential downside. While the announcement that resulted in the impairment proved this thesis incorrect, such asymmetrical estimated returns warranted a significant position in the Portfolio. Ultimately, my belief is that a solid process creates good results, and I believe White Brook is using a solid process and performance will be rewarded in time.

Portfolio Commentary - Continued

During the quarter, Synchrony Financial (SYF), BB&T Corporation (BBT), and Baker Hughes (BHI) were the top contributors to the performance of the Portfolio while Community Health (CYH), Nielsen Holdings (NLSN), and Liberty Global (LBTYK) were the top detractors to the Portfolio's performance.

Positions in Acxiom Corp (ACXM), Community Health (CYH), Level 3 Communications (LVLT), and Nielsen Holdings (NLSN) were exited during the quarter while positions in Box Inc (BOX), CBRE Group (CBG), and the Gold Futures ETF (GLD) were entered during the quarter.

President-Elect Trump's rumored and assumed economic policies drove market performance during the 4th quarter. The Portfolio was overweight financial and technology stocks during the period, with the former outperforming the market and the latter underperforming. The Healthcare Facilities subsector and Community Health (CYH), in particular, were amongst the worst performers in the market on a sector and company specific basis, which when combined with the underperformance of the technology investments offset the benefits of being overweight financial stocks. The loss in Community Health was also a significant detractor in the 3rd quarter of 2016.

Despite the underperformance of the Technology sector, the Portfolio stays heavily concentrated in technology investments. Cash rich and exposed to significant growth opportunities, the Portfolio's technology investments are primed to appreciate in my view, and I am encouraged by their performance over the first two weeks of January.

This quarter the Portfolio benefitted from two acquisition announcements which were formally announced on the same day. On October 31st, CenturyLink (CTL) announced the acquisition of/merger with Level 3 (LVLT), and General Electric (GE) announced the acquisition of Baker Hughes (BHI). White Brook sold the Level 3 position on the news due to concerns about CenturyLink's assets and management quality. Fiber assets continue to be a key strategic asset for the economy both today and in the future, and White Brook believes the business, if well run, should enjoy abnormally high returns, however. Should I discover CenturyLink to be a better asset or have better management and the difference between the price and White Brook's determination of value widen, I wouldn't hesitate to re-enter.

On the other hand, White Brook maintained the Baker Hughes position and allowed the position to grow as the stock appreciated. White Brook believes that by merging GE Energy's assets with Baker Hughes, asset quality, management bench, and the competitive dynamics of the industry all improve while at the same time the end markets are strengthening. White Brook believes the combined entity will generate a solid return for investors over the coming years.

Market Outlook

If 2015 and 2016 were marked by markets appreciating despite earnings per share growth deceleration, the risk in 2017 is that while revenue and earnings growth accelerates, share performance will decline.

Many factors contribute to the "deserved" market multiple at any point in time, but the uncertainty created by a manic President and a feckless Congress enacting an agenda that contradicts prevailing global economic forces are not positive and are likely to result in complex and unpredictable emergent behavior. To be sure, Republican ideas aren't bad and could be economically stimulative, but the people that occupy the US's most influential public offices for the next 2-4 years on both sides of the aisle have exhibited behavior that suggests they are intellectually and ethically challenged. Following the election, my sentiment is more cautious.

My hope is that the government won't obstruct the fundamental strength of the US economy and the improving global growth picture, and that spending and taxation policies won't radically change the improving health of the government. My fear is that Donald Trump views his new job as temporary, and that the US taxpayer will be harmed while Donald Trump and the Trump Organization inheritors are enriched. Over Thanksgiving I had the opportunity to speak extensively and off the record with a "Tea Party" Congressman. In our 45-minute conversation, it became evident that from that viewpoint there's no level of behavior that would warrant impeachment, censure, or even public opposition. My sense is that the President-Elect knows this well.

At the same time the President-Elect appears to be more sensitive to equity market behavior than any of his predecessors. While Presidents Bush were forced to deal with large drawdowns that reflected underlying problems with the economy, the President-Elect is focused on price changes that are reflective of relatively mild changes in sentiment rather than fundamentals. While it has been policy at the Federal Reserve since 2009 to use equity prices as a key determinant in deciding interest rates, to my knowledge, this is the first time a President has cared about relatively small shifts in equity prices. If Congress is willing to go along, as it looks they are, that could be incredibly supportive.

Despite the conflicting themes, White Brook's strategy needs to change very little to prosper during a Trump administration. As it is, White Brook avoids companies where the federal government is a major contributor to revenue or is key to future growth. Instead, White Brook's focus is on companies that have unique assets, are exposed to specific growing trends, create value at above average rates, and can be owned for time periods measured in years rather than months or quarters. I continue to believe this strategy is appropriate in a Trump administration.

As always, there are broadly five investment alternatives one can hold at any time: cash, cash-like alternatives, debt, equity, and real estate, all of which you can or will soon be able to invest in through your investment account at White Brook Capital.

Fixed income securities are a better investment today than they were when I last wrote to you on the topic a quarter ago. The 10-year treasury is up almost 25% over that period. Most other fixed income securities determine their prices based on the treasury curve, and their yields have similarly increased. It is now appropriate to begin to engage in conversations about how best to enact a fixed income strategy, even while it is not yet time to dedicate additional capital to one. It's unclear how much issue will be made of raising the debt ceiling with full Republican control of government, however, there's already more smoke on the issue than would be expected. I believe it prudent to wait until spending bills are passed in 2017, but with higher spending and a more hawkish Federal Reserve, it's likely that bonds with yields heretofore uninvestable will become still more attractive. As yields increase, I believe widely used fixed income ETFs and mortgage REITS will underperform, however, and instead advocate laddering bond maturities of individual issues.

The problem with fixed income ETFs and mortgage REITS is that they are pools of permanent capital invested in securities that mature in relatively short periods of time. Note that the ***value*** of a bond that pays no coupon decays at the rate of inflation. Its ***price***, however, reflects both the market's expectation of inflation and investors' ability to invest in other opportunities. When interest rates increase, new issues, identical in many ways to the existing security, price per the new interest rate environment and the price of all other bonds adjust to account for the more attractive new issue. An individual who already owns one of those securities would take a paper loss as the price adjusts, even if inflation doesn't ultimately depreciate the ***value*** of the payment at maturity. The key to preserving capital and making money at a time of potential fluctuation in interest rates, therefore, is to not take the paper loss by: not being invested, investing in short term maturities whose value and price are negligibly impacted due to the short time until maturity, or holding until maturity.

Unfortunately, over the past 7 years, the length of time to maturity of the average bond has increased, making the impact of changes to both inflation and interest more impactful to the price of fixed income securities and the ETFs and mortgage REITs that buy them. Given the way many analysts and managers are compensated, I expect that firms will try to bunch losses into as short a time as possible to appease clients with better performance in more years, rather than holding debt instruments to maturity and experiencing better but underwhelming returns over the extended period. My advice is to avoid this possibility.

On top of changes in yields driven by Federal Reserve policy change, a change in the corporate tax rate could also significantly disrupt fixed income markets through the underappreciated municipal bond market. Currently municipal bonds are held by individuals and firms attracted to the tax-exempt yield. Lower tax rates also lower the appeal of the tax advantage of that yield and could result in large owners of municipal debt, like insurance companies, selling those holdings in favor of other securities. Again, this is less of a problem if clients hold the security until maturity, but long dated municipal bonds are currently poor investments in my view.

Cash can again be expected to depreciate at the rate of inflation which is increasing. However, cash does represent an option to invest later and, with potential changes in fixed income and equity markets, is more attractive than it has been.

Cash-like securities have also become more attractive since Trump's election. Many of his rumored policies are likely to cause inflation while also potentially destabilizing the global order. Cash-like securities are complex given the fungibility of money, but I believe modest investments in gold and other cash-like commodities to be prudent now.

In Focus: Technology Strategy

My initial inclination was to present a write-up on Box Inc., White Brook Capital's document management provider and as of midway through the 4th quarter one of the Portfolio's largest holdings. With the stock up ~20% in the first two weeks of trading in January, however, I regard such a write-up to be cheerleading rather than a prescriptive call. Instead, I thought it instructive to explain how White Brook thinks about a few themes within technology.

With a current allocation of ~30% of the Portfolio's capital, the Technology sector is a significant investment. As usual, the concentration in technology stocks is a bottom-up decision, driven by the fundamentals of the individual investments rather than one driven by a "need" to be invested in the sector, but there are themes at work that I thought worth remarking upon.

One of the themes is a realization that while technology has a reputation of constantly emerging leaders, today, shoulders of giants are needed to advance. Even while the price of cloud computing and storage decline to commodity pricing levels, the next disciplines, artificial intelligence and machine learning, require a more holistic architecture where computations across multiple disciplines build to meaningful analysis and decision making. While Github, a repository and resource for programmers, and Silicon Valley job-hopping democratize some knowhow, "easy" advances are likely to be local to a specific use case. The ability to make a more meaningful advance instead will rely on access to, and dependence on, a specific methodology, increasingly codified by the technology giants who can charge for access.

A short intellectual hop from our thoughts on artificial intelligence and machine learning is a reflection on the inherent value of data. White Brook's long standing bias has been that whether by means of contract, brand loyalty, or customary practice, successful companies drive value to their owners by having a *history* of interaction with their customers. It's simply easier, and has a higher return on investment, to win new business if an existing relationship exists and it does not require working as hard to win business.

White Brook's thesis is that it makes sense to marry these two thoughts. Data is valuable and old is valuable so manipulating old data is more valuable than new. Perhaps the best illustration of the argument is a company that until recently could conceivably have been a successful counterargument, Facebook.

In most simplifying terms, Facebook makes money by providing valuable current content to engage its audience and selling advertising that reaches this audience. Whether it's Instagram's photos, Messenger and What's App's messaging, Facebook's News Feed, or distributed news, Facebook's properties satisfy its users' desire to know what's occurring in the present at the present. The Company does a very good job at this and is in no danger of hitting the outer edge of its potential in the near term. My sense, however, is that Facebook has a fundamental understanding of the present's inherent limit as its recent bigger bets namely the purchase of Oculus, a leading virtual reality company, its machine learning efforts, and the introduction of Facebook Workplace, its workplace collaboration suite, expand to spaces where the passing of time builds value. White Brook anticipates other products whose revenue is divorced from the selling of current, consumer-focused advertising and expects that, over an extended time frame, Facebook's income from these new business streams will be larger than their ad delivering business if they are able to execute. If they execute, a company consistently questioned for its longevity and its ability to keep its finger on the pulse of the consumer, will become a permanent fixture in our daily lives for decades to come.

(Our previously mentioned investment in Box, represents a unique non-major technology player that has become a leader. They are consistently at least a year or two ahead of the industry and will become invaluable as more industries adopt more collaborative and "data enabled" business processes where ownership of the data doesn't change. White Brook likes the investment on an individual basis, but believes that over our investment horizon will be bought by a major technology company.)

Housekeeping

There is relatively little housekeeping to mention this quarter. You should have received or will receive a note from White Brook once or twice a month with a topic that is related to your overall financial health. My hope is that they are helpful. If you'd like to opt out of those emails, please let me know. White Brook has also begun consulting with a provider of syndicated commercial real estate loans and equity that will allow for White Brook Capital clients to invest directly in real estate. Please reach out if this is something you're interested in.

As always, feel free to reach out by phone or email at your convenience.

Regards,

Basil F. Alsikafi
Portfolio Manager
White Brook Capital