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**Douglass Winthrop**

July 4, 2017

Dear Clients and Friends,

We are pleased to provide our second quarter commentary and, for our clients, your June 30, 2017 portfolio appraisal, performance history and realized gains and losses report.

We would like to begin by thanking our clients for your continued support. Together, we have made significant progress toward our goal of becoming one of the leading independent firms in the investment and wealth management business. We continue to attract wonderful clients, team members and professional services partners. Our good fortune, we believe, is attributable to our culture of mutual respect and civility; the value of our wealth management counsel for our clients; and our commitment to direct investments in high quality companies.

In the past quarter we celebrated the one year mark for our Environment Strategy and welcomed Brad Richards as a Managing Director in our NYC office. Brad is a long-time client of the firm and joins us after a distinguished professional hockey career as a team leader and individual star, winning two Stanley Cup Championships, a Conn Smythe Trophy and a Lady Bing Trophy. Brad's focus at DWA will be on new business development.

## Rewards and risks

During the second quarter, the S&P 500 and MSCI World indices were up 3.1% and 4.0%, respectively, and are up 9.4% and 10.7% year-to-date. Since the February 28, 2009 lows after the Financial Crisis, the S&P 500 is up 294% and the MSCI World is up 204%.

In recent letters we have referred to the equity markets as "fully valued" and we continue to feel that price to earnings multiples are stretched and more likely to contract from here than to expand. Metrics including the Buffett Indicator (the ratio of all corporate equites to GDP) and the Cyclically Adjusted P/E (CAPE) are near historic highs at 128.9% and 29.7x, respectively, and suggest that stocks offer investors little room for error.

That being said, with the 10 year treasury at 2.3%, unemployment at 4.3%, and the S&P 500 expected to grow earnings by 22% this year, investors have just enough confidence, or fear of missing out, to justify new investments. Additionally, history has shown that the growth trajectory and earnings of great companies, and the market as a whole, consistently surprise to the upside, making the market's ultimate valuation more reasonable than it sometimes appears using forward indicators and consensus estimates.

Adding to valuation risk, but also providing a governor for investor sentiment that might otherwise be ebullient, is an ever-present list of global threats. Terrorist attacks on innocent civilians, hackers from China and Eastern Europe, Middle Eastern conflicts, and North Korean missile tests are a few of the Molotov cocktails that could upset the market. And, as if the true bad actors weren't trouble enough, we have seen the erosion of important global partnerships over the past year including the European Union, the Trans Pacific Partnership, and the Paris Climate Agreement.

## The tide is still rising

Amid this backdrop of uncertainty, resilient individuals and businesses continue to rise up and solve problems that governments cannot. We have long believed that the key to progress is private sector capital, driven by consumer demands, and we still believe that consumers and businesses will be the source of inspiration and innovation to solve the world's most pressing problems: feeding a growing population, adapting to climate change, and providing common causes to unify a fractured world.

Economies around the world, led by global consumers, continue to grow steadily and the IMF projects that worldwide GDP will rise from $78 trillion in 2016 to $98 trillion by 2020, up 10x from 1980. Emerging and developing markets will make up 43% of the total by 2020 and China and the USA are expected to generate 39.4% of the total, up from a combined 28.5% in 1980, making these economies of paramount importance to global investors.

## Creating long term opportunities for disciplined investors

The most frequent question we hear today, is "Should I invest in the markets right now, given they appear fully valued and are hitting all-time highs?" Our answer is yes, especially if you have a long term investment horizon, because we believe markets, just like world GDP and population, will continue to grow and hit new highs in the years ahead and the risk of waiting for a market correction is much greater than the potential reward.

The key to investment success is not market timing, but an ability to identify growing companies that can be purchased at attractive prices relative to their long term prospects. Our job as value investors is to curate a portfolio of individual stocks and, when appropriate, bonds that is reasonably priced and well-positioned for long term capital appreciation.
In the past quarter we continued to find opportunities to reinvest in our existing portfolio and to add a few gems that we have long admired and where short-term sentiment had turned negative, providing us with opportunity. Below are three examples of great companies trading at attractive valuations where we were able to add to or establish a position during the second quarter.

**Walt Disney Company** is a global leader in entertainment with a capable and experienced CEO at the helm in Bob Iger. Disney assets including ESPN, ABC, the Disney Channel, Pixar, Marvel, LucasFilm, and Disney World Theme Parks build life-long loyalty from consumers. Disney shares, however, have been under pressure due to questions about ESPN subscribership as consumer preferences for where they consume media and how they pay for it are reshuffled in a new world of communications technology and distribution. As a result we have been able to accumulate shares of Disney at a below-market multiple of earnings (currently trading at 16.4x forward earnings vs. the S&P 500 multiple at 17.7x) over the past two years and continue to add to our holdings. We are excited about the moves that management is making to respond to market challenges for ESPN and new opportunities, including the recently launched Disney World Shanghai, which has exceeded expectations and opened the door to China.

**Alphabet**, the parent company of Google, is another company that we have been fortunate to own and reinvest in alongside a great leadership team headed by Larry Page and Eric Schmidt. Negative press around a $2.7 billion European Union fine has pulled the stock back 8% from recent highs. The stock now trades at 21x forward earnings, with revenue expected to grow at 18% in the next year and an incredible competitive positioning in search, mapping, driverless cars, over the top (OTT) content via YouTube, and productivity tools ranging from Gmail to AdSense. Alphabet has also seeded a portfolio of "moonshots" focused on aging, the internet of things, urban planning and artificial intelligence and has nearly $100 billion of cash for its management team to deploy opportunistically for shareholder benefit.

**Nike** is a company that we have long admired and whose leadership, first under Phil Knight and now Mark Parker, has charted course brilliantly. Nike has grown profitably and globally while reinvesting in innovation and rewarding shareholders with a rising dividend and a shrinking share count. At 21x forward earnings and with a 6% topline growth expectation, we were thrilled to establish an initial position in our portfolio this quarter. Nike closed the quarter with a strong earnings report and the announcement of a deal with Amazon to begin selling products through the Amazon Marketplace.

Each of these companies is representative of the characteristics we value most. They are global, well managed businesses with competitive barriers to entry, pristine financial attributes, and valuations that are attractive relative to their growth prospects. We are excited about them, and our portfolio as a whole.

Douglass Winthrop

**Happy Independence Day**

As individuals and as a firm, we cherish our freedom and find this holiday particularly meaningful. Independence, in our view, does not mean isolation, but instead represents the power of free choice. We believe that our strength comes from teamwork, friendship and mutual trust. On this day of symbolism, it seems appropriate to part with a quote from Alexandre Dumas' *The Three Musketeers:* "All for one, one for all!"

On behalf of the entire team, we wish you a safe, healthy and happy holiday.

Sincerely,

Josh Huffard
Jay Winthrop
Robert Douglass
Lea Paine Highet CFP®
Charlie Howard
Charlie Crane
Luke Fowler
Tim Hughes
Bryce O'Brien
Oak Strawbridge
Bowdy Train
Tom Loizeaux
Brad Richards
Phil Warner
Grant Winthrop