July 14, 2016

Dear Fellow Investor:

The first half of 2016 in the U.S. equity market repeated what by now has become a familiar pattern: a bout of high volatility and harrowing decline followed by recovery, netting out in the end to not much change at all. (I have given up trying to find yet another clever way of characterizing the pattern). The Standard & Poor's 500 Index ended June 2.7% higher than its close last December 31 (3.8% with reinvested dividends). But on the last Friday and Monday of June, the index dropped nearly 6% before regaining almost all of the loss by the following Thursday, June 30-- thereby NOT spoiling Independence Day celebrations. (This kind of market courtesy is rare).

The cause of the fainting spell was, of course, Brexit, the referendum in the United Kingdom in which the electorate chose to leave the European Union, ignoring dire warnings from just about every elected official or "expert" consulted, including our own President Obama. (The British public dubbed the serial admonitions "Project Fear"). Markets concluded, correctly, in my opinion, that while Brexit is certainly a significant political development, its ramifications economically and financially, at least so far, are well contained. Indeed, the best performing developed market year-to-date, up 7.5%, is the FTSE 100, an index of large internationally-oriented British companies—investors figure a weaker British pound will improve the competitiveness of constituent companies.

But a rather bland statistical reading for the S&P 500 masks a darker picture globally. The larger equity markets, those in Europe, China, and Japan are *down* year-to-date, in some cases (China, Japan) by double digits. Emerging markets have in many cases rallied strongly in this year's first half, but remain well below the peak levels of five or six years ago. Many investment geniuses, hedge fund wizards whose heads may regularly be seen talking on cable network news, are down significantly so far in 2016.

In this context I take considerable satisfaction in reporting that virtually all of the equity accounts for which we are responsible outperformed the S&P 500 by respectable amounts. Our accounts were up mid-to-high single digits in the first half of 2016. (The exceptions were brand new accounts which we have only begun to invest). Furthermore our margin of outperformance has increased as the year has progressed.

The brief Brexit brouhaha is of a piece with a larger global phenomenon, not a one-off crisis and as such we must be prepared for similar shocks going forward. Globalization, the free exchange of people, trade, and capital across national borders is in reverse these days after advancing steadily since the end of the Second World War. Geopolitically de-globalization manifests itself in the rise (or attempted rise) of regional powers—Iran in the Mideast, Russia in eastern Europe and Central Asia, China in East Asia—as the dominant political, economic and military super-power, the U.S., increasingly turns inward.

Politically de-globalization manifests itself in an array of populist movements, of the left and of the right, in which those who deem themselves left behind by the sweep of globalization unite to repudiate putative elites who, they feel, foisted the whole farrago on them in the first place. Think of Trump or Sanders in the U.S., the Brexit movement in Britain, Marine Le Pen in France or the Chavistas in Venezuela.

As a result, sundry international institutions and arrangements find themselves under attack. Financial markets are perhaps the most globalized of all entities so bouts of de-globalization affect them with particular acuity. In addition I have described in previous epistles how markets have become increasingly thin, that is, less liquid, as post-2008 regulation has removed many middleman buffers and non-fundamental factors such as high-frequency traders exaggerate the speed and magnitude of otherwise normal market adjustments. Thus reactions in the financial markets have been and are likely to continue to be violent.

Warren Buffett once remarked, “You don’t find out who’s been swimming naked until the tide goes out.” Lo and behold numerous international institutions have been swimming naked and now the globalization tide is going out. Instances in the recent past: the PIIGS crisis in the Eurozone in 2011 and 2012, or China’s attempts to create modern financial markets and a modern consumer-driven economy while maintaining state control. Currently it appears that coordinated efforts by central banks around the world to stimulate economic growth via quantitative easing and other exotic monetary experiments are failing. Expect further exogenous shocks in the future as more naked swimmers are revealed.

Here at Weybosset Research & Management LLC our portfolios are increasingly U.S.-centric. True, we sell farm equipment, restaurant equipment, diesel engines, toothpaste and beer all over the world; but our health-care companies, our banks, our cemeteries, our pipelines and our various government service companies have no meaningful operations abroad. Smaller companies tend to be more domestic, and, yes, our hunt for new investment opportunities has been aimed largely at small and medium (American) companies lately.

When the news of the Brexit vote hit, and recession was widely forecast for the U.K., in my mind I went through a list of our holdings to determine how vulnerable we are to such a development. The only company I could think of with significant U.K. business is Copart, our automobile salvage auction company. But Brexit or no Brexit, I feel certain that the British will continue to wreck their cars with the same frequency as always. I would not have enjoyed similar confidence if we owned, say, a global investment bank.

As I write, the U.S. stock market has broken rather decisively to new all-time highs. We are fully invested, or nearly fully invested, and, at least so far, ahead of the market. So it seems to me that at its midpoint 2016 is progressing satisfactorily. (I hope you agree!).

But I also want to assure you that we are not complacent. The world is a dangerous and fragile place, a fact of which we are fully aware. Our goal is, and always has been, to earn the best possible return for you consistent with the least possible risk. As markets rise vigilance must rise as well.

Thank you again for the confidence you have placed in us. We welcome any and all questions, comments and (God forbid) complaints, so don't be shy, get in touch with us. We'd love to hear from you.

Yours very truly,

Fla Lewis III
Principal