

The status quo in the market has remained (insert any of the following); Volatile, Unpredictable, Capricious, Explosive, etc... each accurately describing today's markets. Market conditions of late have left clients asking "How do you pick stocks in a market like this?" We thought instead of bemoaning the events top of mind; Brexit, Oil prices, How To Make America Great, Home-Brew Computer Servers, The Fed... we would instead try to explain why with all the market turmoil we remain steadfast in our approach.

Our equity selection approach starts by looking at the legs of a stool with each leg representing a pillar supporting the mosaic of our investment thesis. The components that make up our legs are: Free Cash Flow (FCF), Manageable Debt Levels, Good Management Teams, and Bargaining Power. This is not to say that earnings relative to stock price (P/E), market cap, and dividends don't factor into our investment decision, but we have found that if the legs of the stool are solid, performance will follow when we purchase at what we believe is a reasonable price.

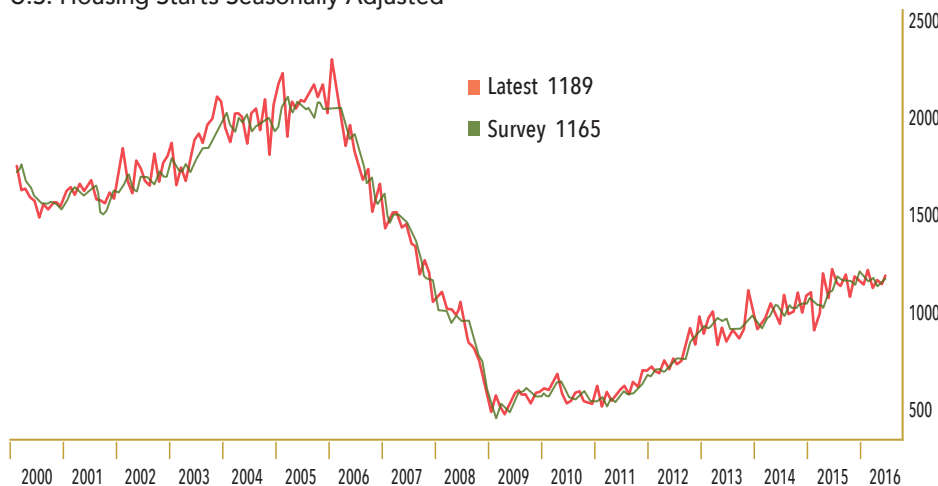
- Positive Free Cash Flows allow companies to operate and grow without needing to raise additional capital, "Cash is King".
- Companies with Manageable Debt Levels usually do not take undue risks nor do they borrow beyond reasonable levels. Throwing good money after bad is usually not a good business practice.
- Management teams that have a track record of being good stewards of investor's cash are attractive in that they give us confidence when looking into the investment horizon.
- Bargaining Power usually means a company has a broad and diverse base of suppliers and customers. This gives the company flexibility to control costs and pursue revenue growth.

All four of the legs are linked and without one, the investment mosaic does not stand. An example can be seen in a recent addition to our Value Strategy, Home Depot Inc (HD) and how it compared to Lowes Companies (following chart). In almost every metric HD was more attractive than LOW, except for Leverage, but with HD generating approximately \$8 Billion in free cash flow per year we believe the leverage to be manageable.

	FCF (\$/Share)	Leverage (Total Assets/Avg Total Equity)	Operating Margin %	Market Share %
HD	\$ 6.43	5.28	13.7	24
LOW	\$ 4.80	3.57	9.8	17

Finally, we would be remiss if we did not touch on some economic investment themes we have been following. U.S. housing has been slowly coming off the lows of early 2009, nationwide housing starts rose 4.8 percent in June to a seasonally adjusted annual rate of 1.189 million units (see chart below), and giving us confidence we remain in the early innings of a housing recovery. Further, post financial crisis, U.S. households have considerably deleveraged, down \$423 Billion in debt since March of 2008. Yet while Housing and debt levels have improved, we still have not seen wage growth as U.S. median household incomes have declined by approximately 7% since 2000. Given current world market conditions, we believe the U.S. economy remains best positioned for growth and favor U.S. large cap equities as providing the most upside long-term.

U.S. Housing Starts Seasonally Adjusted



Source: U.S. Census Bureau