Manole Capital Management
Commerce Club at Oxford Exchange
Phone: 813-728-3344
E-Mail: warren@manolecapital.com
Website: www.manolecapital.com

2nd Quarter 2017 Newsletter

April 2017

Manole Capital Management:

On February 19th, Manole Capital quietly celebrated its 2nd year. We realize that 2 years does not equate to a long-term track record, but we are pleased that the portfolio returned 20% since inception. We look forward to many more years of solid performance.

We continue to focus our attention on the financial and technology sectors, concentrating our time on our "circle of competence". While these two sectors are specific, they represent 1/3rd of the entire S&P 500. Our portfolio is comprised of companies that we intend to own for quite a while, although understandably there is no guarantee that we will own these holdings forever. Our perspective and timeframe can change, as the facts change. This is key to active management and what separates us from passive investing. Our daily job is to monitor the market and continue to invest in those companies we deem attractive, grounded in our bottom's up, fundamental research. Besides monitoring these holdings daily, we are also gauging their success or failure in their respective markets. We believe there is nothing wrong with utilizing low-cost, passive vehicles in the construction of a well-diversified portfolio, especially in areas without expert knowledge. Ultimately, given that every manager has a different perspective on what constitutes "long term", our philosophy of owning wonderful businesses for the long-haul can only be proven over time. As we enter our 3rd year of existence, we hope you come along with us for the journey.

New This Quarter:

We are continuously trying to improve our communication with you. Over the last two quarters, we moved stock specific research from this newsletter onto our website at www.manolecapital.com, under the "Research" tab. In this format, we are attempting to provide macro and 'bigger picture' themes. These are items that can steer the overall markets and impact the success of our individual portfolios.

In this quarterly newsletter, we again are trying something different. Towards the end of the note, you will find one page of random statistics and interesting metrics. While some of these might seem inconsequential to the overall economy, they do help steer our investment themes. We continue to emphasize the extraordinary, secular growth of the "Fin Tech" industry and our unique portfolio. We anticipate excellent growth going forward and believe that these facts help to prove this point. These statistics can be thought of as a proof-of-concept or they can provide for interesting chatter at cocktail parties.

Focus on Fundamentals:

If possible, let's forget politics for a moment and focus on the broader market fundamentals. While politics and various policies might ultimately impact the stock market, we believe that performance is truly driven by the fundamentals of the economy and more importantly, the success or failure of individual companies. At times, certain investors can get swept up in the latest political narrative or news (or "fake news") story. This isn't to say that Trump's latest executive order or recent tweet isn't important. But we at Manole Capital prefer to focus our attention on the boring, non-controversial economic data that impacts individual equities. Analyzing corporate earnings, financial statements and reading into economic indicators is our day job, rather than keeping track of daily media distractions.

Despite a turbulent start to the Trump administration, the stock market continues to hit record highs. According to the National Bureau of Economic Research, this expansion is in its 93rd month. We are now approaching the second longest bull market on record, as we reach its 8th year anniversary (See Endnote A). On the positive side of the equation, we do not question why the market continues to rise. We believe the market is reflecting a better economic outlook, accelerating growth and positive underlying fundamentals.

Lost in the widespread speculation coming from Washington DC and the Trump administration, is the better-than-expected results from 4th quarter earnings. Overall, results were solid, as 68% of companies beat earnings expectations. 4th quarter earnings growth was 7% year-over-year, which was a nice increase from the 3rd quarter. In fact, the 4th quarter was the strongest growth in earnings the market has experienced in over two years. However, revenue growth remains sluggish, under 5% year-over-year. While the 1st half of 2016 showed essentially no earnings growth, the S&P 500 grew roughly 10%

for the full year. Importantly however, as we continue to highlight in our research, while the market is steadily growing, it is far from robust. Rising interest rates are seeing money flee bonds in favor of stocks, offering both growth and healthy yields. We continuously utilize our stringent valuation analysis to quantify how far individual companies can advance before the next correction or pullback.

On the flip side, the length on this market run continues to scare many investors. Some fear that the market is ignoring the risks of a protectionist government and the dangers of trade barriers or even a trade war. We hear this continuously from skeptics on various business shows, and we are not ignoring these risks. The front page of the Wall Street Journal on Monday February 27th had a headline stating, "Markets Flash Warning Sign". This type of skepticism is good for the markets and we too are concerned about various issues. Are we being too euphoric? Is everything perfect? Far from it! We simply build these scenarios into our overall risk / reward analysis and attempt to frame upside and downside opportunities. Regardless of how one values the market, the bar is getting set higher and higher. As stocks lift, investors are raising the stakes on what this economy and President Trump must deliver and accomplish in the future. Investors expect additional rate hikes and a series of pro-growth initiatives from the Trump administration. If Washington fails to deliver or stumbles, so too will stock prices. If things continue to progress and get enacted, the market has plenty of upside ahead.

Stock Market Psychology:

The first mistake that some investors make is selling an upside move too early. Bull markets, based on improving fundamentals, can last longer than most expect. Another mistake is chasing near-term momentum positions from a sentiment standpoint. Sector rotation is unbelievably difficult to do, as is timing the market. We continue to anticipate a modest correction, but its exact timing cannot be known. The rationale for anticipating a slight market correction is simply due to historical fact. We tend to see a ~ 5% pullback every 5 to 6 months and we have not experienced one since Brexit (late June of 2016). The conditions of extreme investor optimism, historically low volatility and some sectors showing overbought conditions leads us to this conclusion. We believe any correction that does arise will prove to be quite temporary. Meanwhile, we remain fully invested and ready to pounce when the opportunity presents itself.

The market is up +5% so far in 2017 and nearly +11% since the election. That is significant change, in a short period of time. This tends to result in angst for those investors that have "missed the rally". Many are hoping for a retreat or pullback that would allow them to get "on board", at lower prices. This is typical bull-market behavior, where investors are feeling the opportunity cost of missed gains. Back in February of last year, the markets fell, but many investors were too afraid to get involved due to heightened uncertainty. Then Brexit occurred and the markets fell again. Investors had another opportunity to increase their exposure to equities, but many failed to react.

While idle cash is quite large, one could argue many investors have missed this entire bull run. Looking at leading online brokers Charles Schwab and TD Ameritrade, it is easy to see that there is a tremendous amount of cash sitting on the sidelines, just waiting to get into the market (See Endnote B). From 2009 to 2015, the Russell 1000 Growth index has averaged +16% per year, significantly higher than the long-run average of 6.4% per year. Treasury yields are the foundation for global finance and a common yardstick or benchmark for valuations of riskier assets. It is our belief that when measured versus historically low interest rates, our equity market is not overvalued. We might not go as far as Warren Buffett who stated on CNBC in February 27th, that "stocks are actually on the cheap side to historical valuations". We consider his perspective dictated by the very long length of his timeframe, which is not based on quarters or even years, but decades. While various valuation metrics can be used to determine whether a sector or company is attractive, taking a top-down approach and simply stating the market is overpriced can be naïve.

Intrinsic Value:

We typically find that our performance outperforms during these periods of stress and uncertainty. Why? Because we own dominant businesses with high barriers to entry that generate free cash flow without needing to access a closed debt market. These companies can invest for the future, when times are difficult, and this provides a steady floor on their valuation when the market falls. During these uncertain periods, we come back to our fundamental analysis, detailed company knowledge and

use widespread market fear as an opportunity to make bargain purchases. We believe that over time, stock prices gravitate toward their intrinsic value. The challenge remains how to define intrinsic? How does one properly value the natural, innate, true worth of a business? Stock valuations can be tricky and easily manipulated by analysts. We have seen imaginative analysts assign billions of dollars of value to companies simply on "eye balls" or page views.

We prefer to measure against profits and free cash flow. Still, with current high profit margins, calculating the true intrinsic value of a company can be difficult. For certain businesses, one could factor in what the cost would be to replace all their corporate assets (infrastructure, management, salesforces, inventory, etc). Yet, even if you could, we believe that many of our companies are worth far more than it would cost to replace them. In some cases, a winner-takes-all mentality has created de-facto monopolies and duopolies. It is these franchises that we seek out and are willing to pay a somewhat higher than average valuation for. Certain of our payment businesses have successfully fought new technology entrants and won, as it is nearly impossible to compete against powerful networks with huge "moats around their franchise".

One year ago:

We are in a vastly different environment from where we were a year ago. In early February of 2016, stocks were tumbling on slowing growth and some worrisome credit trends. Over the last year, our US equity market climbed over 30% from those depths. Worries in China and deflation fears pummeled stocks and created a bizarre world where roughly 1/3rd of all government bonds were at negative yields. On February 11th of 2016, the price of oil was falling and eventually bottomed out at $26.21 per barrel. Over the course of the year, the price of oil more than doubled and the energy sector was the single best performing sector in the market.

One does not drive a car just using the real-view mirror; one must also always look forward. This is because the market is always anticipatory and searching for what lies ahead. We are strong believers that stock prices are a reflection of expected future earnings and that is exactly why the market has risen. Three benign upticks in interest rates have been more reflationary than inflationary. Rates are still historically low, consumer confidence is soaring (See Endnote C), the labor market is strong and pro-growth stimulus is coming over the next few months. The forward-looking market has transitioned from rate-driven to an earnings-driven focus.

One year forward:

Revenue and earnings growth has been soft for quite a while. In 2015, the S&P 500 market index had revenue fall 2% and earnings decline 1%. Last year, revenue improved to only 0.8% growth, but earnings were still down 3%. The sharp declines in energy prices were a drag on the overall market. As we look forward, estimates for 2017 are calling for double-digit growth, but continued softness in top-line revenue growth of only 3%. Wall Street strategists rarely get their annual predictions correct and this year will likely be no different. After the election run-up, many "experts" were forecasting a rise of only 5% in 2017. There were widespread worries about high valuations, slowing growth, and unknowns from President Trump. After only a few months, many of these skeptics are already raising their estimates for the year. Playing catch-up is not new for these market prognosticators, as many fear the danger of straying too far from the herd. Are these strategists zigging now when they should be zagging? This is exactly why we do not employ a market timing mentality. We feel that it cannot be accomplished over a long timeframe. We will continue to focus on core fundamentals and attempt to "read the tea leaves" on how market indicators impact our companies.

While these forecasts might be higher than what we ultimately realize, expectations still look promising. The majority of analysts and economists have not formally factored in infrastructure spending improvements nor have they begun to assess the impact of corporate tax reform. There are simply too many moving parts, not to mention that the timing and realization of these fiscal initiatives is also unknown. What is clear to us is an improvement in sentiment and optimism for future results. Last year, earnings growth was negative and it did not move stocks higher. Instead, valuations lifted and forward multiples rose on better expectations. This year, we are expecting earnings growth to accelerate, without any multiple expansion. If this scenario plays out, the market should rise with earnings growth (i.e. double-digits). In our opinion, this earnings growth is a great catalyst to move the market higher. The more powerful an economic catalyst is, the more stocks will continue to lift. We

do not need valuations to lift to boost the equity market. Simply maintaining the one year forward multiple of ~ 17x and applying a higher growth in earnings should suffice.

When we get that much talked about corporate tax cut, we will see analysts dramatically raise profit margins and overall earnings estimates. Will tax reform impact 2017 or 2018? Will companies allow this tax savings to fall to earnings or will there be other calls on this capital (i.e. buybacks, capital expenditures, etc)? We do not know for sure. What we do know is that the "E", in the "P/E" equation, is understated. In the event that growth of earnings surprises to the upside, the overall market valuation (on a P/E basis) will be much more reasonable.

1st Quarter 2017:

Over the first month, President Trump has had difficulty confirming some of his cabinet posts, and he has encountered serious difficulty implementing his immigration policies. Campaign promises and rhetoric are vastly different from implementing policies in a fiercely divided Washington DC. Conditions in Europe, Japan and China are also not ideal (although they rarely are). The nearly 25-year European Union experiment is facing serious tests, which is leading international investors to flow into US stocks. However, while many continue to focus on the negatives we hear about Greece, Spain, Italy and others, in truth, overall growth in the Eurozone has actually accelerated to levels not seen since 2011. On a fundamental basis, these international markets are showing growth and rebounding off last year's bottom. Eurozone business activity is surging and has surprisingly reached its highest level in over 6 years. There will be always be "bumps in the road", but fundamentally the environment is improving, not getting worse. This should bode well for the sustainability of this rally.

We are in a slow and steady market, experiencing solid growth and benefiting from interest rates that are still at historical low levels. Employment is at or near full employment. Recent earnings reports were quite favorable and many companies posted results at or above expectations. Evidence continues to mount that the US economy is gaining momentum, not decelerating. Retail sales reports are robust and factory output has shown a nice uptick. The US Federal Reserve has followed a predictable path of modestly lifting interest rates, which has allowed the equity market to steadily march higher. All this hard evidence, coupled with Trump promises of fiscal stimulus, has been the ideal environment to push the equity market to all-time highs. At some point, most likely in the next 4 to 6 months, investors will need to see these promises become reality. We do not envision an immediate race from Dow 20,000 to Dow 30,000 (see our note on the irrelevance of The Dow here). In fact, we anticipate some consolidation and higher volatility over the course of this year. The portfolio is positioned to benefit from this movement and we believe it is attractively priced for its above average outlook for growth and profits.

The US Federal Reserve:

Since the Financial Crisis, the most important entity steering the financial and global markets has been the US Federal Reserve. Our central bank has communicated a calming path forward and led us out of the abyss. For nearly 8 years, interest rates have been close to zero and banks have built up impressive capital reserves. However, we are slowly witnessing a change in leadership. Instead of monetary policy, driven by central banks, controlling the market, we now have fiscal policies dominating the conversation. For years, Chairwoman Yellen has pleaded for Washington to take a leadership position to address our slow growth. After years of setting the market's agenda, the Fed is now relegated to responding to politicians. Instead of anticipating, the Fed is now more reactionary. A shift is occurring, and instead of academic policy makers impacting investors, it rests with the unknown vagaries of politicians.

We anticipate a gradual approach by the Fed, with a few short-term interest rate increases this year. Voting Fed member and NY President William Dudley recently said the case for raising rates "has become a lot more compelling in light of the economy's current and expected performance". This should not be surprising or a shock to the system. It is simply the Fed committing to a path of rate normalization, after being at historically low levels for nearly a decade. We would expect other global central banks to continue to purchase their own debt and attempt to spur growth out of a dreaded deflationary environment. As other central banks increase their balance sheets, our Fed has started the process of analyzing how it can shrink its large asset portfolio (which stands at $4.5 trillion). As the Fed runs-off its maturing holdings, the market might struggle digesting some of this supply. One area we continue to focus our attention on is the spread differential between our

Manole Capital Management
Commerce Club at Oxford Exchange
Phone: 813-728-3344
E-Mail: warren@manolecapital.com
Website: www.manolecapital.com

rates and other countries. As our 10 year yields potentially rise towards 2.75%, we find it odd that German and Japanese government bonds are still at paltry lows of 0.20% and 0.06% respectively. At a minimum, yield-starved investors will gravitate towards our government bond markets not only for their safety and security, but also for the better yield. While interest rates will continue to stay historically low, we do not believe that negative rates or zero rates are appropriate for global markets. We do not forecast the timing and size of interest rate changes. Instead, we continue to use the CME's website, as the single best indicator of market expectations. Every economic action, whether it is currencies, interest rates, commodities, policy adjustments or others leads to another economic response. We will leave this to the "expert" economists. Once again, we will model the impact of these potential changes and do our fundamental, bottom's up research.

Washington DC:

President Trump tweeted of a "phenomenal tax plan" coming in a few weeks and the stock market rallied strongly. According to Wilshire Associates estimates, the US stock market rose $175 billion in value following his uttering that phrase. When Trump then mentioned that it was expected that details of a corporate tax reform package would be released "ahead of schedule", the market rose another $100 billion in value. We are clearly now in a "tweeting" environment. While we do not envision "trading the tweets", we do envision an increasing number of volatile events that might create rewarding investment opportunities. We are in a temporary void, where the absence of concrete government rules, substance and framework are getting "huge" responses by the market. The market will continue to respond to the noise, but it will eventually need more substance. Governing and politics are tricky and never easily accomplished. On Election night, many hoped that Trump's unconventional and populist approach could lead to bipartisan alliances. While business sentiment surveys have soared, it is mainly from Republicans. On the flip side, social issues have enraged Democrats and raucous town halls have ensued. Delivering a scripted speech is much easier than delivering on it. It should not be underestimated how difficult it ultimately will be to translate goals into legislative accomplishments.

Before we leave Washington and how it can impact our portfolio, we would like to quickly discuss Dodd-Frank regulations. Many of the rules from the 2,300 pages of Dodd-Frank regulations were properly intended to make our economy and banking system safer following the Financial Crisis. As we have articulated in prior newsletters (seen here), we believe tighter regulations on the banking sector have strengthened our economy and made our financial institutions the envy of the world. Yet, certain rules put in place in 2010 were, in our opinion, government over-reach. We believe The Durbin Amendment was un-necessary and unfairly benefitted one segment of the market (retailers) at the expense of another (banks). This issue has been a focus for House Financial Service Committee chairman Jeb Hensarling (R-Texas) and it might get reversed in a broader de-regulation program. If Washington DC examines the unintended consequences of its Durbin Amendment, it will be very positive for our payment companies. If other issues garner more attention and debit rules remain, there will be no change to the current environment. We like these type of risk / reward scenarios. Heads we win, tails we tie.

Taxes:

While the underlying fundamentals of the US economy are improving, the market is certainly looking forward to tax reform. We believe potential tax reform changes are partially responsible for lifting the US equity markets, but we do not believe it is entirely the rationale for the market liftoff. Doing a little back-of-the-envelope math, it is estimated that each 1% cut in corporate taxes would equate to $1.30 getting added to S&P 500 earnings. This implies that a 10% drop in corporate taxes (to the 25% level) would potentially add $13 to S&P 500 earnings. We continue to believe that the overall market is struggling to generate consistent and predictable growth. As commodities swing from negative to positive and cyclicals show signs of rebounding, we happily continue to focus our attention on steady, recurring revenue models which should benefit from years of future secular growth.

However, there are clouds of uncertainty hanging over this stated Trump priority. Again, making campaign promises is much easier than actually delivering on them and enacting laws. History suggests that the ideal time to push through big economic legislation is early in an administration. Ronald Regan proposed his initial tax-cut plan on February 15th of 1981. George W. Bush made his tax reform proposal on February 8th of 2001. Barack Obama pushed through a large economic stimulus package and signed it into law on February 17th of 2009. While we believe a Trump tax plan is still likely, it has some hurdles

to clear. The first issue to "resolve" is the Affordable Care Act (ACA) or Obamacare. During the campaign, Republicans proclaimed that their first order of business was to "repeal and replace" the ACA. While that might have been a catchy slogan, it will likely be more of a healthcare "repair and reform". Accomplishing a repeal is proving to be much more complicated and difficult to enact. Is it possible to undertake this enormous task without leaving millions of Americans in insurance limbo? Fundamentally, Republican leaders want to handle Obamacare first because it potentially smooths their procedural process. It is a safe assumption that 8 Democratic Senators will not be crossing the aisle to vote for a Trump tax bill. If the GOP can resolve the tax implications and costs of a health plan, it can finish its budgetary process. Under congressional rules, a new budget will give Republicans the umbrella to install a tax overhaul by a simple majority, thus avoiding an expected Senate Democratic filibuster. We envision the Republicans utilizing reconciliation to partially repeal aspects of the ACA. A new means-tested tax credit program will likely get enacted. This market-based universal coverage program should reduce the federal government's role, while increasing state powers. The market has been front-running some Trump promises, but the reality of policy implementation will prove to be much more challenging to accomplish. Sentiment is a powerful driver of the stock market and any indication that some of these policies have stalled will result in a market sell-off. While it is impossible to determine how much of this rally is due to future policies, the consequences of failing to pass tax reform would be economically damaging and politically devastating.

The existing tax cut plan (see Endnote D) crafted by Speaker of the House Paul Ryan and Chairman of the Ways and Means Committee Kevin Brady has numerous critics, even among Republicans. Since the hope of Democratic support is miniscule, the most difficult issues are those that potentially split the Republican base. The first issue is ***complexity***. The White House has already argued that a border-adjustment tax is "too complicated". President Trump stated a desire to simplify the tax code, lower taxes on middle-income families and allow US companies to compete on a level playing field (i.e. reducing corporate taxes). While nobody wants to see exactly how hot dogs are made, it is not ideal to create a new tax system that is excruciatingly difficult to implement with painful adjustments benefitting and hurting various business segments. If we can learn anything from the historic 1986 tax reform process, our goal should be to adopt a tax system that expands the growth of the economy while resulting in a simpler and more efficient code.

The second issue is ***revenue neutrality***. Many fiscal Republicans have made a career on fiscal discipline and lowering deficits. According to Phil Gramm, the former chairman of the Senate Banking Committee, "The ultimate goal of tax reform is to collect revenues while reducing the distorting influence that taxes impose on economic efficiency and growth". Gramm is partially responsible for the 1986 tax reform that stripped out deductions and credits, which distorted the proper allocation of resources and hurt economic efficiency. While many complain Washington is wasteful with spending, we know there are "no free lunches". Any offset to government revenue needs to be matched with savings, over a 10-year period. The revenue neutrality may not work using existing math, but Washington is about to get "imaginative". In his first interview since becoming Treasury Secretary, Steven Mnuchin laid out ambitious goals for his top priority—tax reform. While others tend to doubt that our economy can sustain annual growth above 3%, Secretary Mnuchin stated that the administration will "have its own set of financial projections". We expect the Trump administration to focus on "dynamic" scoring calculations, as opposed to "static" figures. Lifting growth rates tends to lift estimates of future revenue from taxes. This will likely ensure Republican plans can balance the competing goals of cutting taxes while still boosting spending on military and infrastructure projects. We have not heard many details concerning the large infrastructure spending program both Trump and Clinton spoke about during the election. If the administration uses a large, one-time repatriation tax holiday to fund a percentage of its infrastructure spend, it can claim some success. This spending will undoubtedly increase our government's debt and probably lead to higher bond yields. This is the ultimate fuel for the Financial sector. While many financials are still below their Pre-Financial Crisis level, we believe the outlook for this sector is quite promising.

The third and most controversial aspect of tax reform is a ***border adjustment tax or BAT***. In theory, this tax neutralizes the revenue lost from lowering corporate and personal taxes. The proposal would eliminate the corporate income tax and place a 20% tax on imports. Border adjustment proponents believe the relative value of the US dollar to various other global foreign currencies would instantly adjust higher to counter any effect on rising consumer prices. Unfortunately, theory and reality are much different. Any adjustment that taxes imports and exempts exports is much easier to say than accomplish. If revenues

Manole Capital Management
Commerce Club at Oxford Exchange
Phone: 813-728-3344
E-Mail: warren@manolecapital.com
Website: www.manolecapital.com

from exports are excluded when determining profits for tax purposes, while the cost of imports would not be deductible as a business expense, the complexity of reform significantly increases. American investments abroad would dramatically be impacted, not to mention the unintended consequences that would hurt retailers that import goods. If retailers see an explosion of costs (due to a significantly higher US dollar), the real-world adjustment process could see higher consumer prices, fewer purchases, lower profits, potential layoffs and failures of marginal businesses. We do not believe that a BAT is the best solution for tax reform, but it is a decent initial proposal until an acceptable alternative can be negotiated. The clock is ticking on tax reform and we see this as an important component to sustaining the market's rally.

Uncertainty:

President Trump is exceptionally polarizing, inspiring intense support and equally strong animosity from detractors. Unfortunately, one's level of confidence or sentiment seems to be tightly aligned with political leanings. A recent Wall Street Journal poll showed exactly how sentiment and expectations differed depending upon one's political party. 9 out of 10 identified Republicans approve of the job President Trump is doing, while 9 out of 10 Democrats and Hillary Clinton voters disapprove. Republicans finally feel like they have somebody in the White House and in Congress that shares some of their worldviews.

On our part, we prefer to analyze policies, not politics. Congressional Republicans have an ever so slight majority to power through specific pieces of the Trump agenda. President Trump might be able to push through changes to healthcare, taxes and the budget, but it will not be simple to accomplish. A complete absence of bipartisan support will result in Republican initiatives having a shaky foundation. Our impression of Washington DC today has not changed. The same divergent sentiment and voter anger that led to President Trump has morphed into an entirely new, but equally paralyzing phase of political polarization. The chances of bipartisan compromise were ever so slight a few months ago. Today it seems that any spirit of cooperation has left the Beltway altogether.

Realized volatility on the S&P 500 is at lows not experienced since 1962 (See Endnote E). Implied volatility, as measured by the CBOE's VIX, is also near historical lows. We struggle with comments by some insisting that these measures are leading indicators of bullish complacency. We see a very different environment in the equity market. Volatility following earnings remains high, as the market reacts to either positive or negative commentary. Company management teams have been forecasting 2017 revenue and earnings expectations. We continue to expect this news to drive future performance. Even before the inauguration, the market was experiencing large swings in daily volatility. On Wednesday January 11th, President-elect Trump stated that drug makers were "getting away with murder" on prices. The IBB or Biotech ETF fell 3% in response. Two weeks later (on Monday January 30th), once travel restrictions were placed on 7 Muslim-majority countries, global protests ensued and the DJIA fell 0.6%. Not even a week later, on Friday February 3rd, the financial sector rallied nearly 3% when Trump signed an executive order to scale back 2010's Dodd-Frank banking regulations. These changes will not be immediate and the rollback of certain regulations will ultimately be a very hard slog on Capitol Hill. As tweets and statements continue to rankle the markets, we believe the portfolio is positioned to benefit, with its large ownership of transaction-based global exchanges. In addition, the portfolio is primarily US centric, benefits from deregulations, and is devoid of tax issues.

Our "Fin Tech" portfolio:

We continue to focus our attention on the "Fin Tech" industry and stick to our area of expertise. As of today, the portfolio is comprised of 22 growth companies. The breakdown or mix between "Financials" and "Technology" stocks stands at 55% to 45%. Diving a little deeper, the portfolio's three largest exposures are 35% in payment companies (comprised of networks, acquirers and processors), 18% to financial exchanges and 15% to data and information companies. Revenue growth for 2017 and 2018 is estimated to be over 10%. One aspect of our job is to deliver significant growth, in bumpy or steady environments. We are the stewards of your capital and we take this responsibility seriously. Some years, growth will be modest, while it might be excellent in others. When "dark clouds fill the economic skies", we will be prepared to pounce on attractive opportunities.

Manole Capital Management
Commerce Club at Oxford Exchange
Phone: 813-728-3344
E-Mail: warren@manolecapital.com
Website: www.manolecapital.com

Since our portfolio owns companies with high operating margins (average above 35%), revenue growth translates to positive operating leverage and mid-teens growth in earnings and free cash flow. For 2017 and 2018, earnings are estimated to rise in the low-teens, barring any unforeseen circumstances. Unlike the broader market, we believe the growth of our holdings is predictable and sustainable. By focusing on recurring revenue models in secular growth businesses, we have confidence that we are properly set up to capture upside. To paraphrase Warren Buffett, we would rather buy great companies at fair prices than fair businesses on the cheap. We believe significant opportunities on both the long and the short side exist, and that good individual stock selection and timely tactical repositioning can drive total returns higher. In conclusion, the portfolio is poised to do very well in a rising interest rate environment and should benefit from an increase in volatility and uncertainty.

We remain grateful for your trust and we are always available should you wish to chat.

Warren Fisher, CFA
Manole Capital Management

Advice:

Some have asked us for reading recommendations and there are many great market newsletters and investing books to read. In our opinion, the best and cheapest (as it is free) can be read on Berkshire Hathaway's website. The 2016 newsletter, released in late February, is a must read for all investors.

Endnotes:

(A) The longest bull market in history lasted nearly a decade, from October 1990 to March 2000.
(B) Charles Schwab has over 10 million active brokerage accounts with over $2.8 trillion in assets. Over 12.5% of client accounts are in cash, just waiting to get into the market. TD Ameritrade has over $800 billion in assets and 15% of total client balances (or $116 billion) are sitting idly in cash.
(C) The Conference Board's consumer confidence index surged to 114.8 in February, which was the best reading since July 2001.
(D) Collapse seven current individual tax brackets to three, with a top rate for joint filers at 33% (over $225,000), then 25%, then 12% (under $75,000). Other big items are eliminating all itemized deductions except for mortgage interest deductions and charitable contributions. Other changes include: eliminating the 3.8% Obamacare surtax on investment income, reducing capital gains and dividend taxes from 20% to 16.5% and eliminating the carried-interest deduction and the estate tax.
(E) Realized volatility is: (intraday high-intraday low) / ((the intraday high+intraday low)/2)

Manole Capital Management
Commerce Club at Oxford Exchange
Phone: 813-728-3344
E-Mail: warren@manolecapital.com
Website: www.manolecapital.com

2nd Quarter 2017 Newsletter

April 2017

Retail Sales & eCommerce:

- A Census report from the US Dept of Commerce estimated 2016 Total US Retail Sales at $4,875.3 trillion
- While this was up 2.9% YoY, physical retail stores continue to lose significant market share to eCommerce
- In its annual report, Sears stated it has "substantial doubt…related to its ability to continue as a going concern."
- eCommerce represented 8.1% of Total US Retail Sales and its growth YoY was over 15%
- Over the important Thanksgiving shopping period, 25% of all consumer spending was done online
- This is an increase from 2015 at 18.3% and 2014 at 15.7%
- The market has punished retailers for this trend, but physical stores still represent over 91% of total retail sales

Fraud:

- The IRS estimates that it is shortchanged by $458 billion each year from small businesses not reporting taxable trans
- The EMV or chip-in-card standards (launched in October of 2015) is aimed at reducing counterfeit cards
- According to a Fed Reserve study, 44% of all US card fraud was due to counterfeit cards (but it is declining rapidly)
- 11% of US card fraud was due to lost or stolen cards, which are costs the financial instit's or banks are responsible for
- 39% of US card fraud is from card-not-present or CNP fraudulent use (ex: eCommerce or online purchases)
- The UK, which launched chip card technology a decade ago, saw counterfeit card fraud decline with CNP rise 70%

Mobile Payments:

- Juniper estimates that mobile wallets will handle $1.35 trillion in spending in 2017, growing over 30% year-over-year
- The largest component of this spend is 43% from physical goods and 39% from P2P or person-to-person payments
- Apple Pay was launched in Oct '14 and is accepted in 13 countries and 35% of US merchants accept Apple Pay

Credit Cards:

- According to a Nilson Report study, US credit card receivables were over $1 trillion in 2016
- 86% of these receivables were generated from Visa, MasterCard, American Express and Discover
- Of this $1 trillion, $650 billion were subject to finance charges (not paid off in a timely manner)
- There are 157 million Americans that have credit card debt outstanding (that's ~ ½ of every person in the US)

Debit Cards:

- According to a Fed Reserve study, debit interchange generated $18.41 billion in 2015 interchange revenue for issuers
- 60.6 billion debit trans covered $2.31 trillion in spending (2/3rd's of trans and $ volume were Signature)
- The avg card-not-present debit transaction was $70.76 per trans (roughly 2x the size of card present)
- Fraud losses were $2.41 billion in 2015, which is up 53% from 2013

Banks:

- In the US, 7% of people do not have a bank account
- The Dodd-Frank legislation is over 2,300 pages in length and The Volker Rule is 950 pages and has 2,800 footnotes
- According to Fed data, US banks grew loans and leases by 6.9% per year covering 2014 to 2016
- From 2000 to 2007, in what is perceived as a lax period of credit scoring, loans and leases grew 7.9% per year
- Outstanding revolving consumer loans from commercial banks grew 7.8% in 2016 to $714 billion
- According to The Boston Consulting Group, global banks have paid $321 billion in fines since 2008
- These charges stem from regulatory failings, money laundering, market manipulation and terrorist financing

US Households (Federal Reserve study):

- As of the 4th quarter, US HH's had $105 T in assets, with $15+ trillion in debt ~ US household net worth is $92.8 T
- The largest component of this net worth are home values, which now accounts for an all-time high of $26.5 trillion
- Net worth is up about 2/3rd's since the depths of the market lows (March of 2009)
- From 2007-2009, US HH's lost $13 trillion

1980 vs 2016:

- In 1980, inflation was 14%, the S&P 500 traded at 9x, unemployment was > 10% and Gov't Debt to GDP was 30%
- In 2016, inflation was 1.6%, the S&P 500 traded at 17x, unemployment was < 5% and Gov't Debt to GDP was 100%

Manole Capital Management
Commerce Club at Oxford Exchange
Phone: 813-728-3344
E-Mail: warren@manolecapital.com
Website: www.manolecapital.com

2nd Quarter 2017 Newsletter
April 2017

Disclaimer:

Firm: Manole Capital Management LLC is a registered investment adviser. The firm is defined to include all accounts managed by Manole Capital Management LLC.

In general: This disclaimer applies to this document and the verbal or written comments of any person representing it. The information presented is available for client or potential client use only. This summary, which has been furnished on a confidential basis to the recipient, does not constitute an offer of any securities or investment advisory services, which may be made only by means of a private placement memorandum or similar materials which contain a description of material terms and risks. This summary is intended exclusively for the use of the person it has been delivered to by Warren Fisher and it is not to be reproduced or redistributed to any other person without the prior consent of Warren Fisher.

Past Performance: Past performance generally is not, and should not be construed as, an indication of future results. The information provided should not be relied upon as the basis for making any investment decisions or for selecting The Firm. Past portfolio characteristics are not necessarily indicative of future portfolio characteristics and can be changed. Past strategy allocations are not necessarily indicative of future allocations. Strategy allocations are based on the capital used for the strategy mentioned. This document may contain forward-looking statements and projections that are based on current beliefs and assumptions and on information currently available.

Risk of Loss: An investment involves a high degree of risk, including the possibility of a total loss thereof. Any investment or strategy managed by The Firm is speculative in nature and there can be no assurance that the investment objective(s) will be achieved. Investors must be prepared to bear the risk of a total loss of their investment.
Distribution: Manole Capital expressly prohibits any reproduction, in hard copy, electronic or any other form, or any re-distribution of this presentation to any third party without the prior written consent of Manole. This presentation is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use is contrary to local law or regulation.

Additional information: Prospective investors are urged to carefully read the applicable memorandums in its entirety. All information is believed to be reasonable, but involve risks, uncertainties and assumptions and prospective investors may not put undue reliance on any of these statements. Information provided herein is presented as of December 2015 (unless otherwise noted) and is derived from sources Warren Fisher considers reliable, but it cannot guarantee its complete accuracy. Any information may be changed or updated without notice to the recipient.

Tax, legal or accounting advice: This presentation is not intended to provide, and should not be relied upon for, accounting, legal or tax advice or investment recommendations. Any statements of the US federal tax consequences contained in this presentation were not intended to be used and cannot be used to avoid penalties under the US Internal Revenue Code or to promote, market or recommend to another party any tax related matters addressed herein.