BANYAN CAPITAL MANAGEMENT

February 9, 2016

Dear Client:

Banyan's equity composite showed no return for 2015 while the S&P 500 was up 1.4%. We are disappointed when we don't have positive returns even though this is to be expected from time to time.

Last year was a more challenging environment to navigate than recent years. A lot more was going on under the surface than appeared from a quick look at the market averages. Since over 40% of stocks in the S&P 500 were down by 20% or more for the year, it is not surprising that most equity investors lost money in 2015. If a portfolio was invested in small caps, oil or biotech, those investors likely faired much worse because those sectors underperformed most dramatically. Some investors that we hold in the highest regard experienced double digit losses last year.

**Not a reprise of 2008**

For anyone who lived through the agony of 2008, it is only natural to be concerned that recent market action may be a precursor to another such debacle. Currently, none of the classic signs of a repeat are present. To the contrary, the U.S. economy and financial system are on much sounder footing now. Debt ratios within the U.S. are not nearly as high except in government. Household debt which was at the epicenter of the mortgage crisis averaged 130% of income in 2007 versus about 100% today. Thanks to low interest rates and debt repayment, households now devote about 15% of income to debt service versus 18% in 2007. Similarly, our banks are in far better shape to absorb losses today. Bank common equity capital ratios are more than double those that existed during the financial crisis. Most of the poorly run financial institutions like Country Wide, Wachovia and Washington Mutual are no longer around. Other weak institutions from 2007 are under new and better management, plus they have vastly improved balance sheets.

There are areas where debt is a concern. U.S. government debt is 101% of GDP versus 63% in 2007. This ratio has remained stubbornly high over the past five years. Improved economic growth in the 2-3% range would help a great deal. Debt levels for governments elsewhere around the world, such as Japan, the E.U. and China, are more worrisome. Also, the strong dollar and weakening demand is making it harder for commodity based economies to repay debt. There is plenty of financial stress, but so far, it is overwhelmingly centered outside of the U.S.

Banyan Capital Management, Inc.
2100 RiverEdge Parkway, Suite 1030, Atlanta, Georgia 30328
Phone 770-951-2129 Fax 770-951-8277
www.banyancapital.com

**Is a recession coming?**

Another issue that worries investors is whether reduced economic activity elsewhere, particularly in the E.U. and China, will have a spillover effect on the U.S. and lead to another recession in the near term. This fear prompted many investors to aggressively sell stocks in recent weeks which led to a 10% decline in the market averages so far this year. This concern is not new. It has plagued the market for months. Unfortunately, there is no clear answer to the question.

What I can say for sure is that a sharp decline in stock prices is a lousy indicator of an imminent recession. The late economist Paul Samuelson once said, "The stock market has predicted nine out of the last five recessions." We know there is a recession in our future at some point; however, knowing the timing of that recession is problematic. At the same time, long before the next recession is over, the stock market will explode to the upside. The market has a near perfect record in predicting a sustained economic recovery.

Another thing we are certain about, with possibly one exception, is that every company we own today is more valuable than it was twelve months ago. We are also highly confident we will be able to make the same claim twelve months from today even though some stock prices have not followed as of yet. By way of example, consider the case of one of our larger holdings, Berkshire Hathaway. Starting about two years ago Berkshire made investments in Kraft Heinz totaling $9.5 billion. In the past year, that investment has blossomed to a market value of about $25 billion! That's a phenomenal increase in Berkshire's enterprise value. There has been no offsetting diminution in value elsewhere at the company, and yet, the price of the stock is 14% lower today than a year ago.

Dealing with such a divergence can drive investors batty. Understanding a bit about investor psychology helps to deal with the craziness. Most of the time U.S. business conditions range from pretty good to not so good. Rarely are business conditions near perfect or absolutely horrible. You would never know that from watching stock prices. Investors generally vacillate between thinking all news is bad to all news is good. It is not possible to know in advance when the mood will change or how long a given mood may last. It is best to simply ride the mood swings through.

**Banyan's role**

Our job for you is to build permanent wealth. The surest way we know to do that is to invest in companies that are bound to increase in value over time. It is important to not overpay for such businesses. It is also important to not be frightened by the inevitable mood swings of the market. If our companies continue to grow in enterprise value, share prices will ultimately follow. Banyan's equity composite over the past 25 years has compounded at 11.3% per year before fees. (Explanation of how composite is compiled) That record extends over a period that includes two recessions, two bear markets, a major financial crisis and mood swings aplenty. We'll stick with what works in the long run, even at the risk of looking silly in the short run.

We always look forward to the opportunity to visit with you.

Sincerely,

Gary L. Watkins
President