TAYLOR INVESTMENT SERVICES LLC
2016 Q4 LETTER

INTRODUCTION

In 2016 our portfolios underperformed the domestic indices which did double digit returns. For Model accounts, performance was similar to the Vanguard Target Retirement 2025 fund (henceforth '2025 fund') as bonds and international stocks produced moderate returns*. For Plus accounts, returns were generally higher than Model portfolios though less than our large cap benchmark (the Vanguard 500 fund). As always, there are variations among specific accounts, especially those under $200,000.

As a group our stock picks did well (see the ROI by Security (Type) section in your performance report). Winners included many of our largest holdings including healthcare companies UnitedHealth Group (UNH) and Knight Therapeutics (GUD-t), exchange operators Chicago Mercantile Exchange (CME) and TMX Group (X-t), and travel company Priceline (PCLN). These stocks did well because earnings did well, though GUD-t's rise is based more on confidence about management's future capital allocation skills rather than current reality.

Losers included home improvement retailer Lowe's (LOW), staffing firm Robert Half International (RHI), two pharmacy benefit managers Cardinal Health (CAH) and McKesson (MCK), and technology company Enghouse Systems (ENGH-t). The last stock simply got too expensive in 2015 while CAH and MCK fell due to deteriorating prospects. With LOW, my buy timing was off though RHI looks even worse as it rose sharply after my sale despite reporting lower results and then no other new news – other than the election (discussed further below).

Canadian picks once again did well (with a tight range for the Canadian and U.S. dollar) though rising interest rates mostly nullified gains from fixed income investments. Once again the biggest detraction came from cash which doesn't help in a rising market. While I don't believe changes in Model accounts are warranted, Plus accounts could be a different matter – a topic discussed further in this report.

Note: Consolidated performance represents a blended fee rate. All return references in this report refer to consolidated numbers. This report was written in late December. Canadian stocks are listed with their Toronto Exchange symbol with a "-t" or "-v" extension.

*As noted previously, just because we use a comparison containing international and fixed income exposure doesn't mean we have a significant presence in either area.

TWO PORTFOLIO OPTIONS

TIS currently offers two portfolio options:

The Model Account – comprising 56% of managed assets and modeled after my personal accounts, this choice is most suitable for: 1) investors 50 years old and above, 2) with the bulk of investable assets at TIS, 3) who authorize up to a 100% stock allocation but traditionally own portfolios with notable cash and fixed income balances. There are two benchmarks for this option: the S&P 500 (as measured by the Vanguard 500 fund – VFINX*)* for all periods and the 2025 fund (VTTVX) for periods starting in 2012. For comparison, VTTVX is currently 67% invested in stocks, 33% fixed income, with the stock allocation usually falling 2% each year.

The Plus Account – comprising 44% of managed assets, this option is for more aggressive investors desiring a higher stock allocation than the Model. Plus accounts will often contain 1) minimum core account allocations that 2) are potentially larger and 3) may contain positions not in the Model. I had targeted an 80-90% minimum stock allocation for this option but have rarely achieved it. Unless you instruct otherwise, for 2017 I will target 75%, though this remains subject to finding good picks and I view any allocation as a flexible mandate.

Your portfolio option is listed on the cover page of your performance report. **Let me know if you want to make a change, especially if you want a higher stock allocation in Plus accounts.**

LONGER TERM PERSPECTIVE

As noted in the ADV, our "*specific performance objective for the equity allocation of a portfolio is for the time-weighted return on investment to exceed, on a pre-tax basis, the comparative return of the Vanguard 500 fund*

(VFINX) in the 3rd to 5th year anniversary of the first full quarter after the inception of the portfolio".

We did not meet this objective.

For Model accounts, we have a 2nd goal to exceed the 2025 fund over 3 to 5 years and we met that objective. *I do not believe any changes in Model accounts are warranted.* Most of you are older than I am and don't design your portfolios with a specific asset allocation (your preferred levels in stocks, bonds, and cash) in mind. Cash levels dampen portfolio daily volatility and are especially suitable for clients either currently withdrawing funds or planning to do so soon.

For Plus accounts, performance remains in striking distance of my benchmark, but cash levels remain a serious detraction, especially in the current 8 year bull market. In the past, I discouraged clients from providing specific stock minimums mainly because these directions were sometimes accompanied by an impossible directive: 1) be more invested in rising markets, and 2) less invested in falling markets, while 3) always achieving a positive return.

As you will see below, I think the market offers few wonderful prospects but I'm a realist - if you are unsatisfied with current returns, let me exclusively focus on stock picking instead of cash levels. You can do that by giving a specific direction, though please consider any number carefully. As noted above, otherwise I will target a 75% minimum stock allocation though this is subject to finding appropriate selections. If you desire a higher number, let me know.

To increase our stock allocation, I will consider three options depending on their attractiveness at the time: 1) proportionally increasing existing holdings, 2) overweighting specific allocations, and/or 3) adding more index and ETF exposures, with my strongest preference for the first two. For larger accounts I will use $4,000 as a minimum trade size along with bigger core sizes.

If it matters, my kids are Plus accounts. There, I'll use the 75% target but will be mindful to be far more aggressive during any market declines.

FEARLESS FORECAST

My forecast for low positive returns in 2016 might have come true but for one variable: the presidential election. And while we don't know what would have happened with a different outcome, I don't think the market would have moved much regardless. Despite initial trepidation stocks reacted positively to Trump's election due to three potential future catalysts (with my own non-authoritative take for each):

- **Reduced business regulation**. Oddly enough every president seems to come into office with a goal of cutting red tape but few succeed (see *Fortune* (*10-20-2016)* magazine). Maybe this one will be different, and maybe specific industries will benefit. Seeing is believing, but chalk this one up as a mild positive.

- **Repatriation of Foreign Earnings**. This involves allowing domestic companies with overseas earnings to return these profits to the U.S. at a reduced tax rate. Repatriation occurred several years ago, and most believe it provided a one-time boost but little long-lasting economic impact. Still, this one seems another mild positive, especially for companies with significant overseas operations (typically healthcare and technology).

- **Reduction in Corporate Tax Rates.** In theory this is the big one: if for example the federal statutory tax rate was reduced from 35% to 20% earnings for some companies would rise 20% overnight. Indeed, small company domestic stocks have benefitted most from Trump's election as they are the most likely beneficiaries. This would be bullish for many stocks.

Yet, let's ask the obvious question: if these things are such great ideas why weren't they done sooner? We might see accelerating short-term growth paired with a ballooning deficit, higher inflation, rising interest rates, and an almighty US dollar which kills our overseas competiveness. Tight immigration policies and restrictive trade practices could also roil the markets and hurt specific industries and companies. Lastly, elections are quirky things: by 2018 Democrats could regain control of the Congress or Senate. All of this is enough to make my head spin.

In short, I don't know what will happen in 2017.

Forced to make a guess I'm thinking -20% to +20% covers most bases but that prediction is wide enough to achieve irrelevance. So let's just say flattish returns wouldn't be overly surprising, but I expect volatility to pick up.

My view on our portfolios hasn't changed: as *currently* composed, we will likely underperform the market if 2017 actually does provide a double digit return. While I like my picks enough to own them few make me excited (hopefully I'm conservative). As usual, I'm not standing still, casting a wide net to find good picks, and a new holding could change everything.

QUESTIONS AND ANSWERS

This section serves as an overview of TIS philosophy and a discussion of specific 2016 selections. The responses strive for candor, with an assessment of both the strengths and weaknesses of my approach, and seek to answer questions I would want to know in your place. "Portfolios" generally refer to Model accounts unless specifically referring to another option.

Do you think the market is overvalued?

As you know, I believe pondering great and weighty questions like '**is the market going up or down**' tends to be a waste of time. Nobody knows the future. Yet, existing cash levels continue to be linked to a market where finding really good ideas seems hard. It may be I'm looking in the right places, but maybe valuations are stretched. Let's update the numbers on three reasons to think so:

1 – The publication **Value Line Investment Survey** includes a weekly "*Estimated Median Price Appreciation Potential*" estimate for all stocks covered for the next 3 to 5 years. The latest figure stood at 45% which compares to a range of 185% to 35% high and low over the last seven years.

2 – Warren Buffett suggested* monitoring stock market attractiveness by comparing Gross National Product (GNP) against the total market valuation of all domestic companies. According to published sources, this ratio sits at 116% (implying a future return of 0.8%). In the low of 2008 the ratio dropped to 62%.

3 – Revision to the mean suggests that if the S&P 500 return was 6.9% annualized** over the last 10 years, recent 3 and 5 year returns of 8.8% and 14.6% respectively are likely to moderate.

*Fortune; "*Warren Buffett on the Stock Market"*, 12-10-01; **Vanguard 500 as of 12-30-16

These numbers can't be viewed in isolation. If 10 year treasuries continue to rise, valuations will be pressured. If indeed the bull market in interest rates is over, earnings prospects better improve markedly.

None of this means that the market will correct next year – it didn't correct in 2016. But things look expensive to me, though maybe I'm not adequately appreciating future prospects, either from companies or by regulatory or tax changes. But as I note each year, a great pick and the right sizing can overcome a multitude of issues.

What changes will you make to stock selection?

I don't believe major changes in my stock picking are warranted. While 2016 favored many areas where I had little expertise (specifically, energy and materials along with banks), the picks we did own were solid with good performance in our largest holdings.

While my basic technique hasn't changed, I am emphasizing "better business models", companies that generate significant free cash flow. This is an important concept: free cash flow is best defined as the cash one can remove from a business without impacting that business's operations.

This money can be used for dividends, buybacks, and especially mergers and acquisitions, with any resulting debt from transactions easily payable down at the company's option.

Are you overtrading your positions, especially with your selling transactions?

No, of course not.

I wish but the evidence points to a different answer sometimes. I have always believed that 1) money can always find a home elsewhere, and 2) it is only what we own that can hurt us. By nature, TIS employs a stock picking style which embraces the law of averages: that is, by making many decisions, if I am an above average investor the law of averages will pull me higher. Sometimes this involves rapid selling, and sometimes this activity is a mistake.

Let's first acknowledge that a stock that goes up after sale isn't necessarily a 'bad' sale. I believe all stocks have an implied risk/reward ratio and I'm always striving for an optimal balance, especially since stock prices often overshoot earnings progress with valuations overshooting reality.

I'm often selling when valuations move higher and while these trades can look unfortunate in hindsight they don't usually overly bother me. Estimates of risk/reward are inherently nebulous and it is impossible to be perfect with entry and exit points. Plus, we tend to move incrementally anyway, which allows us to capture further gains if the stock moves higher.

That said, there have been times when indifference would have been my best strategy, with long-time holding Enghouse Systems (ENGH-t) the best illustration. At the time, that company had everything: heavy insider owners, strong finances, great management, and a long-lasting acquisition strategy, all trading at a dirt-cheap price. Left alone, gains would have been far higher than what we ultimately realized (even after a drop in 2016).

The sales that do bother me tend to be those where I've purchased the stock and sold shortly after. There's a technical term for this: *waffling.*

I do tend to waffle from time to time, though I'm not saying that short holding periods are always a mistake. Sometimes selling quickly is absolutely the best move, regardless of whether the stock is up or down (no stock ever cares what you pay for it; all that matters is what happens in the future) Instead, the key is whether the original buying thesis, the core reasons why a stock is purchased, remains valid or not - if invalid then sell, if not then hold (or buy more).

In the end, please judge me by all my decisions, but to gain insights I reviewed my block trading for the past 15 months and focused on larger positions with short-term buys and sales. Here's what I found: of the 21 stocks reviewed, six remain inconclusive, eight are lower than the sale price (presumably a good sale), and seven are at higher prices than the sale - in some cases, much higher.

Here's a look at those later trades:

- Mentioned before, the worst is Robert Half International (RHI) which jumped ~30% after my sale despite no new news – other than the election. Yet, this is a trade that doesn't bother me - actual company news was negative and while you can argue for patience usually soft earnings don't beget strong price performance, enough times when I'm not concerned about this anomaly.

- I feel similarly about sales in Microsoft (MSFT), Priceline (PCLN), and United Health (UNH). These were valuation related sales which always look bad in a happy market, though you can argue that I should have just left them alone given continuing good news.

- This leaves sales in Cisco (CSCO), Expeditor's International (EXPD), and Vanguard Value ETF (VTV). All these sales occurred in the 1st quarter of 2016 after purchase at a higher price. The sales of CSCO and EXPD are not ideal but considering that subsequent earnings growth has been minimal, these stocks are likely higher in part because we are in a happy market than their own merits (though admittedly the market usually provides a rising tide for all stocks). With VTV, there is no excuse, especially since the investment is a widely diversified value index fund. I got rattled by the financial exposure in this ETF and essentially bought high and sold low, a trade if repeated enough leads to poor results.

More importantly, this was a time when stock prices were falling. Not only did I sell during this period but I also failed to buy (the largest omission in hindsight was PCLN). While declines have been infrequent lately, I need to be more diligent about viewing falling markets as buying opportunities.

None of this means that there aren't times when aggressive selling isn't prudent: in early 2008 selling most things was absolutely the right move. As always, the key is knowledgeable buying and selling – in any market. So, am I overtrading? Yes, at times. Sometimes I also need to be overbuying, especially during market declines.

When do you plan to retire and what is the future of TIS LLC?

This is a repeat question from last year I plan to include in all Q4 reports. As you know, I have reached the other side of 50 and prudence indicates that you should be kept updated on my future intentions. Plus, my personal situation clearly impacts risk tolerance, having a definitive influence on stock picks and allocations.

My answer is similar to last year: I plan on continuing to work as long as I enjoy it, meet my personal expectations for performance, and of course have clients like you who want my services. Barring health issues, I would likely give clients a minimum 6 month notice before shutting down this business, but I have no current plans to retire.

That said, many TIS clients are currently in outflow mode and right now I am not open to new clients (though additional assets from existing clients are always welcome). Also, the vast majority of assets are centered with clients with long-term histories with TIS and at some point outflows will accelerate. In the final analysis, I am entirely focused on existing clients and wouldn't consider opening to new ones unless and until our investment universe provides more exciting opportunities.

How are the portfolios currently composed?

Let's look at the answer to this question in several ways including industry, market value, team composition, and Lynch category. Obviously individual accounts may differ as these allocations reflect two representative accounts (figures may not add to 100% due to rounding):

By Industry	*Model*	*Plus*
• Cash	37%	26%
• Healthcare	6%	5%
• Financials	7%	12%
• Fixed Income	19%	14%
• Tech	10%	17%
• Miscellaneous	8%	9%
• Canadian	12%	17%

This positioning seems conservative as cash and fixed income make up significant allocations though our growth companies tend to be heavily weighted by Canadian securities, positions I've held in various quantities for years.

Excluding cash and fixed income oriented securities, the portfolios are divided by market value as follows (only one allocation is shown here as this reflects pure stock allocations):

By Market Value (b = billion)

- Small (under 1 to 5b market value): 20%
- Mid (5b to 25b): 24%
- Large (25b to 50b): 12%
- Super (above 50b): 44%

This year allocations are skewed toward very large companies yet small and mid-cap stocks are represented (again, mostly from Canadian exposure), unsurprising since TIS will invest in any size company.

TIS portfolios currently contain 83 positions. Subtracting fixed income ideas reduces the total to 70. Of that number, here is the breakdown by 1st team (holdings typically 3% or more), 2nd team (1-3%), and the farm team (under 1%) in terms of the total dollars allocated to each group:

By "Team"

- 1st Team : 8 stocks or 57%
- 2nd Team: 17 stocks or 35%

- Farm Team: 45 stocks or 8% (only 7 farm team stocks are over $100,000)

Excluding cash, the stock allocation in the portfolio is very concentrated in the top names. This is not surprising if the market is producing fewer investment opportunities as I have tended to concentrate more when we do find an attractive position. In fact, many farm team positions are purely 'tracking' stocks where the price is high and I want to be more aware of any drop.

Finally, excluding cash and fixed income, let's look at the portfolios in terms of my subjectively assigned Lynch category.

By "Lynch Category"

- Stalwarts: 37%
- Fast Growers 53%
- Asset Plays 10%
- Turnaround almost 0%

To refresh your memory, **stalwarts** are consistent earnings growers usually with a significant international presence, **fast growers** are companies seen growing earnings faster than the market, **asset plays** have some sort of attractive underlying characteristic (usually a strong balance sheet and/or high free cash flow), and a **turnaround** has company underlying issues that hopefully will turn around. Not included in this list are **slow growers**, companies growing their earnings modestly, and **cyclicals**, which are typically economically sensitive business models with more volatile earnings than other categories.

This indicates that of the stocks we do own, many are growth companies.

What are your top five holdings and why did you choose them?

In alphabetical order the largest positions in the consolidated TIS portfolio, excluding closed end preferreds and cash, include Alphabet (GOOG), Intercontinental Exchange (ICE), Priceline (PCLN), TMX Group (X-t), and UnitedHealth Group (UNH). Three of these stocks are repeat 5 holdings from last year.

- **Alphabet** (GOOG – fast grower). This technology company is a rare business model in today's market: a large company growing sales and earnings at double digit rates. While growth will inevitably slow, the parent company of Google continues to see expanding prospects in core search (particularly mobile) and YouTube. The business also features a very strong balance sheet (albeit with a lot overseas) and tremendous free cash flow. Not all is good here: as noted in previous reports, GOOG's business reporting is extremely opaque and thus deriving independent estimates and projections is very hard. Plus, a strong U.S. dollar will pressure international earnings. In essence, Google is the quintessential 'numbers buy' but those numbers remain impressive.

- **Intercontinental Exchange** (ICE – fast grower). Like last year, ICE remains our largest holding and I see this as a very good business trading at an appropriate price. Featuring a gatekeeper business model (the business gets a toll for every transaction and every additional transaction is more profitable than the last) operating as a virtual duopoly in some products, the company spews free cash flow which is often used for acquisitions to supplement and diversify growth. Importantly, ICE is also very pro-shareholder, with a terrific CEO who always seems to make the right moves. There are continuing gyrations in monthly results as much of ICE's earnings are tied to unpredictable energy and financial volume changes, but a drop in one area is often counterbalanced by a rise in another.

- **Priceline** (PCLN – fast grower). By the numbers PCLN is one of more profitable business models I've ever seen with a truly unique ability to generate massive free cash flow at high sales rates. Last year was another strong one featuring double digit sales and earnings and the stock responded accordingly. Yet, not all is wonderful here as two huge intertwined negatives persist: PCLN's heavy European travel focus leaves the business susceptible to both headline news (mainly terrorist attacks) and Euro weakness. Lastly, as with most technology companies, profits will always attract numerous competitors, and I continue to expect the stock to fluctuate significantly.

- **TMX Group** (X-t – asset play). Like ICE, this is another gatekeeper exchange stock with tremendous free cash flow generation. I could have been more aggressive in the stock last year, but X-t's negatives are more pronounced: total dependence on Canada with related exposure to the Canadian dollar with volumes linked predominantly to volatile oil, gas, and minerals markets. Also, there's new competition though X-t retains a strong market share as it pays down debt and raises the dividend. I like this one and can see owning varying position sizes here over the long-term.

- **UnitedHealth Group** (UNH – stalwart). UNH offered an unusual proposition at the start of 2016: above average earnings growth prospects at a below average valuation, especially for a stalwart. Indeed, UNH did well last year, benefitting from wide diversification of its business lines with growth both in health plans and the even faster growing Optum division. The stock's valuation is more in line with prospects today though I can see us owning a core position in this strong cash flow generator for many years.

Describe your top 5 holdings at the start of 2016 and how they contributed to performance.

In alphabetical order, these include Cisco (CSCO), Intercontinental Exchange (ICE), Knight Therapeutics (GUD-t), Priceline (PCLN), and UnitedHealth Group (UNH). In a year when the market was happy all our major picks did well.

- **Cisco** (CSCO – stalwart). Modest earnings in 2016 still led to a rising stock price but I curtailed our gain with a poorly timed reduction at the start of the year. While we retain a position near-term prospects remain modest at best as sales and earnings look to be down at the start of 2017, though the stock remains cheaply valued and the company's balance sheet overloaded with cash (mostly overseas).

- **Intercontinental Exchange** (ICE – fast grower). Solid earnings moved the shares higher but a valuation influenced reduction early in the year curtailed gains (a pattern addressed elsewhere in this report) as this stock kept pace with the market.

- **Knight Therapeutics** (GUD-t – asset play). One of our better performers in 2016, admittedly I attribute gains here more due to luck than merit as the company's deal making prowess has been modest compared to the capital held by the company. As such, this is not a stock for the short-term, as prospects for the future hinge on intelligent capital allocation by management which will likely require considerable patience. I did not trade in this stock in 2016.

- **Priceline** (PCLN – fast grower). We did well in PCLN but could have done better as I had a major case of buyer's remorse in March after enlarging the position in February which could have added perhaps another 0.5% to 1% to total returns. That said, in a happy market most sells look poor in hindsight but it is hard not to conclude that I am overtrading some holdings.

- **UnitedHealth Group** (UNH – stalwart). UNH was our most profitable stock position (in dollar terms) in 2016 though a late October sell in anticipation of a Democratic presidency curtailed an even larger gain, especially for Plus accounts. Should I have been more deliberate? I would have been more deliberate in a lot of stocks, especially if I knew a late rally was coming. I was also concerned about UNH's pharmacy benefit management division when similar companies reported poor results but so far there have been no shortfalls. Like PCLN, UNH represents a missed opportunity for further gains but did well regardless in a market that did not favor healthcare stocks.

What new positions did you add in Q4?

Here is a list of major additions to the portfolios, though not all trades appeared in every account. Google (GOOG) is discussed above as TIS subtracted to this position earlier in the quarter but then increased again later on.

- **CGI Group** (GIB – stalwart). A long-time holding at varying sizes for years, this Canadian based consulting company features a geographically diverse business that generates huge free cash flow with growth regularly supplemented by acquisitions. After a long period integrating a large purchase, revenue is finally starting to pick up as the company has eliminated many low margin contracts and GIB is also regularly buying its own shares.

- **Facebook** (FB – fast grower). This social media company features a cash heavy balance sheet, huge free cash flow, and a high sales rate but predictions about an 'investment year' (a synonym for higher spending or slower growth) in 2017 and questions about ad effectiveness brought the valuation for this company to a more palatable level, especially given future growth possibilities.

- **Verisign** (VRSN – asset play). Domain registrar VRSN features a wide array of positives, including strong finances, consistent buyback plan, and huge free cash flow. Despite the good news prospects for a muted Q4 due to high registrations last year in China have pressured the stock but we are taking a longer-term view.

- **Vanguard Financials ETF (**VFH **-** ETF**).** This ETF contains over 400 financial industry stocks but most exposure is centered on the largest banks in the country. In essence, I am bowing to conventional wisdom with this purchase, believing that a modified regulatory environment and especially higher interest rates could benefit large banks in particular.

What were the major sales in Q4?

The list below covers major reductions in the portfolios. Not all trades appeared in every account. Sales are grouped by themes with commentary as warranted. I could add back to these stocks at any time. GOOG was discussed previously.

- **Normal Reduction After Price Rise (**all stalwarts except as noted**)** – Accenture (ACN), Chicago Mercantile Exchange (CME – fast grower), Cisco (CSCO), Marsh and McLennan (MMC), Quintiles International (Q), UnitedHealth Group (UNH). Given prior knowledge of the presidential outcome, I would not have reduced UNH.

- **Low conviction idea –** (LOW – stalwart). I was indecisive with this home oriented retailer, fearing the company's slowing same store growth, difficult upcoming comparisons, modest store unit growth rate, though frankly these concerns existed before purchase. A disappointing earnings report and now rising rates don't make me think my sale was in error but it seems obvious my original buy was.

- **Deteriorating Fundamentals –** (RHI - asset play). I sold the stock in this finance and technology personal placement firm as sales and margins trends got worse but Trump's election has made investors optimistic that a slowing economy will accelerate which would specifically benefit a company like this one, especially if there is a corporate tax rate cut. In short, I didn't see the gain coming and had no reason to see it coming.

POSITIONS

This is a full list of TIS companies. Not all stocks will appear in your personal portfolio. Valuations referenced are for prices as of late December 2016. These opinions are subject to change at a moment's notice, and no profile should be construed as a recommendation for any listed security. Stocks discussed in detail previously are not repeated.

Stocks are grouped into three classifications: the first string (generally 3% or more) which appear in all portfolios, second team (generally 1-3% or more) appearing in most portfolios, and the farm team (less than 1%) which appear in far fewer accounts but are likely candidates to be larger positions. The profiles are listed in alphabetical order by symbol within the subgroups. Finally, there is a small section for outliers, positions that don't fit normal categories. I own every position listed below except for the closed end preferreds which are more or less interchangeable. All first string stocks were listed above and not repeated below.

SECOND STRING – these profiles describe the positives and negatives with the individual company and explain why the position isn't larger. Overtrading a position mentioned below is a hindsight observation of buying and selling a position too much.

- **Accenture** (ACN – stalwart). I like consulting companies as they typically feature strong balance sheets, high free cash flow, and steady growth supplemented by acquisition and this one is no exception. I did reduce the position mid-year similar to the current price as the valuation remains above normal; recent sales growth rates have moderated to upper mid-single digits.

- **BioSyent** (RX-V – fast grower). One of our more speculative stocks, RX-V is a pharmaceutical firm based in Canada currently featuring one major profitable product with several others growing but still small on an absolute basis. Margins have been under pressure recently as the company expands its sales force in anticipation of higher sales but success is not assured yet I like management and will remain patient.

- **Chicago Mercantile Exchange** (CME – fast grower/asset play). A TIS favorite, exchange company CME features solid finances, high free cash flow, and a generous dividend policy, with earnings dependent on trading volume in commodities and financials. I reduced the position late in the year as the price spiked beyond typical levels though recent trading volumes have been spectacular.

- **Constellation Software** (CSU-t – fast grower). This software company features a solid balance sheet, huge free cash flow, and otherwise modest organic growth supplemented by acquisitions. We added to this position in the middle of the year at a lower price but CSU-t is more richly valued today.

- **Enghouse Systems** (ENGH-t – fast grower). A residual of a much larger position, I like ENGH-t's strong balance sheet, powerful free cash flow, and ongoing acquisitions which are centered on less expensive smaller buys. After getting frothy last year the valuation is at more reasonable levels today though organic growth remains modest.

- **Johnson and Johnson** (JNJ – stalwart). I never traded in this health care company's stock last year but JNJ had a volatile time, rising sharply after mid-year before falling back recently. This trading range is being created by ongoing fears of bio-similars, drugs that can mimic currently licensed drugs at lower cost, along with dull results from JNJ's medical devices and consumer products divisions. That said, JNJ maintains strong finances, pays a solid dividend, and could easily supplement growth via acquisitions.

- **MasterCard** (MA – stalwart). Last year I resisted the temptation to reduce this credit card processing stock as the valuation is not cheap but MA's strong balance sheet, high free cash flow, and growing dividend and ongoing buyback plan was paired with lower double digit sales and earnings growth. We will continue to be deliberate with our holding here.

- **Microsoft** (MSFT - stalwart). Charms with this software company are obvious including huge cash balances (much overseas), gigantic free cash flow, and dominant business areas but sales growth has been modest. Still, investors bid up the stock, enthused by a growing cloud division and maybe by a questionable acquisition of Linkedin. We reduced here early in Jan before adding back a few weeks later but not at the same level as I did not anticipate the cloud business would be rewarded so handsomely.

- **Moody's** (MCO – asset play). This bond rating company was in line for a terrific 2016 while featuring an ok balance sheet, tremendous free cash flow, and a dominant business duopoly before the threat of rising rates pulled the stock down. Plus, the ever timely Justice department finally got around to charging the company for perceived violations stemming from the 2008 finance crisis (though none of the endless litigation involves the government's own culpability in the fiasco). We added to the stock early in the year at a lower price before paring back in June at a price similar to the current one. I like MCO long-term and it is helpful to have short-term negatives to create buying opportunities assuming the investor is patient.

- **Oracle** (ORCL – stalwart). ORCL sounds a lot like MSFT: muted top line growth, high free cash flow, and a solid if not as spectacular balance sheet, with growth supplemented by questionable acquisitions. What's missing is the right cloud narrative: with MSFT, the cloud is seen as *supplementing* growth, but with ORCL the cloud is seen as *cannibalizing* growth. I've been patient here, incrementally adding mid-year, but we have yet to show any large gains here as the stock has been a continual disappointment.

- **Paychex** (PAYX - stalwart). PAYX is a model stalwart featuring a cash heavy balance sheet, consistent earnings performance, and huge free cash flow with a large dividend. I added here earlier in the year and performance has met my expectations but the stock is not cheap and eventually PAYX will likely need to supplement growth via acquisitions.

- **VanEck Vectors Morningstar Wide Moat ETF** (MOAT – ETF). If you recall, MOAT is a 100% stock ETF composed of selections from Morningstar's Wide Moat Index. After changes in how the ETF was composed we added the position after mid-year; I would anticipate leaving it alone unless we need funds for better ideas.

- **Visa** (V – stalwart). A modest year was otherwise overshadowed by a now completed acquisition of Visa Europe as this credit card processor features an ok balance sheet, high free cash flow, and sales growth which paled compared to its primary competitor MA. We reduced near the current price in early May but would welcome an opportunity to add again though the stock is not cheap.

FARM TEAM – these profiles describe the business and explain why the position isn't larger. Only farm team stocks appearing across most portfolios are listed. TIS provides a full list of all farm team stocks in the annual meeting materials (available by request in Feb 2017).

- **Apple** (AAPL – asset play). After many stellar years this large technology firm continues to sell phones like hotcakes but sales and margin rates turned negative this year with no new obvious product lines that can move the dial.

- **Five Below** (FIVE – fast grower). Retailer FIVE continues to open profitable stores like clockwork and offers a long runway for growth but the valuation reflects the good news.

- **Genuine Parts** (GPC – stalwart). A residual of a larger position, sales and earnings have stalled for this distributor despite ongoing acquisitions.

- **NASDAQ** (NDAQ – fast grower). Like most exchanges, NDAQ is an excellent business with high free cash flow though organic growth tends to be more moderate than comparable companies as the company's product lines face greater competition.

- **O'Reilly Automotive** (ORLY – fast grower). Auto parts retailer ORYL is a terrific operator with strong execution, consistent same store sales, and high valuation which reflects the good news.

- **Quintiles IMS Holdings** (Q – stalwart). A residual of a larger position sold at a nice gain, healthcare concern Q must integrate two disparate business models and could be a larger position again at the right price assuming management executes.

- **Roper Technologies** (ROP – fast grower). I like this technology integrator's business model, historical growth rate, emphasis on free cash flow, and clear shareholder communications but the stock is expensive.

- **S&P Global** (SPGI – fast grower). A residual of a larger position, financial firm SPGI's global rating business could be pressured by higher rates but I like the company's significant free cash flow and other business lines.

OUTLIERS – these are mostly closed end preferreds with capped upside but downside risk from rising rates, though this includes two higher risk bank preferreds at higher yields

- **Preferred Stock,** mostly from closed end funds from **Gabelli** and two banks (**Bank of America** & **Wells Fargo**). Currently trading with a yield of 5.5 to 6%*, I like closed end preferreds because 1) as an asset class they have similar credit risk exposures, so I will often trade them based on relative yields, 2) many now trade under the issue price which means if they were ever called it would be at a higher price, 3) the dividends are cumulative which means if they were ever suspended and then reestablished all past dividends would be due, and 4) the underlying investments are relatively straightforward to evaluate. They aren't perfect: rising rates can crush the share prices (and did late last year) and liquidity (getting in and out in quantity and at the right price) can be very difficult at times. For Model accounts in particular, if yields continue to rise I will be inclined to gradually increase exposure. The bank preferreds are far more risky: while they have higher dividend yields (above 6% now), credit risk is only as solid as the underlying banks themselves and the dividends are not cumulative. That said, the current yields are attractive in most environments.

  *GDL-b yields far less but has a fixed liquidation date and thus acts more like a short-term bond.

  NOTE: I have a substantial position in these securities in my personal accounts (more than 17%) and will likely increase the allocation further in the quarters ahead.

CONCLUSION

As always, I hope this review has given you a better understanding of my investment philosophy and your portfolio composition. I appreciate the trust you have placed in my firm to manage your assets. If you have any questions or comments, please don't hesitate to contact me.

Paul Taylor, TIS LLC