KASE CAPITAL

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February 1, 2017

Dear Partner:

In this, my 18th annual letter, I seek to frankly assess the fund's performance and share my thoughts on various matters including, most importantly, why I am very confident in our fund's future prospects. Below I disclose and discuss our fund's largest long positions as well as some of its shorts.

**Performance**

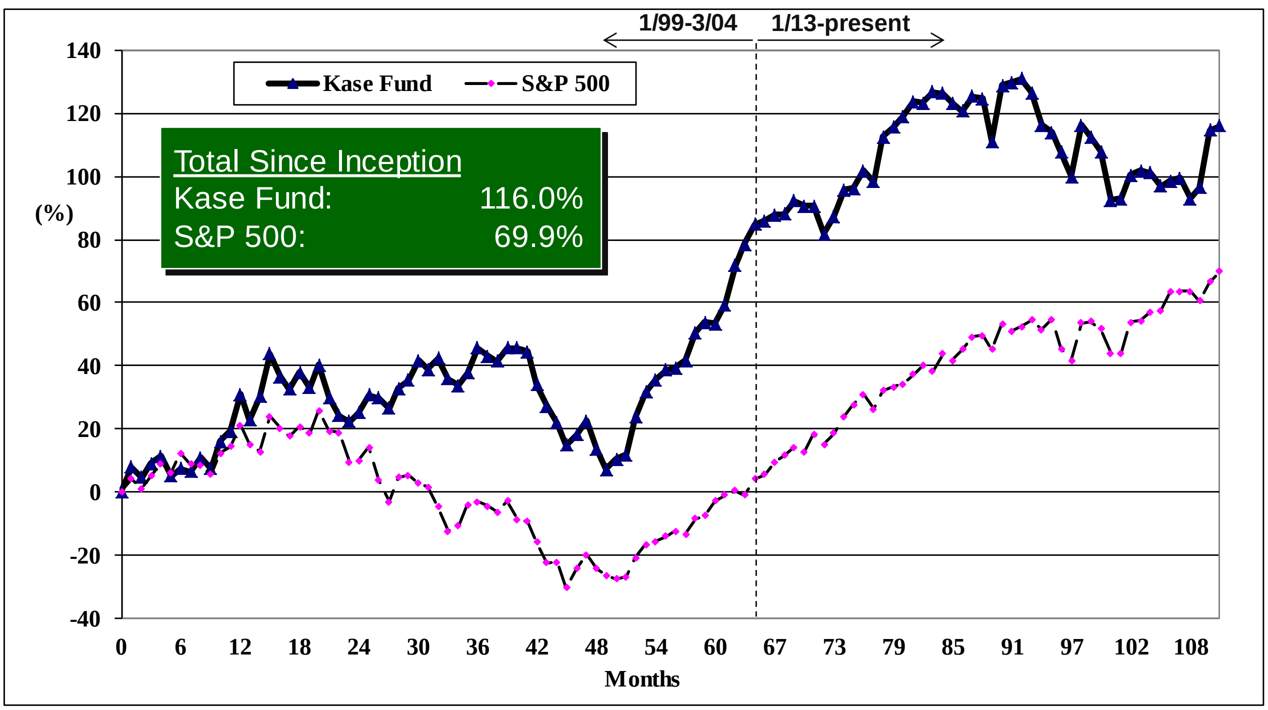
Our fund rose 3.8% in 2016 vs. 12.0% for the S&P 500 (with dividends reinvested), as this table shows:

| | 2016 | Since Inception |
|---|---|---|
| Kase Fund – net | 3.8% | 168.4% |
| S&P 500 | 12.0% | 156.0% |

Past performance is not indicative of future results. Please refer to the disclosure section at the end of this letter. The Kase Fund was launched on 1/1/99.

**Returns Managing the Fund Solo**

Following the re-launch of our fund four years ago, we had two solid years (+16.6% in 2013 and +13.7% in 2014), a disappointing 2015 (-7.3%), and a partial rebound last year, for a total return of 27.6%. This chart shows the returns of the fund relative to the S&P 500 during the entire time I've managed it solo (the first 5¼ years plus the last four):



**Commentary on 2016**
I'm disappointed that our fund trailed the market in 2016. That said, we did earn positive returns, which I certainly wasn't expecting when our fund was down 7.2% entering the fourth quarter. But Trump's election triggered a stock market rally that benefitted our portfolio, especially Fannie Mae, which soared 131% during the quarter. I will also note that our fund was quite conservatively positioned all year, especially after I hit the reset button in late September.

Our biggest winners last year were SodaStream (142.0%), Fannie Mae (137.8%), Spirit Airlines (45.2%), Reading International (26.6%) and Berkshire Hathaway (23.5%). We continue to own all five, each of which I discuss in Appendix A.

Offsetting these gains were two longs, Spark Networks (-78.2%) and Avis (-38.2%), and two shorts, World Acceptance (+73.3%) and Exact Sciences (+44.7%). Spark turned into a classic value trap that I failed to recognize until it was too late – the only good thing that can be said here is that I was able to exit by the end of the year so we captured the tax loss. Avis was my worst sale of the year: fearing the impact of Uber on the business car rental market, I sold right at what ended up being the bottom. I discuss World, Exact and some of our other short positions at the end of this letter.

**Rebuilding the Portfolio After Hitting the Reset Button**
I decided to hit the reset button in late September for three reasons: a) our fund's poor performance; b) my feeling out of sync with the market and finding few bargains; and c) my generally cautious view of the macro environment. As such, I went through our entire portfolio, carefully examining every long and short position, asking a simple question: "Right now, at today's price, am I 'trembling with greed'?" If the answer was "no" or "I'm not sure," then I exited. After this process was complete, our fund was down to seven core long and seven core short positions, with 40% long and 14% short exposure.

Since then, I've been seeking to rebuild the long book back to its usual positioning – roughly 80-100% invested – but, until last week, hadn't had any success whatsoever. Trump's election made me even more cautious (for reasons outlined in Appendix B), yet stocks became even more expensive as the markets rose.

But then, in quick succession, I identified and invested in three stocks recently: Mondelez, CSX and Pershing Square Holdings, now my first, second and ninth largest positions. All are in my sweet spot: I know the companies and the people involved well, and believe I have an edge in understanding the investment opportunities, as I discuss below.

**Portfolio Positioning, Construction and Largest Positions**
Our fund currently has ten core long and ten core short positions, with 56% long and 17% short exposure. I still have a lot of work to do to rebuild the portfolio, but I'm now feeling much more optimistic about this challenge.

That said, I'm not willing to hold positions about which I have only lukewarm feelings, especially given my macro views, which I discuss in Appendix B. I see many investors today owning stocks that they would admit are, at best, 10% undervalued – or even fully valued – because cash is yielding nothing and bonds are still mostly offering, to quote James Grant, "return-free risk." I refuse to invest that way. If I can't find a highly attractive stock, then I'll just hold cash.

On the long side, I seek to construct a portfolio that is both highly concentrated, yet also diverse in terms of industries, types of value, catalysts, and risk. I break it down into the following categories:

- Blue-chip companies whose stocks are the foundation of the portfolio like Berkshire Hathaway, Mondelez and CSX. These stocks are moderately undervalued (though not crazy cheap), but the businesses are of exceptional quality so there's less risk;
- "Platform" companies: Howard Hughes and Platform Specialty Products;
- Companies in consolidating industries: Spirit Airlines;
- A handful of special situations, turnarounds or small-cap companies such as Reading International, SodaStream and Fannie Mae.

Here are all 11 long positions in our fund, ranked in descending order of size:

1. Mondelez
2. CSX
3. Howard Hughes
4. Berkshire Hathaway
5. Fannie Mae
6. Reading International
7. Platform Specialty Products
8. Spirit Airlines
9. Pershing Square Holdings
10. SodaStream
11. Grupo Prisa

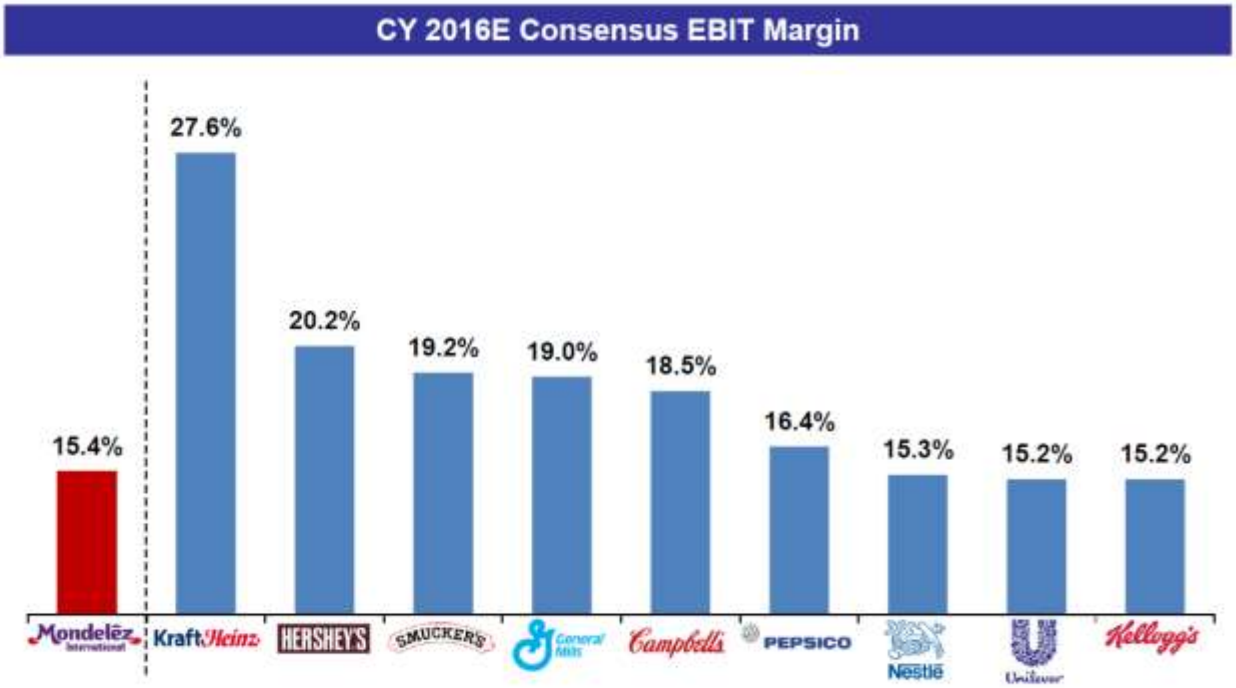
My commentary on seven of these stocks is in Appendix A, and here is a discussion of the three new positions:

**Mondelez**

Mondelez is a global snack food company with leading brands such as Oreo, Nabisco, Chips Ahoy, Cadbury, Toblerone and Milka chocolates, Trident gum, and Tang powdered beverages. It is the other half of Kraft Foods – the two companies separated in 2012.

Worldwide, Mondelez has #1 positions in biscuits, chocolates and candy, and is #2 in gum. It is an enormous company, with revenues and net income exceeding $26 billion and $3 billion, respectively, and a market cap of $68.4 billion at today's share price of $43.89.

Though it is undoubtedly one of the world's great businesses, the stock appears to reflect this, trading today at 3.2x revenues, 18.3x trailing EBITDA and 22.7x this year's earnings estimates. But I believe it's highly attractive for two primary reasons: first, there is substantial opportunity to increase margins, as this chart comparing Mondelez to its peers clearly shows:




Source: CapitalIQ, 2016 consensus analysts' estimates; graph from Pershing Sq. investor presentation

Second, I wouldn't be surprised to see Kraft Heinz acquire Mondelez in 2017 at a healthy premium to today's price. There has been widespread speculation about this combination for some time, but based on my knowledge of the company and many of the key people, I think it's more likely to happen than the consensus view.

**CSX**

CSX offers us another bite at the Hunter Harrison apple. Harrison is a legend in the railroad industry for the remarkable turnarounds he led at Illinois Central, Canadian National and, over the past few years, Canadian Pacific, a very successful investment for us.

I invested in CP in December 2012 after attending the company's analyst/investor day, during which I met Harrison and saw the remarkable strides the company had already made in less than six months of his leadership. While the stock had already doubled over the previous 14 months to ~$100, I thought it still had plenty of room to run.

The story initially played out exactly as I'd anticipated: the company's revenues rose at a healthy clip and its operating ratio (a measure of costs) plunged, resulting in soaring earnings – and the stock price followed suit, peaking at over $200 in late 2014. I sold a fair amount of our position in the high $100s and low $200s, banking substantial profits, and, with the turnaround mostly complete, exited the position entirely last September.

A nearly identical story is now playing out at CSX. After failing in his attempt to have CP acquire CSX, Harrison recently resigned from CP and teamed up with former CP board member Paul Hilal, who's raised a $1+ billion fund focused exclusively on CSX. The goal is to install Harrison as CEO so that he can work his magic yet again on another chronically underperforming railroad.

I know Harrison well from the years we owned CP, and Paul Hilal has been a close friend for nearly three decades. I think it's highly likely that they will strike a deal with CSX in the very near future to make Harrison the CEO, and that he will once again far exceed expectations, driving the stock up 50-100% from its current level of $47.09 in the next 18-36 months.

**Pershing Square Holdings**
PSH is a publicly traded investment holding company managed by Bill Ackman of Pershing Square Capital Management. He and I have been close friends since we met three decades ago in our early years at Harvard, so I've followed his investment career closely and believe that he's one of the most talented investors in the world.

After a spectacular decade-long run, capped by a 40.4% return in 2014 and further gains into the first half of 2015, the Pershing Square funds lost nearly 40% of their value in the second half of 2015 and first quarter of 2016. Since then, the funds have had three positive quarters, but still ended 2016 down 13.5% for the year.

Not surprisingly, in this short-term-performance-oriented business, Pershing Square's total assets have shrunk from ~$20 billion at the peak to $11 billion today, of which $4.5 billion is in PSH.

Because PSH is a holding company, it's a permanent capital vehicle, meaning investors can't redeem, as they can in a traditional hedge fund; rather, they simply sell their stock (in this way, PSH is a bit like Berkshire Hathaway). This means that PSH can trade almost anywhere relative to its net asset value (NAV): when Pershing Square first launched PSH, when returns were strong, it traded very close to NAV, but now it trades at a 16% discount. Thus, investors in PSH will likely benefit in two ways, NAV rising and the discount narrowing, if Ackman can turn performance around.

Investors are like companies: there are only two types, those that are having problems and those that are going to have problems. The key to investing is correctly identifying when a good company or investor is suffering from temporary, rather than permanent, problems. I'm confident that Ackman is in the former category.

All but two of Pershing Square's 13 holdings are public, so I have analyzed the portfolio carefully and believe that it is a collection of excellent businesses with attractively priced stocks. As for the big losses, well over half were due to one very large bet in Valeant going completely awry, but occasional blow-ups like this are par for the course for concentrated investors like Ackman – and Valeant is now only ~3% of Pershing Square's capital.

**Short Positions**
Here are brief updates on four of our 10 short positions, ranked in descending order of size:

**Wingstop**
Wingstop is in the chicken wing restaurant franchise business, with 949 restaurants in 40 states (93% of units) and 6 countries. Wingstop is a decent company with reasonable growth prospects, but its business is largely undifferentiated and faces ferocious competition from all sides. It has

only proved that its business and brand work in two states, yet its valuation assumes that it can scale rapidly across the U.S. and abroad, a highly questionable proposition. Given that the stock is currently priced for perfection at 56x earnings, 32x EBITDA and 11x revenues, if I'm wrong, it has little upside – and if I'm right, look out below… For further details, see my presentation at the Robin Hood Investors Conference last November.

**Exact Sciences**

Exact appeared to well on its way to bankruptcy less than a year ago, but instead rose from the ashes after the U.S. Preventive Services Task Force issued its final colorectal cancer screening recommendations, which granted the company's colon cancer test equal standing among the many other included screening tests. The company has spent massive sums on marketing, including a national television campaign, but this has only resulted in modest growth, far below what is needed to justify this company's $2+ billion market cap, because the test is much too expensive, offers minimal benefits (somewhat better cancer detection, but at the cost of a much higher false positive rate) and, most importantly, customers don't like having to poop in a bucket and then mail it to the company. I continue to believe that it's a $3 stock at best, for reasons I outlined in this article and in my latest presentation at the Robin Hood Investors Conference.

**Herbalife**

On July 15th, Herbalife's stock rose sharply when it announced a settlement with the FTC in which it agreed to pay a $200 million fine and overhaul its business, which the FTC found to be a pyramid scheme (though it carefully avoided using those two words). I anticipated the settlement and stock's reaction, so had only a small position, and used the rally to add materially to our short position in the mid-$60s (the stock ended the year at $48.14). I think the settlement agreement has real teeth, so Herbalife will have to clean up its predatory business, leaving only its legitimate business, which I believe is quite small and certainly can't support the company's nearly $6 billion enterprise value. In addition, Herbalife recently disclosed that it is still being investigated by the Securities and Exchange Commission for its "anti-corruption compliance in China," its primary growth market which accounted for 20% of its sales in 2016.

**World Acceptance**

World Acceptance, a predatory subprime installment lender, rallied after Trump's election on hopes that the new administration would rein in the Consumer Financial Protection Bureau, which has been investigating World for years and which, on August 7, 2015, notified the company that "the staff of CFPB's Enforcement Office is considering recommending that the CFPB take legal action against the Company [because it] violated the Consumer Financial Protection Act of 2010." I'm surprised that the CFPB has taken so long to act, but when it does, I expect that it will take strong action to rein in World. In the meantime, the company is trying to stave off regulatory action by ending the worst of its abuses, which is causing the business to suffer: in the fourth quarter, revenues and earnings per share fell 6.4% and 35.3%, respectively, which is why the stock fell 25% in January.

**Conclusion**
The long bull market has been difficult for fundamental, bottom-up stock pickers like me, but I'm increasingly optimistic that the environment going forward will be much more favorable.

I believe that our portfolio is attractively priced right now and poised to generate healthy, market-beating returns going forward – and should volatility arise, we are exceptionally well positioned to take advantage of it.

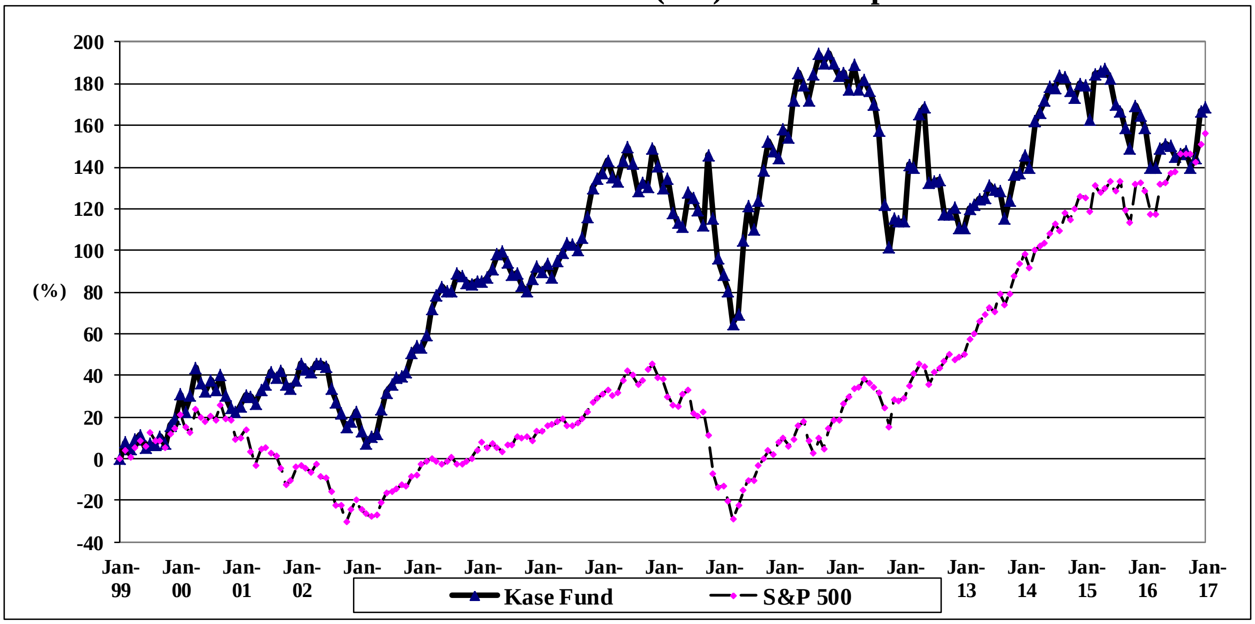
I greatly appreciate your confidence, and remain steadfast in my commitment to earn it. Please feel free to contact me with any thoughts or questions.

Sincerely yours,

Whitney Tilson

Whitney Tilson

## Kase Fund Performance (Net) Since Inception




Past performance is not indicative of future results.

## Kase Fund Monthly Performance (Net) Since Inception

| | 1999 | | 2000 | | 2001 | | 2002 | | 2003 | | 2004 | | 2005 | | 2006 | | 2007 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 |
| January | **7.8** | 4.1 | **-6.3** | -5.0 | **4.4** | 3.6 | **-1.8** | -1.5 | **-5.5** | -2.6 | **4.7** | 1.8 | **1.1** | -2.4 | **1.9** | 2.7 | **2.4** | 1.7 |
| February | **-2.9** | -3.1 | **6.2** | -1.9 | **-0.6** | -9.2 | **-1.1** | -2.0 | **2.9** | -1.6 | **7.0** | 1.5 | **2.1** | 2.0 | **-3.1** | 0.2 | **-3.3** | -2.1 |
| March | **4.1** | 4.0 | **10.3** | 9.8 | **-2.6** | -6.4 | **3.0** | 3.7 | **1.4** | 0.9 | **3.9** | -1.5 | **3.9** | -1.7 | **3.9** | 1.3 | **-0.8** | 1.1 |
| April | **2.1** | 3.7 | **-5.1** | -3.0 | **5.1** | 7.8 | **-0.2** | -6.0 | **10.5** | 8.2 | **2.4** | -1.5 | **0.6** | -1.9 | **2.2** | 1.4 | **4.4** | 4.6 |
| May | **-5.7** | -2.5 | **-2.8** | -2.0 | **1.8** | 0.6 | **0.0** | -0.8 | **6.6** | 5.3 | **-1.4** | 1.4 | **-2.6** | 3.2 | **1.8** | -2.9 | **2.5** | 3.3 |
| June | **2.2** | 5.8 | **4.1** | 2.4 | **4.6** | -2.4 | **-7.3** | -7.1 | **2.9** | 1.3 | **0.1** | 1.9 | **-3.1** | 0.1 | **-0.2** | 0.2 | **-3.0** | -1.5 |
| July | **-0.7** | -3.2 | **-3.6** | -1.6 | **-1.1** | -1.0 | **-5.0** | -7.9 | **2.3** | 1.7 | **4.6** | -3.4 | **0.5** | 3.7 | **-0.9** | 0.7 | **-5.4** | -3.0 |
| August | **4.1** | -0.4 | **5.4** | 6.1 | **2.5** | -6.3 | **-4.3** | 0.5 | **0.4** | 1.9 | **-0.9** | 0.4 | **-3.2** | -1.0 | **2.9** | 2.3 | **1.7** | 1.5 |
| September | **-3.3** | -2.7 | **-7.2** | -5.3 | **-6.1** | -8.1 | **-5.4** | -10.9 | **1.7** | -1.0 | **-1.6** | 1.1 | **-1.5** | 0.8 | **5.0** | 2.6 | **-1.1** | 3.6 |
| October | **8.1** | 6.4 | **-4.5** | -0.3 | **-0.8** | 1.9 | **2.8** | 8.8 | **6.2** | 5.6 | **-0.4** | 1.5 | **3.5** | -1.6 | **6.3** | 3.5 | **8.2** | 1.7 |
| November | **2.8** | 2.0 | **-1.5** | -7.9 | **2.3** | 7.6 | **4.1** | 5.8 | **2.2** | 0.8 | **0.8** | 4.0 | **3.1** | 3.7 | **1.9** | 1.7 | **-3.6** | -4.2 |
| December | **9.8** | 5.9 | **2.3** | 0.5 | **6.5** | 0.9 | **-7.4** | -5.8 | **-0.4** | 5.3 | **-0.2** | 3.4 | **-1.3** | 0.0 | **1.4** | 1.4 | **-4.3** | -0.7 |
| YTD TOTAL | **31.0** | **21.0** | **-4.5** | **-9.1** | **16.5** | **-11.9** | **-22.2** | **-22.1** | **35.1** | **28.6** | **20.6** | **10.9** | **2.6** | **4.9** | **25.2** | **15.8** | **-3.2** | **5.5** |

| | 2008 | | 2009 | | 2010 | | 2011 | | 2012 | | 2013 | | 2014 | | 2015 | | 2016 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 | Kase Fund | S&P 500 |
| January | **1.9** | -5.9 | **-3.6** | -8.4 | **-1.6** | -3.6 | **-2.8** | 2.4 | **12.6** | 4.5 | **4.5** | 5.2 | **-2.2** | -3.5 | **-6.0** | -3.0 | **-7.4** | -5.0 |
| February | **-6.9** | -3.3 | **-8.9** | -10.8 | **7.3** | 3.1 | **4.1** | 3.4 | **-0.8** | 4.3 | **0.8** | 1.4 | **9.1** | 4.6 | **8.6** | 5.7 | **0.2** | -0.1 |
| March | **-2.3** | -0.5 | **2.9** | 9.0 | **4.6** | 6.0 | **-4.1** | 0.0 | **10.9** | 3.3 | **1.3** | 3.8 | **1.7** | 0.8 | **0.5** | -1.6 | **3.9** | 6.8 |
| April | **-0.9** | 4.9 | **20.1** | 9.6 | **-2.1** | 1.6 | **1.9** | 3.0 | **1.3** | -0.6 | **0.1** | 1.9 | **2.1** | 0.7 | **0.5** | 1.0 | **0.7** | 0.4 |
| May | **7.9** | 1.2 | **8.1** | 5.5 | **-2.6** | -8.0 | **-1.9** | -1.1 | **-13.6** | -6.0 | **2.8** | 2.3 | **2.6** | 2.3 | **-1.9** | 1.3 | **-0.3** | 1.8 |
| June | **-1.2** | -8.4 | **-5.0** | 0.2 | **4.5** | -5.2 | **-2.4** | -1.7 | **0.5** | 4.1 | **-1.0** | -1.3 | **-0.3** | 2.1 | **-4.5** | -1.9 | **-2.1** | 0.3 |
| July | **-2.5** | -0.9 | **6.8** | 7.6 | **3.5** | 7.0 | **-4.6** | -2.0 | **0.2** | 1.4 | **-0.1** | 5.1 | **2.0** | -1.4 | **-1.1** | 2.1 | **0.8** | 3.7 |
| August | **-3.3** | 1.3 | **6.3** | 3.6 | **-1.5** | -4.5 | **-13.9** | -5.4 | **-7.2** | 2.3 | **-5.8** | -2.9 | **-0.2** | 4.0 | **-2.9** | -6.0 | **0.1** | 0.1 |
| September | **15.9** | -9.1 | **5.9** | 3.7 | **1.7** | 8.9 | **-9.3** | -7.0 | **0.0** | 2.6 | **3.9** | 3.1 | **-1.7** | -1.4 | **-3.8** | -2.5 | **-3.3** | 0.0 |
| October | **-12.5** | -16.8 | **-1.9** | -1.8 | **-1.7** | 3.8 | **7.0** | 10.9 | **1.6** | -1.9 | **5.6** | 4.6 | **-1.4** | 2.5 | **8.2** | 8.4 | **1.8** | -1.8 |
| November | **-8.9** | -7.1 | **-1.2** | 6.0 | **-1.9** | 0.0 | **-0.6** | -0.2 | **-4.5** | 0.6 | **0.2** | 3.0 | **2.6** | 2.7 | **-1.7** | 0.3 | **9.3** | 3.7 |
| December | **-4.0** | 1.1 | **5.5** | 1.9 | **0.5** | 6.7 | **0.1** | 1.0 | **0.1** | 0.9 | **3.6** | 2.5 | **-0.4** | 0.3 | **-2.4** | -1.6 | **0.6** | 2.0 |
| YTD TOTAL | **-18.1** | **-37.0** | **37.1** | **26.5** | **10.5** | **15.1** | **-24.9** | **2.1** | **-1.7** | **16.0** | **16.6** | **32.4** | **13.7** | **13.7** | **-7.3** | **1.4** | **3.8** | **12.0** |

Past performance is not indicative of future results.

Note: Returns in 2001, 2003, 2009 and 2013-2016 reflect the benefit of the high-water mark, assuming an investor at inception.

# Appendix A: Top 10 Long Positions

Note: The stocks are listed in descending order of size as of 2/1/17.

**1) Mondelez**
Discussed in the body of the letter.

**2) CSX**
Discussed in the body of the letter.

**3) The Howard Hughes Corp.**
When General Growth Properties, our most successful investment ever, emerged from bankruptcy in early November 2010, it did so as two companies: General Growth Properties (GGP), which had all of the best malls, and Howard Hughes (HHC), a collection of 34 master planned communities, operating properties, and development opportunities in 18 states. Soon thereafter I sold GGP, but held onto HHC (thank goodness, as the stock has more than tripled since then) in the belief that while most of its properties are generating few if any cash flows and are thus very hard to value, the company has undervalued, high-quality assets in premier locations and that there are many value-creating opportunities that can be tapped.

In July and August 2012 I visited four of Howard Hughes's properties that account for two-thirds of the company's book value: Summerlin (Las Vegas), The Woodlands (Houston), Ward Centers (Honolulu), and South Street Seaport (NYC). In all cases, I was extremely impressed with the properties, the managers running them, and the development plans underway. I also got to know HHC's CEO, David Weinreb, who's a brilliant entrepreneur with a long, highly successful track record in real estate development.

At that time, when the stock was in the $65 range, I estimated (see this slide presentation) that HHC's intrinsic value was ~$125/share and loaded up on the stock. It was a great call, as the stock steadily rose to above $150 in mid-2014, where it stayed for most of the subsequent year. In 2016, however, the stock sold off hard amidst the market turmoil early in the year, falling to a low around $80 in mid-February before rallying to end the year essentially flat at $114.10.

The primary reason for the stock's decline was the collapse in the price of oil, which hit Houston hard, which in turn caused investors to fear the impact on two of HHC's major assets, master planned communities The Woodlands and Bridgeland, which are located just outside of the city. This concern has some merit – Houston has indeed been a weak market for HHC since then – but I believe the stock's selloff is very much overdone for a number of reasons:

- The Woodlands and Bridgeland are located in Houston's thriving suburbs and cater to a higher-income demographic;
- HHC carefully controls all development and sales in its Master Planned Communities, so there's low risk of overbuilding and distressed sales;
- The Houston MPCs account for only ~25% of HHC's total value, so the stock is cheap even if you value them at zero;
- The rest of HHC's portfolio is doing very well thanks to the company's superb execution. Development continues apace at Ward Center in Honolulu, Downtown Summerlin in Las

Vegas is booming, and perhaps most importantly the new Pier 17 at South Street Seaport is opening later this year (I recently took a tour and it's going to be spectacular!).

HHC is very difficult to value with precision, so I hesitate to give a precise number, but I'm highly confident that it's worth at least $150 and probably more than $200 (vs. today's price of $107.08) – and rising at a solid clip – so this is a stock I hope to own for many more years.

For more on HHC and its valuation, see these two well-done slide presentations by two bloggers, from February 2015 and February 2016.

**4) Berkshire Hathaway**
I've written many times about Berkshire in the past, so I will hit the highlights here and refer you to my latest slide presentation for an extensive discussion.

I estimate that Berkshire's intrinsic value has risen to $292,500/A share, based on ~$155,000 of investments per share plus 10 times the $13,750 the pre-tax earnings of the operating businesses. With the stock at $245,430 today, it trades 16% below intrinsic value.

I think the current price is moderately attractive for an extraordinary company that is very conservatively managed, growing at a decent clip, and which would benefit enormously if the corporate tax rate is cut. That said, the post-election run-up in the stock has made it less interesting than it was a year ago, when I aggressively bought it around $190,000/share, making it more than a 10% position. As the stock has risen and the discount to intrinsic value has closed, I've banked some profits and today the position is a bit under 6%.

**5) Fannie Mae**
In the midst of the financial crisis in late 2008, with Fannie Mae and Freddie Mac (the so-called government-sponsored entities or GSEs) teetering on the verge of bankruptcy, the government put them into conservatorship, providing them with open-ended lines of credit in exchange for 10% interest on any monies advanced (which ended up totaling $187 billion) plus warrants for 79.9% of each of their stocks. This was an important and necessary action that helped stabilize the housing market and financial system, so no one is challenging the terms of this bailout.

In August 2012, however, just before the GSEs started reporting enormous profits that would soon result in them repaying, with interest, every penny the government had advanced, the government announced (in something called the Third Amendment) that it was changing the terms of the deal and would, going forward, "sweep" 100% of the profits from the GSEs, effectively wiping out shareholders and preventing the GSEs from rebuilding their capital bases. Consequently, the GSEs have now repaid the government in full, plus interest, plus the government still owns warrants for 79.9% of their stocks, plus the government has pocketed *an additional $63 billion* from the companies (through September 2016).

Numerous shareholders have filed various lawsuits, which are winding their way through the courts, charging that the Third Amendment was an unwarranted and illegal seizure. The government's primary defense has been that its actions were essential to avoid a "death spiral" in the national housing market.

This is complete malarkey: by 2012, the crisis had passed, the housing market was recovering strongly, and the GSEs were having no difficulty accessing the capital markets. In reality, I am convinced that the government's actions were driven not by the fear that the GSEs were going to post ongoing losses, but precisely the opposite: because the GSEs were about to become *massively* profitable.

By imposing the Third Amendment, the government achieved two goals: a) it solved a political problem (it wouldn't have looked good for big hedge funds, who were by that point the GSEs' largest shareholders, to make billions from investments in entities bailed out by the government); and b) the government got access to tens of billions of dollars that it could spend as it saw fit.

If the government were honest about these reasons, however, a court would surely overturn the Third Amendment, so the government's attorneys have been making the "death spiral" argument while simultaneously fighting to keep confidential emails and other documents related to its decisions at the time, saying that their release could "have a destabilizing effect on the Nation's housing market and economy" and "easily could set off a chain of volatile and unpredictable reactions in the financial markets that could not be contained."

Again, this is total malarkey, but for the past few years, judges deferred to the government's confidentiality requests – until recently.

In a blistering reproach of Treasury and FHFA officials, in May the judge overseeing the primary lawsuit rejected the government's efforts to stonewall the plaintiffs (and the public), writing:

> While the court recognizes that protection of the Nation's financial markets and fledgling financial institutions were legitimate goals when the court first entered its order, with the passage of time, the potential for harm to the Nation's markets and then-fledgling financial institutions no longer exists. Instead of harm to the Nation resulting from disclosure, the only "harm" presented is the potential for criticism of an agency, institution, and the decision-makers of those entities. The court will not condone the misuse of a protective order as a shield to insulate public officials from criticism in the way they execute their public duties.

When the government was finally forced to reveal a small fraction of the documents the plaintiffs sought, it became clear why it had fought so hard to avoid doing so, as they're completely damning to its defense. As one article noted:

> In a deposition taken last July, for example, Susan McFarland, Fannie's former chief financial officer, said she told high-level officials at the Treasury on Aug. 9, 2012, that the company was, in fact, "now in a sustainable profitability, that we would be able to deliver sustainable profits over time."
>
> …In addition to telling Treasury officials in early August 2012 that Fannie would be able to sustain profits, Ms. McFarland said that Fannie could soon reap about $50 billion in income because of the reversal of an accounting entry, known as a deferred tax asset, required under accounting rules when the company began earning profits again.
>
> …In her deposition, Ms. McFarland said that she believed her conversation with the Treasury propelled the government to change the terms of the bailout to seize Fannie's and Freddie's

> profits. "When the amendment went into place," Ms. McFarland testified, "part of my reaction was they did that in response to my communication of our forecasts and the implication of those forecasts, that it was probably a desire not to allow capital to build up within the enterprises and not to allow the enterprises to recapitalize themselves."

The government, however, didn't turn over all of the documents the shareholders sought and instead appealed, but in a ruling two days ago three judges for the Court of Appeals for the Federal Circuit ruled unanimously that 48 of the 56 documents were not privileged and should be released to the plaintiffs, which should happen in the coming weeks.

I believe this marks a turning point. Now that the government's big lie has been exposed, the courts are likely to overturn this illegal seizure.

But it may not come to this, as the new Trump administration has indicated that it wants to strike a deal to liberate the GSEs from government control. Here's an excerpt from an interview that Steve Mnuchin, Trump's appointee to be our next Treasury Secretary, did with Maria Bartiromo shortly after the election:

> Maria: "Would you move to have these privatized?"
>
> Mnuchin: "Absolutely. We gotta get Fannie and Freddie out of government ownership. It makes no sense that these are owned by the government and have been controlled by the government for as long as they have. In many cases this displaces private lending in the mortgage markets and we need these entities that will be safe; so let me just be clear we'll make sure that when they're restructured they're absolutely safe and they don't get taken over again but we gotta get them out of government control."
>
> Maria: "This is a big deal. These are huge institutions. You think that…if we saw that as not complicated, wouldn't that have happened already…that it would get out of government?"
>
> Mnuchin: "Well, I think with this administration [Obama] it hasn't been a priority. If it had been a priority it would have. And in our administration it's right up there in the list of the top 10 things that we're going to get done and we'll get it done reasonably fast."

In either scenario, I think the stocks of the GSEs will appreciate *4-10 times* from here.

For more on the GSEs, I recommend this presentation that Bill Ackman of Pershing Square Capital Management gave in May 2014.

**6) Reading International**
RDI is a small ($384 million market cap), underfollowed (only one analyst), family-controlled business that owns and operates cinemas in the U.S. (#11 player), Australia (#4) and New Zealand (#3), from which the stable and healthy cash flow has been invested in a collection of real estate assets in these countries.

Simply putting a conservative market multiple on the cash flow generated by the cinema business gets one to around $14/share, only a small discount to today's price of $16.27, so the real question is: what's the real estate worth? My answer: a lot – but it's hard to know exactly how much. The two gems are both in New York City:

1) Cinemas 123, located on 3rd Avenue between $59^{th}$ and $60^{th}$ streets. RDI owns a 75% interest in a 7,907 sq. ft. parcel that currently hosts a three-theater cinema. The property is located in one of the most valuable areas of Manhattan, across from Bloomingdale's, and I believe it will soon be developed into a mixed-use retail and residential asset. I believe that it's easily worth an incremental $40 million to RDI, possibly double that.

2) 44 Union Square, located on the northeast corner of Union Square. RDI owns and is in the process of developing this unique property, which will have 65,000 leasable square feet. Here's a link to the company's marketing web site for the property. The one analyst who follows the company (from B. Riley) pegs the value of this property at $261 million or $11.19/share.

RDI's stock is trading at a substantial discount to its intrinsic value (which I estimate is in the mid-$20s) because, soon after the death of the patriarch of the controlling family in 2014, thermonuclear war broke out among his three children. The patriarch, Jim Cotter Sr., made his son, Jim Cotter Jr., his successor as CEO, but then his two daughters, Margaret and Ellen, ousted their brother and installed Ellen as the CEO.

I was so concerned about the behavior of the three siblings that I joined another shareholder and we filed an "intervention suit" with the goal of gathering information and protecting our (and other shareholders') interests. After reviewing thousands of documents and finding no smoking guns, we settled the suit late last year.

I was pleased to see an all-cash offer to buy the company for $18.50/share by the CEO of a major Russian theater chain, financed by prominent investment firms TPG Capital and the Santo Domingo Group. So far, the company has rebuffed the offer, but it provides intriguing upside.

**7) Platform Specialty Products**
Platform is a collection of "asset-light, high-touch" specialty chemicals businesses with a superb new CEO, Rakesh Sachdev (formerly the CEO of Sigma Aldrich), and a proven deal-doing chairman, Martin Franklin, of Jarden fame.

The company came into being in late 2013 when a SPAC headed by Franklin paid $1.8 billion to acquire MacDermid, a high-quality specialty chemicals business. Since then, PAH has acquired five additional businesses, Chemtura AgroSciences, Agriphar, Arysta, OM Group and Alent, and is now positioned as a leading global crop solutions business that offers a full product portfolio and diversity across crop varieties and geographies. The objective is to repeat what Franklin did with Jarden (resulting in investors making more than 30x their money) by being smart and strategic in acquiring and integrating other companies in the specialty chemicals industry.

I first purchased the stock ~$14 in late 2013 and, initially, everything went according to plan. Platform made a number of large acquisitions and in less than six months the stock doubled and remained in the mid- to high-$20s through May 2015…and then the wheels came off the bus, causing the stock to get obliterated, as it was in the crosshairs of the weakest sectors of the market, namely:

- Companies with exposure to emerging markets (especially China and Brazil), commodities, and/or the agricultural sector;
- Companies with a lot of debt;
- Serial acquirers that rely on their own high stock price and/or cheap debt to make acquisitions; and
- Stocks widely owned by hedge funds.

However, the company hasn't performed nearly as poorly as the stock. It was forced to reduce guidance a number of times, due almost entirely to factors beyond its control, but the high-margin, low cap ex businesses it owns continue to generate robust free cash flow, and Sachdev, Franklin and their team are rapidly cutting costs and improving operations. The company is certainly being affected by weakness in some of its markets and there will be no more acquisitions for a while in light of the high debt level and low share price, but that's okay, as there's plenty to digest.

Thus, I took advantage of the stock's weakness a year ago, buying aggressively in the $6-7 range, which has worked out well as it's now at $12.39. Thus, while the stock was down 23.5% in 2016, it was a material winner for our fund.

Franklin made investors in Jarden more than 30x their money by not only being a savvy acquirer, but also a great operating manager (and hiring others). Platform is now entering this latter phase and I think it's a good bet that the results over the next 2-3 years will be strong, allowing the company to pay down a meaningful amount of debt. If I'm right, then I think the stock is a double in the next couple of years.

**8) Spirit Airlines**
Spirit has 96 aircraft operating more than 400 daily flights to 59 destinations in the U.S., Latin America and the Caribbean. It is an ultra-low-cost carrier (ULCC), which is not to be confused with low-cost carriers like Southwest, JetBlue and Virgin America. ULCCs include Allegiant and Frontier in the U.S. and Ryanair and Easyjet in Europe.

Spirit has been growing like a weed, tripling its revenue and more than quadrupling its operating income since the 2009. More importantly, Spirit has an enormous growth runway in front of it. It serves only ~200 markets currently, but believes that more than 500 markets meet its threshold for growth. I don't doubt this and think that Spirit will continue to grow at a rapid clip for at least another decade, just as Ryanair has done in Europe over the past decade. If I'm right, then I expect Spirit's stock will perform along the same lines as Ryanair's.

My investment thesis can be summarized in one sentence: there are very few companies I'm aware of that are growing revenues at a double-digit rate, with 20%+ operating margins, ~25% returns on invested capital, with net cash positions, whose stocks are trading at a P/E of ~13x (it was less than 9x when I bought the stock in the fall of 2015).

Shortly after establishing this position, I gave a 74-slide presentation at the Robin Hood Investors Conference in November 2015, laying out my thesis on Spirit when the stock was at $33.77. In addition, I published three articles about the company, *Spirit Airlines Is Poised To Be*

*The Next Ryanair*, *An Analysis Of The Price War Between American And Spirit Airlines*, and *My Experience Flying Spirit Airlines This Week*.

The investment so far is playing out beautifully. The price war is easing, the market has reacted favorably to the new CEO, and the stock has risen smartly from the mid-$30s (our average cost is $36.80) to today's level of $53.88. We continue to hold a modest position, though I've banked some profits – I always remember the wisdom a former airline CEO shared with me: "You can't own airlines stocks; you can only rent them."

**9) Pershing Square Holdings**
Discussed in the body of the letter.

**10) SodaStream**
SodaStream manufactures home beverage carbonation systems, which enable consumers to easily transform ordinary tap water instantly into carbonated soft drinks and sparkling water. I think it's an excellent business: customers love it and it has an attractive razor-and-blade business model, as its carbonation machines require new CO2 cartridges a few times each year on average, which is a very high margin business for SodaStream.

The stock was a high-growth darling, soaring to over $70 in 2013. When it got cut in half to around $35 in mid-2014, I started buying. It turned out that I was much too early, as the stock declined steadily for the next 18 months, eventually falling to under $12 a year ago.

While I was very discouraged, I never lost faith and bought at various points on the way down, lastly around $13, very close to the bottom.

Since then, the company has reported strong earnings and the stock has gone parabolic, closing today at $44.51. I've been trimming the position and banking profits most of the way up, as the stock is no longer cheap, at 1.9x trailing revenues and 26.3x this year's earnings estimates, but there's a lot of business momentum here and the company is a good acquisition candidate, so I continue to hold a 2% position.

For more on SodaStream, see this presentation I made at the Robin Hood Investors Conference in October 2014.

# Appendix B: My Macro Views

I hesitate to share my current macro views because I don't want anyone to think that our fund's conservative positioning is primarily a bearish macro call. It isn't. That said, it *is* somewhat informed by my general view that there is a disconnect between the complacency in the markets and the risks in the world, so the compromise I chose was to put this section in an appendix rather than the main body of the letter.

**Overview**
Like everyone else, I read the newspapers and closely follow world events. There is never any shortage of economic, political and military turmoil, nor of gloom-and-doom prognosticators who remind me of Buffett's famous maxim: "Forecasts may tell you a great deal about the forecaster; they tell you nothing about the future." I also recall what Bill Miller once said: "If it's in the headlines, it's in the stock price."

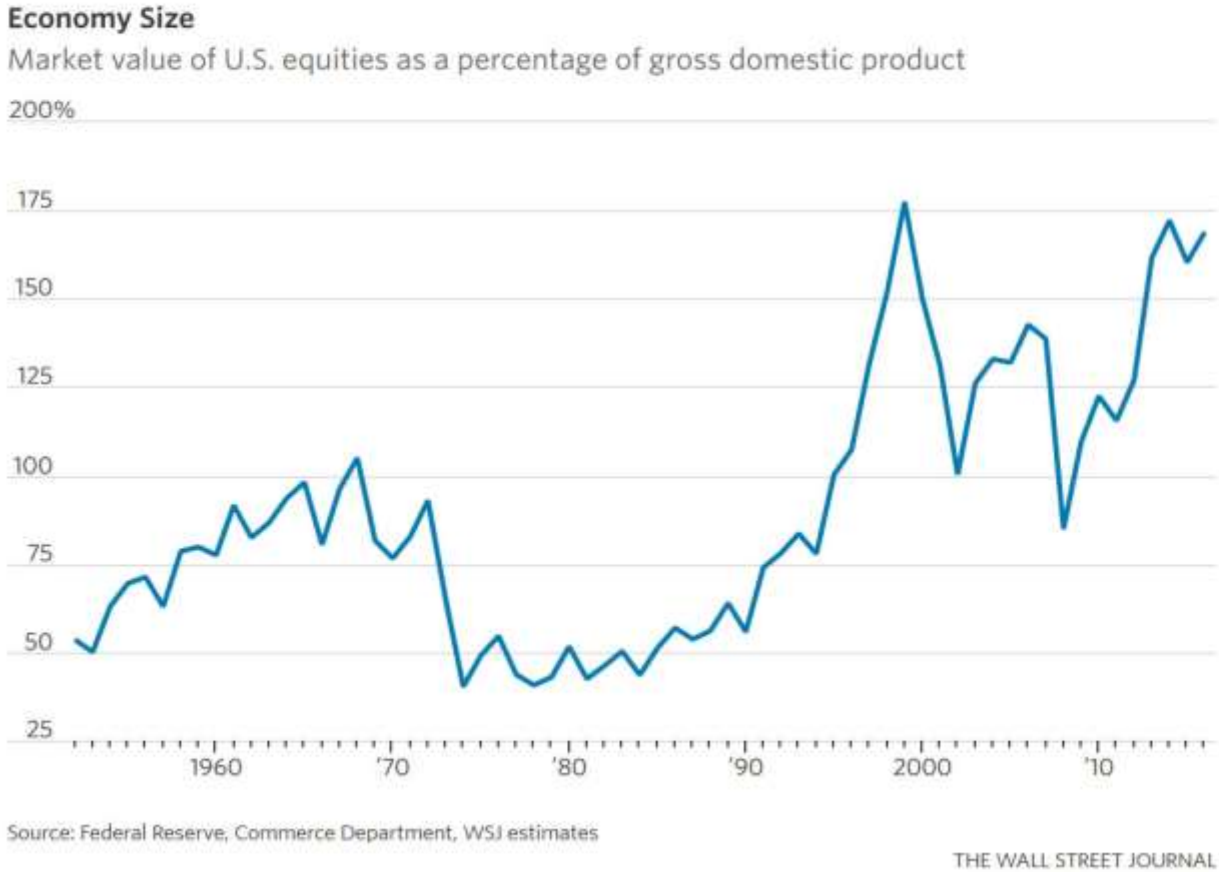
Thus, nearly all of the time, I ignore macro events and focus on being a good bottom-up stock picker, with only occasional exceptions in obvious, extreme cases such as the internet and housing bubbles. I don't think we're in such a situation now, so I am not battening down the hatches, but I do think there is reason for caution.

Setting aside the uncertainty associated with the new administration (discussed below), U.S. economic growth is anemic and corporate profit margins are under pressure. Despite this, however, I'm cautiously optimistic about the U.S. economy and markets – but much less so as I look around the world. Europe is a mess, with its stagnant economies, high unemployment, refugee crisis, terrorist attacks, rising nationalism, tremendous uncertainty about how (or even whether) Brexit will play out, and weak banks (nearly a decade after the financial crisis, Europe still hasn't cleaned up its banking system).

I'm even more bearish on the rest of the world: the Middle East, Russia, Japan and Brazil are even bigger messes, and China is a total wild card. I think the Chinese are among the hardest working, most capitalistic people on earth, and what the country has achieved economically in the past few decades is unprecedented in human history. But it's also an enormously corrupt kleptocracy with little rule of law, largely falsified/manipulated government and corporate statistics, significant imbalances, and numerous apparent bubbles (e.g., infrastructure and housing). And now there's the very real possibility of an economic and even military confrontation with the new Trump administration over trade, Taiwan and the Spratly Islands. I can't confidently predict how things will play out in China, but I can't rule out significant turmoil in the world's second-largest economy, which would no doubt impact economies and markets worldwide.

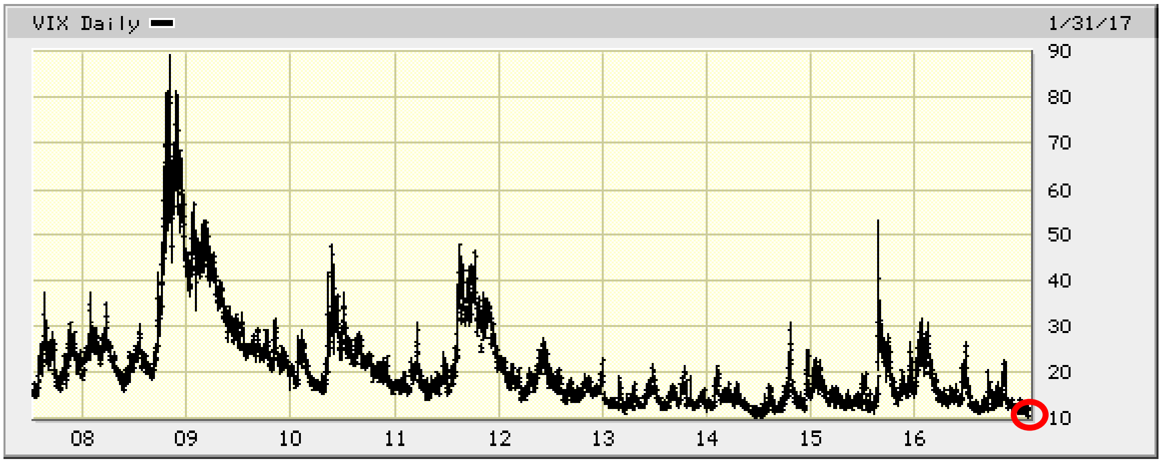
**Valuations**
Of course there are always risks, however, so the real question is: am I being compensated for these risks in the form of cheap stocks? The short answer is emphatically no. By any measure, stocks are fully valued (though, to be clear, I don't think we're in bubble territory).

This chart shows that the market value of U.S. stocks as a percentage of GDP is near an all-time high:




And this chart shows that the Shiller P/E ratio now exceeds 28x, a 15-year high:

Lastly, the CBOE Volatility Index (VIX), also known as the "fear gauge", is at historically low levels, indicating a high degree of investor complacency:




I'll conclude with Buffett's famous maxim: "Be fearful when others are greedy and greedy when others are fearful."

**Views on the Trump Administration**

Now I'd like to turn to the big question on every investor's mind: what impact will the new Trump administration have on stocks? The short answer is: I'm not sure.

Over the past year, I have studied Donald Trump intensely – his childhood, personal life, business career, presidential campaign, and what he's said and done since winning the election and taking office. As a result, I have extremely grave concerns (to say the least) about Trump's character, temperament, personality traits and patterns of behavior, as well as his policies and advisors.

Here is a slide I presented at the Robin Hood Investors Conference in November in which I tried to be even-handed in highlighting the potential pros and cons associated with Trump's personal characteristics and major policies:

| **Trump's promise** | **Upside** | **Downside** |
|---|---|---|
| Characteristics | | |
| Business, not political experience | Bloomberg | Berlusconi |
| Have an open mind | Better, non-ideological decisions | Decisions based on the last person who had input |
| Go with his gut | His gut in some areas has been very accurate | Bad decisions |
| Be unpredictable | Keeps enemies off balance | Uncertainty/chaos |
| Policies | | |
| Shake things up, drain the swamp | Washington needs shaking up/draining | Political turmoil |
| Renegotiate trade agreements | Better trade agreements | Trade war(s) |
| U.S.-first foreign policy | Benefits U.S. | Breakdown of post-WWII order |
| Reduce regulations | Unleash economic growth | Businesses running amok |
| Cut taxes & invest in infrastructure | Stimulate the economy | Higher deficits, inflation and/or interest rates |

My view is significantly tilted toward the downside. That said, my job as the steward of your capital isn't to form political opinions, but rather to make you money. While I have strong opinions about the man, I am much less sure what his impact will be on stocks – though I do think that there is: a) likely to be more volatility (perhaps a boom and then a bust, a common occurrence during his long business career); and b) materially greater risk of one or more events that really shock the market, such as a nuclear confrontation with China, a significant trade war, substantial domestic protests and violence, and/or the collapse of major alliances. These concerns are a secondary reason for our fund's conservative positioning today (the primary reason is that I haven't yet found enough super-cheap stocks to buy).

I acknowledge, however, that there's a credible bull case for U.S. stocks going forward. Our economy and corporations are in decent shape, but growth has been sluggish, some would argue in part due to high taxes, burdensome regulations, Obamacare and/or the feeling among many businesspeople that the Obama administration was anti-business.

Now, coming into power is an extremely aggressive President with a cabinet and advisors of mostly businesspeople, backed by control of both houses of Congress (plus the majority of governorships and state legislatures), promising the most pro-business agenda ever: huge cuts in taxes and regulations, stimulus spending on infrastructure, strong anti-labor positions, etc.

There's already evidence that this is leading to a sharp rise in business and consumer confidence. Regarding the former, in the aftermath of Trump's win, according to a survey by the National Federation of Independent Businesses, 50% of respondents, up from only 12% prior to the election, now expect better business conditions in the next six months. In addition, the small business optimism index had its biggest one-month gain in 37 years in December, hitting a 12-year high, as this chart shows:


Consumer confidence also climbed in December to the highest level since August 2001 as Americans were more upbeat about the outlook than at any time in the last 13 years, as this chart shows:


Given that consumption and business investment account for the lion's share of our GDP (69% and 17%, respectively), it's entirely possible that this soaring confidence could fuel a virtuous cycle of businesses expanding capital spending and boosting hiring and wages, plus consumers also increasing spending, which leads to a boom in economic growth and corporate profitability – and, no doubt, a soaring stock market.

Even if this happens however, it might prove to be a sugar high. Cutting regulations, for example, can boost corporate profits in the short run, but can eventually lead to calamities like the housing bubble and environmental damage. Similarly, tax cuts can boost profits and spending in the short run – but can lead to big budget deficits.

In conclusion, I'm open to the possibility that optimistic investors, who currently dominate the market, will be proven right – maybe Trump will surprise us and/or his advisors and our institutions will be strong enough to restrain him and/or our economy and corporate profits will do well irrespective of his behavior. America is very strong and we've thrived over the past 200+ years despite some very dysfunctional men serving as President.

I am certainly hoping for a positive outcome – but hope is not a strategy. The range of outcomes is wide, and investors would be foolish to assume that only the upside outcomes are possible/likely. I'm not predicting calamity, but I *am* predicting volatility, so I think investors are making a mistake to overlook President Trump's unconventional and erratic behavior and the many ways it could roil the markets.

I'm perfectly happy to invest in times of great uncertainty – for example, late 2008/early 2009 or even as recently as January and February last year – but only when I'm being compensated for it in the form of cheap stocks, which are as rare as hen's teeth these days, so I am investing our capital accordingly.

The T2 Accredited Fund, LP (dba the Kase Fund) (the "Fund") commenced operations on January 1, 1999. The Fund's investment objective is to achieve long-term after-tax capital appreciation commensurate with moderate risk, primarily by investing with a long-term perspective in a concentrated portfolio of U.S. stocks. In carrying out the Partnership's investment objective, the Investment Manager, T2 Partners Management, LP (dba Kase Capital Management), seeks to buy stocks at a steep discount to intrinsic value such that there is low risk of capital loss and significant upside potential. The primary focus of the Investment Manager is on the long-term fortunes of the companies in the Partnership's portfolio or which are otherwise followed by the Investment Manager, relative to the prices of their stocks.

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Performance results shown are for the Kase Fund and are presented net of all fees, including management and incentive fees, brokerage commissions, administrative expenses, and other operating expenses of the Fund. Net performance includes the reinvestment of all dividends, interest, and capital gains.

The fee schedule for the Investment Manager includes a 1% annual management fee and a 20% incentive fee allocation. In practice, the incentive fee is "earned" on an annual, not monthly, basis or upon a withdrawal from the Fund. Because some investors may have different fee arrangements and depending on the timing of a specific investment, net performance for an individual investor may vary from the net performance as stated herein.

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