BoyleCapital

January 27, 2020

Dear Fellow Investors,

What a difference a year makes! Portfolios and the overall market posted strong returns for 2019 following a challenging 2018. As we head into a new year and decade, there is reason for both optimism and caution. Markets clearly aren't as cheap as they were several years ago, yet our portfolios remain undervalued and poised for attractive returns as the decades long conservatorship of mortgage giants Fannie Mae and Freddie Mac grinds toward a completion and the incredibly cheap energy patch rebounds.

The biggest driver of returns for portfolios in 2019 was our investments in Fannie Mae and Freddie Mac (portfolios predominantly own the preferred stocks of Fannie and/or Freddie), which were up roughly 70% on the year as newly appointed FHFA Director Mark Calabria and the administration took the first steps toward an ultimate recapitalization of the mortgage giants. Heading into the new year, we expect further administrative progress to be made over the next six months including the hiring of a financial advisor by the FHFA and the finalization of a capital rule by the FHFA. Both are critical steps in setting the companies up for a successful re-IPO expected to occur in 2021. As to how that might look for our investments, Craig Phillips, former assistant to the Treasury Secretary and chief architect of the Treasury housing plan released last fall, provided some hints in an interview with Housing Finance Strategies last month. One of the keys to a successful exit of the companies from conservatorship, according to Phillips, is the fair treatment of the historic holders of common stock and junior preferred stock. Phillips specifically recommended:

"The junior preferred stock should be exchanged for common stock on a basis that is viewed as fair, based on capital markets standards and the prevailing market value of those securities. The U.S. Treasury should exercise its warrants to acquire 79.9% of the common stock of the GSEs, as agreed in the PSPAs. Since the beginning of the conservatorships, Treasury has received dividends totaling over $300 billion on its original capital infusion of $191 billion. Consequently, the liquidation preference of the senior preferred stock should be reduced to zero and the Treasury should be considered repaid. These actions are aligned with the interests of the U.S. Government to move forward in recapitalizing the GSEs."

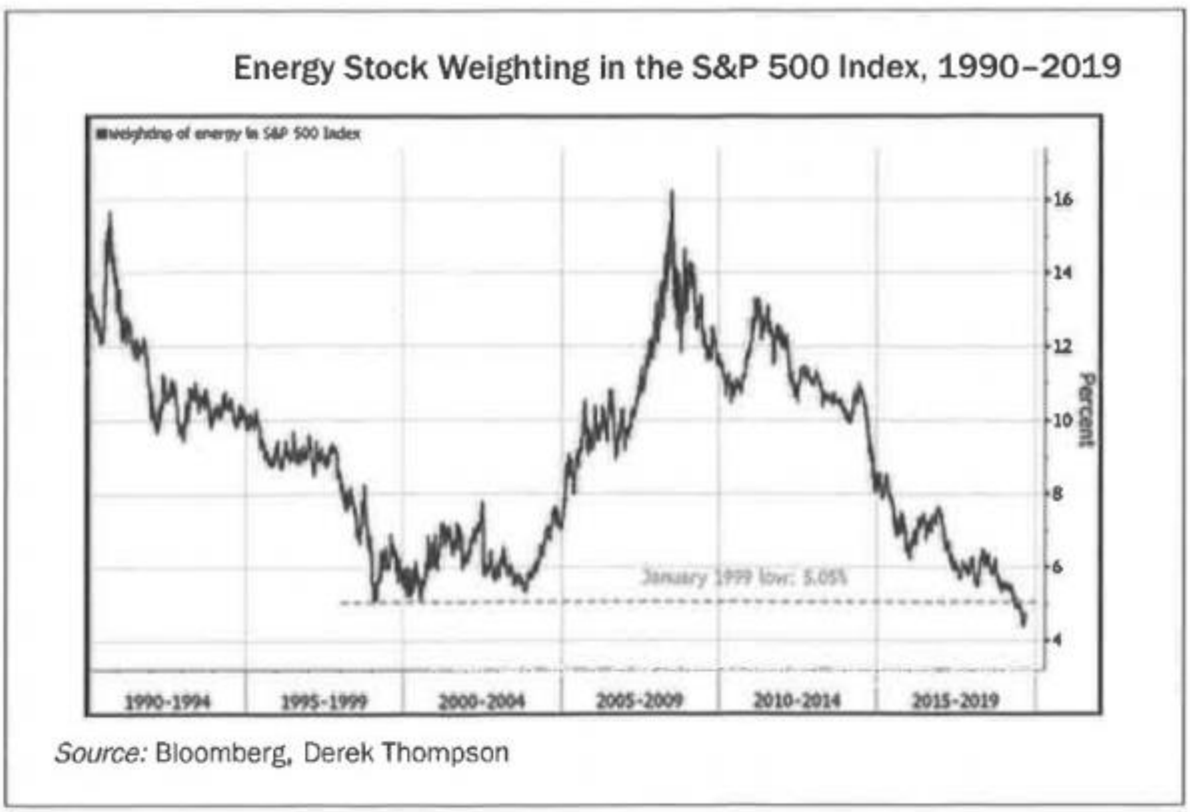
While it is true that Phillips is no longer part of the Treasury Department, and therefore not part of the discussion today, it is unlikely he was just shooting from the hip. As someone that was tasked with putting together the housing finance reform plan and who spent two years studying the issues, his suggestions are not to be taken lightly and generally align with our views on the eventual outcomes. The hiring of a financial advisor by the FHFA, which is expected within the next month, will be instrumental in working toward the endzone.

Hanging in the balance for the administration is the prospect of a historic legal judgement in favor of the shareholders. As noted last quarter, the 5th Circuit Court of Appeals declared the net worth sweep to be illegal and remanded the case back to the district court for further fact finding and a determination of damages. We look for the plaintiffs to file a request for summary judgement by the end of summer, increasing the pressure on the administration to settle the outstanding issues or roll the dice on the timing of a judgement that could stretch beyond a hundred billion dollars right in front of the upcoming election.

Given the election stakes, we expect the actors involved to take the necessary steps to make it nearly impossible for a different administration to unscramble the egg and pursue a different path. Those steps include the use of a consent decree to allow the entities to exit conservatorship this year, as well as another amendment to the Preferred Stock Purchase Agreement (PSPA) prior to year-end.

Despite last year's gains, Fannie and Freddie preferred shares remain at 50% of par value with arguably lower risk than a year ago. Housing starts in December were up more than 16% from 2018 to a level last seen in 2006 and the capital amounts at Fannie and Freddie continue to improve every quarter. Combined with favorable capital markets, the outlook has never been better for our GSE investments. As always, stay tuned for further updates.

From the good to the bad, our energy exposure has been a portfolio anchor though there is reason to believe the turn is near. At just north of 4% in the S&P 500, the energy sector has never been more unloved.



Source: Bloomberg, Derek Thompson

As such, capital flows have all but dried up for the space. For evidence, consider that in 2016 more than $30 billion was raised by North America exploration and production companies. Last year, the amount was barely $1 billion. These financial constraints, along with high decline rates, are starting to show in the growth of U.S. production, which has driven the global oil market over the past five years. Calling the turn is impossible, but capital to a business is like oxygen to a room; eventually it matters.

In a wide-ranging Barron's interview in early December, the legendary Peter Lynch said he believes oil, energy services and natural gas can provide triples. According to Lynch, "everybody assumes the world's not going to use oil for the next 20 years, or five years, or next year. China might sell five million electric vehicles next year, but they might also sell 17 million internal combustion engines. They don't have old cars to retire. There are no electric airplanes. Longer term, solar, windmills really work. But you need natural gas and oil to bridge to this."

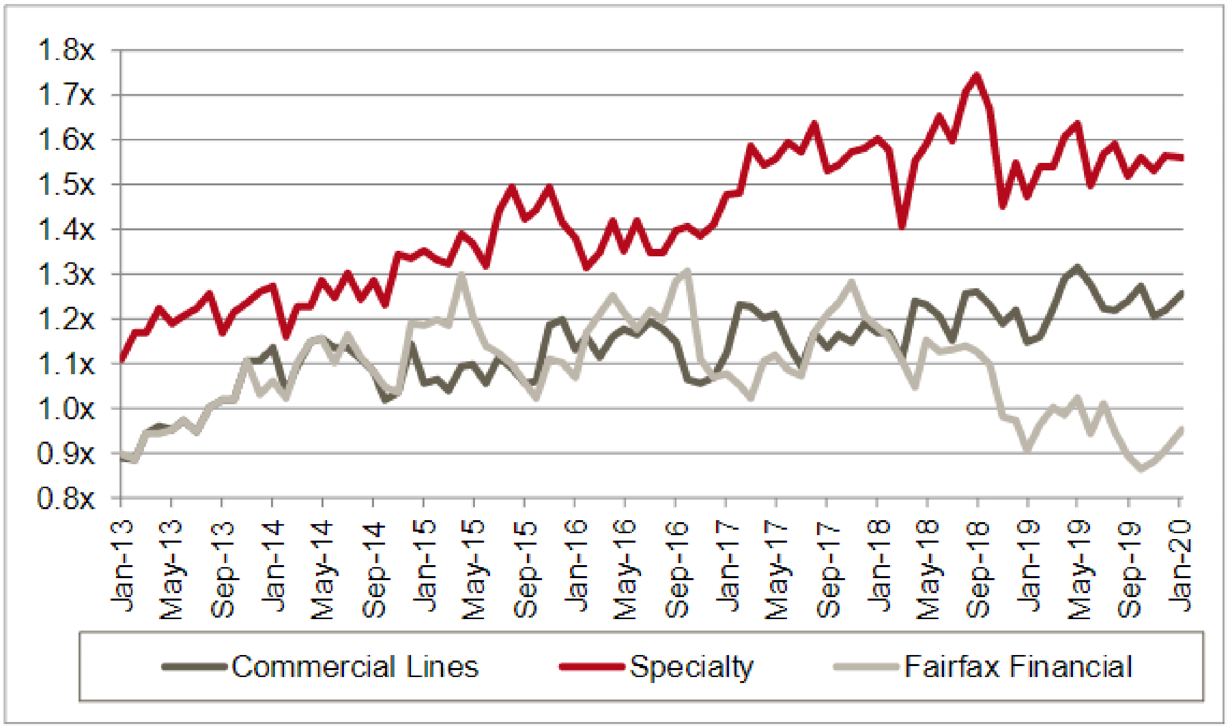
Lynch's former company, Fidelity Investments, is among the largest owners of portfolio holding Birchcliff Energy, which is near all-time lows despite posting strong results in 2019. Weighing on shares recently was the release of its 2020 capital budget which emphasized higher capital expenditures in 2020 at a time when capital constraint is the major focus by investors.

This contrarian decision sets the stage for significant free cash flow in 2021 and beyond as the company will look to fill the remaining spare capacity of the 100% owned and operated infrastructure throughout 2020 and 2021 and then flip the switch to cash flow harvesting mode whereby the management forecasted cumulative free cash flow over the five years starting 2020 is $760 million using $60 WTI, $2.10/GJ AECO, and $2.50 DAWN/NYMEX gas pricing. At today's strip pricing, cumulative free cash flow over the five-year period would be $325 million. Assuming the midpoint of the two numbers, Birchcliff has the potential to generate more free cash flow over the next five years than the current market cap of the company. Absent a collapse in commodity prices from here (which would be short lived given the aforementioned capital constraints), it is likely shares are near a bottom. If not, don't be surprised if a suitor comes knocking.

Other portfolio holdings of significance include Berkshire Hathaway and Fairfax Financial. In the case of Berkshire, we added to our holding recently after trimming our position in Bank of America. As explained in our trade note, Berkshire Hathaway's investments in Bank of America and Apple saw substantial appreciation throughout 2019 while Berkshire shares were up modestly. In fact, 2019 was the sixth worst performance for Berkshire relative to the S&P 500 since 1965. The last time that Berkshire underperformed the S&P 500 as poorly as it did last year was in 2009. The following three years, Berkshire enjoyed substantial outperformance as it played catch up. Sitting on a cash pile of roughly $130 billion, Berkshire is itching for something to do. When the time is right, we think Buffett will be in the center of the recapitalization of Fannie and Freddie. In the meantime, Berkshire shares are not overly expensive and provide substantial optionality should markets pullback.

Much like Berkshire, Fairfax shares lagged the broader market despite substantial appreciation in underlying portfolio holdings. As a result, shares have rarely been cheaper on an absolute basis and in relation to peers. We expect the disconnect to close in the quarters ahead.

P&C Insurance Price/Book Value Multiples



Source: Cormark Securities Inc.

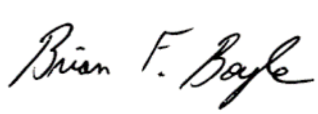
Summary

As we move into a new decade, many investors are forgetting that price eventually matters. A large part of the market today is focused in a handful of large cap technology companies. Dominant as they might be, fundamentals mean nothing if share prices are too high. History is littered with excellent businesses that went through long periods of little or no investment return. Every decade or so, it seems investors are reminded.

Our portfolio holdings are inexpensively priced and with housing finance reform expected to take another leap forward this year, we believe we are positioned to build on the strong gains from 2019.

All of us at Boyle Capital send our best wishes for a happy, healthy and prosperous 2020.

Sincerely,



Brian F. Boyle, CFA