AVENIR CORPORATION

INVESTMENT MANAGERS

February 2018

To Our Friends and Fellow Investors,

U.S. equity markets enjoyed a remarkably strong year in 2017, and, with the passage of the tax act at the end of the year, continued their upward trend in January only to sharply reverse course in early February. The recent downdraft, spurred by renewed concerns of rising interest rates and inflation, appears to be an overdue correction for a market that has risen steadily for over a year. Indeed, after years of sub-par economic performance following the great recession, the pro-growth agenda of the administration combined with deregulation and tax cuts has spurred both business and consumer confidence to multi-year highs.

The tax cut, which reduced corporate rates from 35% to 21%, is significant as it both increases corporate valuations on an absolute basis and removes uncertainty around tax policy for the foreseeable future. Companies are responding with announcements of new investment, wage increases and one-time bonuses for employees. In short, the tax cut is stimulative in the near term, which augers well for continued economic growth over the next year or so, and places U.S. companies on an even footing with international peers from a tax perspective, meaning that overseas capital and future earnings are likely coming back to the U.S. However, the tax cut came at a cost of longer term fiscal stability. Economists estimate that the tax cut will add approximately $1.5 trillion to the national debt, and it remains to be seen if the near term growth spurt will be enough to offset the absolute increase in future obligations.

Coincidentally, after years of crisis and slumber, global growth perked up significantly in 2017. According to the IMF, the global economy rose 3.7% in 2017, its strongest gain since 2011, and is expected to gain 3.9 % this year. Stock markets are up significantly around the world, commodity prices are up while interest rates and inflation have remained low. Underlying this growth is easy money: some central banks led by the U.S. have started raising interest rates, but the European Central Bank and Japan remain highly accommodative. The low interest rate environment around the world has led to a global search for yield which has elevated all asset classes and correspondingly made certain sectors acutely vulnerable to a shift in perceptions about interest rates.

As is well known, in response to the global financial crisis, the U.S. Federal Reserve took extraordinary measures to protect the economy from collapse. Today, nearly ten years later, the Fed is faced with the difficult task of unwinding the measures put in place without unduly disrupting asset markets. In the near term, the market most at risk is the U.S. Treasury market. As the Fed slowly lifts interest rates, bond prices should react accordingly. If the Fed moves too fast, or if economic growth fails to keep pace, then other credit and equity markets will react negatively, and under any scenario, the prospect of rising rates will increase volatility across all markets. As noted above, fears of rising rates are sending shivers through financial markets, piercing the calm that accompanied the market’s steady rise over the past year.

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Meanwhile, as financial markets around the world have benefitted from coordinated central bank monetary policies designed to keep interest rates low, governments' fiscal policies have not kept pace. In almost every country, government debt as a percentage of GDP is at or near all-time highs. While we welcome the return to global economic growth, we are skeptical that the recent upturn in growth is sustainable given the absolute levels of debt around the world. Moreover, we share many economists' concerns that when the next crisis comes, governments including ours have become so indebted that their ability to respond will be much more limited than in previous periods.

Valuation

The powerful combination of low interest rates, tax cuts and improved confidence propelled equity markets to new highs in 2017, while volatility reached all-time lows. In general, valuations are elevated, though in light of current interest rates, not extreme. We have anticipated a return to a more normal market environment and are focusing our attention on areas that remain attractive. Specifically, though volatility has remained subdued until recently, technology and innovation continue to disrupt and foster change in many industries, creating interesting opportunities in retail, media and telecommunications, among others. Secular trends toward mobility and the use of data have given rise to new business models which threaten and often destroy many established businesses unprepared for change. This creative destruction is occurring across numerous industries and is healthy for the economy as a whole. Change is often unpleasant for those on the losing end, which presents problems for policy makers and society to the extent it fosters populism, but for investors, however, change presents opportunities as businesses in industries in the midst of disruption are often mispriced. Avenir's investments in telecommunications infrastructure, data centers and related enterprises are well positioned for the secular changes in the information technology sector, while our investments in the retail sector are positioned to benefit both because of and despite the fundamental shifts to on-line throughout the sector.

In fact, it is clear that the pace of change across nearly every sector of the economy is accelerating as the increasingly data driven economy leads to the development of new services and innovative ways of interacting with consumers. The most illuminating recent example is the emergence of Bitcoin, which is a cryptocurrency based on an underlying software technology called blockchain. Developed several years ago, blockchain technology is essentially a digital ledger that may have many potential applications in financial services and other industries where there are cumbersome transaction and recording processes. It is less clear how the cryptocurrency called Bitcoin and its peers, which are essentially software applications built on top of blockchain technology, will fare over time. However, Bitcoin and blockchain are often conflated and used interchangeably by enthusiasts and early adopters who have embraced this new technology as a means of exchange. It is reminiscent of the early days of the internet, when various ideas were put forth on how to capitalize on the new information technology, some sustainable and with us today, and others long gone and forgotten. We are paying close attention to how blockchain, Bitcoin and related technologies may filter into the real economy, and we remain acutely aware of how data driven change is affecting our current and prospective investments.

In the near term, we expect businesses to continue to perform well, aided by a more friendly tax regime which supports fundamental strength in corporate earnings. Though there is some evidence of wage increases, a significant uptick in inflation does not appear imminent. Rising

interest rates, led by Fed policy as well as market driven activity, are a long term concern, especially as fears about rising interest rates often cause unsettling market gyrations. Interest rates have been unusually low for so long that any move up appears significant; however, for the foreseeable future, interest rates are expected to remain low in absolute terms. Apart from general concerns about interest rates and inflation, potential disruptions to an otherwise rosy economic outlook are expected and will likely be political, social or related to an international crisis. Indeed, the relative calmness extant in financial markets over the past year or so is in sharp contrast to the heated political divisions and conflicting views on the state and direction of the U.S. economy. Further confounding financial markets, the intense rhetoric over international trade, immigration and geopolitical hotspots has yet to spill over to the current market environment. The relative calm of the past year was an anomaly. Financial markets fluctuate, and we think that the return of volatility, while unsettling at times, will provide opportunities to invest in new ideas and take advantage of dislocations.

We are grateful for the opportunity to work with you and look forward to hearing from you soon.

Respectfully,

Peter C. Keefe James H. Rooney

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