Poplar Forest Partners Strategy Quarterly Update

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September 30, 2016

Poplar Forest Capital

Dear Partner,

In the small town where I grew up, having your own car seemed like a path to freedom and happiness. I suppose that's why my father refused to allow me to buy one. As he saw it, a car would lead to girls and drinking and he feared my schoolwork would suffer. I did get to drive my mother's old Pinto station wagon to school and work, but it certainly did not attract girls. There was an upside; my parents promised to buy me a car if I achieved a 3.0 or better in my first year of college.

As we loaded my belongings into my father's pickup truck at the end of freshman year, I noticed new license plates on the dashboard that read "J DALE" - I was getting a car! The details were withheld until we got home. After we unpacked the truck, Dad took me to the machine shop where my reward was being repainted. That 1973 Chevy Caprice Classic convertible was a thing of beauty - fire engine red with a white top. Admittedly, it was 11 years old and got maybe 8 miles to the gallon, but it could also seat 6-7 people comfortably. Needless to say, it was a hit when I rolled into the fraternity parking lot for the start of my second year at school.

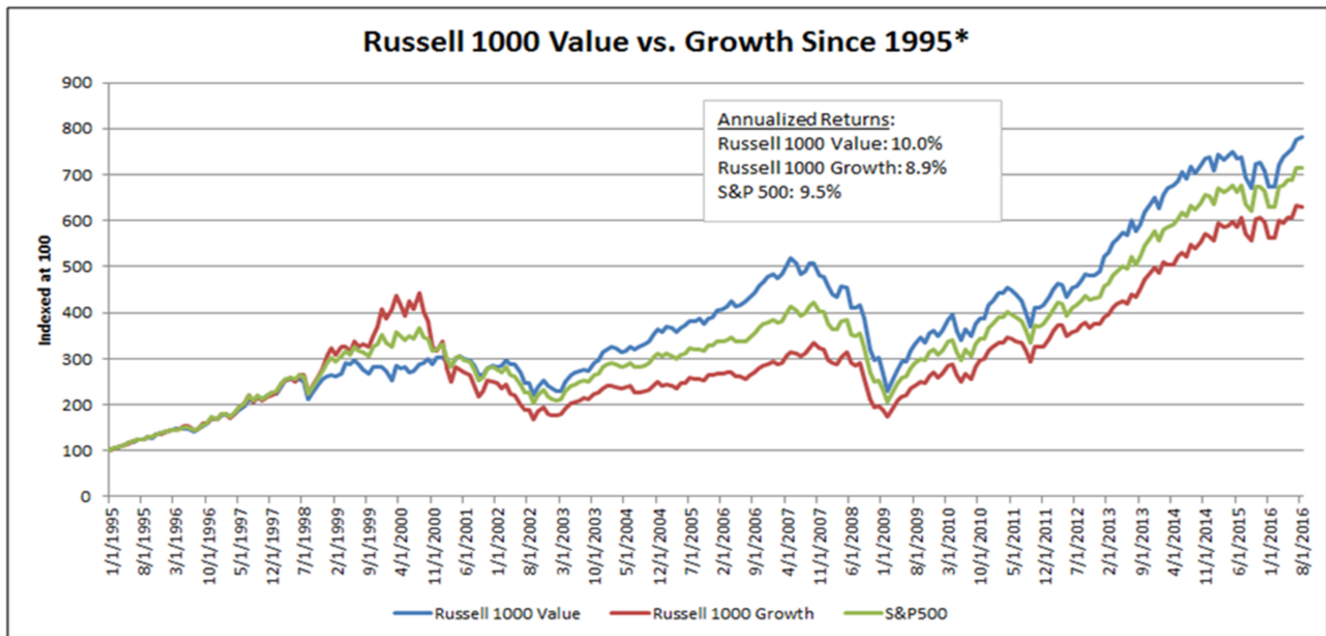
My love affair with that car sadly ended when I graduated. I was headed to New York City and having a land yacht in Manhattan just wasn't practical. Besides, I needed the money. So I sold my beloved red convertible. Four years later, the situation had changed - I was approaching the end of graduate school in Boston and would soon be moving to Los Angeles for a job - I was going to need a car.

There were 12 inches of snow on the ground on that late March day when I headed out to find a used red convertible I could afford. The Chrysler salesman could hardly believe his ears. "Sure'" he said, "you can take the used La Baron for a spin." It was freezing cold, but I still put the top down for the test drive. The car had been on the lot for months and there weren't many prospective convertible buyers in late winter in Boston. They were so anxious to sell it that they gave me a great price. What’s more, they let me put the down payment on my credit card, financed the rest, and agreed to make the first two payments. In the intervening 25 years, I've owned a succession of red convertibles with "J DALE" plates. Though I'm always sensitive to price, I've never gotten as good a deal as I did on that cold winter day.

I wouldn’t call myself a “car guy”, but I love to cruise down the highway on a sunny day with the top down and great tunes playing. I have a hard time imagining myself in one of the driverless vehicles that are getting so much press these days. Automobiles have become ever more sophisticated for decades and I suspect Henry Ford would be amazed at what is packed into today’s new vehicles. I really appreciate my car's navigation system and rear view camera, but I'm not ready to give up the wheel. While I acknowledge a computer directed vehicle may be safer than one piloted by a distracted driver, isn't a better solution to eliminate distractions?

Just as new technology has improved the driving experience, innovation has also improved investors’ returns. Index funds have now been around for 40 years and they have certainly saved clients’ money while avoiding the underperformance that can come with a poorly managed fund. Index funds have given rise to new investment vehicles like ETFs (exchange traded funds) which allow investors to buy and sell baskets of stocks at any minute of the trading day. Index funds have also grown more

sophisticated with "smart beta" and "factor" based portfolios available to those wanting to slice the market different ways. Most of these new investment choices are lower in cost because they don't rely on humans for decision making. Just as a computer directed car may be safer than one steered by a distracted driver, computer orchestrated investing may produce better outcomes than poorly managed investment strategies. For many investors, simply getting an "average" return is an improvement; I've always strived to do far better than average.



Note: Russell 1000 Value and Growth index performance data from FTSE Russell. S&P500 index returns from CapitalIQ. All returns are US based. Chart and annualized returns (gross) are from January 1, 1995 to August 31, 2016. Gross returns assume dividends are reinvested. **Past performance does not guarantee future results.**

Though it doesn't work every year, value investing has demonstrated an ability to deliver market beating results over long periods of time, as you can see above. We believe the current environment offers a particularly compelling opportunity for value stocks. The general premise is simple: statistically cheap stocks reflect low expectations. If the future turns out to be better, which can often happen when expectations are low, then the stock will often move higher. As a contrarian value investor, I've watched with interest the development of factor based ETFs like the iShares Edge MSCI USA Value Factor ETF. That fund's prospectus states that it "seeks to track the investment results of an index composed of U.S. large- and mid-capitalization stocks with value characteristics and relative lower valuations." The supporting documents summarize the stock selection process as "combining the z-scores of the three valuation descriptors, namely Forward Price to Earnings, Enterprise Value/Operating Cash Flows and Price to Book Value." BlackRock, the sponsor of the Value ETF, charges 0.15% per year for a fund that seeks to merely track the performance of an index of value stocks. While "combining z-scores" may sound impressive, I think Poplar Forest's active investment process may produce index-beating returns after expenses.

How We Steer Our Portfolios

We have access to the same type of data used in the creation of the MSCI USA Enhanced Value Index, but we don't just buy a stock because a computer algorithm says to. **Computers may be good at identifying statistically cheap stocks, but many of those stocks are cheap for good reasons**. For example, as of June 30, 2016, General Motors and Ford accounted for 5.4% of the iShares Value ETF. We acknowledge that those stocks look cheap, as they are trading at around 7x earnings, but we worry that their profits may decline from here given U.S. auto sales are at all time high levels.

At Poplar Forest, we're focused on delivering results that can't be replicated by a computer algorithm. We spend our time investigating companies with the goal of distinguishing the "cheap for good reason" from the real bargains (like a red convertible on a cold winter day). We spend a great deal of our time evaluating businesses that have produced disappointing results – the proverbial car with a wheel in the ditch. Sometimes disappointing results signify a broken axle, but occasionally it's just a blown tire that can be repaired. The share price of a good company suffering from weak short-term results may not look statistically cheap, but when the business is fixed and results improve, that out-of-favor purchase may end up looking like a real bargain in hindsight.

During the recent quarter, for example, we invested in Ralph Lauren, whose stock had declined 50% from its high in late 2014. In prior years, management had wanted the business to grow at what turned out to be a higher than prudent rate and, as a result, they introduced too many new products. An impressive new management team was recently hired to clean up the resulting mess. The new team quickly decided to simplify the product line which resulted in reduced sales this year. Profits declined as revenues fell. This company has enjoyed profit margins of 15% or more for years, but the repositioning of the business has resulted in currently depressed margins of just 10%. As this turnaround takes hold, we expect revenues to start growing again and margins to recover to prior levels. If we are right in our assessment of the company's outlook, margin expansion alone seems sufficient to drive a mid-teens earnings growth rate over the next three years. Sales growth and the deployment of free cash flow will hopefully add to that growth rate. With a P/E ratio roughly in line with the S&P 500®, the stock doesn't look like a traditional "value" stock. In our view, the current valuation is misleading because earnings are depressed. We are excited that the margin recovery potential could allow us to earn a better than 20% annual return on our investment in the coming few years.

While many observers fret because the 500 stocks in the S&P collectively look a little pricey and their profit margins look high, our investment process has continued to identify individual companies, like the one described above, that appear to offer far different prospects than the stock market as a whole. The bottom up, research-intensive investment process we use can't be replicated by computer. It takes a lot of time and effort by our six person investment team to find, analyze and stay current with our investments, but since we limit ourselves to high conviction portfolios of 25-35 individual stocks, it works. As a practical matter, once we've invested in a company, we tend to own it for about four years. With roughly 30 stocks and an average four year holding period, we need just 7-8 great new ideas a year to keep our strategy running on all cylinders. I'm thrilled to work with a great group of patient, talented, and

experienced professionals who believe in what we do and who've all joined me in investing their own hard-earned money in our funds.

I started investing in stocks when I was in high school. In college, I dug into the work of Graham and Dodd (the original proponents of buying statistically cheap stocks) and John Neff, a legendary value investor. I also studied Warren Buffett who built on Graham and Dodd's work by demonstrating that value is more than just buying statistically cheap stocks: a bargain can sometimes involve paying a little more for a good business with above average prospects – provided those prospects are under-appreciated by the market. This foundation combined with first hand exposure to great portfolio managers at the Capital Group/American Funds led me to develop an investment process I've now been using for more than 20 years. My goal: market-beating, long-term investment results.

Judging the success of an investment strategy isn't as easy as you might believe. The biggest challenge is in distinguishing stock picking skill from general market movements. Sanford Bernstein, a Wall Street research and investment firm, recently tried to tackle this challenge in a newly published study entitled "What is Worth Paying For in an Asset Manager" Their work systematically dissects a fund's investment results into "factors" and "idiosyncratic alpha." The "factors" (value, momentum, quality, and low volatility) can be cheaply replicated by a computer directed ETF. The "idiosyncratic" piece can't be explained by an algorithm – it's the piece of the puzzle that truly reflects human inputs. That's what we do at Poplar Forest: we pick stocks based on more than numerical data by employing our own qualitative analysis and judgment.

We asked Bernstein to use their system to evaluate the fund. Unsurprisingly, our historic results were highly correlated with the "value factor" – in other words, we are value investors. Beyond that, Bernstein found that, in their study period of March 2011 through June 2016, the fund demonstrated statistically significant "idiosyncratic alpha" (excess return relative to a benchmark) of roughly 3.6% per year (before fees) relative to an equal weighted basket of the four factor ETFs. For over 20 years, I've believed that my investment process would produce market beating returns and now Bernstein has produced statistically significant evidence that it has. For more details on their methodology, please see Bernstein's report: "Fund Management Strategy: Examining Idiosyncratic Returns in the US Market."

The Road Ahead

Bob Kirby, a former Capital Group colleague and an outstanding money manager, was also a passionate race car driver. He often noted that racing and investing are similar in that, as he put it, "You have to finish to win." That mindset has long been a part of my investment process as expressed in self-imposed restrictions to build portfolios with at least 85% dividend paying and at least 85% investment grade rated companies. Focusing on sustainable free cash flow and on the price paid relative to the perceived value received are also factors that I believe help ensure we "finish the race."

At this point in the economic cycle, and with the stock market near all-time high levels, protecting against downside risk is a growing factor in our investment process. As a first step, and as a measure of

increased conservativism, we are building a 2018 recession into our base case financial forecasts. We don't currently see the preconditions for a recession, but we want to make sure that we have our eyes open to the potential downside risks in the portfolio in case a recession develops unexpectedly. If the economy continues to grow as we expect, the results generated by the companies we invest in could be even better than forecast. In addition, we recently started a series of internal meetings focused solely on a systematic review of variables that could be early indicators of recession.

Our operating premise is that recessions occur when a sector (or sectors) of the economy is operating at an over safe speed. This was the case with housing in 2005-2007 and technology in 1997-1999. At this point in time, the auto business seems to be running a little hot, but a slowdown there wouldn't seem sufficient to bring on a recession. More generally, we expect the economy to largely continue on its current path of moderate growth, slowly rising inflation and rolling corrections within particular industries (like energy and industrials recently) that keep the U.S. economic engine from over-heating. Provided the engine doesn't get too hot, we are likely a long way from needing a recessionary pit stop.

We've also considered an environment in which the economy grows at such a slow speed that interest rates stay "lower for longer." With financial services companies making up a large part of our portfolios, we sometimes get questions about how we'd fare in such an environment. Given the valuations on our core financial service investments, I think we are being more than adequately compensated for the risk of such an outcome. These stocks are valued at around 7-8x earnings and 70-80% of book value. If interest rates remain low, earnings growth will be low, but we believe deployment of free cash flow should allow us to earn a roughly 10% rate of return. If interest rates move back to historic premiums relative to inflation, as we expect, we believe we'll enjoy far better returns from these investments - in short, the risk/reward ratio seems skewed in our favor.

While we are spending a little more time looking for recessionary road signs, our focus remains on bottom-up stock selection. We continue to be drawn to prospective investments that hinge on "self-help" factors like those involved in the turnaround of Ralph Lauren that I discussed earlier. At a time when many advisors and investors seem understandably nervous about the market as a whole, we have a decidedly different outlook due to our selectivity; we don't own 500 stocks, or 150 – we build portfolios of 25-35 stocks that we've carefully chosen. Our knowledge of the circumstances of company specific factors makes us enthused about the prospects for our portfolio. We've enjoyed market-beating results through the first nine months of this year, and we hope to generate strong gains in the years to come.

The total return of an investment can be broken down into two key components: fundamentals and valuation changes. We break fundamentals down into organic sales growth, profitability and deployment of free cash flow. When looking at our portfolio relative to the broad market, we believe improved profitability will be the key driver of our results in coming years. We expect profitability improvements to contribute roughly 7% a year to the weighted average EPS growth of companies in the portfolio in 2017-2020. On top of that, we assume revenue growth consistent with a slow growing economy and a modest contribution from the deployment of free cash flow. If we are correct in our assessment, the companies in our portfolio could produce double digit annual earnings growth in the next three years. This growth,

combined with a reasonable dividend yield and a discounted valuation relative to the broad market, may be a recipe for market-beating results.

We appreciate the patience of our client partners who understand that even great investment processes don't beat the market every year. So far, 2016 has been a year in which your patience has been rewarded. Of course, we've got many miles to go, but in my opinion, the outlook is bright. It's a beautiful sunny day. The tank is full of gas and Waze (another technological marvel on which I rely) says traffic is light. I've got the top down and Tom Petty's *Runnin' Down a Dream* is playing at top volume. There is plenty of room in the car so I hope you'll settle in and enjoy the ride. I look forward to sharing a long and successful road trip with all of you.

Thank you for your continued confidence in Poplar Forest.

Dale

J. Dale Harvey

October 3, 2016

Contrarian Value- Partners Strategy

Poplar Forest Capital
Contrarian Value - Partners Strategy
Average Annual Total Returns as of September 30, 2016

	QTR	YTD	1YR	3YR	5YR	Annualized Since Inception (11/1/2007)
Composite Gross	8.93%	15.51%	22.50%	10.36%	18.69%	8.17%
Composite Net	8.67%	14.66%	21.30%	9.27%	17.48%	7.00%
S&P 500	3.85%	7.84%	15.43%	11.16%	16.37%	6.13%
Russell 1000 Value	3.48%	10.00%	16.20%	9.70%	16.15%	4.99%

Past Performance is not indicative of future results and individual account performance may vary. Please see additional disclosures at the back of this document.

In my last few letters, I've shared with readers our belief that we were on the verge of a multi-year period when value strategies, like that followed by Poplar Forest, would produce market beating returns. So far this year, that has been the case as evidenced by the Russell 1000® Value Index producing a superior return relative to the S&P 500® Index. While the S&P has produced a respectable gain of 7.84% in the nine months ending September 30, 2016, the Value index generated an even better 10.00% return. In comparison, the Partners Strategy delivered a 14.66% return.

These results are all the more satisfying given that financial service companies, our largest sector exposure, were a headwind to our results over the last nine months. We continue to feel that the risk/reward tradeoff for this group is highly compelling as the stocks seem to embed expectations for interest rates to stay at a very low level for the foreseeable future. If the U.S. Federal Reserve continues to hold rates steady, we still believe given their valuations, the finance stocks we own will produce results at least in line with the market. If, however, the Fed starts to normalize monetary policy by raising rates, these stocks may be big winners.

At the individual stock level, the biggest detractors for the nine months ending September 30, 2016 were: American International Group (financial), Citigroup (financial), Lincoln National (financial), MetLife (financial), and WPX Energy (energy). Early this year, we sold WPX and reinvested the proceeds into Devon Energy as we believed that Devon offered comparable upside with much less downside relative to WPX. That trade allowed us to capture a tax loss while also improving, in our opinion, the risk/reward ratio of the portfolio.

The top positive contributors to the Strategy's results for the nine months ending September 30, 2016 were spread across industries: Hewlett Packard Enterprises (technology), MSC Industrial Direct (industrial), Reliance Steel & Aluminum (materials), Freeport-McMoRan (materials), and Dun & Bradstreet (industrials). As discussed in my letter above, we are focused on building portfolios of carefully chosen

stocks whose future results may be driven more by company specific factors than by macroeconomic variables.

I continue to be excited about the value I see in the portfolio today. We ended the quarter with 5.5% in cash and our research efforts continued to identify what appear to be very attractive new investment opportunities. Given our current cash position, we will continue to be patient with a focus on identifying what we believe are the most compelling risk/reward opportunities in the market. We believe that investing in financially strong companies when they are out of favor, and thus trading at heavily discounted prices, can offer very compelling prospective returns – particularly in the current low yield investment environment.

Disclosures

Investing involves risk. Principal loss is possible. Investments in medium-sized companies involve additional risks such as limited liquidity and greater volatility. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities.

Opinions expressed are subject to change at any time, are not guaranteed, and should not be considered investment advice. Discussion of a particular security should not be considered a recommendation to purchase or sell that security. There is no assurance that any security discussed will remain in our portfolios for any particular length of time. Securities discussed do not represent an entire portfolio and in the aggregate represent only a small percentage of a portfolio. It should not be assumed that any securities discussed were or will prove to be profitable.

As of September 30, 2016, the Contrarian Value Partners Strategy's 10 largest holdings accounted for 43.75% of total assets. The Strategy's 10 largest holdings at September 30, 2016:

Hewlett Packard Enterprise Company	**4.95%**
The Dun & Bradstreet Corporation	**4.61%**
Lincoln National Corporation	**4.44%**
Reliance Steel & Aluminum Co.	**4.44%**
MetLife, Inc.	**4.38%**
MSC Industrial Direct Co. Inc.	**4.34%**
Bank of America Corporation	**4.33%**
American International Group, Inc.	**4.19%**
Citigroup Inc.	**4.09%**
Baker Hughes Incorporated	**3.97%**

Dividend Yield is a financial ratio that indicates how much a company pays out in dividends each year relative to its share price. Dividend yield is represented as a percentage and can be calculated by dividing the dollar value of dividends paid in a given year per share of stock held by the dollar value of one share of stock.

Downside risk is the financial risk associated with losses. That is, it is the risk of the actual return being below the expected return, or the uncertainty about the magnitude of that difference.

The economic cycle is the natural fluctuation of the economy between periods of expansion (growth) and contraction (recession). Factors such as gross domestic product (GDP), interest rates, levels of employment and consumer spending can help to determine the current stage of the economic cycle.

An ETF, or exchange traded fund, is a marketable security that tracks an index, a commodity, bonds, or a basket of assets like an index fund. Unlike mutual funds, an ETF trades like a common stock on a stock exchange. ETFs experience price changes throughout the day as they are bought and sold. An index

fund is a type of mutual fund with a portfolio constructed to match or track the components of a market index, such as the Standard & Poor's 500 Index (S&P 500). Tax features, liquidity and fees may differ between ETF and mutual fund products.

Earnings Per Share is calculated by dividing a company's net income by its outstanding common shares.

Free cash flow is revenue less operating expenses including interest expenses and maintenance capital spending. It is the discretionary cash that a company has after all expenses and is available for purposes such as dividend payments, investing back into the business or share repurchases.

Forward earnings per share or forward price/ earnings is a measure of the price-to-earnings ratio (P/E) using forecasted earnings for the P/E calculation. The forecasted earnings used in the formula can either be for the next 12 months or for the next full-year fiscal period.

The MSCI USA Enhanced Value Index captures large and mid-cap representation across the US equity markets exhibiting overall value style characteristics. The index is designed to represent the performance of securities that exhibit higher value characteristics relative to their peers within the corresponding GICS® sector. The value investment style characteristics for index construction are defined using three variables: Price-to-Book Value, Price-to-Forward Earnings and Enterprise Value-to-Cash flow from Operations.

Margin is the difference between a product or service's selling price and its cost of production or to the ratio between a company's revenues and expenses.

Normalized earnings are adjusted to remove the effects of seasonality, revenue and expenses that are unusual or one-time influences. Normalized earnings help business owners, financial analysts and other stakeholders understand a company's true earnings from its normal operations.

Price/Book is the ratio of a firm's closing stock price and its fiscal year end book value per share.

Price/Earnings (P/E) Ratio is the ratio of a firm's closing stock price and its earnings per share.

The Russell 1000® Growth Index measures the performance of those Russell 1000 companies with higher price/book ratios and higher forecasted growth values. You cannot invest directly in an index.

The Russell 1000 Value index measures the performance of the Russell 1000's value segment, which is defined to include firms whose share prices have lower price/book ratios and lower expected long/term mean earnings growth rates.

The S&P 500® Index is a market-value weighted index consisting of 500 stocks chosen for market size, liquidity, and industry group representation. It is not possible to invest directly in an index.

Smart beta defines a set of investment strategies that emphasize the use of alternative index construction rules to traditional market capitalization based indices. Smart beta emphasizes capturing investment factors or market inefficiencies in a rules-based and transparent way.

Value investing is an investment strategy where stocks are selected that trade for less than their intrinsic values. Value investors actively seek stocks they believe the market has undervalued.

A Z-score is a numerical measurement of a value's relationship to the mean in a group of values. If a Z-score is 0, it represents the score is identical to the mean score. Z-scores may also be positive or negative, with a positive value indicating the score is above the mean and a negative score indicating it is below the mean. Positive and negative scores also reveal the number of standard deviations the score is either above or below the mean.

Growth stocks typically are more volatile than value stocks; however, value stocks have a lower expected growth rate in earnings and sales.

Composite Specific Disclosures

Contrarian Value – Partners Strategy Composite contains fully discretionary contrarian value accounts that will generally hold 25 to 35 companies with (i) an investment-grade debt rating, (ii) a history of paying stock dividends, and (iii) a market capitalization among the top 1,000 companies in the United States. These accounts are managed using a long-term approach to security selection. We define value investing as buying businesses at a discount to our assessment of fair value. We believe fair value is a function of sustainable free cash flow and the growth of that free cash flow. This perspective leads to an investment process that considers both valuation and growth. The balance between these two metrics will vary over time based on where we see opportunity. As no single benchmark is constructed in a manner consistent with our process, we present two indices: the S&P 500® Total Return Index with its balance of growth and value and the Russell 1000® Value Index which is comprised of companies with lower price-to-book ratios and lower expected growth rates.

Poplar Forest Capital LLC is an independent SEC-registered investment advisor that commenced operations in October 2007. Poplar Forest Capital LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Poplar Forest Capital LLC has been independently verified for the period October 31, 2007, through March 31, 2016. A copy of the verification report is available upon request.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

The Contrarian Value – Partners Strategy Composite was created on November 1, 2013, and has an inception date of November 1, 2007.

The S&P 500® Total Return Index focuses on the large cap segment of the market and includes 500 leading companies in leading industries of the U.S. economy, capturing approximately 75% coverage of U.S. equities. The Russell 1000® Value Index is market-cap weighted and measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with

lower price-to-book ratios and lower expected growth values. The benchmark definitions and returns have been taken from published sources.

Composite results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The U.S. dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Net-of-fee performance is calculated using the monthly fraction of the highest annual management fee incurred, applied monthly: for the period from composite inception through March 31, 2013: 1.15%, and for the period April 1, 2013 through current: 1.00%. The annual internal dispersion measure presented is an asset-weighted standard deviation calculation based on accounts in the composite the entire year. External dispersion is not presented prior to December 31, 2010, because 36 monthly composite returns are not available. Additional information regarding policies for valuing portfolios, calculating performance, and preparing compliant presentations is available upon request. Past performance is not indicative of future results and individual account performance may vary. The firm maintains a complete list of composite descriptions, which is available upon request.

The investment management fee schedule is as follows: for pooled investment vehicles management fees are 1.00% with breakpoints outlined in the specific offering documents; for separate accounts it is 1.00% on the first $25 million and 0.60% on the remainder. Actual investment advisory fees incurred by clients may vary.

The compliant presentation and a list of composite descriptions are available upon request by calling Patty Shields at (626) 304-6045.