WKW Partners, LLC

Investment Advisory Philosophy

If we invested like everyone else, how would we outperform? So we invest differently than many managers. This is not to say that what other managers do is wrong or inferior, but that how we invest often contradicts conventional investing wisdom. But our differences work for our clients and for us, as indicated by our investment performance.

To help prospective investors understand some of those differences that we used to achieve the above results, we are presenting what we consider to be the major differences between major fund managers and us, and offer an explanation behind our unconventional investing style.

First, by way of clarification, we are an investment advisor, not a wealth manager. We look through about 6,300 public stocks, pick stocks that meet our criteria, and put those stocks in a private investment fund. We do not allocate capital, invest in bonds, third world countries, venture capital, gold, or anything else. Just stocks. We buy them, sell them, or hold cash until we find them. In an investment advisory world that touts exotic trading strategies, "black boxes" and "secret sauces", we operate a very simple model.

Second, the fund we manage is often referred to as a "hedge fund" but we do not hedge any positions in our portfolio. We buy or sell stocks expecting each position to appreciate in value. Hedges may have their place in the right situations but we do not use them.

Third, we are very concerned about capital preservation. At first glance, some aspects of our investing style may appear to be less safe than conventional investing. However, we believe that a deeper look at what we do will confirm that we have considerable risk-management components at work throughout our investment process.

Fourth, we have a tagline that states *"…stop thinking about the market and look for great ideas…"* By this tagline we mean that there are marketplace battles playing out among companies everyday, regardless of what the market, the dollar, the Fed, or any other macro variable is doing. While the undulations of the macro economy are important, what's critical to us is the outcome of these marketplace battles.

Last, we define risk as the probability of a permanent loss of capital. Many financial academics use a different definition - standard deviation of a stock price - as the definition of risk. Their definition of risk treats positive deviations and negative deviations the same, as if they were equally painful to the investor. However, positive deviations are almost always welcome and negative deviations are to be avoided, and we select our stocks and construct our portfolio to reflect that belief.

With those points as a foundation, let's explore some specifics of our philosophy and practice.

U.S. DOMICILE

The stocks we buy must be issued by companies domiciled in the U.S. This is a risk-management decision because we want the companies in our portfolio to be regulated by the SEC, as opposed to a foreign regulator. Nevertheless, many of our US-domiciled/SEC-regulated companies have material international exposure.

DIVERSIFICATION AND CONCENTRATION

The stock universe contains all stocks in all various sectors and industries. These sectors rotate from being in favor to being out of favor, and a diversified manager will usually maintain some exposure to every sector/industry for the sake of being diversified. However, due to this diversification, some of that manager's capital could be invested in a sector whose performance detracts from portfolio performance.

We do not operate a diversified portfolio but concentrate in stocks that we believe are working. And we limit the number of such stocks to 20 so that we can adequately track them and their ecosystems. This "concentration" means that our portfolio will not contain exposure to many sectors and industries that we believe are out of favor. Many managers (including Warren Buffett) operate like we do, but they just don't advertise it.

Some prospective investors may think we generated our returns "on one stock". The implication is that we have been "lucky" and what we have done is not repeatable. However, we've owned about 187 different stocks since inception through December 2015 and made money in about 52% of them. There have been some big winners, some small winners, and more losers than we like.[1]

An additional benefit of avoiding out-of-favor sectors is that by focusing on "what is working", we have a much better chance of creating wealth for our clients.

Diversification is a proper technique for wealth preservation and we encourage our clients to diversify their assets if that is their goal. And within their diversified portfolio, we encourage clients to allocate to us only a level of assets with which they are comfortable given their over-reaching investment goals.

MARGIN/LEVERAGE

We seldom use margin (or leverage) but we do use it when we have some great investing opportunities. Ideally, we would be 100% invested at all times. In those times, if we find another great idea, the use of margin allows us to take advantage of the idea without liquidating other good ideas.

MARKET CAPITALIZATION/LIQUIDITY

We are growth managers and buy stocks of companies across a broad spectrum of market capitalization. However, due to our focus on growth, we tend to find the best growth stocks among the smaller capitalization stocks.

Concurrently, however, we want all our positions to be highly liquid so that we can trade freely without moving the stock price. Our self-imposed liquidity restraint is that any specific stock position cannot be more than two days average trading volume. Therefore, we avoid so-called penny stocks or relatively illiquid securities. Based on this constraint, we believe we have a capacity to manage between $300 and $500 million without changing our strategy or impairing our potential investment returns. For that reason, we will have a soft close at $300 million AUM.

HIGH WATER MARK

If the portfolio loses money, we do not earn a performance fee until your account is made whole. Therefore, we are highly sensitive to changes in an underlying story and its affect on the position value. We have a big incentive to not work for free so we work very hard to avoid the hole to begin with.

FEES

We have certain constraints and restrictions, either self-imposed or imposed by regulators, on what we can and can't do. If we perform within those rules, then we get paid a management fee and a performance fee. This incentive aligns our interests with those of our clients. Some client prospects insist that we must utilize an exotic investment or trading strategies to justify our fees. We think, however, that our end results are worth the price.

INVESTMENT PROCESS

Our investment process is organized and disciplined, but very flexible so that we can respond to changing conditions. The real world is not so precise as to allow a uniform evaluation of every stock. While we systematize what we can, there is a large element of our process that requires human intervention.

Great ideas, inventions and works of art have always been created by people. In our investment process, good long-term results have been achieved by talented individuals, and we believe the human factor must remain at the core of the investment process. At the end of the day, our clients must believe in our judgment and our ability to pick the right stocks.

Each stock trade, whether it is to open or close a trade, is preceded by a fundamental analysis, a determination of a target price and the catalytic event(s) that are expected. Technical tools are used to assist in the timing of the open and closing position.

One of our favorite stock screens is to find stocks that are hitting their 52-week high. This is unconventional because such stocks may appear to have already experienced their stock moves, which would seem to limit their upside.

However, there are some real benefits to "shopping" among stocks that have reached their 52-week high. These benefits include:

- all great stocks rise above their 52-week highs – to become great, a stock has to reach this price point
- a stock that reaches its 52-week high has already experienced a good stock move (from its low), often has positive relative strength, and is obviously in demand by other investors
- if a group of similar stocks are all reaching their 52-week highs, then there is a good chance that there is something fundamental going on the sector. If so, what is it? Is there a trend? What is feeding the trend? Will the trend continue?
- As an example, Apple (AAPL) hit a 52-week high of about $21 in July 2009. Would a buyer risk that he was buying at the top? Yes. But was he? No – the stock rose to $134 (split-adjusted) over the next 6 years.

The 52-week high is not a guarantee of a great stock, but it's a great place to shop for them.

Conversely, the risk of buying a stock that has hit its 52-week high is that we might be buying at the top. But we would much rather start our stock search with a stock that is increasing in price and take the risk that it may begin to decline, than invest in a stock that is already in a decline and try to guess when it will turn around.

Another aspect of our investment process is our trading strategy. We use limits on all our orders but never use stop losses (due to stocks gapping down). While we often buy into investment themes that we expect to last for years, the best stocks within those themes have their periods when they are better buys and times when they are better to sell. So we trade around stocks within long-term themes and, as a result, most of our gains are short-term in nature.

Lastly, we try to average up. Many investors increase their holding if the stock goes down in price. However, we view an increasing stock price as a sign of strength and enjoy increasing our positions in appreciating stocks.

RISK

Due to owning no more than 20 stocks at a time, we are constantly aware of, and reevaluating, the inherent risks within the names, something that someone with 100 stocks cannot possibly do. Not only do we know the stocks in our portfolio, but we generally know the ecosystem of competitors, suppliers and customers.

Many investors buy stocks with the intention of holding them for multiple years based upon current information. This "buy and hold" strategy is great as long as there are no unfavorable changes in the stock's story. But there are almost always some unfavorable changes to a story, which makes a predetermined decision to "hold", despite the change, somewhat risky.

As mentioned previously, each stock has a story and we manage risk by monitoring the story. If a stock price moves against us with no change in the story, our analysis often encourages us to withstand the price volatility and continue to hold the position. If, however, the story has deteriorated, then we will sell the stock. In this manner, discipline trumps conviction – no matter how we "feel" about a stock, once the story deteriorates, we liquidate. Additionally, sometimes the story gets better while the price doesn't move commensurately. In these events, the price of the stock has gotten cheaper relative to the story and we might "average up" if our analysis supports it. But sometimes the story doesn't change and the stock takes off due to some level of investor exuberance. In this event, we may sell the stock because the price rise has outpaced fundamental elements of the story.

High turnover reduces risk when it is the result of taking small losses in order to avoid larger losses. We do not hold on to stocks with deteriorating fundamentals.

Lastly, we use cash and position size to our advantage. Cash is a defensive investment decision when we cannot find stocks that work in our clients' favor. Our compensation structure gives us a large incentive to avoid losses (hence we use cash positions) and to find great stocks. Conversely, we have the flexibility and freedom to allow any one stock to be 25% of the portfolio (at cost) and have made a considerable bet on a single position when the facts and our analysis warranted it. Of course, we are very mindful of the risks of such a large position and only concentrate to this degree on rare occasions.

As a summary of our risk management process, here is a list of risk-related aspects of our process:

- Fundamental analysis
- SEC-regulated companies
- Relatively small number of stocks to really know
- Use of no derivatives
- Use of modest leverage
- High liquidity stocks
- Planned soft close at $300 million AUM
- High water mark and alignment of interests
- Disciplined investment process and discipline trumping conviction
- Close attention paid to the underlying story
- Flexibility to hold cash

We hope this summary of our unconventional process provides some insight into a unique and very successful investment record. If you are interested in learning more, then please contact us.

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