ACADEMY
CAPITAL MANAGEMENT

July 19, 2017

Enclosed is your statement for the second quarter of 2017.

During the past quarter, “animal spirits” continued to drive prices higher in most asset classes. As a result, the S&P 500, the Dow and the tech-heavy NASDAQ all rose. At the same time, fixed income investors saw gains across varying maturities and ratings. We use the phrase “animal spirits” to designate an environment in which prices seem to reflect more emotion than reason.

We continue to make an unusual economic journey beyond our last recession. That is reasonable given that it was caused by a financial market failure rather than a central bank induced slowdown. Recoveries after such failures are typically slow (20 years plus), due to the challenges of rehabilitating the private sector debt. In this sense, the recovery has been unusually quick. Interest rates are moving up, bank stocks have risen and enthusiasm for home ownership has returned. However, the severe political and social instability that characterizes such large shifts seems to have paralyzed the ability to generate fiscal stimulus and improved productivity through major infrastructure project11s. Without fiscal stimulus, it seems likely that growth rates will remain anemic.

That said, we do not invest by making broad economic forecasts. Rather, we try to view each investment as a business owner might, with an emphasis on understanding the strength and worth of its business model. But today’s high prices have multiple impacts. One is to force us to trim some stock positions due to a rise in prices beyond their underlying values rather than a pessimistic outlook. The other is to fund disruptive ideas (such as Uber), accelerating the erosion of competitive advantages and causing us to sell or trim some positions affected. The combined result has been an increase in cash.

In the second quarter, we customarily discuss the earnings growth of the companies that formed the bulk of our prior year’s investments. There is an important distinction here. We focus on earnings growth *per share*. Many companies, including some in our portfolio, have been more concerned with increasing earnings and size than per share value.

We prefer companies that grow organically and gain market share by investing in their business. In the long run, such investment creates superior shareholder value. To do so, however, takes long-term leadership and financial strength because market share growth is not only slow, but expensive. Along the way, it may even narrow margins, depress earnings and drop the stock price. Not surprisingly this is the road less traveled, but it has long been the source of our best investment opportunities.

As we have written previously, we look for long-term (10 years or more) aggregate EPS growth of 6-8% per year in the companies that we hold in our portfolios. This growth is what

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ultimately drives market value growth. During 2016, we held the following companies for the entire year. We have listed the changes in their year over year EPS changes in percentage terms after the company names:

Company	%Change in EPS*
Abbott Labs	3%
Anheuser-Busch	-84%
AFLAC	5%
Berkshire Hathaway	0%
BP, PLC	20%
Citigroup	-17%
Core Labs	-45%
Comcast	8%
Diageo	-19%
Fleetcor	10%
Franklin Resources	-10%
Google (Alphabet)	24%
Heineken	6%
IBM	-8%
Johnson and Johnson	8%
Liberty Global	nmf
Mastercard	11%
Microsoft	5%
Nat'l-Oilwell Varco	nmf
Nestle Sa	-5%
Oracle	-6%
Pepsi	4%
Philip Morris	1%
Schlumberger	-28%
Valeant	-23%
Wal-Mart	-6%
Western Union	2%
Zoetis	11%

*For EPS, we have used Value Line's most recent numbers using the closest fiscal years. These EPS represent Value Line's best attempt at a description of after-tax operating earnings per share. (Nestle's EPS excludes sale gain of Galderma.)

The average *increase* in the EPS of our stock holdings was a -5% last year. Even after removing the extremes of Anheuser-Busch and the oil stocks, the increase was a miniscule 0.2%. Just as in other years, the average reflects some industry-specific issues, but 2016's EPS average increase was below our target, even though company execution was generally sound. This continued slow earnings growth is an indicator of the current economic challenges discussed above.

We highlight earnings regularly because it puts the focus on the underlying business rather than the stock price. As stated in the 1996 Berkshire Hathaway annual report: "If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes." With respect to this reasoning, we will present next year's quarterly review with an average of EPS growth during the years we have held. We believe that such a presentation will remove some of the "noise" of annual volatility and increase the "information" of EPS growth.

We hope this letter helps you understand our process. We want you to stay informed and feel comfortable about our investing discipline. If you're new to Academy, past quarterly letters may be useful and may be obtained through your financial advisor or Margie Shelton at our office. In addition, our website (www.academycapitalmgmt.com) has our investment reports on the individual holdings in your portfolio.

Please contact Robert Stovall at our office if you would like copy of our current Form ADV – Part 2A.

As always, we appreciate the stewardship responsibilities you entrust to us and your patience with our investment process.

Academy Capital Management

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