ACADEMY
CAPITAL MANAGEMENT

July 20, 2018

Enclosed is your statement for the second quarter of 2018.

During the past quarter, stock prices of the S&P 500, the Dow and the tech -heavy NASDAQ all rose in response to good earnings. At the same time, rising rates caused fixed income investors to experience losses in bonds of various maturities and ratings. The good earnings and rising rates are both signs of continued recovery.

This recovery is more fragile than most. Our most recent recession was caused by a financial market failure rather than central bank attempts to cool the economy. Recoveries after such market failures are typically slow (20 years plus), due to the challenges of rehabilitating private sector debt. Recognizing this, public sector leadership took innovative approaches to support banks and to provide monetary stimulation. But the success of these approaches comes at a cost – an increase in public sector debt that will weigh on our recovery. Given heavy debt levels, we believe that growth rates will remain anemic and subpar. The Fed's current attempt to slow the economy may be misplaced as anemic growth could morph into another serious recession.

While we pay attention to such economic factors, we do not invest by making broad 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. "Price is what you pay, but value is what you get" is a maxim for a business-like approach to investing. As we have noted in these letters, the price of a stock moves more widely than the underlying earnings pattern would warrant. Other assets such as real estate or private businesses do not have such wide price swings. Herein lies our opportunity. If the price varies more widely than the value, patient and intelligent investing can create good returns while reducing risk. The critical question to answer is "where is the value?"

In our opinion, value is captured by identifying and purchasing earnings streams. To secure earnings, we invest in companies that have competitive advantages. However, industry characteristics cause these earnings to vary within three broadly different patterns: cyclicals, defensives and compounders. We will discuss these patterns in more depth in a future letter. For the present, it may suffice to say that we own companies in each category. We have traditionally used the second quarter letter to focus on company earnings and this year is no different. As we promised in last year's second quarter letter, we are extending our overview so as to encompass earnings per share (EPS) growth over the past five years rather than simply the past year. We have come to believe that our past practice of highlighting only short term EPS changes provided too much "noise" of EPS volatility and too little "information" of EPS growth.

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

500 NORTH VALLEY MILLS DRIVE, SUITE 200
WACO, TEXAS 76710
254-751-0555 P 254-751-0611 F

ultimately drives market value growth. The companies we held for at least the entire year 2017, and their 5 year EPS changes in percentage terms, are as follows:

Company	**5 Yr %Change in EPS***
Apple	46%
Anheuser-Busch	-29%
AFLAC	16%
Berkshire Hathaway	23%
Citigroup	38%
Comcast	81%
Diageo	15%
Fleetcor	239%
Google (Alphabet)	121%
Heineken	34%
Johnson and Johnson	22%
Liberty Global	60%
Mastercard	109%
Microsoft	13%
Nat’l-Oilwell Varco	-109%
Nestle Sa	-36%
Oracle	11%
Pepsi	33%
Philip Morris	-9%
Schlumberger	-63%
Valeant	-15%
Western Union	-8%
Zoetis	69%

*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 five-year *increase* in the EPS of our stock holdings was 24%. During this same period, the price increase of our stocks (including cash) was over twice that amount: 51%. Normally we might celebrate this as the result of buying undervalued stocks that appreciated to “fair value.” However, the same dynamics have occurred within the S&P 500 – meaning that most of the gain for the last five years has been due to P/E expansion, not earnings growth. Such results are not sustainable – over time, growth in stock prices must reflect growth in earnings.

In fact, there are already indications of unsustainability. According to economic consultants, GaveKal Capital, during the first six months of 2018, Amazon, Microsoft, Apple, Mastercard and four other tech stocks accounted for for 105% of the S&P 500 index’s gain. The other 492 stocks were, collectively, down year to date. We do not wish to induce excessive concern, but we note that these were the kind of statistics we found and quoted in our letters in 1999.

In response to the increased risks of Fed action and high stock valuations, we are taking a stricter approach to our portfolio discipline. We are continuing to raise cash on a gradual basis. To find this cash, we are selling economically sensitive cyclicals on periodic strength. In addition, we are trimming positions in our increasingly “expensive” defensives. On the other hand, we are retaining our “compounders” and searching for more of them due to their resilience. This will, over time, make them an increasingly large category in your portfolio.

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 Joyce Bell 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

500 NORTH VALLEY MILLS DRIVE, SUITE 200
WACO, TEXAS 76710
254-751-0555 P 254-751-0611 F