SUNCOAST EQUITY MANAGEMENT, LLC

October 2, 2015

Dear Client:

Market volatility returned this past quarter and erased the single digit gains reached in early July. We ended the third quarter with year to date performance of -0.5% versus -5.3% for S&P 500. So what is the likely cause of the recent market turmoil? The main culprits are the continued decline in commodity prices, especially oil, and the faltering economic growth in China. The U.S. economy remains fairly resilient at present and GDP growth forecasts of 2.5% seem reasonable. Growth here at home is being held back by a slow and uneven domestic economic recovery from the recession five years ago, and by a recent slowdown in global trade in general including U.S. exports abroad. Ups and downs of the equity market are quite common, especially in light of the market rise we have had since 2009. Notwithstanding, the overall outlook for our portfolio companies remains solid, so a steady hand guiding the portfolio and taking advantage of select price declines will navigate us through the volatility.

Portfolio changes and highlights

During the quarter we sold two businesses and redeployed the proceeds into two holdings that are new this year and complement our existing holdings. **Cognizant Technology Solutions** (CTSH) provides IT services like consulting, BPO (Business Process Outsourcing), and Infrastructure software development and maintenance much like our long term holding **Accenture** (ACN**)**. The company is making significant investments in SMAC – Social, Media, data Analytics, and Cloud computing and is recognized as a market leader with very high customer satisfaction ratings. CTSH prides itself on its in-depth knowledge of key industries like finance, healthcare, manufacturing, and retail and should continue to gain market share in the global IT services market. Both CTSH and ACN are benefiting from trends such as an emphasis on compliance/regulation in the financial and healthcare markets like the Affordable HealthCare Act (ACA). There is strong demand in Europe where businesses are shifting towards digital transformation to reduce costs and optimize their workforce and CTSH is expanding to new geographies like Latin America. As we do with all our businesses, we will watch industry trends as some of its competitors try to pick up market share by cutting prices. But for now both Cognizant and Accenture are increasing market share, revenues, and profits nicely.

MasterCard (MA) became part of our portfolio in April and we added to it this quarter. MA is complementary to one of our most important holdings **Visa** (V). Both these companies benefit from the strong global trend towards cashless payments. Generating a fee of 1%-3% on each transaction, it is a tollbooth-like business with great leverage. The more participants that use either Visa or MasterCard for transactions, the greater leverage they gain on costs and it is far less costly and capital intensive to expand their network than it might be to install a tollbooth system on every highway to capture the income. MA will be entering new markets and not just "emerging" markets. With Europe's Multilateral Interchange Fee regulation going into effect in June 2016, MA will be able to enter the French market. Currently Cartes Bancaire (CB) holds a near monopoly and in 2014 the company reported 5% payment volume gains in a flat economic environment. So what is the opportunity? MA can take share through its technological advantage over CB and its scale by negotiating multi-country contracts with merchants. According to a recent Evercore ISI report, if MA won 100% of the French payments market it would add 60% to MA's European purchase volume. More realistically according to the same report, is that every 10% gain in French domestic payments volume market share, MA's earnings increase by 1%.

The two challenges we watch with MA and V (since they earn such significant profits), are that they are an easy regulatory target and the competitive threat of alternative payment systems. Despite their strong growth, early threats from such upstarts like Square and even our own holding PayPal (PYPL), were of little concern to us since both partly used MA and V's network and paid them for it. In fact you may recall from earlier letters that we raised our weighting in the late summer of 2010 when the market reacted to early success of Square and other early payment systems, some of which fizzled. About that same time V's stock price was also down because of the proposed impact of Dodd Frank, so we took advantage of the decline and increased our ownership since we believed the perceived threat was overdone.

A future threat to MA and V, as well to other payment processing businesses and financial institutions, especially banks, is the idea of a shared ledger technology, known to techies as block chain. The idea of shared ledger allows a better way to "push" a cashless transaction authorized by you for payment to others. The traditional credit and debit card technology is mostly a "pull" transaction where you give a retailer or service company the authorization to take funds from your bank account. You have undoubtedly heard references to bitcoin and perhaps you might know someone that has used it. Bitcoin might be looked at as a first application of shared ledger and it has had some serious safety issues. Block chain can be thought of as a platform much like TCP/IP is the basic communication language of the internet. But much like email was one of the first applications of the internet protocol, better and more trusted applications of shared technology will emerge. It will take some time though and you can be sure V and MA are involved. *Forbes* magazine had an excellent article in the September 28th issue covering the developments, and is where this information comes from. The block chain / bitcoin application is behind in capacity according to the article as it can handle only 7 transactions a second, versus V which can process 56,000. There is much speculation that new generations of shared ledger applications could eliminate or lower the tollbooth charges by V and MA, but this remains to be seen. We seriously doubt it will be done for free. You still need to pay some credible entity for the safety and confidence of record keeping of the exchanges. The revenue model may turn out similar to many current software companies which are trying to change to cloud subscription fees for their needed service and products.

We sold **Discovery Communications** (DISCK) after a four and half year ownership. The business performed well for us in our early years of ownership and the stock rose accordingly. Our original thesis played out with DISCK raising advertising rates and renewing distribution contracts at higher prices with cable providers. We also favored the low content costs of such franchises as "Shark Week" and its mix of international assets. Recent business results however, are seeing an early impact from shifting consumer consumption of entertainment from cable TV to online and as a subset to the move to mobile devices. Newer clients did not benefit from our DISCK ownership as market concerns over the shift have negatively impacted most media company stock prices. Although the selloff of these companies may be overdone and may lead to consolidation which often happens when businesses weaken, we preferred to step aside. The opportunity for DISCK to raise prices further for channel and content distribution and advertising, seems murky to us. Management of the company may feel otherwise but we redeployed the proceeds and will keep an eye on DISCK.

In July **eBay** (EBAY) spun off its **PayPal** business (PYPL) to shareholders. With the company separated into two publicly traded companies, each can focus on its core business. In May of last year EBAY faced a competitive blow as **Google** (GOOG) flexed its muscles. GOOG "improved" its search engine algorithm that negatively impacted eBay's ranking and ability for potential customers to find links to its site. Separately, EBAY has always been the key sales site for small to midsize retailers and resellers. Historically **Amazon** sold its own inventory sourced from product manufacturers. Well, welcome Amazon to the party! Recent progress by Amazon to develop its third party platform, showing its customers products from other companies seems to be eating into and attracting eBay's core small and midsize sellers. Post spinoff, eBay's portfolio weighting dropped to 2.4% with PYPL at 3.3%. With the above competitive issues we decided to sell our small position in eBay.

<u>Keep calm and keep your investment plan on</u>

History has proven that equity in publicly owned corporate America has moved forward over the long term with only a few significant setbacks in terms of time or amount. Setbacks similar to the type we are currently experiencing can surface for good reason or for no reason at all. News media will characterize a decline of more than 10% a "correction" and more than 20% a "bear market." Market prognosticators would view the current state of affairs in correction territory. We have always believed that the stock market is constantly adjusting to "new information" usually judged or interpreted, and that this "new information" causes a great deal of randomness in stock prices. In any given year market pricing can temporarily deviate from "fair value" on the downside or upside. So on a short term basis the "new information" shared minute by minute on CNBC or your favorite news sources, can rattle market prices as we have seen. That can produce a calendar year return in a range of -10% to +10%, or even some other number, worse or better.

Changing portfolio positions or your allocation (in terms of your overall portfolio) based on market activity is a sure way to react with the market, instead of with the long-term fundamentals of the business. It is this activity or “timing” that can turn a temporary decline in a stock’s price into a permanent portfolio loss. We have seen so many examples over the years of folks that have tried to “time” the market by reducing their investments after a decline began, only to get back in after they felt emotionally better, which is almost always after the market rebounds and the “new information” has already been positive. We have never seen an example in our careers where someone was rewarded for selling out at the beginning of a decline then reinvesting while the mood and market were still negative.

As investors you should always stay with your financial plan and goals. If you are at that point in life when you are living off your investments, plan accordingly with your advisor the withdrawals you need and assess your reserves on a regular schedule. If you are not drawing on your investments for living expenses and instead plan on passing some or all to family or charity, continue a prudent path of preservation and growth. If you are currently accumulating savings, then it is good to stick with a systematic investment program, sometimes referred to averaging in. Or you can accelerate that a bit during “corrections” and “bear markets.”

Our actions on your behalf (and our own since we own the same portfolio) to preserve and grow your wealth are based on where we think our investments are headed, not reacting to where they have been. It is also our responsibility to assess the current price to value environment. Looking forward, as companies grow their earnings (intrinsic value) we expect stock prices to eventually follow.

SEM-DIS preference is to own a select group of companies, under a proven methodology with years of execution experience (twenty plus), to create relative positive investment results while taking less risk. The outlook for growth for the **SEM** portfolio remains solid with earnings growth projection in the 11%-12% range on average, compared to 3%-5% earnings growth for the S&P 500 for this year and GDP growth of about 2.5%. Alternatively you could choose to own corporate America through a broad investment in index funds. But our portfolio has a better growth rate, stronger balance sheet and is better positioned versus owning the entire market when taking the long view.

Given the territory we are in today, where does the **SEM** portfolio stand? Pricing is slightly more attractive and intrinsic value has grown since the beginning of the year. This is a good combination for sure. If we see intrinsic value continue to improve and stock prices temporarily decline, then it gets better not worse. That is the thought process of a truly successful investor.

Thanks as always for your support and please call us anytime.

Sincerely,

Don

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Performance results versus the Standard & Poor's 500 Index

Time Period	SEM % Return*	S&P 500 % Return	SEM - Value of $1,000,000	S&P 500 - Value of $1,000,000
First Nine Months 2015	-0.5%	-5.3%	$ 995,300	$ 947,100
One-Year	+3.2%	-0.6%	$ 1,031,800	$ 993,900
Three-Year	+13.5%	+12.4%	$ 1,463,300	$ 1,420,200
Five-Years	+14.7%	+13.3%	$ 1,982,300	$ 1,870,200
Seven-Years	+10.5%	+9.8%	$ 2,010,400	$ 1,918,000
Ten-Years	+7.7%	+6.8%	$ 2,096,000	$ 1,930,500
Fifteen-Years	+5.9%	+4.0%	$ 2,377,500	$ 1,791,100
Inception (17 3/4 Years)	***+8.2%***	***+5.9%***	***$ 4,049,100***	***$ 2,748,800***

* Composite results of all SEM managed accounts, net of all fees.
Note: Performance for the three, five, seven, ten, fifteen and since inception year periods represent the annual average rates of return