2016 Performace:

The fund slightly outperforms S&P 500 during the year. We have gross return of 13.87% and net return of 12.33% in 2016:

	2016 1Q	2016 2Q	2016 3Q	2016 4Q	2016
Fund	0.41%	0.08%	1.95%	9.65%	12.33%
S&P 500	1.35%	2.46%	3.85%	3.82%	11.96%

Berkshire Hathaway, financials, and our new holding in Level 3 Communication contribute majority of all our gain. Our large cash position negatively affects the performance. Throughout 2016, our average cash position is 34.1%. We build up several positions in the 2nd half that consume some cash. We ended the year with a cash position above 20%. Preservation of capital is still our number one priority for 2017. As usual, I will discuss some of our existing and new positions, and share some observation on technology trends and macro economy.

Existing positions:

Berkshire:

Berkshire continued to outperform the market in the 2nd half. The stock return 23.4% in 2016. A potential Trump tax cut and infrastructure spending help drive the stock price. Looking back, the most notable thing that Buffett did in 2016 are probably things that he didn't do. On one hand, large deals are certainly getting harder for Berkshire. For example, in mid-2016, Berkshire passed on the opportunity to buy Oncor electronic delivery, which is then acquired by NextEra for $18.4 billion. On the other hand, Buffett also didn't do anything with his financial holdings, such as Wells Fargo and American Express, which recovered in 4Q/16. Berkshire now has more than $80 billion in cash as of 3Q/16. It will easily surpass $100 billion if Buffett stay put in 2017. We think Berkshire share is fairly valued now. We mildly trimmed some position to put into better ideas.

Financials:

Bank of America and our ill-timed position in Wells Fargo are bailed out by Trump presidency. A combination of better interest rates outlook and bond rotation fueled the entire banking sector. SPDR® Bank ETF rallied 42.9% since our last letter. (Yes, you read it right, 42.9%). The surge of price caught us by surprise. Thus, we re-evaluate the risk reward profile of holding bank stocks. Eventually we sold our positions in BAC, WFC TARP Warrant and meaningfully trimmed WFC stakes. Wells Fargo now is a less than 10% of our portfolio. We are monitoring WFC's retail bank activity closely as the bank recently roll out new compensation plan to replace sales goals.

Intel:

We liquated the rest of the Intel in 2nd half 2016 as its share rose along with the semiconductor industry. While we spend significant amount of time in 2014 and 2015 researching semiconductor stocks, we essentially missed the rally in the whole sector. Semiconductor sector (PHLX Semi, or SOX) has returned 36.6% in 2016, outperforming every single sector in the broad market.

We learned a painful lesson during the process: be willing to break a predetermined mindset. While the valuation of companies that I studied were cheaper, their competitors generally had better economics or management teams. Even knowing this dynamic, I still brought the cheaper name but not the better name. From example, TSMC vs Intel, Broadcom vs Skyworks, the list goes on. We paid a very steep opportunity cost. We wish we can minimized this kind of mistake going forward. We will also be careful on how to spend our time with cyclical stocks.

New Positions:

Interactive Broker(IBKR):

We started a position in IBKR in 2Q/16 and brought more in 2nd half. The average price we paid is $34.4. Since financial crisis, IBKR has successfully transitioned itself from a market maker to discount brokerage firm. IBKR is well known in trader community for its low commission costs and comprehensive analytical tools. In recent years, it also expands aggressively into the lucrative prime brokerage businesses.

To be fair, all four discount brokerage firms (AMTD, ETFC, IBKR, SCHW) are decent businesses after years of consolidations. They generally have very high profit margins and are set to benefit from rising interest rate and DOL fiduciary ruling. In recent quarters, IBKR’s adjusted pretax operating margin ranged around 50-55%. While IBKR is less interest sensitive, it has two advantages that its competitors do not have: lowest transaction cost (by a big margin) and a global footprint. We believe both advantages are very hard to duplicate at a large scale and IBKR will grow its business for years to come.

One risk with IBKR is that a shift toward passive investing in last few years. In 2016, while IBKR grew its accounts by 16% and client equity by 27%, its DARTs (Daily average revenue trade) still decrease single digit year over year. We will closely monitor IBKR’s progress in improving its DARTs as market becomes more active after the election.

Level 3 communication(LVLT):

We initiate a major position in LVLT during 3Q/16. We are very lucky that CenturyLink announced a cash/stock deal to buy LVLT right after we build a sizable position. We brought more after the deal. Our cost basis for LVLT is $48.9. For many investors, this acquisition put an end to a decade of painful memory in investing in long-haul fiber during the dot-com bubble.

The industry has come a long way since 2000s through bankruptcies and consolidations. The combination of CenturyLink and LVLT today represents almost every next-gen fiber that were laid in the ground during the dot-com era: CenturyLink, Global Crossing, Level 3, Qwest, TW telecom, WilTel, etc. While both business (CTL & LVLT) face their own growth challenges, we think that the combined company is materially undervalued at $24 per share. Not to mention the high dividend yield (9%). We expect to hold the CTL shares after the acquisition.

Tencent:

Our field trip China provide us essentially one idea: Tencent. You don't need to be genius to figure out that the digital economy in China is at least several years ahead of United States. The major enablers of the digital economy are Tencent and Alibaba. While I am very familiar with Tencent's dominance in gaming, social network and advertising. The company recently make breakthroughs in three areas that I previously have not pay attention.

- Wechat payment: Along with Alipay, Tencent's Wechat Payment has essentially replaced plastic cards in China. Compare to Alipay, Wechat Payment has a much broader penetration in offline merchants. In addition, the recent push into consumer loan will help Tencent tapped into most lucrative business in internet banking.

- Wechat "miniprogram": Wechat "miniprogram" is a build-in HTML 5 that allows users to navigate different apps without leaving Wechat. While tech giants have talked about instant apps for years, (Apps that runs without downloading), the underlying technology is very hard to implement. It requires both a vast user and merchant bases. We believe this breakthrough will allow Tencent to finally able to connect user directly with merchants, thus materially challenging Alibaba and Baidu's core businesses.

- Equity investments: several "unicorns" Tencent invested has grown into a much bigger business the past two years through either consolidation or support from Wechat. The three most notable business are Didi, Meituan and Sogou. The equity investments show on Tencent's balance sheet is only 66.6 billion RMB. We believe the intrinsic value of these group are many times over the stated value.

We start building positions in Tencent(ADR) in December 2016. Our average price paid is $23.84.

Thoughts on Technology:

Last year, we observed that several powerful technology trends were maturing at the same time: public cloud, flash storage, and network speed. In 2016, we witnessed the staggering amount to effort by tech industry in developing artificial intelligence(AI). These factors lead us to believe we are entering an infection point that technology will disrupt almost every traditional industry down the road.

To be specific, we already witnessed technology's disruption in retailing and print industry. In the next few years, auto, finance and media industry will completely be turned upside down. Beyond 2020, traditional industrial and manufacturing can also be disrupted.

The fund will be more technology focused going forward. That means we will not only put more effort into finding tech ideas, but we will also think hard on avoiding value traps. In addition, we believe US tech giants has NOT yet flex its muscle in expanding into traditional industries. We think in the next years, there can be a wave of M&A in traditional industries by tech giants as they need to find new growth opportunities. Thus, we are also researching strategic ideas that can be a good fit to tech giants.

Thoughts on Economy:

World economy today is never more connected and complex. In some areas, we are in uncharted territory, where no there is no historical guidance (such as negative interest rate). Among countless macro risks we have, China's credit bubble remains my number one concern.

Back in 2011 when we first notice trust and wealth management product were introduced to households, the total debt to GDP ratio is around 200%. Fast-forward five year, the total debt to GDP has ballooned to 300% thanks to various "financial innovation". Credit risks has now penetrated every level of financial system.

In 2016, the Chinese government successfully pushed of equity and currency crisis by a combination of credit easing and capital control. The recent data shows that China banks extend record 12.65 trillion yuan in loans in 2016, a 13% growth on already very large base. Forty five percent of the new loan in 2016 come from residential housing, which historically has not been a driver for loan growth. As a result, housing price surged to record prices in tier I and tier II cities, with many cities showing more than 25% price increase. The wealth effect clearly helped the consumer spending. Manufacturing index also expand five month in a roll since August. So far China seem to be at good ground. But this is at the expense of credit expansion that will eventually hunt us down.

While we do not know outcome of the credit bubble, we do know that we must **"think the unthinkable":** What if debt to GDP level reach 5 to 1? What if Dollar/Yuan goes beyond 8 to 1? We hope for the best and prepare for the worst.

Conclusion:

As global risks continue to intensify and valuation of equity at high end, we will stick with our strategy of preserving capital. So far we stayed with blue chip ideas that has large economical moat, limited downside, and can grow in the foreseeable future. In the meantime, we are also exploring arbitrage opportunities that while has less upside, can provide us a stable return for the portfolio. While a high cash position certainly hurt our performance, we believe it will enable us to take advantage in a down market. We look forward to report to you in 1H/2017.