2016 ANNUAL REPORT

Each account experienced different returns due to differences in account size and the inception date. We have taken some time to explain these differences in greater detail on pages 25 and 26.

We encourage all of you to read them.

For additional information email: info@selectivewm.com

Selective Summary

Year	Selective[1]	S&P 500[3]	Relative
2009	+86.0%	+60.1%	+25.9%
2010	+23.3%	(4.5%)	+27.8%
2013[2]	+39.2%	+24.2%	+15.0%
2014	(4.4%)	+13.7%	(18.3%)
2015	+5.2%	+1.4%	+3.8%
2016	+18.6%	+12.0%	+6.6%
Cumulative	+283.0%	+145.2%	+137.7%

Accomplished at preceding investment partnership. (2009–2010)

Table 1: Selective Companies Presently Owned

Selective Company	Report	Symbol	Purchase Price	Current Price[4]	Dividends	Gain (Loss)[5]
Alphabet	PDF	GOOG	$513.32	$771.82	$0.90	+50.5%
Biglari Holdings	PDF	BH	$372.54	$473.20	$1.48	+27.4%
Union Pacific	PDF	UNP	$84.92	$103.68	$3.04	+25.7%
Wells Fargo	PDF	WFC	$45.43	$55.11	$0.38	+22.1%
IBM	PDF	IBM	$151.39	$165.99	$8.50	+15.3%
Cognizant Technologies	PDF	CTSH	$50.36	$56.03	-	+11.3%
Oracle	PDF	ORCL	$36.05	$38.45	$0.60	+8.3%
Baidu	PDF	BIDU	$155.85	$164.41	-	+5.5%

Table 2: Businesses Sold During 2016

Business	Report	Symbol	Purchase Price	Sale Price	Dividends	Gain (Loss)[4]
LinkedIn	PDF	LNKD	$100.93	$189.60	-	+87.9%
SPS Commerce	PDF	SPSC	$41.41	$60.40	-	+45.9%
National Research Corp	PDF	NRCIB	$32.61	$33.70	$3.11	+12.9%
Wal-Mart	PDF	WMT	$69.10	$69.15	$1.25	+1.9%
Autohome	PDF	ATHM	$25.03	$25.46	-	+1.7%

1) Returns are based on a composite of accounts with values greater than $5,000.
2) Returns from inception (March 1st) to year-end. Returns for partial years are not annualized. All returns are TWR net of all fees and trading expenses.
3) S&P 500 returns are total returns - which include price changes and dividends. The S&P 500 is not a suitable benchmark and is used for general comparison. We do not believe there is a suitable benchmark given the concentrated nature of our investment style.
4) Current prices reflect market close as of December 31, 2016.
5) Gain (Loss) calculation includes the payment of dividends.

The Year in Review

In 2016 we posted a healthy gain of 18.6% compared to 12.0% for the S&P 500. We were very pleased with the absolute and relative performance. When reflecting on how the results were generated we are even more pleased. The position sizes were prudent ranging from 7% to 15% and our cash balance averaged more than 20% throughout the year. The majority of our purchases were made during the steep market declines experienced in February with very little purchasing otherwise. The business operations at our Selective Companies were excellent and they continue to meet the criteria set forth in the Selective Process. Overall, we consider the year a great success.

Year	Selective	S&P 500	Relative
2016	+18.6%	+12.0%	+6.6%

In addition to strong returns the firm continues to experience outstanding growth due to your client referrals. We mentioned last year that we were targeting $20 million in assets to launch the Selective Opportunity Fund. The fund would help reduce client expenses and increase the number of Selective Companies available for purchase. Thanks to your commitment we ended the year at just under $30 million dollars in assets. Since the firm inception asset growth has exceeded more than 100% per year on average.

As we grow we intend to focus on finding ways to lower costs and pass those savings on to you. One way we are lowering costs in 2017 is by launching the Selective Opportunity Fund (SLCTX). The Fund will pool our client assets which will reduce the overall trade commissions, on average, and as the Fund grows the operating expense ratio will decline - saving you more money. In addition to cost savings the Fund will allow us to invest in a broader range of Selective Companies and enable the use of covered calls for all clients. The covered call strategy is a way that we attempt to purchase Selective Companies at *lower* prices than what are available at the prevailing market prices. For additional information about how we utilize covered calls feel free to email me at cdevlin@selectivewm.com.

Looking Ahead

As we enter 2017 we want to take a moment to clearly articulate what will change with the launch of the Selective Opportunity Fund – and more importantly – what will not. As we launch the Fund your ownership of Selective Companies will move from your separately managed account (SMA) to the Selective Opportunity Fund. Whether you own your Selective Companies in an SMA or at the Fund level will not have a material impact on your investment success over time. The heartbeat of Selective remains the same – to buy Selective Companies that produce irreplaceable goods and services, are highly profitable, possess pricing power, demonstrate careful debt management, skillfully reinvest earnings, and are led by world class leaders. This has been and continues to be the back bone of our Selective Process.

In addition to maintaining the same investment philosophy we remain committed to exceptional transparency. We believe that as an investor you have the right to know what you own, and why you own it. As we launch the Fund we will be revamping our website to provide even more detail about the Selective Companies you own. This process will take a few weeks to implement and we appreciate your patience during this time. Logging into the site during this brief period will show your current account value and a single holding – the Selective Opportunity Fund. Once we finish implementing our new software solution you will be able to view how much of each Selective Company you personally own, as well as the in-depth research reports and business videos you have grown accustom to. We believe having clients that think like business owners is a key competitive advantage for our firm. We will always maintain our commitment to providing you timely information about the companies you own.

As far as the market is concerned, we continue to believe that businesses are expensive. A few of our Selective Buyback Companies will not be repurchased immediately after the Fund launch due to the elevated price levels. These companies are Wells Fargo, Biglari Holdings, and Oracle. The remaining Selective Companies will be repurchased. The cash balance to start the year will be in excess of 50%. We intend to approach the market the same way we always have – with patience. We will patiently wait for Selective Opportunities to buy the world's most dominant businesses at brilliant prices. We don't know how long it will take for Selective Opportunities to present themselves, but to anchor your expectations, our main focus in 2017 is to protect client principle. If the market were to advance substantially this year it would not surprise us if our performance would lag the market due to our large cash position. We have a list of more than 200 well researched Selective Companies that we are eagerly awaiting to purchase when the price is right. Stay tuned…

Selective Company Categorizations

Last year we took some time to highlight the economics of one of our Selective Buyback Companies - Union Pacific. As a reminder, a Selective Buyback Company is one that is mature and has less room for growth. Due to the limited prospects for growth the majority of earnings from these businesses are distributed as dividends or used to repurchase shares. We enjoy owning Selective Buyback Companies when the stock price of these businesses are low because we are effectively buying out our business partners at attractive prices. When the price rises for a Selective Buyback Company we consider selling the position due to the decreased effectiveness of the buyback program. We currently own five Selective Buyback Companies as shown in Table 3.

Our Selective Companies with long runways for growth are labeled Selective Growth Companies. These businesses tend to retain the majority of earnings and reinvest those earnings back into attractive business ventures in order to grow the business. We ignore price movements in our Selective Growth Companies as we intend to own these for long periods of time and enjoy the robust growth in the operating business over the years. We currently own three Selective Growth Companies. The categorization of each can be found below.

Table 3: Categorization of our Selective Companies

Selective Growth Companies	Selective Buyback Companies
Alphabet Inc.	Oracle Corporation
Cognizant Technology	Union Pacific Corporation
Baidu	International Business Machines
	Biglari Holdings Inc
	Wells Fargo & Co.

Selective Companies Owned As of December 31, 2016

In this section we detail the business operations of your Selective Companies during the last twelve months. The discussion focuses on what has changed from a competitive standpoint (if anything), and our expectations for the future. Overall, your Selective Companies performed extremely well with record profits at 5 out of 8 companies. The remaining three earned healthy profits. As of December 31, 2016 all 8 businesses have experienced gains since our initial purchase as shown in Table 1.

Table 1: Selective Companies Presently Owned

Selective Company	Report	Symbol	Purchase Price	Current Price[3]	Dividends	Gain (Loss)[4]
Alphabet		GOOG	$513.32	$771.82	$0.90	+50.5%
Biglari Holdings		BH	$372.54	$473.20	$1.48	+27.4%
Union Pacific		UNP	$84.92	$103.68	$3.04	+25.7%
Wells Fargo		WFC	$45.43	$55.11	$0.38	+22.1%
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Cognizant Technologies		CTSH	$50.36	$56.03	-	+11.3%
Oracle		ORCL	$36.05	$38.45	$0.60	+8.3%
Baidu		BIDU	$155.85	$164.41	-	+5.5%

Table 4 highlights the relative attractiveness of our Selective Companies compared to the broader S&P 500 index. These figures are estimated based on our projection for earnings in the upcoming years. Obviously earnings projections are difficult and not a guarantee, however, it should give a general sense of how our businesses compare to the average S&P 500 company. The figure in the table below are a weighted average that excludes the cash portion of the portfolio. We include this information because we believe that over long periods of time purchasing superior companies at lower prices produces the best investment results.

Table 4: Selective Portfolio Metrics

Metric	Selective[1]	S&P 500[2]
Future 5-Year EPS Growth	15%	8%
Return on Equity	>50%	~13%
Debt to Equity Ratio	5 out of 8 Debt Free	116%
Forward P/E Ratio	14	18

1) Internal calculations based on weighted average for each individual business in the Selective Portfolio.
2) YCharts Investment Data Research.

Alphabet Inc.

Ticker: GOOG
Purchase Price: $513.32, Current Price: $771.82
Dividends: $0.90
Gain: +50.5%

2016 In Review – Alphabet had a sensational year with operating profits growing in excess of 20% to more than $22 billion. Revenues at the company exceeded $85 billion, compared to $74 billion in 2015. The growth was fueled by increased advertising across Alphabet's flagship internet properties, Google and YouTube. To put this outstanding accomplishment in perspective the global advertising spend in 2016 is estimated to be $550 billion, meaning Alphabet captured more than 15% of all advertising dollars spent on planet earth. Across all devices the market share for search, excluding China, continues to climb with an estimated 77% globally. This compares to global market shares of 8% for Bing and 6% for Yahoo!. The mobile search market share for Google is now an astounding 94%. This is extremely positive news because mobile searches are more frequent than desktop searches and is the fastest growing search channel today.

We believe the economic moat around Alphabet's core search business improved throughout 2016 and the Android operating system continues to enjoy a duopoly, with the iOS, in mobile operating systems. This dynamic likely won't change in the near future due to a catch 22 in the industry: Developers don't make apps for operating systems with no market share, and users don't buy phones with no apps. This dynamic has made it elusive for companies such as Microsoft (less than 1% share) to compete despite spending billions to enter the space.

Last year we mentioned that if Alphabet charged $15 dollars per device for the Android operating system it would nearly double the profits for the company. During 2016 the company elected to continue to give away the operating system for free (which helps drive the 94% market share for search on mobile devices). There are no plans to charge for the Android system in the future, but if this did occur it could increase profits substantially.

Another key development in 2016 was Alphabet's dramatic improvement in artificial intelligence (AI). The company launched the Google Assistant that is available on both the Google Home and Google Pixel (smartphone). I personally purchased both devices and am extremely impressed with the quality and usefulness of the assistant. Josh, the operations manager here at Selective, purchased an iPhone 7 the same day I purchased my Pixel. After testing both devices side by side the AI advantage Google has from billions of search queries per day is evident. The search results from the assistant are faster, more

accurate, and significantly more useful than the iOS counterpart. I am a strong believer that the Pixel is a superior phone to the iPhone, which could drive earnings growth considerably. To shed some light on the size of the Pixel opportunity, in 2016 Apple generated $136 billion in revenue from iPhone sales (remember Alphabet's *total* revenue was $85 billion). All-in-all we couldn't be happier with the results for 2016.

Future Expectations – Our future expectations are similar to last year. We expect the revenue and operating profit from the core search business (and YouTube) to climb at a double digit pace throughout 2017. The company now has more avenues for meaningful growth in the future which include; autonomous driving software, the Google Pixel smartphone, and the Google Home. The future for Alphabet is extremely bright.

Biglari Holdings Inc.

Ticker: BH
Purchase Price: $372.54, Current Price: $473.20
Dividends: $1.48
Gain: +27.4%

2016 In Review – Operations at Biglari Holdings (BH) reached record levels on a per share basis. The overall size of the company didn't change much, but the share buyback executed in 2015 had the effect of increasing pre-tax earnings per share by more than 50%. Before analyzing the progress here is a quick refresher on the makeup of the company.

There are four major divisions of the business: Steak n' Shake and Western Sizzle (Restaurants), First Guard Insurance Company (Insurance), Maxim Magazine (Media), and investments in The Lion Fund I & II. The Lion Fund I & II hold two sizeable positions – BH and Cracker Barrel (CBRL) – and several small positions (other investments). We consider the BH shares held in The Lion Funds that are legally owned by the company as retired and value the CBRL shares by looking at the earnings BH would be entitled to on a 'look through' basis. Since The Lion Funds own 20% of CBRL, the look through earnings are calculated by multiplying CBRL company results by 20%. And finally, BH has some cash at the parent company (Cash) and non-recourse debt (Debt) held in the subsidiaries. The table below summarizes the year-over-year progress of each business division on a per share basis.

Operating Results on a Per Share Basis

	2015		2016		
Division	Revenue	Operating Profit (Loss)	Revenue	Operating Profit (Loss)	YoY
Restaurants	$537.15	$117.39	$678.28	$156.15	33%
Insurance	$10.42	$2.76	$18.69	$4.80	74%
Media	$13.32	($7.59)	$5.37	($6.60)	-13%
Cracker Barrel	$317.77	$20.83	$442.39	$30.60	47%
Corporate Expenses	-	($80.31)	-	($104.32)	30%
Total Operating Income	**$878.66**	**$53.08**	**$1,144.73**	**$80.63**	**52%**

Balance Sheet Summary on a Per Share Basis
Note: Excludes BH & CBRL stock from investments

	2015	2016
Line Item	Amount	Amount
Stock Price	$325.82	$473.20
Cash	$44.48	$62.48
Debt	$239.10	$241.50
Other Investments	$31.45	$35.49
Enterprise Value	**$488.99**	**$616.73**

Future Expectations – Even after the +30% rise in BH stock price during 2016 the EV/Operating Earnings ratio is still considerably lower than the average S&P 500 constituent. Last year we mentioned that were unsure if Sardar would continue to make high quality investments, but felt that the company was so cheap it would be a good investment either way. The valuation of the business is not as attractive as it once was. The improved operating results on a per share basis are largely due to the buyback accomplished in 2015 and further improvement will require the business to perform better. The acquisition of Maxim Magazine appears to be a failure as revenue has declined substantially from last year and it appears that this division will be shut down or sold soon. We do not intend to repurchase Biglari at the current price levels when the Fund launches. The gains in intrinsic value on a per share basis in the last two years have been primarily driven from share repurchases. The price is considerably higher than when we made our originally purchase.

Union Pacific Corporation

Ticker: UNP
Purchase Price: $84.92, Current Price: $103.68
Dividends: $3.04
Gain: +25.7%

2016 In Review – Union Pacific had a difficult year with carloads reaching the lowest level since the Great Recession. During the worst of the recession carloads averaged 8.3 million per year which translated into an operating profit of $3.6 billion. Last year the company had similar volumes, 8.4 million carloads, due to a lack of coal demand and little or no oil drilling activity in the United States. Despite the lowest carloads since the Great Recession the company posted an operating profit of $7.3 billion – more than double the operating profit on roughly the same number of carloads as 2008-2009. The incredible increase in profitability was due to price increases and efficiency gains. Efficiency gains include increasing the train length, reducing dwell times, and implementing new technologies to accomplish more with less individuals. After paying taxes the company had a net income of nearly $4 billion dollars.

At the start of the year the price of the stock declined sharply and the company aggressively repurchased shares retiring more than 4.5% of the stock, while simultaneously paying more than $1.9 billion in dividends (~3% yield on our purchase price). Overall we were very pleased with Union Pacific's operations despite a very challenging macroeconomic environment.

Future Expectations – We currently have no reason to believe that carloads will materially increase in 2017. The price of natural gas remains low, which means coal demand continues to be depressed. The number of oil rigs is at 550 compared to 510 this time last year. Under these conditions we would anticipate operating profits to be roughly the same as 2016. That being said, the newly elected president has suggested several things that could have a positive impact on carloads: A more friendly operating environment for coal fired power plants, a more friendly operating environment for oil fracking, and a lower corporate tax rate.

To put this opportunity in perspective, if coal volumes reached historical averages and the tax rate were reduced to 15% Union Pacific would earn north of $10 billion in operating profit and $8 billion in net income (a 100% increase). If this does occur the company is undervalued at the current prices levels, but if the changes are not implemented the price seems appropriate. You can view a Selective Video explaining the relationship between the corporate tax rate and profits here:

https://www.youtube.com/watch?v=2_xXaOrmuoI&t=1s

Wells Fargo

Ticker: WFC
Purchase Price: $45.43, Current Price: $55.11
Dividends: $0.38
Gain: +22.1%

2016 In Review – It was a difficult year for the Wells Fargo Company. In the early fall news broke that employees of the company opened nearly 2 million shell accounts to meet various sales targets. Many of these accounts were opened illegally and without customer consent. These actions were inexcusable and created substantial work to rebuild the reputation of the bank in the years ahead. During the media maelstrom that followed the price of the business declined to a level that we believed was attractive and we purchased the company. We wrote extensively about exactly what occurred in our original research report which can be found here.

Since our purchase there have been several positive developments at the bank. John Sloan, the new CEO, has made restoring trust his number one goal in the years to come. Rebuilding trust with customers is paramount to success for any institution and the early efforts indicate that things are moving in the right direction. The following actions have been taken:

1) The company has put in place a "Sales Practice Remediation Plan" to eliminate the behavior that originally caused the scandal. Incentives are now focused more on customer satisfaction with no production sales goals. Success is based on customer service, increases in primary customers, household relationship growth, and risk management. The new plan is geared toward team performance and branch goals, not individual goals. The company will be closely monitoring results for any unintended outcomes or behaviors prompted by the new plan.
2) The company has been diligently contacting customers to address their concerns and apologize for any harm that was done. Thus far Wells Fargo has refunded $3.2 million to customers for remediation.
3) The company implemented a nationwide mediation program at no cost to customers. The program is an opportunity for Wells Fargo customers to receive free legal counsel in law suits against Wells Fargo. While this has potential conflicts of interest, we believe this has been done in good faith.
4) The company increased its minimum hourly pay by 12% and is now 86% higher than the national average.

The new plan seems to be effective thus far. There was a modest increase in banker interactions year-over-year and customers are opening more checking accounts than are being closed. Also, customer experience scores are trending up from the lows in October.

The financial results for Wells were very different from the headlines. The bank continues to grow despite the negative goodwill that occurred throughout the year. At year end Wells Fargo posted $21.9 billion in profit – nearly a record for the company. The total loans increased $51.9 billion to a total of $964.1 billion and total deposits increased $67.3 billion to $1.3 trillion; both records for the bank. Due to the ultra-low interest rate environment the net interest margin was a paltry 2.87%. We would anticipate that rate increases would increase the profitability at Wells considerably.

Future Expectations – We anticipate that the scandal of 2016 will fade into the past for customers throughout 2017 and business will return to normal. Our primary focus will be continuing to analyze Wells Fargo's lending practices and ensuring that if the economy performs poorly the bank will remain profitable. We will perform an internal analysis of the loan portfolio and 'stress test' this portfolio semi-annually to ensure Wells Fargo continues to operate as the best of the large banks.

We also continue to think about what impact interest rate increases would have on the bank. The company has purposely positioned their balance sheet to earn less money today and earn more money in the future if rates were to rise. While we make no guesses as to where interest rates will be in the future, we do believe this is a prudent way to run the bank. The way the assets and liabilities are currently structured it is estimated that for every 25 basis points interest rates rise it would yield about $600 million per year in increased profits (~3%).

Due to the tremendous size of Wells we do not anticipate robust growth in the coming years, but expect to earn an adequate return through the share repurchases and dividends paid by the company. This makes Wells Fargo a Selective Buyback Company and due to the sharp price rise from our purchase we will not be purchasing the company again at current levels.

International Business Machines

Ticker: IBM
Purchase Price: $151.39, Current Price: $165.99
Dividends: $8.50
Gain: +15.3%

2016 In Review – IBM continued to have difficulties with revenue and profits slowly on the decline. The company earned just under $12 billion and utilized this cash to acquire 15 new companies, while simultaneously paying $9 billion in dividends and share repurchases. In constant currency the business is earning about 5% less than it did in 2015, but as we stated before, the strategic imperatives will soon be large enough to reverse the downward trend. The strategic imperatives are now 42% of the total revenue and cloud revenue is currently $13.7 billion (up 35% from the previous year). The strong grow in these key areas will be large enough to offset the declines in the legacy business by 2018. The long struggle for IBM should be nearing an end. Last year we mentioned that despite the struggles at IBM we believed it was a worthwhile investment due to the high quality nature of the business and the very low price. The business remains high quality, but with a 40% price increase from a year ago it is not as cheap as it was last year.

Future Expectations – The share buyback program continues with great success. When we first bought the company IBM had just over 1.1 billion shares outstanding – today that figure is less than 948 million. This represents a 17% increase in our ownership of IBM with no further investment on our end. In addition to the strong share repurchase program the company has paid us nearly 10% of our initial investment in dividends. Our expectations for IBM remain unchanged – we believe that 2018 will be the first year that revenue and profits return back to growth. Due to the large increase in the stock price during 2016 it is possible we may exit our position in IBM since the effectiveness of the share repurchase program will diminish as the price rises.

Cognizant Technology Solutions

Ticker: CTSH
Purchase Price: $50.36, Current Price: $56.03
Gain: +11.3%

2016 In Review – Cognizant had a wonderful year posting 10% year-over-year growth on the key metrics for the business. Revenue and income reached all-time highs at $13.5 billion and nearly $2 billion, respectively. The company is 30% larger than when we originally made our purchase back in 2014. There was one notable negative event in 2016 – a violation of the Foreign Corrupt Practices Act (FCPA). The volition coincided with the resignation of long-time President Gordon Coburn. Based on the facts we assume that Mr. Coburn likely bribed Indian officials for building permits for some facilities in India. The company has stated that the FCPA violation was tied to a "small number of company-owned facilities."

After the announcement the stock price of Cognizant collapsed 17%, or $4.5 billion, to the lowest level in nearly two years. We quickly began evaluating the potential impact of the violation and came to the conclusion that the financial impact would likely not be material relative to the decline in price for the business. We came to this conclusion by specifically reading through the FCPA to determine the potential size of fines levied against the company. The fines are typically capped at $2 million per incident, but can range based on severity and type. It is stated that *"the court has the authority to increase the FCPA-mandated fines under the Alternative Fines Act, 18 U.S.C. 3571(d), up to twice the amount the offender stood to gain through his or her illicit financial transaction…"* Cognizant has 10 locations in India and even if all of these real estate assets were acquired through bribes, which was extremely unlikely, the total value of these facilities multiplied by two would be much less than $4.5 billion. Additionally, the company had a net cash position of $4.1 billion at the time of the announcement, so the fines would be paid easily. We also evaluated the impact on customer relationships, the most valuable asset for Cognizant, and concluded they would not be impacted in the long-term from the announcement. We purchased more shares during this turbulent time.

During the most recent conference call it was disclosed that the total improper payments found to date is ~$5 million dollars. We will keep you posted on future developments of the internal investigation. We outlined our stance on this from an ethical perspective in the section of this annual report titled "Selective Insight: Business Ethics" and a Selective Video on this topic can be found here:

https://www.youtube.com/watch?v=W7-OY75wtbM&t=1s

Future Expectations – We expect Cognizant to have another record year in 2017. We would expect revenue to grow between 3% and 10% plus any additional revenue from acquisitions. The company currently has a large cash balance of $5 billion with only $900 million in debt remaining from the original ~$1.7 billion issued to purchase Trizetto two years ago. We would not be surprised to see this cash balance utilized for another large acquisition, dividends, or share repurchases.

Two major developments we intend to watch closely throughout the year are the potential changes the new administration may have on the H-1B visa program. This program allows skilled workers from foreign countries to work in the United States and Cognizant is the largest recipient of such visas in the world. If this program is modified or change we believe it could negatively impact Cognizant for roughly 12 to 24 months, but long-term the business economics would remain unchanged.

Also, Elliot Management, a large hedge fund, recently purchased 4% of the company and has launched an activist campaign to encourage Cognizant to deploy more profits back to owners. The letter Elliot sent to Cognizant's management team can be found here:

http://elliottletters.com/cognizant

We do not have a strong preference about how the capital is allocated at this time and trust management's decision making processes. We will keep you informed about how Elliot's involvement impacts the company during 2017.

Oracle Corporation

Ticker: ORCL
Purchase Price: $36.05, Current Price: $38.45
Dividends: $0.60
Gain: +8.3%

2016 In Review – Oracle was in a similar position to IBM during 2016. The shift from selling perpetual licenses, where cash is collected up front, to providing SaaS or cloud based solutions dampened near term results. Recurring revenue at Oracle grew very quickly and the company still enjoys the same dominance in the enterprise software space. Revenue was stable, despite the mix shift toward recurring revenue. In the upcoming years the cloud based model will allow Oracle to exhibit the same type of growth it has enjoyed in the last decade. The CEO, Sanfra Catz, eluded to this on the last conference call:

"While the investments we've made to transition our Business to the cloud had limited our ability to expand earnings per share near term, they've been important to ensure that Oracle remains the technology leader. With cloud overtaking new software licenses revenue, we expect our Business to once again exhibit the same pattern we delivered over the previous decades…"

In addition to largely completing this transition to the cloud based model Oracle also spent $9.3 to purchase the fast growing competitor, NetSuite. NetSuite offers ERP software to businesses that track inventory and manufacturing processes and perform accounting tasks. This SaaS solution is a natural complement to Oracle existing database and HR ERP software solutions. Oracle had a fantastic 2016.

Future Expectations – We are launching the Selective Opportunity Fund on February 1st and as part of our preparation efforts for the Fund launch we will be selling our Oracle position. This will occur in late January. The reason for the sale is that our total Oracle position is too small to contribute meaningfully to the Fund performance (even if Oracle were to double it would not add a meaningful return to the Fund). The price of Oracle is currently higher than we would like to repurchase the position. We will be watching the company closely in the future.

Baidu Inc.

Ticker: BIDU
Purchase Price: $155.85, Current Price: $164.41
Gain: +5.5%

2016 In Review – Baidu posted record revenue with growth just under 10%, despite having a very difficult year. The company ran into serious regulatory issues early in the year when a student passed away after receiving a rare cancer treatment that he found from Baidu search results. This incident received attention at a national level and regulators requested that Baidu reduce the number of paid ads that appear on search pages, as well as spend additional effort vetting advertisers. Baidu went above and beyond the regulatory requests and is striving for the best user experience possible for search in China. The company suspended all advertisers on their website and individually vetted each one prior to allowing them to advertise again. With more than 500,000 unique advertisers this process took most of the year. Despite the major setback, the operating profit of the core search business was nearly $4.8 billion or 12% higher than the previous year. This goes to show the robust growth of Baidu's search business.

The company made substantial progress in the online-to-offline (O2O) efforts. As a reminder, O2O is an ecosystem Baidu is creating where users search for services online, such as a food take-out delivery, and purchase this item in an offline store, like a local restaurant. In order to grow the ecosystem Baidu is attracting users to their platform by subsidizing the offline purchases (i.e. a coupon for the food purchased). The company originally planned to spend $3.2 billion investing into this platform over three years, with 2016 being the first year of investment. During the year the company spent more than $2 billion developing the transaction platform and the Gross Merchandise Volume (GMV) purchased through the platform nearly doubled from $6 billion in 2015 to almost $12 billion in 2016. The company is not yet monetizing this GMV in a meaningful way, but we can make some estimates to evaluate if this $2 billion investment is going to be worthwhile.

In order to calculate the additional profit from the O2O business we multiply the increase in GMV during 2016 by the estimated take rate on these transactions, which we think may be 10%. Therefore, the $6 billion in additional GMV could potentially generate $600 million in revenue for Baidu. This could be an outstanding investment, but it is too soon to tell. If users are sticky and increase spending on the platform over time then the $600 million in revenue would repeat each year (or possibly go up) without much incremental investment. This would mean the $2 billion investment could yield nearly 25% depending on the profit margin of this new revenue. As a platform business we believe this

margin could be very high (and go higher). The success of this investment will be determined by user behavior in the future, which is currently unknown. Without subsidies will users come back to the platform? Will they switch platforms as more competitors arise? These questions will be answered in the future, but at the current time we believe this is sufficient data to continue the efforts and the company seems to agree. It is important to remember that is the O2O business completely fails, the core search business of Baidu is still an incredible investment at current price levels. The success of this division would be an added bonus to a sound investment.

Future Expectations – Despite the challenging year we see no material change to our original investment thesis. The profit engine of Baidu is intact and the growth dynamics highlighted in last year's report remain in place. With the regulatory issues behind the company and the advertising customer base fully vetted, we anticipate Baidu will resume growth in the high teens (low 20s) throughout 2017. We currently believe Baidu is our cheapest business, but unlike IBM last year, it also is one of our most dominant. To get an idea how cheap the company is you can watch a Selective Video here:

https://www.youtube.com/watch?v=go-nHoLKLxU&t=164s

Note: Baidu starts around the 2:20 mark.

Businesses Sold During 2016

During 2016 we sold five companies for a variety of reasons. LinkedIn was acquired from us, SPS Commerce was sold due to valuation, National Research was sold to free up cash, and the remaining two were sold as defensive measures due to changes in our future projections of the business. We are pleased to say that all five companies were sold for a profit.

Table 2: Businesses Sold During 2016

Business	Report	Symbol	Purchase Price	Sale Price	Dividends	Gain (Loss)[4]
LinkedIn	PDF	LNKD	$100.93	$189.60	-	+87.9%
SPS Commerce	PDF	SPSC	$41.41	$60.40	-	+45.9%
National Research Corp	PDF	NRCIB	$32.61	$33.70	$3.11	+12.9%
Wal-Mart	PDF	WMT	$69.10	$69.15	$1.25	+1.9%
Autohome	PDF	ATHM	$25.03	$25.46	-	+1.7%

LinkedIn

Ticker: LNKD
Purchase Year: 2016, Sale Year: 2016
Purchase Price: $100.93, Sale Price: $189.60
Gain: +87.9%

Sell Decision – We sold LinkedIn shortly after the announcement that Microsoft would be acquiring the company for $26.2 billion or $196 per share. After the acquisition was announced Business Insider conducted an interview about our investment which can be found here:

http://www.businessinsider.com/sumzero-chris-devlin-linkedin-2016-6

Due to the small size of our firm, when a company we own is acquired we have very little say in the outcome of the acquisition. We do believe the purchase price for LinkedIn was fair and this was a very successful investment for us, despite the short-term duration.

SPS Commerce

Ticker: SPSC
Purchase Year: 2016, Sale Year: 2016
Purchase Price: $41.41, Sale Price: $60.40
Gain: +45.9%

Sell Decision – Our sale of SPS Commerce was based on valuation. At our time of purchase we believed the company was undervalued and after a 46% gain in market capitalization we believed the price had exceeded the intrinsic value of the business. It is important to note that the large cash balance and no debt at SPS Commerce meant that the change in enterprise value, the most important figure when considering price, was more than the change in market value. The table below presents the mathematics behind the change in enterprise value for SPS Commerce based on the change in the stock price.

Decision	Date	Share Price	Shares Outstanding	Cash	Debt	Market Capitalization	%Δ Market Cap	Enterprise Value	%Δ EV
Purchase	March 10, 2016	$41.41	16,843,440	$144M	$0	$697M	-	$553M	-
Sale	July 10, 2016	$60.40	16,883,068	$135M	$0	$1,019M	**46%**	$884M	**60%**

As the table above demonstrates, the 46% change in stock price equated to a 60% change in the enterprise value of the business. Based on the increase in valuation for the business we elected to sell and protect our investment. For additional details about market capitalization, enterprise value, and how large cash balances impact these two variables you can watch a Selective Video here:

https://www.youtube.com/watch?v=8m3Z4Ijah04

National Research Corp

Ticker: NRCIB
Purchase Year: 2014, Sale Year: 2016
Purchase Price: $32.61, Sale Price: $33.70
Dividends: $3.11
Gain: +12.9%

Sell Decision –National Research Corp was sold to free up additional cash for the purchase of LinkedIn. The business continues to perform very well and is on our radar for future purchase. We had mentioned last year that we wrote a letter to the Board of Directors outlining the detriments of the two class share structure utilized at NRCI. Due to our small size the Board did not reply to our letter and nothing material occurred as a result of our efforts.

Wal-Mart

Ticker: WMT
Purchase Year: 2015, Sale Year: 2016
Purchase Price: $69.10, Sale Price: $69.15
Dividends: $1.25
Gain: +1.9%

Sell Decision – As we continued to assess the competitive position of Wal-Mart against e-commerce rival, Amazon, we became less comfortable with the long-term prospects of the company. At the time we purchased Wal-Mart we knew the company had a dominant position in brick-and-mortar retail and that the competitive landscape for retailing was shifting online. We were not sure if Wal-Mart would win or lose against Amazon during this shift, but we assumed the change would be gradual and money could be made as owners of Wal-Mart during the transition regardless of the ultimate outcome. The shift continues to be gradual (89% of all retail purchases are still done in stores, compared to 92% 10 years ago), but the speed at which Amazon is winning has accelerated. The company was sold as a precaution against Amazon winning market share at a speed that is faster than we originally anticipated.

Autohome

Ticker: ATHM
Purchase Year: 2015, Sale Year: 2016
Purchase Price: $25.03, Sale Price: $25.46
Gain: +1.7%

Sell Decision – Operations at Autohome were progressing nicely throughout 2016 with revenue and cash flows increasing more than 15% year-over-year. However, the newly elected administration in the United States has suggested policies that could potentially put pressure on the exchange rate between the US dollar and Chinese Yuan. Specifically, the president elect has suggested a 45% tariff on Chinese goods to make them less attractive for Americans to purchase. The theory behind the tariff is that this would bring manufacturing back to the United States. If a tariff, regardless of size, were implemented against Chinese goods it may be logical for the Chinese government to devalue the Yuan to keep their exports competitive in the United States. The sample of the following pages is an example of how this could potentially work.

Selective Insights: How Tariffs Impact Trade

When tariffs are levied against the imported goods of one nation the impact is not as straight forward as one might suspect. Below is a highly simplified example of how potential tariffs against China could impact the trade relationship between these two counties.

<u>Initial Condition: Exchange rate is 6 Yuan per Dollar</u>

A product is manufactured in China for 50 Yuan and purchased by an American business, such as Wal-Mart, for 60 Yuan ($10.00). The product is marked up $2.50 and sold to a US consumer for $12.50.

<u>Add Tariffs</u>

The same product is manufactured in China for 50 Yuan and purchased by Wal-Mart for 60 Yuan, plus a 45% tariff. The purchase price is now $14.50 . In order to maintain the same level of profitability Wal-Mart would sell the product to a US consumer for $17.00. The theory is that this would put pressure on Wal-Mart to find a cheaper source for the good, potentially a US firm (unlikely). However, China could respond by devaluing their currency to remain competitive.

<u>New Assumption: China devalues the Yuan to an exchange rate of 9 Yuan per Dollar</u>

The same product is manufactured in China for 50 Yuan and purchased by Wal-Mart for 60 Yuan ($6.67), plus a 45% tariff ($3.00). The total purchase price is now $9.67 and the product is sold to a US consumer for $12.17. This would keep the profits identical for the American company and the Chinese company. The difference is that now the US dollar and Chinese Yuan trade at a different rate. The new exchange rate would have a very material impact on other areas of the US-China relationship. One such consequence is that it is now cheaper for Americans to purchase assets in China.

If the tariffs are implemented it has the potential to decrease the price of Autohome for US investors. Autohome currently earns roughly 1.2 billion Yuan or $200 million US dollars. A new exchange rate would not impact the profits of Autohome in the local currency – it would still be 1.2 billion. However, the company would only be earning $133 million US dollars after the currency exchange, making Autohome less valuable to US investors.

At our time of sale we owned both Baidu and Autohome and decided the currency risk was too great to continue ownership of both Chinese companies. We elected to sell Autohome and maintain our ownership in Baidu.

Selective Insight: Business Ethics

Every year we dedicate some time in our annual report to highlight lessons learned or teach about an important aspect of business ownership. This year we've elected to dedicate some time to discuss business ethics. In 2016 two of our Selective Companies, Baidu and Cognizant, had events occur that were highly publicized and placed them under regulatory scrutiny. We also purchased Wells Fargo after the announcement of the account opening scandal. Due to the flurry of events related to ethics surrounding our businesses we wanted to outline our expectations for a Selective Company in general and then specifically address the events that occurred at our businesses. For those interested, please take some time to read our Selective Insight on Business Ethics located here.

Closing Remarks

Overall we were extremely pleased with performance of our Selective Companies throughout 2016. Investment performance from the inception of the firm is ahead of the market after all fees have been paid and the Selective Process continues to improve each year from lessons learned. The firm has grown more than 100% per year since inception and after exceeding more than $30 million assets we will be launching the Selective Opportunity Fund. The Fund is part of our commitment to lower your expenses as we continue to grow in size. As we enter into 2017 we are again taking a defensive posture with our investment portfolio and currently have more than 50% cash. We are confident that Selective Opportunities will materialize at some point in time – but the key word for 2017 is 'patience'. Looking forward to another great year.

Sincerely,

/Christopher J. Devlin/

Christopher J. Devlin
Chief Investment Officer, Selective Wealth Management
1/21/2017

Clarifications

For those of you that have questions about the returns in your account we would appreciate it if you would read the following carefully because they answer some frequently asked questions and should put your mind at ease with respect to how we are managing your investment account.

Clarification #1 – Your results are different than what is reported on the preceding pages.

Through 2016, we manage all of our client accounts separately, which means that the businesses you purchased and how much you paid is dependent on when you opened your account or contributed funds throughout the year. For this reason all accounts have different results. The results reported are an average of all accounts.

We work extremely hard to make the best decision for each account based on the size of the account and when it was opened. If you are new to the firm your results are likely materially different than those reported – that is expected because you weren't with us for each decision we made this year.

Clarification #2 – You may not have owned all the businesses found in this report.

When a business is available at what we believe to be an attractive price we review how much cash is available in each account and then purchase a position that we believe to be an appropriate size. If you did not own a business found in this report it is for one of two reasons:

1) You did not have an account when we made the original purchase. If you opened an account after we made an original purchase it is unlikely that you owned that business this year. We purchased the business on your behalf *only if* the business was selling for the same price we originally paid or less. If the business rose in price we did not make the purchase in your new account. This is to your advantage as it protects your investment principle.
2) You did not have enough cash in your account at the time of purchase.

Clarification #3 – Returns for each individual business are from the time of purchase to the time of sale.

The sections of this report entitled "Businesses Sold In 2016" & "Selective Companies Presently Owned" describe each business that we purchased, held, or sold during this year. The returns presented in these sections are total returns – meaning the return of the investment from start to finish – regardless of duration. The calendar year of purchase and sale is also provided to show an approximate holding period. We find this presentation style simple, clear, and believe it is a fair way to evaluate the success of each individual investment.

Clarification #4 – The purchase price and sale price for each business may differ from your account.

The purchase price and sale price for each business is typically the same for all clients. Differences exist for individuals that opened an account after we made an initial purchase if the price of the business had declined from our original purchase price. Those new accounts will have a different purchase price.

Clarification #5 – Different accounts held different percentages of the same investment.

Accounts may have purchased a different percentage of a particular investment based on account size. This is to minimize the impact of trading commissions charged by our custodian to your account. For example, a $100,000 account may purchase 10% of a particular stock ($10,000), but a $5,000 account may purchase 20% of the same stock ($1,000). The trading commission of $11 represents 1.1% of the smaller accounts purchase price, but only 0.11% of the larger account. Had we purchased only 10%, or $500, in the smaller account the trading commission would be 2.2%. For this reason smaller accounts are typically more concentrated.

Disclaimers & Disclosures

Past performance does not guarantee future results, and a loss of original capital may occur. The information herein should not be construed as a recommendation to purchase or sell any particular security or an assurance that any particular security held in a portfolio will remain in the portfolio or that a previously held security will not be repurchased. Securities discussed herein may not represent a portfolio's entire holdings. It should not be assumed that any of the security transactions or holdings discussed herein have been or will equal or exceed the investment performance of the securities discussed.

This report is provided for the general information of the clients of Selective Wealth Management LLC. It is not intended for distribution to prospective investors unless preceded or accompanied by an effective prospectus, which contains more information on fees, charges, and other expenses and should be read carefully before investing or sending money.

Definition of the Firm

Selective Wealth Management LLC (the "Firm") is a registered investment adviser that was established in 2012 and has a single, all-cap, value-oriented, concentrated investment style approach. The Firm is based out of Lynchburg, Virginia and services institutional and retail clients in the United States. A list of the Firm's composite descriptions, as well as information regarding the Firm's policies for valuing investments, calculating performance and preparing compliant presentations, are available upon request.

Fees

Returns are presented net of management fees, custodial fees, withholding taxes and trading expenses.

Fee Schedule

The standard fixed management for all accounts is 1.25% and accounts are billed in arrears.