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MONEY MANAGER INTERVIEW

STEVEN ABERNATHY

The Abernathy Group II Family Office

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Managing Assets for Families Through Value-Based Investing

STEVEN ABERNATHY, THE ABERNATHY GROUP II FAMILY OFFICE



STEVEN ABERNATHY is the Founder and Chairman of The Abernathy Group II Family Office. Since 2010 the firm has counseled families on how to manage multigenerational wealth. Mr. Abernathy is also a specialist in shareholder rights. He was a Special Limited Partner and Director of the Executive Services Division at Cowen & Co. He was also a Senior Vice President of Portfolio Management at Shearson American Express. He is a member of the CFA Institute, the New York Society of Security Analysts and a graduate of Fordham University.

SECTOR — GENERAL INVESTING

(AHS504) **TWST: Could you please identify yourself?**

Mr. Abernathy: My name is Steven Abernathy, and I am the Chairman of The Abernathy Group II Family Office.

TWST: Could you tell me a little bit about the firm?

Mr. Abernathy: We are a family office which was created for our own family back in 2011. In 2012, we opened it up to other families that were co-investors in the hedge fund we managed from the 1990s and the early 2000s, dedicated to technology and health care.

TWST: Do you think there is a need out there for firms that are dedicated to wealthier families?

Mr. Abernathy: It is one of the more underserved needs that I have seen over my career. And I am not just saying that because I run a family office. There's a complete and utter misconception that families with assets of \$10 million or more are best served by the nation's brokerage firms. I don't feel like that is the truth. And I can tell you, the evidence suggests it is not the truth. Almost every wealthy family in the nation with \$1 billion or more has their own single-family office. Why? The main reason is that a family office is structured solely to serve the family. It is not built to serve the brokerage firm which employs the salesperson giving advice. There is a big difference between the two structures.

Therefore, my first statement to every family, which has nothing to do with my personal family office, is a structural statement. Technology has enabled the family office structure to serve families with as little as \$10 million today. Every family with \$10 million or more should

meet with a family office to understand the very important differences between a family office and a brokerage firm. My belief is that eventually, every family with \$10 million or more will be represented by the family office structure, not a brokerage firm. We are only one of many choices, and I am sure there is a good fit for almost every family if you look closely.

Warren Buffett offered some of the wisest words for investors seeking an adviser. Warren said there are two variables every investor must embrace when selecting an adviser. It's a simple recipe. First, the adviser needs to be honest, and second, the adviser needs to be competent. However, they must be both honest and competent, because one without the other leads to disaster. Here's why he offered this sage advice. If the adviser is honest yet not competent, the adviser is going to make unintelligent investments, and you will lose your wealth. And if the adviser is competent yet not honest, the adviser will find a way to magically make the money in your account move into the adviser's personal account. So Warren Buffett's sage advice offers a wealth of wisdom.

Our advice for any family with \$10 million or more in assets that wants or needs help with their personal legal, financial, tax and estate planning is to implement that simple formula. Let me offer a few words of advice for families interested in a better solution than getting advice from a conflicted brokerage firm. I built this multifamily office

for my family, so I had the luxury a lot of families don't have in that I could pick and choose how to structure this firm to best serve our families, not to generate a bunch of transactions.

Highlights

Steven Abernathy discusses running a family office. Mr. Abernathy says there is an underserved need for firms dedicated to wealthier families. He reflects Warren Buffett's advice for seeking an adviser: Choose an adviser that is both honest and competent. He also says every adviser should have owned and run a business for at least a decade. Mr. Abernathy says that since the election, he has started to reallocate assets for the families he represents, and he is watching interest rates closely. He has increased the firm's subjection to variable rate assets, and on the equity side, the international component has been reduced.

Honesty is the first building block of any framework or structure that you are going to offer your family. Make sure the adviser works only for you and your family. Having the adviser receive compensation from any other source anywhere is a prescription for disaster, meaning conflicts of interest. Get rid of all of the conflicts of interest at all costs. And don't let the adviser hide under that legal mask that says, I told you there were conflicts, therefore I can now engage in those conflicts. This type of chicanery is incredibly unfair and deceiving, yet many of the nation's largest brokerage firms operate under this loophole.

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The Department of Labor, DOL, is advancing the Fiduciary Rule, which maintains any adviser to a pension fund needs to be a legal fiduciary. If the DOL rule passes, it will mean that any advice delivered to a retirement account or pension fund participant that is not in their best interests will be liable for prosecution. This is 101-level business intelligence. The Fiduciary Rule should be enforced for all advisers, bottom line. Every wealthy family must ensure their advisers have no conflicts of interest. And the only way to do that is to hire them — make sure they work directly for their family.

Next is determining competence. How do you figure out whether someone is competent or not? It is incredibly simple. Any competent professional investor will have an audited track record from a well-known accounting firm. Every family should insist on a professionally audited track record from anyone offering investment advice. End of story. I mean there is no professional investor on the planet that doesn't have an audited track record. They all do. If the adviser tries to give you hypothetical portfolios, which I've seen many times in my life, where they've just gone back and picked funds that outperformed historically, you need to look elsewhere.

Finally, most decision-makers in a family are going to be able to relate to this last requirement. Every adviser should have owned and run a business for at least a decade before you hire them. The reason? Most families are going to be responsible for running a business. Decision-makers understand that someone who is the CEO or a very senior person running a business must have decision-making skills that are outstanding along with solid people skills. These skill sets are often helpful to a family's decision-maker.

I think there are three pieces of advice for most families interested in setting up an intelligent structure to help them make decisions for their family. First, make sure the person you're hiring is honest, meaning make sure they work directly for you and accept compensation from no other source. You must trust them. Second, make sure they are competent. Insist on an audited track record, preferably 10 years or more. And third, make sure they have run a

business before, because decision-making and people skills are going to be incredibly important to you at some point in the future.

TWST: When you look at 2017, what are some of the issues that you think might arise, particularly for family investors and family offices?

Mr. Abernathy: It's clear that we face a future with a changing government. And we aren't exactly sure what to expect yet. Most wealthy families are focused on staying wealthy. Family offices should first protect the family's asset base and only then focus on growing it.

I also think fees are important. Every fee you pay detracts from your net worth. So ensuring the fees you're being charged are reasonable and the fees charged truly incent the adviser to offer as much help as they can. Families should expect fees to be a fraction of 1% and be tax-deductible — that is a structure every family should demand.

TWST: With some of the Trump proposals, there is an effort to get American companies to return to the United States with operations, with cash. There is also an effort to reduce regulation. Are those things going to have an impact on wealthier families and family offices?

Mr. Abernathy: They most certainly will, if they are implemented. The question always becomes, will the head of the United States be able to implement these proposals? It is very easy to have campaign rhetoric or campaign promises go unfulfilled. And I'm not saying that is going to happen with President-elect Trump. I'm hoping many of the initiatives he outlined actually are implemented. On the other hand, I'm hopeful a few of the initiatives he outlined aren't going to be implemented, because it would set us back 50 years with respect to protectionism.

The bottom line is I don't think we know what will happen yet. However, if his initiatives are implemented, it will likely be a positive for companies doing business in America. So I would say that smaller-capitalization companies will benefit more than larger exporting companies. We've started to reallocate assets for the families we represent.

TWST: And there has been talk about a rise in interest rates. So you're watching that, too?

Mr. Abernathy: We are watching it like a hawk, yes.

TWST: What impact might that have?

Mr. Abernathy: Well, for almost 10 years now interest rates have been so low that pension funds and professional investment firms have been unable to match their liabilities with the interest rate structure they need to fulfill those liabilities. Now that interest rates have popped back up a little bit, it's going to help them match liabilities. That is helpful. However, higher interest rates are restrictive toward businesses. The reality is that if interest rates go from 1.8% on the 10-year U.S. Treasury note to 2.5%, it's not a big deal, little will change. If interest rates go from 1.5% on a 10-year Treasury to 5% on a 10-year Treasury, that's a big change, and that will be a negative for the U.S. GDP.

TWST: How do you respond to that with what you do?

Mr. Abernathy: We manage assets on both sides of the balance sheet, on the liability side and on the asset side. For the assets we are overseeing, we have increased our subjection to variable rate assets. These are debt instruments that will reset as interest rates rise.

We have shortened the term of the assets on the debt side, meaning we've gone from longer-term bonds to much shorter-term bonds.

On the equity side, we've taken down our subjection to foreign economies, meaning the international component of our portfolios has been reduced. And we've slightly lowered our subjection to the largest companies in the United States that are export-driven and reallocated that money into the smaller-capitalization value companies in the United States.

TWST: And moving to another topic, you've worked on activism and investor activism. What do you see going forward in the next year? Is it going to pick up, or do you think it'll be about the same as it was?

Mr. Abernathy: Shareholder activism is a topic that is relevant to many families, because families typically own large positions in companies, both private and public. Most activist targets are value investments. History has shown that value investments tend to outperform most other segments of the market over time. Almost every activist target company has made some mistakes. They've done some things that were not intelligent, and because of that, they have often become significantly undervalued.

Activists often seek undervalued companies with a clear pathway to value creation. The best activists today are incredibly intelligent investors. Keep in mind there are about 375 companies claiming to be activists, yet in our opinion, there are probably 50 who are real activists and probably only 15 who are real experts, meaning investors you can confidently follow when they file a form 13D.

We have written several papers on the activist investing category. The top 15 activists are the smartest people in the room, without a doubt. They spend the time to truly understand the company's business model. They figure out what's wrong with the company. They figure out how long it's going to them to fix what's wrong with the company, and they determine how much it's going to cost. If they determine the company is undervalued, and there is a clear pathway to value creation, they buy the stock and/or bonds, then go to work with the board and management to fix the company. They invest their time and their money. All of the legal fees are borne by the activists. And when their plans to fix the company work, all shareholders benefit. They're perfectly aligned with shareholders.

It's not the same structure that was prevalent during the 1980s, when you had greenmailers taking big positions in companies and then forcing management to buy their stock at a premium to the market. Today's activists are outstanding investors and strategic thinkers. They really are the consultants of the future. Think about it just for a second. For the last 50 years, when a company got in trouble, they hired Bain or Accenture to come in and fix the company. Then they wrote them a check for \$25 million to \$75 million to do it. The activists of today will do it for free. And they demonstrate their conviction by buying 5% to 20% of the stock outstanding before they fix the company as the way they plan to make money, which aligns them perfectly with all other investors.

In essence, you get the best consulting on the planet free, with a vested interest that is shareholder friendly. I think activism will have legs for many years to come.

TWST: And do you see it picking up in 2017?

Mr. Abernathy: Well, it has already picked up. In the last three years you've had shareholder activists coming out of the woodwork. It used to be that there were about 200 firms claiming to be shareholder activists. Now they are 375 companies claiming to be shareholder activists. As technology allows communication to become more prevalent and easier to access, you will find more and more shareholders becoming involved and supporting activism. Shareholder activism in its truest form is a positive for the market in most instances.

TWST: Do you think it will increase too if there's a lessening of government regulation?

Mr. Abernathy: It depends on where the regulation is focused. It feels like regulation is going to support the shareholders. And remember, it's the shareholders that own the company, not management. Shareholders own the company. The board works for shareholders, and management works for the board. Management doesn't work for shareholders. They should have shareholders' interests in mind, but they are responding to the board's commands. We hope that less regulation will be a positive for shareholder ownership.

TWST: We were talking about the quality of the people that are involved with activism. Do you think President Trump might look to some of them as he starts to staff his administration and find officials who will help around the government, or even just people he can contact when he is trying negotiate treaties?

Mr. Abernathy: Most certainly, we've already seen some of the most well-respected activists, Wilbur Ross and Carl Icahn as examples, mentioned as candidates for one or more of the posts in the Trump administration. So it appears that he is trying to create a staff composed of the best business people available anywhere, and activists could make up a good part of that component. Shareholder activists have proven track records of creating value. Over the course of the last 15 years, activism has outperformed the market by about 12% a year. So activists know what they're doing. Certainly, the best, the top 15 activists in this nation really know what they're doing. And while no one is always right, activists are right so often that it's worthwhile knowing what positions they are taking and to follow them when there is a clear path to value creation.

TWST: Thank you. (ES)

STEVEN ABERNATHY

Founder & Chairman

The Abernathy Group II Family Office

17 State St.

16th Floor

New York, NY 10004

(212) 293-3499

www.abernathygroupfamilyoffice.com