FIRST LONG ISLAND INVESTORS, LLC

SECOND QUARTER 2016 REPORT

INVESTMENT PERSPECTIVE

INVESTMENT COMMITTEE

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June 30, 2016

"Fear keeps you from making as much money as you ought to."

Jesse Livermore, (aka the Great Bear on Wall Street)

The second quarter ended with significant volatility (both down and up) after an even more volatile start to the first quarter. Various fears contributed to the volatility in both quarters. The most recent of which was from the surprise vote by a slim majority in the United Kingdom which chose to depart the European Union (Brexit). However, even after absorbing such volatility in both quarters, the following are the surprisingly reasonable results year to date through June 30, 2016 for the major domestic averages:

S&P 500 Index	+3.8%
Dow Jones Industrial Average	+4.3%
Nasdaq Composite	-2.7%
Russell 1000 Value Index	+6.3%
Russell 1000 Growth Index	+1.4%
Barclays Aggregate Bond Index	+5.3%
HFRX Equity Hedge Index	-3.9%

The above shows that despite the increased level of volatility (which we have warned of in the last several of our quarterly letters and web seminars) market performance has not been anything near catastrophic. With respect to our FLI strategies, some strategies are doing well, for example FLI Dividend Growth is quite positive and beating its benchmarks so far this year. Long-term investors who wish to achieve reasonable appreciation over the long term must hold on and endure periods of volatility.

Speaking of volatility, the most recent serving of it from the United Kingdom appears to be overdone at least for our domestic economy. Exports to Great Britain account for about three tenths of one percent of our gross domestic product. Britain is not even in the top five of our trading partners. Some economists believe that the uncertainty caused by this vote, which may take as many as two years or more to implement, may cause Gross Domestic Product (GDP) growth in the U.S. to be about one quarter of one percent slower than prior estimates, and perhaps global GDP growth to be about one half of one percent slower than previous estimates.

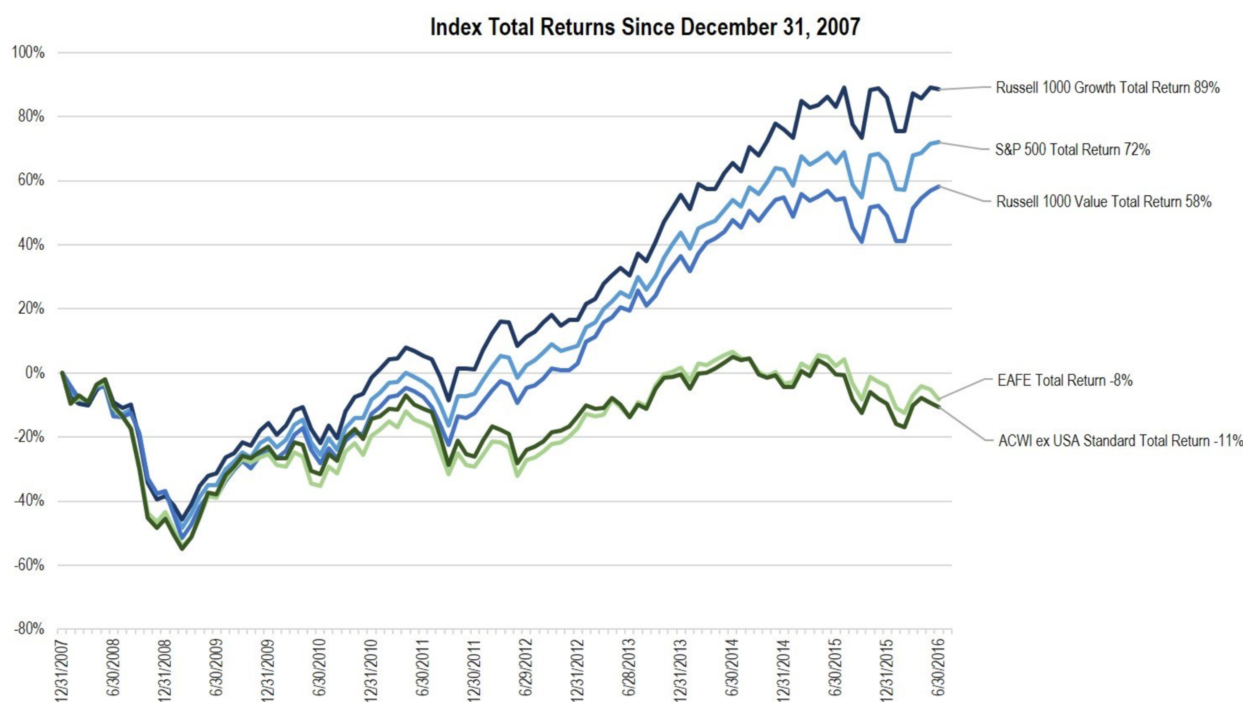
Their belief is that neither the U.S. nor the global economy should fall into recession at this time. Of course, it is too early to tell as these are initial estimates, however, it is fairly certain that the British Pound Sterling has lost value, and this could cause an increase in inflation in the United Kingdom as imports of products for consumers and businesses there will be more costly with a weaker currency.

It seems to us that, despite shocking and fearful headlines, business in the U.S. will be pretty much the same for consumers and for most businesses. This volatility and uncertainty, however, will most likely keep the Federal Reserve on the sidelines and, thus, we probably will not see an interest rate increase in the immediate future (earliest likelihood December). Also, the anticipated modest growth slowdown could also cause commodities prices to remain reasonable, which should keep domestic inflation at relatively low levels, in our opinion.

Let me make an observation: for many years now our equity, bond, and commodity markets seem to have been impacted by trouble emanating from the Eurozone. For several years, it was the prospect of economic failure in Greece causing that country to consider departing the European Union. After many years of haggling and agita, that does not seem to be happening. Now, we can obsess about the United Kingdom, which might be the first country to leave the European Union. I am not minimizing potential volatility, however, we believe that business will go on pretty much as it has. We don't foresee a financial crisis similar to what we faced in 2008/2009. In addition, domestic banks seem to be on more of a solid financial footing with much higher capital and improved credit quality. (The Fed recently issued the results of a supervisory stress test showing banks would be resilient in a recession.)

What we do face is stagnant earnings growth for many companies. In fact, operating earnings have dropped somewhat in the last year reflecting, in our opinion, a lack of supportive fiscal policy from a bogged down Congress. This is holding back investment from many U.S. companies that have significant cash balances. Instead, some of that money is being used for company stock buybacks as well as mergers and acquisitions. The buybacks make reported earnings per share for those companies increase more than the operating earnings. Our task is to find those companies for our various investment strategies that may be buying back stock, but also have real earnings growth.

Given the constant concerns about Europe and fears of a slowdown in the Chinese economy, we have for many years underweighted our client's exposure to internationally domiciled companies. This goes against what many consultants and major banks would advise, but it works for us and so far we have been right according to the poor results for international indices. The following graph shows how the international indices have performed versus domestic indices since December 31, 2007:



Source: Standard & Poor's Financial Services LLC, FTSE Russell, MSCI INC., First Long Island Investors

As you can see, foreign indices have done very poorly versus domestic indices. At some point, this might change, but we would rather be late to that party and have avoided investing more heavily in international markets for the past several years. In addition to political uncertainty in Europe, Japan, and China, both Europe and Japan suffer from demographic challenges as their populations are not growing (except for an influx of immigrants to Europe from the Middle East). Europe is also facing a serious economic and cultural problem from its open border immigration policy. We are content to primarily own U.S. domiciled companies that do substantial international business as well as those whose operations are almost purely domestic.

The above discussion amplifies why a prudent and conservative asset allocation, as well as being focused on the long term, are essential. Being a long-term investor with a prudent asset allocation reduces the effect of volatility over the longer term, in our opinion. It is why our investment committee meets every quarter to go over the asset allocation of every one of our clients.

We have made it clear for several quarters that volatility would spike this year given concerns (among many) about global growth, volatile oil prices, and the U.S. presidential election. We look at each client's asset allocation through a defensive lens. This task has been made more difficult by the paltry returns on bonds. Keep in mind that as of June 30, 2016 the 10-year Treasury yield was 1.5%; and a 5-year AAA rated municipal bond yielded less than one percent. Neither provides an after-tax return above the current rate of inflation and this financial repression may continue for an extended period.

To summarize, volatility is something we must learn to live with. We have helped our clients achieve reasonable absolute returns as well as their goals while enduring and recovering from many market downturns due to volatility (or otherwise) which sometimes is caused more by political uncertainty than economic issues. In the past thirty years, we have faced market downturns equal to that of June 24th, the day after the Brexit vote, fifty times including June 24th. We always review asset allocations for changes driven by valuation and a client's change of circumstances. Speaking of valuation, we do not believe markets are cheap, but we also do not believe prices are in nosebleed territory for the companies and real estate related investments that we invest in. Please remember that we prefer to invest in concentrated portfolios, where we and the managers we work with seek out the highest quality companies, with good prospects for earnings and/or dividend growth supported by strong financial fundamentals or companies believed to be undervalued. Yet despite these favorable characteristics, patience is required as there is no substitute for focusing on the longer term. Returns in most asset classes are lumpy, however patience will help investors endure volatility.

As the opening quote suggests, those who capitulate to fear will rob themselves of meaningful returns over the long term. To last as investors for the long term, one has to have a prudent asset allocation. It is our goal to achieve that for all of our clients. We remain cautiously optimistic for the long-term investor to make reasonable returns in this volatile world we live in.

Best regards,

Robert D. Rosenthal
Chairman, Chief Executive Officer,
and Chief Investment Officer

Disclosures, Important Information

**The forecast provided above is based on the reasonable beliefs of First Long Island Investors, LLC and is not a guarantee of future performance. Actual results may differ materially. Past performance statistics may not be indicative of future results. Disclaimer: The views expressed are the views of Robert D. Rosenthal through the period ending June 30, 2016, and are subject to change at any time based on market and other conditions. This is not an offer or solicitation for the purchase or sale of any security and should not be construed as such. References to specific securities and issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.* *Content may not be reproduced, distributed, or transmitted, in whole or in portion, by any means, without written permission from First Long Island Investors, LLC. Copyright © 2016 by First Long Island Investors, LLC. All rights reserved.*