TRIAD
INVESTMENT MANAGEMENT

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4th Quarter 2014 Investment Review

Investment Thoughts

"I'd rather have a lumpy 15% than a smooth 12%." Warren Buffett

Our company culture is to focus on long-term investing success. That's what I get up in the morning thinking about and what I'm still thinking about when I go to bed. And perhaps when I'm sleeping. I can't be sure, as I'm not too good at remembering dreams. But at least I don't recall any nightmares, investment or otherwise.

Now, many professional investors tell a similar story: we're long-term investors, we don't worry about short-term results, blah, blah, blah. But when you observe their actions, it may reveal a fixation on short-term results, as demonstrated by an average holding period measured in months, not years. Stock renters you might say, not owners. There are of course good reasons for this. Good for managers but not necessarily for clients. Why?

Professional investors generally like their well-paying jobs. So much so, that many work hard to keep their jobs. Meanwhile, many clients desire consistently above-average short-term results. When clients focus on short-term results, many investment managers, with an eye on their employment, will in turn emphasize short-term results. As the German Proverb says: "*Whose bread I eat: his song I sing*."

Unfortunately the competitive world of investing conspires against ***consistently above-average short term-term results***. Our belief is you might achieve ***consistent*** results—market-like returns—OR you might earn ***above-average*** long-term results, but it's highly unlikely you'll get BOTH. Why?

In our competitive investment business, above-average results over long periods after manager fees are the exception, not the norm. The reality is ***around three-quarters of professional money managers underperform their benchmarks after fees over longer periods***. It's the nature of a highly-competitive business with lots of smart people willing to work hard to earn significant compensation rewards. Why such a high failure rate? Many managers fear the wrath of their clients should performance temporarily slip, and therefore engage in what's known as "***hugging the benchmark***" which means investing very much like the index the manager is trying to beat. Common sense would dictate if you try to resemble something by mimicking it, guess what? You'll succeed, which means results similar to the benchmark. However, after deducting fees and other expenses, it's usually a losing proposition for the client. So, if investing like everyone else is a tough way to outperform, how might we achieve above-average results in the competitive world of investing?

It's probably no surprise that I believe ***investors must invest differently than the vast majority of the crowd to have a chance of above-average results.*** If you invest in a conventional manner, you'll likely get conventional, below-average results after fees. If you invest in a significantly different manner, you should expect different results, sometimes doing better than the market, sometimes worse. Over time, diligence and preparation combined with unconventional approaches can lead to better than average results. However, unconventional investing can cause discomfort at times for both clients and us.

So ***it's critical for clients to develop a long-term orientation and the patience*** to wait for the potential rewards. We will forgo a potential new client if we determine that the philosophical alignment is weak. We feel it's better to have a smaller group of like-minded clients than to have a larger number of less-committed clients. Said another way, we'd rather have great investment results with a small group of clients than lousy results with a large group of clients. Life is simply too short for that sort of heartache.

Economic Conditions

"***Anyone who isn't confused really doesn't understand the situation.***" Edward R. Murrow

Murrow, the late, great broadcast journalist who came to fame during World War II, could be describing today's global economy. U.S.-based investors today must increasingly consider events outside of our borders. Although we invest primarily in U.S.-based businesses, many of these companies operate worldwide. So, paying attention to world events is imperative to understanding the risks and opportunities facing each company.

World economic conditions seem to be in greater focus lately, perhaps because the list of global concerns is so long. We have continuing economic malaise in Europe, with Greece potentially departing from the Euro currency. As the TV pitchman says, "*But wait, there's more*". Other challenged European countries include Italy, Spain, Portugal, even France. What ails Europe is pretty simple: less-competitive economies and a very large social safety net, also known as a welfare state. Global competitors without these extensive social obligations (China, India, many areas of Asia and Latin America) can often provide similar goods and services at much lower cost due to lower wages, taxes, workplace rules, etc. Structural reform of taxes, labor rules and business regulations is needed but entrenched interests means it will take years for meaningful reform to emerge. Expect sluggish European growth for some time to come.

But we're only getting started on the global picture. Staying within the European sphere, the Russian invasion of Ukraine has created a backlash of harsh financial restrictions for Vladimir Putin and his cast of Russian oligarchs. The recent plunge in oil prices will likely put Russia into recession, crimping Mr. Putin's wallet and ability to reassemble the former Soviet empire. I'm hoping Vlad the dictator will learn to behave. Time will tell.

China is emerging from its teenager years of rapid growth and approaching adulthood, as the previous ten years of roughly 8-9% real GDP growth gives way to slower, but still respectable growth of perhaps 5 to 7% per year. Slower Chinese growth is one reason oil prices are down, along with other commodities including iron ore, steel, copper, coal and cement. While China still needs housing, roads and other infrastructure, the future will likely see less spending on building things and more emphasis on domestic consumer spending. The Chinese locomotive that powered the world economy over the past 10 years or has downshifted to a slower, but perhaps more sustainable pace.

Japan seems to have passed middle-age and settled into old age. The Japanese economy has been stuck in the mud for over twenty years, and hasn't shown many signs of freeing itself. The current administration is trying a three-pronged approach: fiscal stimulus, monetary stimulus, and economic restructuring. Basically, the first two are increased government spending and flooding the economy with cash. It's the last prong that holds the most potency. Japan's domestic economy has been largely sheltered from foreign competition for a very long time. The result is less-competitive domestic businesses. Slow growth, high prices and extensive local regulations favoring domestic producers make Japan a tough place to do business. In addition the population is aging and Japan must fund pension and healthcare costs while the workforce to pay for it all isn't growing much. A lack of immigration adds to Japan's woes. It doesn't seem likely to improve much in the near term.

Given the weakened condition of many so-called "developed" economies, the global economy will depend more heavily on lesser-developed or "emerging" regions and economies to drive global growth, including China, India, Indonesia, Vietnam, Africa, South America, Mexico, Eastern Europe and others.

These global concerns about weaker economies, combined with political and military tensions, seem to be creating heightened investor anxiety. Since the U.S. continues to perform relatively well, nervous global investors have been buying U.S. Treasury bonds and other perceived "safe havens", pushing up their prices and reducing their long-term investment appeal. These conditions have implications for the investment environment.

Investment Conditions

Given the bevy of global concerns, stock market investors lately seem to be favoring larger companies with relatively recession-resistant operations including consumer products, healthcare, utilities and some technology businesses. The result is increased demand for these businesses. Greater demand leads to richly-valued investments that we continue to avoid. Areas that seem less popular and more undervalued include smaller and mid-size businesses in economically-sensitive areas such as manufacturing, retailing, energy and finance. This is where we continue to fish. The tide will turn, pun intended.

As interest rates begin to rise this year and next, many financial companies we own will benefit from the ability to invest in assets with higher yields. Energy prices should rebound later this year and our energy holdings will benefit. Lower gasoline prices and decent U.S. economic growth this year and perhaps next year creates favorable conditions for retail sales.

Above all, we attempt to invest only when a ***"margin of safety"*** exists where the price paid is low in relation to estimated business value over our three to five year investment horizon.

Margin of safety also relates to business quality and the people managing the business. We generally prefer good businesses with owner-operator managers who have a large ownership position to increase the odds that decisions are made with shareholders in mind. There are plenty of poor decisions made by corporate "agent" managers who are more interested in "empire-building" and cashing their paycheck instead of long-term wealth-building for shareholders. It brings to mind the saying "***No one washes a rental car***".

We finished the year with below-average results for equity accounts compared to the major stock market indexes. It was a year to be invested in big and safe. We were negatively impacted by our Energy holdings, as the price of oil tumbled from over $100 per barrel midyear to below $50 currently. Six of our ten worst performing stocks in 2014 were Energy companies. Two Energy holdings suffered ***permanent business impairment*** and were sold at a loss. These two losers cost our portfolios roughly 6% of performance for the full year. That's the bad news. The good news is we don't make these mistakes frequently. And, we know what went wrong, and don't plan to repeat our mistakes. Yours truly and my partner Dave Hutchison were both co-invested with clients in these mistakes. We eat our own cooking, and sometimes it doesn't taste very good. The remaining Energy holdings are good-quality businesses in a very out-of-favor area. We plan to hold onto the rest, and may add to holdings should prices decline from current bargain levels to silly levels.

I have regularly warned clients that at times we will look rather foolish. This is one of those times. Here's an excerpt from ***2013's*** Fourth Quarter Investment Review:

> "We know that ***we'll frequently be out of sync with markets***. Some years better, some years worse. If you want different—meaning better—results than other investors and markets, you need to do things differently. We do. Occasionally we look smart. Occasionally we look not so smart—ok, dumb. Last year, we thought stock valuations were getting a bit high, and we reduced some positions that looked more fully valued. We rolled the proceeds into neglected stocks. They remained neglected throughout 2013. They may continue to be unloved during 2014. It's a central part of our process to look longer-term when others can't or won't. ***Our willingness to endure short-term pain creates the opportunity for long-term gain***."

Little did I know that my comments would prove accurate. They did indeed "continue to be unloved during 2014'". I'm not hoping for a repeat performance in 2015.

To paraphrase Warren Buffett "***We'd rather have a bumpy but higher result than a smooth but lower result"***. Like Buffett, we don't believe that market volatility equals risk. In our view, ***risk is the chance of permanent loss of capital***, not market fluctuations. So, while many investors focus on 3 to 5 ***month*** horizons, we continue to focus on 3 to 5 ***year*** horizons, as this gives us the ability to benefit from an irrational fixation on short-term results. Hang in there.

We have in previous Client Reviews stated long-term stock market goals, which is to ***generate returns 3% to 5% above market indices, net of fees, over the long term***. As of year-end 2013 we had accomplished that goal since Triad's inception in April 2008. Given our weaker results in 2014, we find ourselves slightly behind this goal, with April 2008 through December

2014 composite equity returns of 10.9% vs. 8.5% for the S&P 500, still 2.4% better, but slightly below our lofty target. ***Not only is it unusual for managers to clearly state their goals, it's more unusual for most to match the benchmark, let alone surpass it with a reasonable margin to spare***. We'll continue to work hard striving to put further distance between us and the competition.

The six year stock market rise from 2009 to 2014 has elevated stock market valuations, creating challenges for rational business investors like Triad. As mentioned previously, over the past 18 months we have been selling good businesses as they reach our target valuations, and rummaging around in the bargain bin looking for good, undervalued companies. It's harder to find such bargains, and this environment might continue for a while longer. But we've been through enough market cycles to know that it's a mistake to follow the crowd and chase popular, overvalued merchandise. And while we don't make stock market predictions our best guess is that over the next 5 years stock market returns including dividends might be 6-8% per year, at best. Of course, our goal is to do better than market indexes net of fees.

Eventually the market cycle will turn and more opportunities will arrive. Until then, we're going to remain patient, disciplined and focused. ***We have found previous periods of great volatility and turmoil***, such as September 2008 through March 2009, and August through October of 2011, ***to be very productive for investment opportunities***. While we don't relish increased volatility, it will occur periodically and we should benefit when it arrives.

Let us know of any changes to your financial situation that might suggest altering your investment portfolio or if you'd like a current copy of our SEC Form ADV Part II. Also, we have included a current copy of our Privacy Notice.

We encourage comments, questions and suggestions. As always, ***your*** LOYALTY and PATIENCE remain our secret weapons. We remain diligent, disciplined, optimistic, and co-invested with our clients: we continue to eat our own cooking. It's the right way to operate.

Sincerely,

John Heldman, CFA
January 26, 2015

"Many shall be restored that are now fallen and many shall fall that are now in honor." **Horace**

"Always do right. This will gratify some people, and astonish the rest." **Mark Twain**

The securities discussed herein do not represent all of the securities purchased, sold or recommended for each strategy during the quarter. The reader should not assume that an investment in these securities was or will be profitable. Inherent in any investment is the possibility of loss. Past performance is no guarantee of future results.

Triad Investment Management, LLC claims compliance with the Global Investment Performance Standards (GIPS®). Triad has been independently verified by Ashland Partners & Company, LLP for the period from the strategy's inception, April 30, 2008, through September 30, 2014. Triad is an SEC-registered investment advisor. The composite includes all fully discretionary separately managed accounts that follow the firm's Concentrated All-Cap Equity investment strategy, including those accounts no longer with the firm. Triad's strategy is to invest in a concentrated portfolio (usually holding between 20 to 30 securities) of common stocks, unrestricted as to market capitalization, of both domestic and international companies. The U.S. Dollar is the currency used to express performance. Past performance is not a guarantee of future results, and there is a risk of loss in investing in equities. Results are presented net of fees and include the reinvestment of all income. Investments made by Triad for its clients differ significantly in comparison to the referenced indexes in terms of security holdings, industry weightings, and asset allocations. Accordingly, investment results and volatility will differ from those of the benchmarks. As of June 30, 2013, the Triad Equity Composite was renamed the Concentrated All-Cap Equity Composite. For more information or for a copy of the firm's fully compliant presentation and the firm's list of composite descriptions, please contact us at (949) 679-3991.

%	4Q 14	YTD	1 Year	3 Year	5 Year	Inception
Triad Concentrated All-Cap Equity	2.8	1.8	1.8	23.2	14.6	10.9
S&P 500 Index	4.9	13.7	13.7	20.4	15.5	8.5

As of December 31, 2014. Results presented net of management fees.