TRIAD INVESTMENT MANAGEMENT

1301 Dove Street, Suite 1080
Newport Beach, CA 92660
Tel: (949) 679-3991
www.triadim.com

4th Quarter 2015 Investment Review

"The industrial environment is in a recession. I don't care what anybody says, because nobody knows that market better than we do…we touch 250,000 active customers a month."

Dan Florness, Chief Executive Officer, Fastenal Co., October 13, 2015

Investment Thoughts

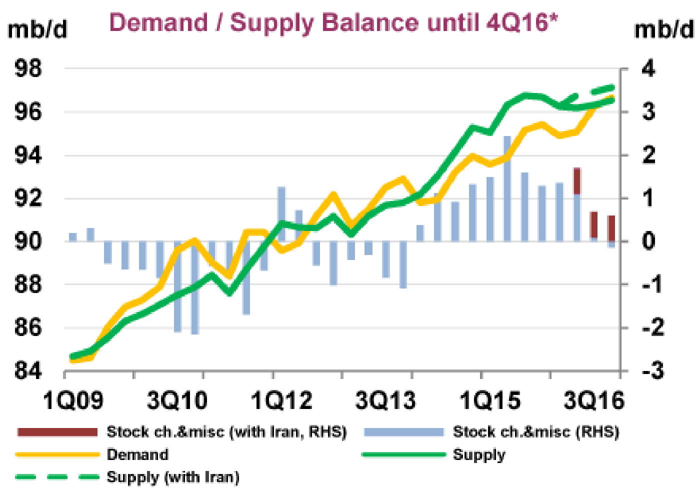
For those unfamiliar, Fastenal is a highly-regarded U.S.-based national distributor of industrial items such as fasteners (hence the name) and other gotta-have parts needed to keep factories and businesses humming. It's been a very well-managed company for decades. So when the CEO made this comment back in October it corresponded with what we had been observing on our own last year. Mr. Market, whose occasional bouts of panic and euphoria can be a source of opportunity, has also been worrying about the economy.

The industrial slowdown is partly due to rampant overcapacity in many industries, particularly commodities such as metals (iron ore, copper, steel, etc.), agriculture (corn, wheat, soybeans) and energy (oil, natural gas, coal). The booming global economy, led by Chinese commodity imports, resulted in significant production increases in most commodities. Now it's hangover time. It will take time for many of these markets to reduce supply to meet current demand as China's growth slows and global sluggishness continues.

We've been affected in two ways: 1) declining oil prices are directly impacting our Energy businesses; and 2) causing secondary impacts on Industrial companies that derive a portion of their revenues from selling pumps, valves, machinery and other equipment to energy producers. The good news is current investor pessimism has created undervaluation in these areas—in a market that isn't cheap overall—providing the potential for strong price recovery over the next few years. We're positioned to take advantage of a rebound in oil prices. Let's take a closer look at oil industry conditions and discuss why we're optimistic.

Despite the negative headlines, we believe oil prices will rebound over the next 12 to 18 months. Why? Simple, supply and demand. On the supply side, while pundits talk about a world awash in oil, except for the United States, very few producing regions around the world have managed to increase oil production meaningfully during the past 5 years of high oil prices. Normally oil producers maximize production given such high prices. That they've not indicates to us that the "easy" oil has been found and the world needs to draw upon higher cost sources—offshore deep-water, Canadian oil-sands, U.S. shale, even the Arctic regions are being explored—to meet increasing global demand over the coming decades.

World oil demand is roughly 95 million barrels per day and is growing annually about 1 to 1.5 million barrels per day. Supply is around 97 million barrels per day and has been growing at a slightly faster pace over the past couple of years. The chart below shows a modest amount of excess supply compared to recent demand, with the gap likely to narrow by year-end:

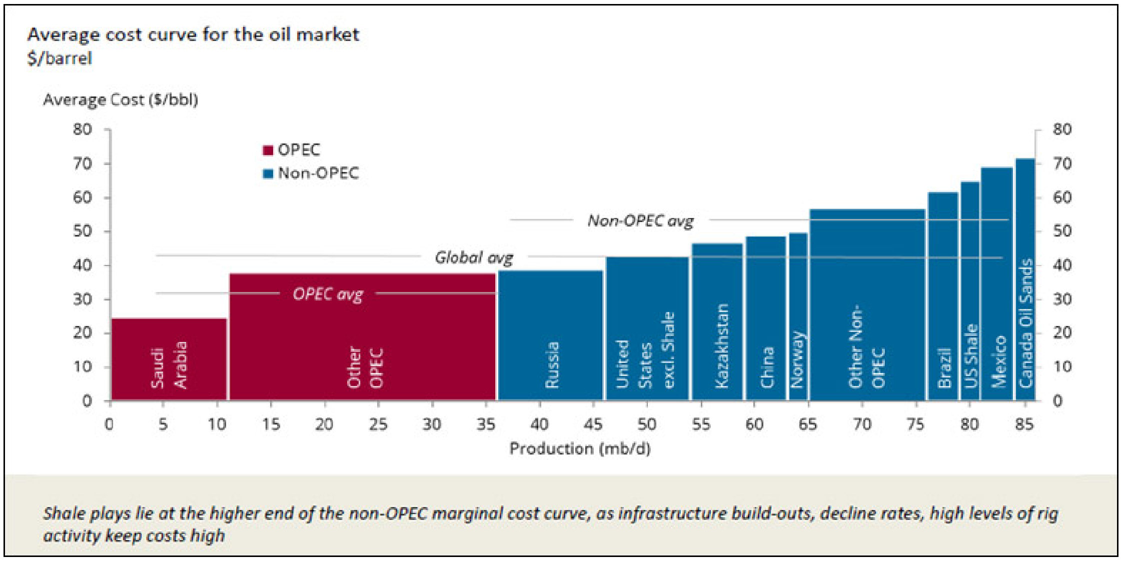


Source: International Energy Agency Oil Market Report

We believe oil market conditions are set for improvement. Global growth in demand has been sluggish given Emerging Market economies such as Russia, China and Brazil are experiencing economic slowdowns or recession. While it's fashionable to write off these countries in light of current challenges, the highest rates of economic growth over the next couple of decades will be in developing economies. The billions of people in these countries who get by on a few dollars per day still desire improved living conditions. China and India combined will account for roughly 50% of expected oil consumption over the coming decades as their populations grow and the growing fleet of cars, trucks, trains and airplanes results in much higher energy consumption. Consider this: **China consumes around half as much oil as the U.S. despite having a population almost four times as large**. Another fact: the U.S. has 5% of the world's population but consumes around 25% of the world's oil. Think about that.

On the supply side, many oil producers in the U.S. and elsewhere are living on borrowed time, as the day of reckoning approaches. Banks are reducing credit lines, stock and bond markets aren't funding many smaller companies, price hedges put in place 12-18 months ago are expiring and current oil prices at $30 per barrel are too low to justify much exploration. The dominoes are about to start falling, and the result will be shrinking oil production.

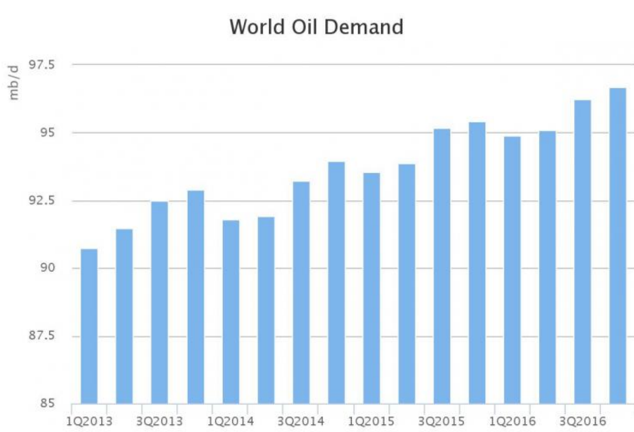
Oil is an unusual commodity as the cost to produce varies dramatically depending on the region. No surprise, Saudi Arabia and many other OPEC members are blessed with good geology and therefore lower costs of around $20-$40 per barrel. The higher-cost producers are more recent players on the global oil scene; at prices of $100 per barrel Brazil, Canadian oil sands and U.S. shale players, with costs of roughly $50-$70 per barrel, can earn a profit. With oil now at $30, some of these higher-cost producers will soon find it necessary to reduce production since they're not making much, if any, profit. The chart below depicts average costs for the major global producing regions:



Shale plays lie at the higher end of the non-OPEC marginal cost curve, as infrastructure build-outs, decline rates, high levels of rig activity keep costs high

Saudi Arabia and other OPEC members enjoy low costs thanks to Mother Nature, who blessed these areas with large, easy to extract deposits. As the chart demonstrates, above 75 million barrels per day (and remember world demand is 95 million barrels per day), the costs are above $60 per barrel, well above today's $30 level. High-cost areas such as Brazil, U.S. shale, Mexico and Canadian oil sands must reduce production eventually. In fact, oil companies have deferred spending on roughly $400 billion of projects in 2015 alone.

Eventually low prices will tame production while at the same time stimulating demand (Detroit auto makers should be renamed truck makers; due to low gasoline prices, around half of current sales are gas-guzzling trucks and SUVs). The laws of supply and demand haven't been repealed, and it's our view that conditions will improve over the next year or so. Oil consumption grows year after year, and will continue for at least another couple of decades. The wide-scale adoption of electric cars and other oil alternatives is now further away, thanks in part to low oil prices. The chart below shows oil demand growth over the past few years:



As for our investment strategy, we have chosen to invest not in oil producers but rather in what we believe are lower-risk companies who provide equipment, supplies and services and have less direct exposure to fluctuating commodity prices. Parts and equipment wear out, supplies must be replenished and regardless of current prices the world still demands and gets 95 million barrels of oil per day. So our companies will feel some pain but should ultimately come out of this cyclical downturn intact, and perhaps even stronger through acquisitions of weakened competitors. It's happened before in previous periods of weakness.

Our bottom line is this: we're experiencing a relatively small imbalance between demand and supply. The last major cyclical oil market downturn in the mid-1980's resulted in 10 million barrels per day of excess supply (roughly 20% excess capacity), which took years to rebalance. This cycle has about 2 million barrels of excess supply (around 2% excess), which we believe will shrink over the next year. If prices stay low for another 2 to 3 years then major additional exploration and development spending reductions could result in eventual oil shortages and skyrocketing prices. Based on today's depressed valuations for many oil and industrial companies, we believe the opportunity is upon us for significant investment returns over the next couple of years. The laws of supply and demand and a little patience should do the trick.

Economic Conditions

The big picture view remains a relatively strong U.S. domestic economy—led by the service sector—while the industrial economy struggles and remains near recession. Conditions are even worse outside the U.S. with global weakness just about everywhere. China seems to be in turmoil, attempting to transition from heavy infrastructure investment and reliance upon an export-led economy, to more emphasis on domestic consumption. This transition comes as China deals with high debt levels accumulated to stimulate the economy in the wake of the 2008 financial crisis. In addition, the Chinese authorities are confronted with an inefficient state sector, a lack of free markets, widespread corruption, volatile stock markets, and increased pressure to satisfy a restive population which has tasted the fruits of capitalism and desires more economic progress and individual freedom. China has become a significant player on the global stage, and its economic health is a key piece of a vibrant global economy.

Europe is still sluggish, although there are signs of life after many years of austerity. Stronger European growth would also benefit the U.S. economy. But many other areas are still suffering, including Japan, other parts of Asia, South America, Africa and Russia, to name a few. The global economy is more interconnected than ever, so a slowdown beyond our borders can negatively impact many businesses in the U.S. and around the world. But progress continues, and the unmet needs of billions of people creates major opportunities.

Investment Conditions

Last year was weak for equity markets, and while it's early 2016 could be another challenging year. One thing I can rely upon is my inability to predict short-term stock market trends.

However, we do have a better feel for current market valuation levels, which still seem fairly-valued to somewhat over-valued in certain areas, although recent weakness has improved this measure. As well, corporate profit margins remain above historical averages, and any weakness in the economy could create further profit pressures.

Many of our companies have lagged the averages and been in their own “bear” market for the past two years. In today’s uncertain world, investors have favored stable growth businesses and avoided cyclical businesses. In their quest for “safety”, investors have piled into the shares of a small number of large growth companies to levels that could be considered “unsafe” (the acronym FANG has arisen to describe 4 major companies: Facebook, Amazon, Netflix, Google). It’s somewhat reminiscent of the “dot-com” technology boom of the late 1990’s. Which popped. Or the 2003-2007 sub-prime lending boom and real estate bubble. Which also burst. This one isn’t as extreme as those prior bubble periods, but has some similarities.

The good news is **we believe that many of our investments have significant appreciation potential over the next year or two**. Many of our companies are selling at depressed valuations, far below our estimates of long-term intrinsic value. It’s the nature of markets to become disconnected from reality on occasion. This seems to us to be one of those times. I’ve been at this for 30 years and believe my silly barometer works pretty well. Time will tell if we are correct. Triad’s past history has been to rebound from weaker periods (such as the two previous market downturns of 2008-09 and 2011) with stronger results and while I can offer no guarantees, that’s certainly our aim this time as well.

Until conditions improve, we’ll remain rational during market gyrations, and attempt to take advantage of the opportunities that short-term market volatility and the irrational behavior of others can provide. As Warren Buffett’s mentor Benjamin Graham famously remarked, **“*In the short run, the market is a voting machine, but in the long run, it is a weighing machine.*”**

The Federal Reserve has embarked on a path of raising interest rates, and we’d guess several more rate hikes this year, barring unexpected weakness in the global economy. Our financial holdings, such as Wells Fargo, American International Group and others, should benefit from higher interest rates, although the impact is likely to be modest in 2016, and more important next year. Over time higher rates should be a tailwind for some of our holdings, so we don’t look negatively on rising rates.

The bond markets have come under some stress, in part due to anticipated rate hikes, and also due to weakness in energy and commodity companies, many of whom are major borrowers. We’d guess this will continue throughout the year; the good news is with bond prices trending lower, yields are now higher, and we’d anticipate more opportunities to come.

We stated the following several times last year and it’s still worth repeating:

> ***“We don’t expect stock markets over the next 5 years to match the past 5 years given current above-average valuations.*** However, ***we believe our holdings have above-average prospects*** based on reasonable valuations, good businesses and

> strong, "*culturally-correct*" managers. Of course, that's what you'd expect us to say, but it's also what we firmly believe. At this stage of the game, ***we're more interested in avoiding permanent capital losses than chasing crowd favorites in an attempt to keep up with market averages.*** We hope you agree."

Let us know of any changes to your financial situation that might suggest altering your investment portfolio and also if you'd like a current copy of our SEC Form ADV Part 2.

We encourage your questions and comments. As always, ***your*** LOYALTY and PATIENCE remain our secret weapons. We remain diligent, disciplined, and optimistic. And, we continue to eat our own cooking, which means investing alongside you in generally the same securities. It's the right way to operate.

We appreciate your attention in reading through this long letter. I wanted to convey our thinking as clearly as possible. Hopefully I've done that. In challenging times such as we're currently experiencing, we work hard every day to take advantage of the opportunities that such periods can create. We look forward to reporting progress over the coming months.

Sincerely,

John Heldman, CFA

January 25, 2016

"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, 2015. 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 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 15	YTD	1 Year	3 Year	5 Year	Inception
Triad Concentrated All-Cap Equity	(0.1)	(20.8)	(20.8)	0.5	4.1	6.2
S&P 500 Index	7.0	1.4	1.4	15.1	12.6	7.5

As of December 31, 2015. Results presented net of management fees.