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2nd Quarter 2016 Investment Review

"The market can remain irrational longer than you can remain solvent."

John Maynard Keynes, Economist (1883-1946)

"If something cannot go on forever, it will stop."

Herbert Stein, Economist (1916-1999)

Investment Thoughts

Mr. Market, that imaginary stock market character whose mood swings between wild optimism and depression with some regularity, has lately been feeling good. Stock prices have rebounded from declines earlier in the year, and the major averages are near record highs. It appears that investors are quite satisfied with worldly events. All's well, right?

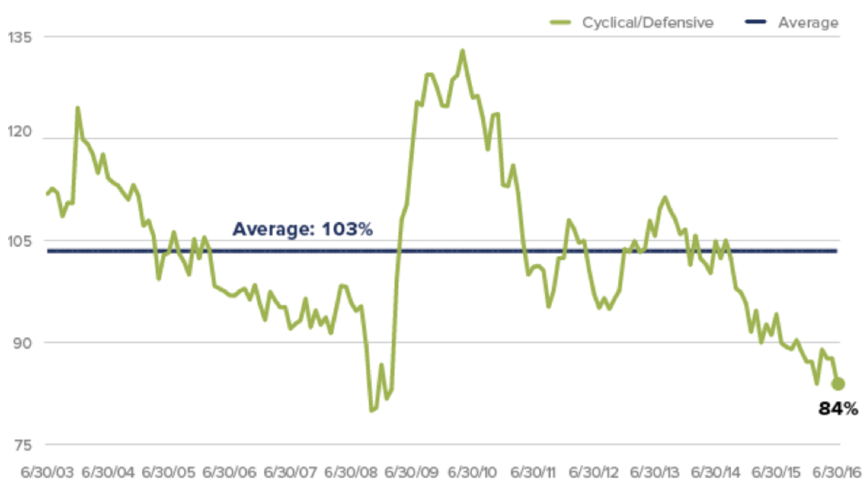
Not exactly. Even a casual observer of the global political and economic scene might agree that beneath the surface of positive feelings, an undercurrent of apprehension is apparent. This buoyant market seems to be floating on a cloud of fear, as many investors are fixated on perceived safety, low volatility, and that currently elusive but highly desirable prize: ***income***.

With global government bond yields in the repressed vicinity of 1.50% or less—Germany recently sold 10 year bonds with a negative yield, which means you get back over the 10 years less than you paid—it's a tough time to be an income seeker. As a result, income-starved investors have been bidding up the price of anything that generates income: government, investment-grade and high yield corporate bonds, and mortgage securities in the fixed income world. In the equity world, Real Estate Investment Trusts, Utilities, Consumer Staples, Telecom and other income-oriented shares have been purchased hand over fist for the past few years. My email inbox is bombarded daily with offers from brokers for all manner of investment sausage: privately traded REITs, real estate partnerships, "hedged" alternative income, blah, blah, blah. It's junk dressed up with an income wrapper. These purveyors know when the ducks—income-starved prospective investors—are quacking, you gotta feed them the equivalent of investment junk food.

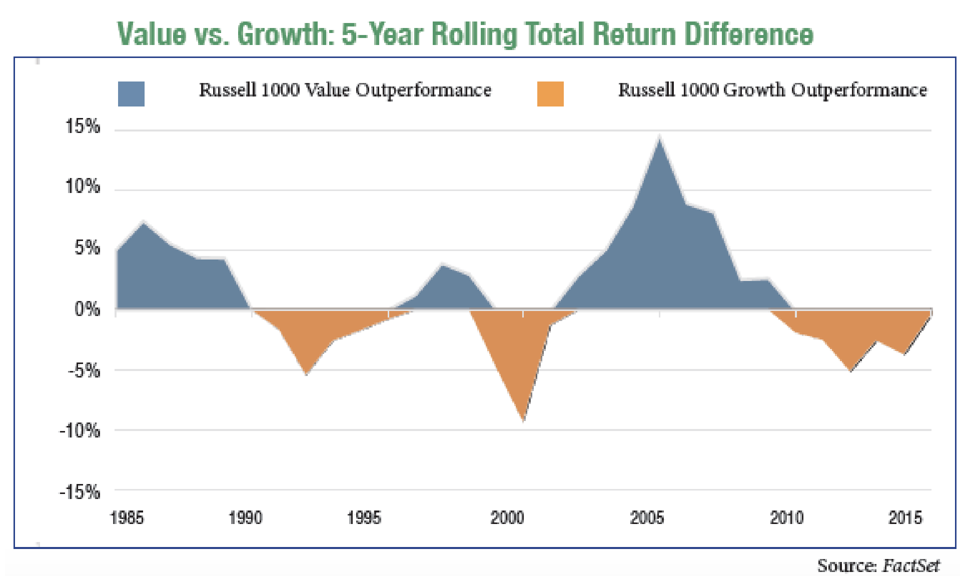
While perhaps not a full-blown bubble, investor enthusiasm for income has pushed some valuations to levels that haven't been seen for a long time. If interest rates stay low, the valuation levels might hold. But my guess is profligate governments around the world will eventually be forced to pay more to borrow. When the correction happens is anybody's guess, but ***reversion to the mean***—the tendency for high-priced merchandise to become lower-priced merchandise, and vice versa—has been a fairly reliable bet over longer time periods. We're steering clear of what we'd characterize as a "***safety, low volatility, income bubble***" in these highly popular areas, anticipating investor heartburn at some point.

As the following charts demonstrate, the environment for our style of value-based investing has been out of favor for quite some time. However, the good news is this won't last forever, as styles swing back and forth over longer periods of time. As Herbert Stein famously remarked, "*if something cannot go on forever, it will stop*."

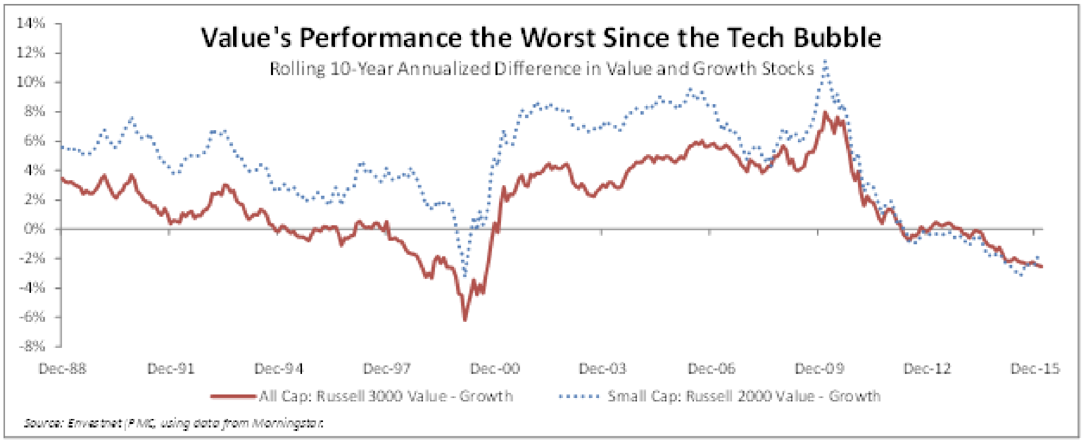
The chart below shows the relationship between cyclical stocks, which we own more of, versus more defensive stocks that are currently favored, and in our view are largely overvalued. This level of extreme divergences has only been seen once before in the past 13 years, and that was during the financial crisis of 2008-2009, when risk aversion was rampant—I should point out this aversion to risk was ***after*** the stock market crash when the proverbial horse had left the barn:



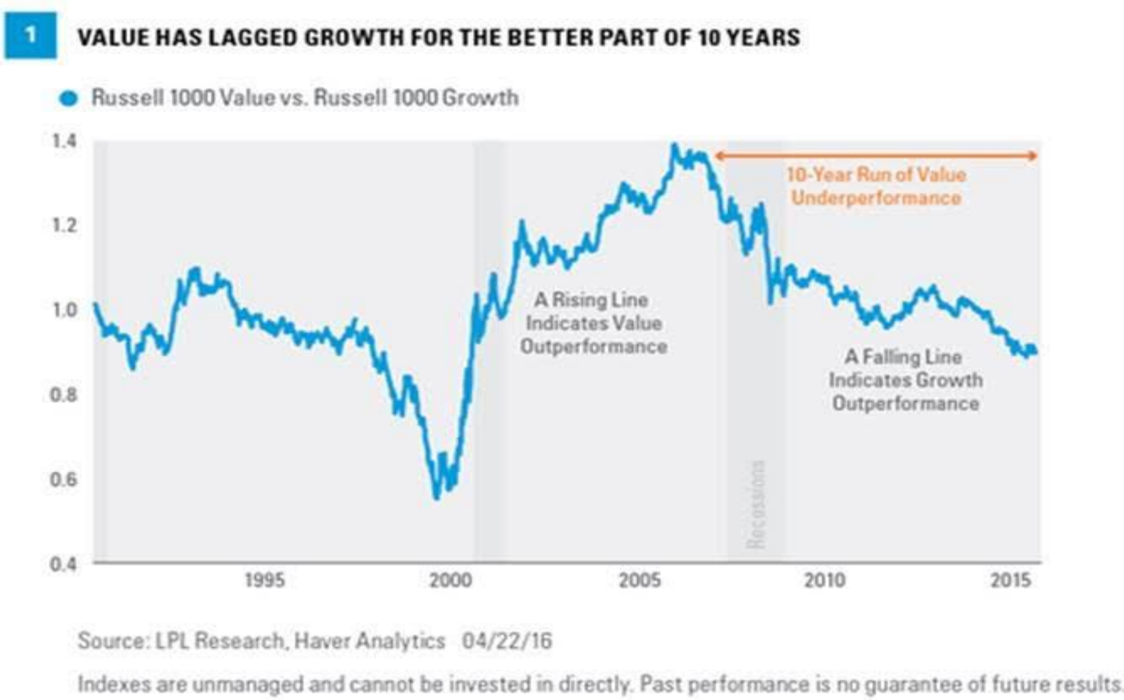
Here's another look at the same phenomenon. Blue indicates value-based investment indexes are outperforming growth indexes. As can be seen, value has been out of fashion since 2010:



To prove we're not making up this stuff, here's a couple more charts demonstrating the same thing. Value-based investing has been relatively weaker than growth since 2010 by this reckoning:



The last chart also depicts a tough environment for value-based investing, which in this chart shows about 10 years of relative underperformance:



The challenge for us is a slight twist on the famous Keynes quote: ***"the market can stay irrational longer than you can remain patient."*** Our task is to stay focused, rational, and most importantly, patient.

Economic Conditions

Fears continue to abound that the global economy will continue its lackluster, moribund ways, or worse, we'll be plunged into another global crisis and/or depression. While I'll admit that the list of worries is worryingly long, it's just too easy to be a pessimistic cynic (yes, that's redundant). The old order (political stability, moderate economic growth, established trade patterns) has given way to a free-for-all of turmoil. Terrorism, porous borders, regional conflicts, civil wars, immigration, trade disputes and rising nationalism have resulted from an upending of what used to be, to what is going to be. In short, ***there seems to be a bull market in Fear***, and a bear market in intelligent risk-taking.

Brexit and the rise of Donald Trump in the U.S. are, in my view, related. As I discussed in my last letter, the world has changed, and will continue to change. We call it progress, and it is in many ways, but there have been casualties, and there will be more pain in certain areas. Several mega trends appear to be responsible for our current situation:

Globalization of labor markets means well-paid workers in middle class jobs in developed economies (mostly the U.S. and Europe) are threatened by lower-wage workers in developing economies. While this means flat-screen TVs can be purchased for $500, or shirts for $15, the trade-off is some workers lose jobs that are hard to replace.

Technology innovations are also creating upheaval. Robots replace factory workers, overseas call centers replace domestic workers and other forms of technology substitute for human labor. I guess eventually we'll all be jobless and lying on the beach.

The third major trend is **Deregulation**, which lowers regulatory barriers and creates more competition, often with job losses. Railroads, airlines and telecommunications in the U.S. have all gone through the Deregulation ringer with millions of lost jobs.

It's quite natural for an individual or country to conclude that the terms of global trade seem unfair, or their share of the pie is being reduced. It can be difficult to measure the benefits of participating in the global economy, whereas if you lose your job to foreign competition, it's easy to measure the costs. Unless the U.S. and other developed economies revert to a truly domestic only policy and reject free trade, trade conflicts are a fact of life in a global economy.

The economist Joseph Schumpeter coined the phrase "***creative destruction***", to describe new processes and methods destroying the old. We're seeing a form of this today in a less friendly, more competitive, nationalistic world. Many developing countries seek to join the developed world, and are willing to compete to make it happen. Immigration is the most visible sign of this quest for improved living conditions, better jobs, personal safety and liberty.

Economic progress over the past couple of centuries has been remarkable, and even more so over the past couple of decades. We live in the richest society ever, although admittedly the wealth is unevenly distributed. But wealth has always been unevenly distributed. Just ask the serfs who worked the land for feudal landlords in medieval times. Regardless, progress is difficult to stop, unless economic freedom, education, technological innovation and the rule of law disappear. I'm optimistic that despite the current global travails, humanity will persevere and the still enormous unmet needs of billions of people around the world will lead to further economic development and higher living standards for the average person.

While we don't attempt to forecast the economy, we're keeping an eye on current conditions. Growth has been reasonably good, interest rates remain remarkably low, and the U.S. continues to stand out as a relatively good performer among a weak cast of global economies. The job market has been strong, housing continues to rebound and auto sales are good. When the party will end is hard to know, but we are watching carefully for signs of excesses.

Investment Conditions

I've been lamenting the lack of great investment opportunities for the past couple of years. Is the "market" fully valued? It seems that way from our perspective. We haven't been finding many great businesses, run by great managers, selling for bargain prices. We have found many businesses we'd like to own—someday, when prices are more attractive. So we continue to turn over as many "rocks" as we can, hoping to find a gem or two.

The major stock market averages are close to all-time highs and seem fully valued, but our individual holdings aren't in the same position. Consider the following. I recently reviewed the top 20 holdings in our Concentrated All-Cap stock portfolios at quarter-end—comprising just over 80% of the portfolio—and calculated that ***they are priced on average around 50% below their all-time high prices.*** Why's that, you might logically ask?

Our process results in selling fully valued stocks, and recycling the proceeds into undervalued stocks. This is what we've done over the past 3 years or so, selling some winners and buying other companies where the stock prices had declined. We think we've made good purchases, and the next couple of years will determine if we're right. ***We view our current holdings as having quite a bit of unrecognized value***, and don't worry so much about the "market" being at all-time high levels. Our holdings aren't anywhere near their "peak" levels, but we won't mind if they get there.

Given the lack of quality merchandise at bargain prices, we've invested in businesses where the value is not readily apparent, for a variety of reasons. Sometimes it's hidden, non-income producing assets that have significant value. Or companies with an opportunity to "fix" some internal issues, such as cutting costs, selling underperforming divisions, buying back undervalued stock or other actions that are not as dependent on higher stock market valuations.

Our process has led us to companies that have experienced their own "bear market" due to poor industry conditions (Energy, Industrial and other cyclical businesses) with the decline in stock prices providing opportunities for those willing to wait a year or two for a rebound (it feels like a lonely room with lots of space but not many market participants). As the Energy markets rebound from very depressed levels, our portfolios should benefit directly from our Energy company holdings, and also related Industrial businesses which sell equipment and supplies to the energy markets.

We have several other notable areas of investment worth mentioning. The "old media" business is another area we've invested in: broadcast television and cable networks. We think these companies remain relevant in a world of Netflix, Hulu, Facebook, Snapchat, Tumblr, Twitter and whatever else occupies eyeballs. In addition, our Financial services companies should benefit from future interest rate increases and still look attractive to us. It's highly likely that sometime between now and the next millennium (just under 1,000 years if you're calculating) we will witness an increase in interest rates. And lastly, we've been investing in victims of "market jitters", or companies that have been avoided due to stock market gyrations: asset managers and investment banks.

As a reminder, we seek three primary elements—our Triad—in each common stock investment are:

- We focus on businesses with ***understandable and attractive economics***; if we don't understand a business, how can we place a value on it?

- We seek "***owner-operators***" who have significant ownership stakes in the business, which should align their interests with ours

- We invest only when the purchase price is at a ***substantial discount*** to our 3 to 5 year estimated value, and focus on a concentrated portfolio of our best ideas

Our intensive study of our current holdings gives us comfort that true value exists within our portfolios, and while the major stock market averages seem likely to post average returns at best, and likely below-average over the next 3 to 5 years, we still feel very good about the long-term prospects for our select group of focused investments.

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.

Sincerely,

John Heldman, CFA

July 22, 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 March 31, 2016. 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.

%	2Q 16	YTD	1 Year	3 Year	5 Year	Inception
Triad Concentrated All-Cap Equity	(1.2)	(0.7)	(16.1)	(2.2)	3.9	5.7
S&P 500 Index	2.5	3.8	4.0	11.7	12.1	7.6

As of June 30, 2016. Results presented net of management fees.