TRIAD
INVESTMENT MANAGEMENT

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4rd Quarter 2017 Investment Review

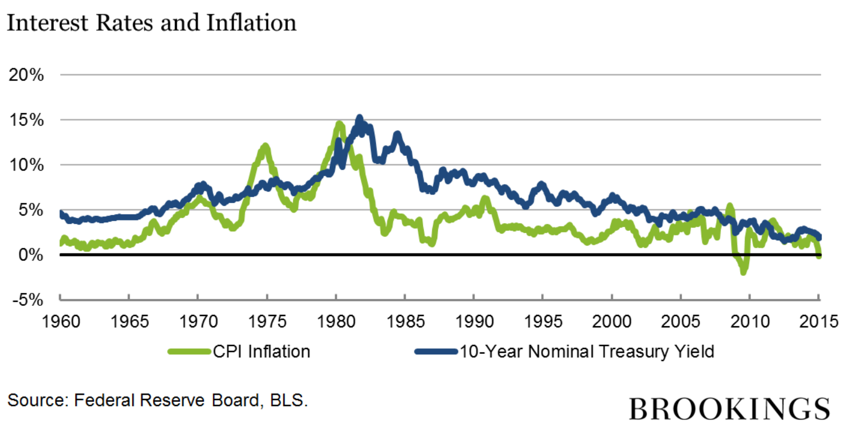
"Inflation is when you pay fifteen dollars for the ten-dollar haircut you used to get for five dollars when you had hair."

Sam Ewing, former professional baseball player

Investment Thoughts

Why does the stock market continue to defy the skeptics and keep climbing? Simple. Stocks are driven longer-term by two factors. Earnings and interest rates. Corporate earnings rebounded from the depths of the financial crisis and have been grinding out gains for years. But the big driver of the stock market isn't earnings growth. No, the big stimulus has been an increase in market valuations. Depressed market levels have been transformed into joyously optimistic market valuations. It's the nature of public markets dominated by humans who get depressed, and occasionally become giddy. Right now, we seem to be in the giddy phase.

But it's not entirely investor giddiness that's responsible for today's elevated market levels. One explanation for high valuations is logical, reasonable and supportable; today's ***very low interest rates***. Low price inflation leads to low interest rates, which in turn support high valuations. Economists must pull out their magnifying glasses to detect inflation nowadays. If inflation stays restrained, interest rates could stay low, and it's possible—but not guaranteed—that market valuations will remain higher than average. But, if inflation starts picking up, both stock and bond markets could be vulnerable. This chart shows the relationship between inflation and interest rates:

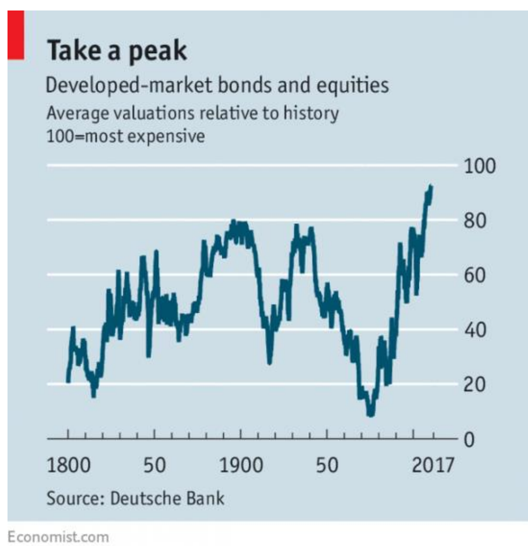


However, signs of higher inflation are emerging. Many municipalities have recently raised the minimum wage. Unemployment is around 4% nationally, which historically has led to labor shortages and pay raises for workers. Global trade barriers are on the rise, and cheap imported goods might be harder to find, possibly leading to price increases. The U.S. Dollar has weakened, which results in higher prices for imported goods. Immigration reform has slowed the influx of foreign workers, also creating labor shortages in some areas. Energy and commodity prices have risen, further stoking the inflationary forces. Higher prices put upward pressure on interest rates.

But inflation isn't the only factor working to move rates higher. The Federal Reserve has committed to reducing the massive Quantitative Easing (QE) that has been in place since the Global Financial Crisis (GFC) of 2008, replacing QE with QT—Quantitative Tightening. Simply put, the Fed will be draining liquidity from the financial system to the tune of a couple trillion dollars—yes trillion—over the next few years. This tightening will be achieved by reduced buying by the Fed of Treasury bonds and mortgages, putting upward pressure on interest rates over the next few years.

There are offsetting forces that might keep inflation low, and put a lid on interest rates. It's the same forces that have kept inflation in check for years. Global competition keeps companies from raising prices. New technologies often lead to better goods at cheaper prices. The internet makes it easy to check prices. These megatrends aren't going away anytime soon.

Regardless, we could still see a cyclical bout of higher inflation, and higher interest rates, over the next year or two. It's possible that investors in both stocks and bonds could be surprised by higher than anticipated inflation. It wouldn't take a lot to knock both markets down, given today's high valuation levels. I included this chart in the last letter, but it's still relevant:



You could say the investment markets are priced for perfection. You could say valuations are off the charts—almost in this case. Regardless, many investors probably aren't prepared for major shocks, such as higher inflation and interest rates.

We have taken into consideration our precautions about inflation, interest rates and sky-high valuations when investing your capital. We haven't owned the stock market beneficiaries of low interest rates, such as utilities, real estate investment trusts, and other higher-yielding stock market sectors. Or growth stocks, which generally respond better to low interest rates. On the bond side, our portfolios are relatively short-term and shouldn't be significantly impacted by higher interest rates. While we can't predict the course of rates over the next year, we try to prepare ourselves in case nasty surprises arrive.

Economic Conditions

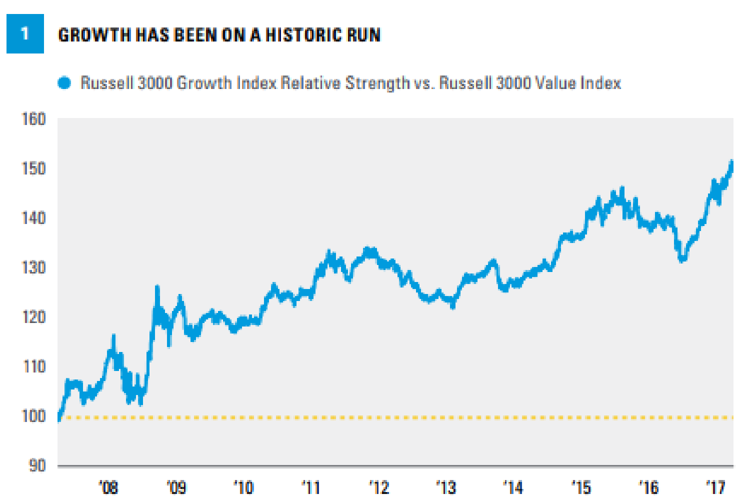
The good news is this economic cycle continues to roll along, making it one of the longest on record. Europe has started to grow, and China seems to be gathering strength. The outlook seems positive for synchronized global growth over the next year, and perhaps longer. The Federal Reserve raised rates last year, and more rate hikes are anticipated before 2018 ends.

With the global economy picking up steam, it won't fall on the shoulders of the U.S. economy to support growth. Global economic conditions are good, and might stay that way for the foreseeable future. But good times are eventually followed by not-so-good times; after almost ten years of growth, we're on the lookout for signs of deterioration.

Investment Conditions

Despite today's lofty valuations we continue to find enough good values to remain fully invested in client portfolios. We don't need hundreds of ideas, just a handful of new ones each year. I offer one example of the degree of disparity between the current haves—FANG stocks—and the have nots, AKA our stocks. I recently read an article in one of the popular personal finance magazines which recommended one of our current holdings as being an undervalued stock. A brokerage firm mentioned in the article ventured that the shares could be worth $96 per share. We'd agree. The stock trades today for $53 per share. Quite a disparity, even in a fully-priced market. While this is but one example, many of our stocks sell at large discounts to our appraised value.

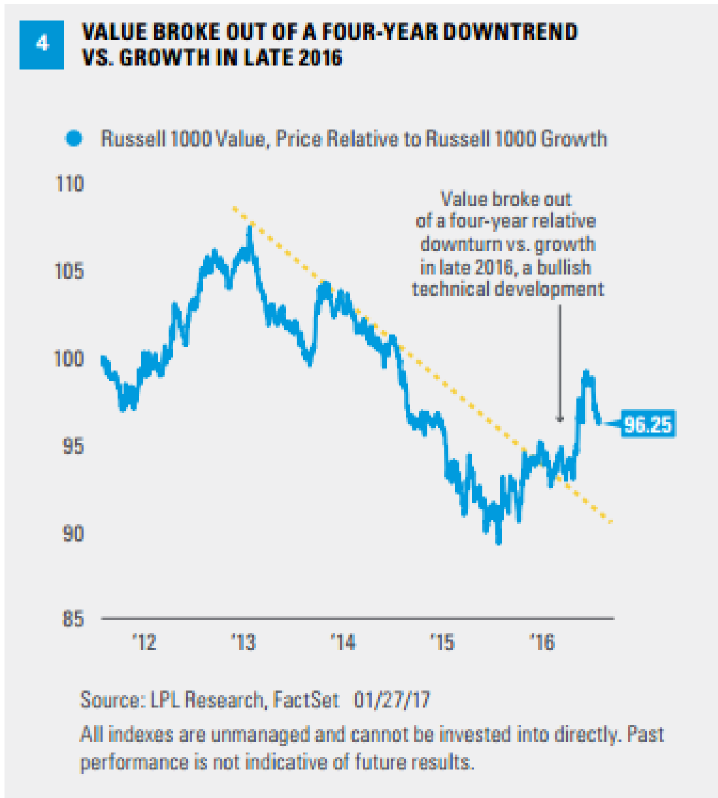
I've mentioned many times over the past several years the enormous disparity in returns between so-called "growth" stocks and "value" stocks as shown below:



Source: LPL Research, FactSet 09/15/17

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

Broadly speaking, growth stocks have trounced value stocks for years. But nothing lasts forever. The next chart hints at a possible resurgence for value-oriented stocks over the coming years. We look forward to a stock market focused more on value and less on popularity:



Within our stock portfolios, we have exposure to areas that should do well as the global economy continues to grow, including Energy, Industrials, Financial Services and Consumer stocks. In addition, oil prices have bounced back from multiyear lows, and energy companies are starting to spend again. We own equipment and service suppliers, so we're not as dependent on the direction of oil prices. As long as oil drilling and production continues—the world consumes around 35 billion barrels of oil each year—our companies will benefit over the next 2-3 years from the resumption of oilfield activity.

Interest rate increases over the next couple of years could provide additional benefits to our stock portfolios. Higher rates benefit our financial services companies, as they reinvest cash-flows into higher-yielding assets.

Overall, our portfolios should be beneficiaries of a robust global economy. Roughly two-thirds of our holdings are cyclical businesses that should experience higher sales and earnings in a stronger global economy. We own good businesses in depressed areas such as Energy, Chemicals, Agriculture, Capital Goods and Industrials. After a multi-year downturn, we look forward to a resumption of sales and earnings growth.

Bond yields are rising as market interest rates rise, providing investment opportunities but also more risk. We continue to keep our bond maturities relatively short-term while we await higher rates over the next few years. As with stocks, it requires patience and diligence to navigate a challenging, but improving, fixed income environment.

While we've had positive results so far in 2018, we believe our stocks are significantly undervalued and still have plenty of upside potential to reach our valuation targets. In a market still enamored with large growth stocks, our boring companies will eventually be recognized. We won't be surprised if it happens relatively quickly.

Let us know of any changes to your financial situation that might suggest altering your investment portfolio and 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.

We continue to eat our own cooking, which means investing alongside clients in the same securities—yes, even those that haven't necessarily gone up. It's the right way to operate.

Sincerely,

John

John Heldman, CFA

January 24, 2018

"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 ACA Compliance Group for the period from the strategy's inception, April 30, 2008, through September 30, 2017. Triad has subsequently been independently verified by Alpha Performance Verification Services from October 1, 2017 through December 31, 2017. Triad is an SEC-registered investment adviser. 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 17	YTD	1 Year	3 Year	5 Year	Inception
Triad Concentrated All-Cap Equity	1.7	2.9	2.9	(3.6)	2.8	6.2
S&P 500 Index	6.6	21.8	21.8	11.4	15.8	9.4

As of December 31, 2017. Results presented net of management fees.