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2nd Quarter 2018 Investment Review

"The purpose of the Margin of Safety is to render the forecast unnecessary"

Benjamin Graham, Warren Buffett's mentor

Investment Thoughts

I recently looked up the definitions of Repetition, Rehash, Regurgitate and Recycle. The dictionary entry said: "*see Triad Quarterly Investment Reviews*." Of course, I'm joking. But I do understand that these Reviews can emit the scent of recycled content.

For instance, I've used many Ben Graham quotes in previous writings. But, many of his observations are still relevant decades later. However, I also recognize that the world has changed significantly since Ben started writing about investing during the Great Depression of the 1930s. Still, the basic tenets that Graham espoused haven't really changed. He believed you should only invest when a margin of safety is evident. Ben would aim to buy stocks at a minimum 33% discount to a very conservatively calculated net asset value. Ben reasoned that if he bought with a large margin of safety he didn't need to worry about inherently unreliable business forecasts. He figured his was a "hard to lose" approach in a widely-diversified portfolio. He was right. Ben made more money than he could spend.

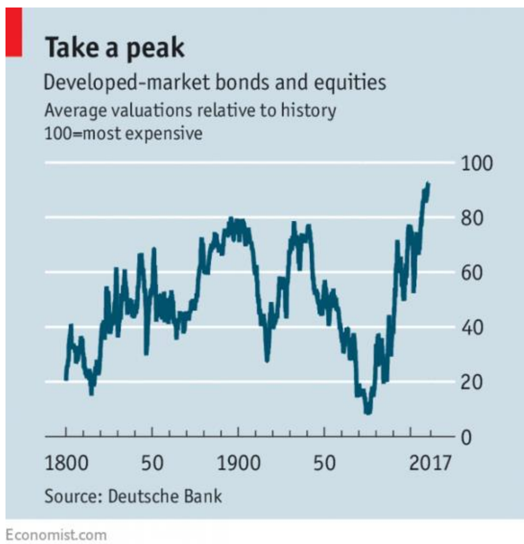
But that was then. Investing was less efficient decades ago, and a smart, disciplined person could gain advantage. Today, competition for investment ideas is much greater. Computers allow for broad searching and monitoring of thousands of companies and millions of data points. Hedge funds, with their high fees and lucrative management incentives, attract plenty of able competitors.

Nevertheless, some fundamentals still apply. Investing, as opposed to speculating, involves purchasing an asset at no more than, and preferably at a sizable discount from, true intrinsic value. But the definition of value has evolved. While Graham was buying mostly tangible assets—railroads, factories, machinery, inventory—at a discount, many of the best businesses today have relatively few tangible assets. Instead, intangible assets such as patents, brands, trademarks, copyrights and goodwill can offer protection from competitive ruin.

Another thing that hasn't changed much, and likely won't. People. Human nature doesn't change very quickly. We still revert to our basic instincts in certain situations, whether it's a charging Rhino on the African savannah or a crumbling stock market. They're both life-threatening, right? Some people will always panic at market bottoms, and become wildly optimistic near market tops. In other words, just the opposite of what cold, hard logic might dictate. Buy high, sell low? A recipe for lousy results. As Ben famously remarked, "***In the short-term the stock market is a voting machine, but in the long-term it's a weighing machine***."

Our challenge is to stick with proven fundamental success principles, while being mindful that as the world changes, these core ideas can be applied in new ways. It's a balancing act. On one hand, as noted investor and philanthropist John Templeton remarked: "The four most expensive words in the English language are '***it's different this time.***'" Which means, be careful. Just when you think a New Era has arrived, the Old Era principles reassert themselves. On the other hand, we also recognize that the world is continuously evolving. Hence, the balancing act.

Regardless, right now, in our Old Era view, the world is expensive. Stocks, bonds, real estate, private equity, art, collectibles. You name it, and it's much higher-valued today than historically. So, that goes into the mix of things that we consider. Everything looks good today. The economy is growing, inflation is relatively subdued, interest rates are low, the world is at peace. Investment markets reflect this happy state of affairs by pricing assets at "***priced-for-perfection***" levels. Continuing the repetition theme, the chart below has been used before, but it still describes our worldwide investment dilemma—navigating a very expensive investing environment:



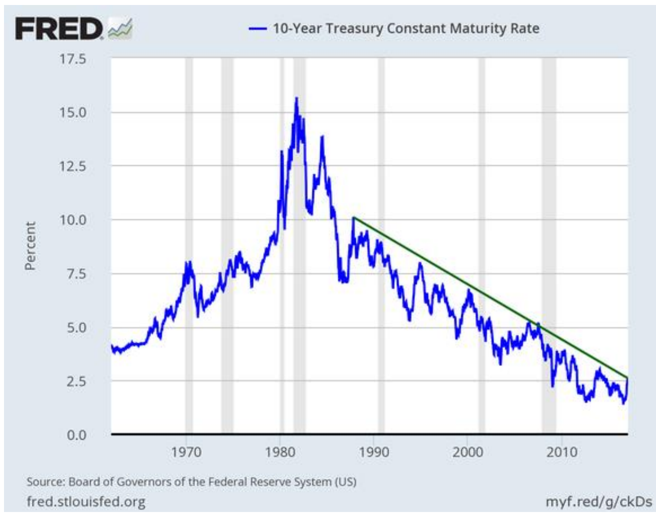
We'll carry on utilizing the same principles we've used for decades, while being mindful that eventually things change. We still attempt to buy a dollar of assets for far less than a dollar. We don't follow the crowd, but follow the money. And we eat our own cooking, investing our own funds alongside clients generally in the same securities.

Economic Conditions

The decade-long U.S. economic expansion continues to grind on. The classic signs of recession are not yet apparent, with one exception. The "***yield curve.***" This financial jargon describes the various interest rates from 3 months to 30 years. Normally, short-term rates are lower than long-term rates. Unless, the Fed is pushing up short-term rates. Which it's been doing for the past couple of years, but very gradually. Nevertheless, the difference between short and long rates is very narrow. Historically, when short rates rise above long rates, the R word comes into play. That's recession. Maybe that happens again. Maybe not. History doesn't necessarily repeat, but it does rhyme, I've been told. We're keeping our eyes and ears open for signs of weakness, but nothing to yell fire about yet.

The unemployment rate has steadily dropped to 3.8% currently, down from a peak of 10% in October 2009, and the lowest rate since December 2000. Good news, right? Who would have guessed that three months later, in March 2001, the economy would be entering recession? Not the professional economists and other forecasters. We can't predict, but we can prepare.

Government-engineered interest rate suppression has certainly helped to power the economy back to strength, and kept it there. Of course, low interest rates have been with us for ten years. Financial advisers under the age of 30 haven't experienced a rising rate environment. In fact, you'd have to go back 20 years or more to find significantly higher rates, as this chart demonstrates:



But the punch bowl of low rates is slowly being taken away from the party-goers. We'll see if the party continues, or a hangover ensues. Rates are still very low historically. If future rate increases are modest, the economy could chug along for another couple of years without incident. If inflation kicks up—and yes, it's starting to move higher—then higher interest rates should follow. For investors, that could be an entirely different, perhaps unpleasant, situation. We'll be watching.

Investment Conditions

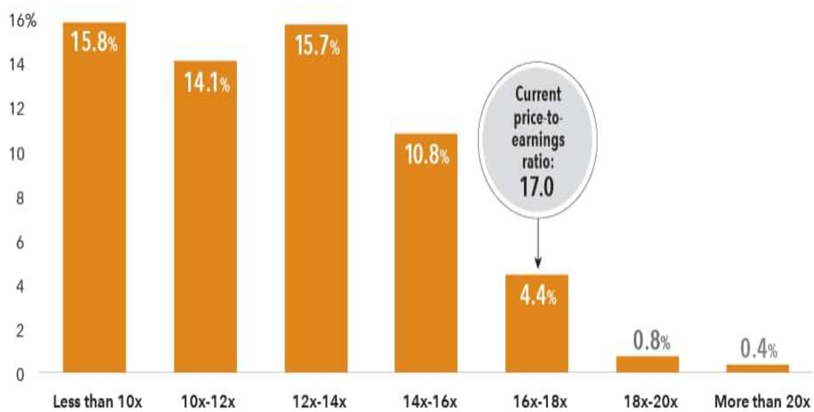
The big picture for us hasn't changed significantly over the past four years—more of that repetition thing—although can we detect emerging signs of change. As I've rehashed many times, so-called growth stocks have been the Belle of the ball, attracting the lion's share of investor attention, while value stocks have languished like a wallflower on the dance floor. We appreciate growth, we just don't want to pay inflated prices for growth. But in this era many investors, wanting to participate, have resigned themselves to pay up. It's a kid's game of musical chairs played on a grand scale, as investors assume they're smarter than the next person and will have a chair when the music stops.

As I've discussed far too often—repetition again—the magic potion for these conditions has been low interest rates, which many investors use to justify high valuations. The acronym TINA has even entered the investment lexicon: There Is No Alternative. The rationale is this: "***everything else is expensive, so I might as well buy stocks.***" They provide the highest long-term returns, right?

Yes, except when you start from a very high valuation point. Today, for example. When market Price-to-Earnings ratios are low, future stock market returns are high. And the opposite applies; when the starting valuation is high, future returns are low. This isn't my opinion, these are historical market observations over decades.

It's that Margin of Safety concept rearing its head again. When valuations are low, expectations are usually low—and a little growth can go a long way. Conversely, when valuations are high, expectations are high, and a bit of disappointment can crush these high hopes. As shown below, given current valuations the broad U.S. stock market has historically earned low to mid-single-digit returns over the ensuing five years—not horrible, but not much more than low-yielding bonds:

Average 5-Year Annualized S&P 500 Return by Forward Price-to-Earnings Ratio Since 1985



Source: Thomson Reuters, as of 2/28/18.

What about the FAANGs—Facebook, Apple, Amazon, Netflix, Google—we get asked? What about the FAANGs, I wonder? Five seemingly unassailable businesses, with strong global business models, destined to rule the world? Robert Arnott, the founder of Newport Beach-based Research Affiliates—roughly $200 Billion in managed assets—was recently asked the same question in a Barron's magazine interview. His response:

> "*The most popular and beloved stocks are always justified by the argument "it's different this time." Seven of the eight largest companies in the world as of March 31 are tech darlings Apple, Alphabet (Google parent), Amazon, Facebook, Microsoft, Tencent and Alibaba. They are trading at lofty multiples, as if everything is going to be just fine. Some of these compete against each other, so the likelihood of them all succeeding is limited."*
>
> *"History tells us that of the top 10 stocks in the world, eight will disappear over the next decade—if history is any guide Apple might be in the top 10, but won't be No. 1. That means it would underperform the market. The rest will fall off the list. So, if your investment horizon is 10 years, those top stocks have about a 90% chance each of underperforming. Why would you want that?"*

I'd venture to guess that if you asked 100 FAANG investors, very few—if any—believe that Arnott's scenario is plausible. Yet, Arnott is just making historical observations, not opinions. The reality is sustaining dominance over very long time periods is very difficult. New competition arises. Government regulators come after you. Technology changes. But investors forget history.

Below is a chart demonstrating the remarkable impact that a small group of technology companies has had on the broad stock market S&P 500 Index over the past four and one-third years (actually, how broad can the S&P 500 be if fewer than 10 stocks account for the lion's share of the returns? But that's a subject for another day):

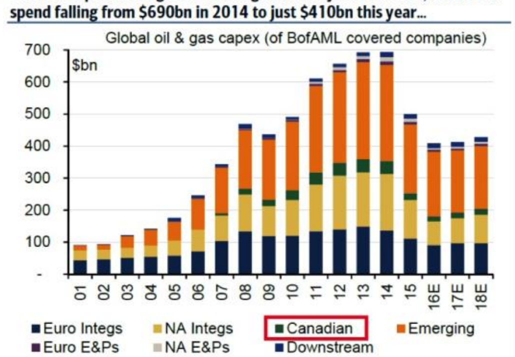
	Period: 12/31/2013 to 3/21/2018		
Ticker	**Company**		**Total Return Contribution**
SPX Index	**S&P 500 Index**		**60.1%**
	Top 10 Contributors		
1	**Amazon.com Inc**		**8.2%**
2	**NVIDIA Corp**	Sums to	**7.1%**
3	**Apple Inc**	35.7%, more	**5.6%**
4	**Microsoft Corp**	than half the	**5.4%**
5	**Facebook Inc**	60.1% S&P	**3.9%**
6	**Alphabet Inc**	500 increase	**3.2%**
7	**Netflix Inc**		**2.3%**
8	Berkshire Hathaway Inc		2.1%
9	JPMorgan Chase & Co		2.1%
10	UnitedHealth Group Inc		1.8%

Sixty percent of the stock market return over this period has been accounted for by seven technology companies. Can this go on forever? Theoretically I suppose so. If so, they'd end up being the stock market, having consumed everything in sight. Practically speaking, I very much doubt it. As Economist Herbert Stein remarked: "***If something cannot go on forever, it will stop***." This is only one person's opinion, and **it could be different this time**. But I'd bet with John Templeton on this one. In any case, given prevailing high valuations, our view is now is not the time to bet on continued global dominance for this select group of technology businesses.

It wouldn't be a complete Quarterly Review without a word about Oil. I've probably spent too much time discussing our Energy/Oil investments. But after enduring almost four years of industry decline, we believe we're finally at a recovery point. The outlook over the next two to three years is reasonably good, and perhaps better than that. In our opinion, our lawyers would add.

Energy companies have spent the past four years cutting exploration and development spending, and continued production has resulted in oil field depletion and output declines:

Chart 1: Capex in the global oil and gas industry has tumbled, with total spend falling from $690bn in 2014 to just $410bn this year...



Source: BofAML Global Research

OPEC Secretary General Mohammad Barkindo was quoted by the Wall Street Journal during a March industry conference: "***We have a possible future of crisis…The global industry needs to focus on the threat of underinvestment.***" So, no, we're not surprised that oil prices have rebounded. Given the current lack of spending, we'd also not be surprised if oil prices were even higher over the next few years.

Meanwhile, the demand for oil increases every year. While you might see a Prius, Volt, or Tesla tooling around town, the reality is most drivers prefer, and are buying, big trucks and sport utility vehicles. Gas guzzlers. In addition, emerging economies are far behind developed economies in vehicle usage but that will change over the next couple of decades. China has 15 motor vehicles per 100 people. India has 5 per 100 people. The United States has 90 vehicles per 100 citizens. As a result, energy demand is projected to grow for the foreseeable future.

At some point demand will plateau, and way down the road—pun intended—decline. We don't plan to stick around that long. For now, without spending increases, we face a possibility of reduced supplies over the next five years, and oil prices perhaps over $100 per barrel.

We think it's inescapable that oil companies must start spending again, and the oil suppliers we own—who aren't as dependent on oil prices, just increased activity—could perform well in an upturn. It hasn't really begun yet, but we believe the next few years will show above-average growth in these areas. In a relatively pricey market, there is value in neglected and depressed assets.

Company Commentaries/Spotlight

We're adding a new section to the Quarterly Review where we'll offer comments about select companies and other news that should help to better understand our decision-making process:

DaVita Inc.

DaVita is one of only two nationwide providers—each with ~35% market share—of kidney dialysis services, with growing international operations. Unfortunately, dialysis is a growing business. I say unfortunately as it's usually required due to kidney failure associated with adult diabetes and high blood pressure. Both of which are in many cases manmade, preventable diseases. But our modern society includes many temptations that lead to poor diets, lack of exercise, smoking, and stress. Diabetes is spreading globally, as developing countries adopt our ways. Think McDonald's, KFC, Marlboro, and sedentary activities such as watching television.

We like DaVita's national network—very hard to duplicate—and the critical, lifesaving nature of their services. In addition, we like the long-term growth prospects—especially internationally—above-average profitability and shareholder-oriented management team. Investors have been wary of the company due to concerns about government reimbursement levels and adverse regulatory actions. DaVita earns little profit from Medicare/Medicaid patients, and instead makes its profit from a smaller pool of commercial customers. Regardless, patients need the service, and DaVita must be paid, whether it's government or private payers. Meanwhile, these concerns create investment opportunity, allowing us to invest at reasonable valuations. The company seems to agree, having repurchased $2 billion of shares during the past three full years.

Fossil Group

Fossil designs, markets and distributes watches and related accessories—handbags, belts, etc.—globally through company-owned stores, other retailers, and increasingly, online. The company was caught flat-footed by the surging popularity of "smart" watches such as the Apple Watch, and has experienced sales declines over the past several years. But the company isn't standing still. In fact, it's cut costs, bought another company to enhance the electronic capabilities of Fossil watches and looks ready to start growing again.

We think the company is now positioned well for the opportunity to grow sales and earnings over the next couple of years. But we also understand that while the global watch business is very large and room exists for Fossil, it's an increasingly competitive business. We'll be keeping an eye on the exits as progress unfolds.

Nielsen Holdings

Nielsen measures television viewership—the Watch segment—and increasingly, other forms of viewing and listening such as online, mobile, etc. Nielsen also gathers retail consumer purchase data—the Buy segment—used by consumer goods manufacturers and retailers for marketing and sales purposes. The company has a long history and extensive experience, going back almost 100 years. It's been the dominant provider of data and analytics for decades.

More recently, changes in consumer video viewing habits, combined with retail upheaval has meant Nielsen must move more quickly to meet the needs of clients. Nielsen has responded by creating new services and made acquisitions to gain new capabilities and enhance customer satisfaction.

Nielsen provides a critical function to clients such as advertisers, who rely on Nielsen data to know who is viewing video content, whether on a television, computer, tablet, or phone screen. It's the currency upon which billions of dollars are exchanged by advertisers, content providers, consumer goods manufacturers and retailers. We like Nielsen's entrenched business position, decades of experience, valuable databases, high profitability, ample free cash-flow, and global opportunities. Nielsen's indispensable services should result in sales and earnings growth over the longer-term.

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 Heldman, CFA

July 19, 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

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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 been subsequently independently verified by Alpha Performance Verification Services from October 1, 2017 through June 30, 2018. 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.

%	2Q18	YTD	1 Year	3 Year	5 Year	Inception*
Concentrated All-Cap Equity Composite	9.2	5.8	6.5	0.4	2.4	6.5
S&P 500 Index	3.4	2.7	14.4	11.9	13.4	9.2

As of June 30, 2018. Periods over one year are annualized. Results presented net of management fees.
*Inception date April 30, 2008