TRIAD INVESTMENT MANAGEMENT

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3rd Quarter 2018 Investment Review

"All the signs are right this time
You don't have to try so very hard
If you live in this world
You're feelin' the change of the guard"

Change of the Guard, Steely Dan

Investment Thoughts

If's there one thing we can count on in this world, it's constant change. Yeah, I know, it's a cliché.

We tell clients, prospective clients, and anyone else who will listen, that we don't spend a lot of time trying to predict the future. Rather, we spend our time trying to assess current conditions, and let the future unfold as it will.

So, where are we at right now? As I'm guessing you've noticed, there's a lot going on in the world today. Much of it positive, some could be negative. Our job is to add up the positives and negatives, determine the score, and decide if the environment warrants investing your capital.

We've been cautious for the past few years, mostly about investment valuations, whether stocks or bonds. Our concerns so far seem misplaced, as the stock market marched higher, and bond investors have done okay, collecting coupon income and not experiencing much principal erosion. So far.

At times I feel like the proverbial stopped clock, telling the correct time only twice each day. Which is another way of saying, occasionally you'll be right.

But it *feels different right now*, in a way that indicates further caution.

Outwardly, things look pretty good. The economy is growing, and unemployment is at a record low of under 4%. If you're breathing, you can get a job. Recent tax cuts have put more money in the pockets of many consumers.

But under the surface, change is occurring. Inflation is picking up, despite what the Federal Reserve tells you. The Fed has been raising rates for the past two years and looks likely to raise rates further in 2019. Why, if the Fed thinks inflation is low?

Asset prices are high. The Fed is trying to dampen speculative fever by raising borrowing costs. In my view, it's a combination of inflation worries and asset bubble worries.

The reality is investors have partied for the past ten years, feasting on a long-term diet of ultralow interest rates. Now, that party seems to be winding down, and a harsher reality may be on the horizon.

What does this mean for us? At the margin, with interest rates rising, there is less punishment in holding cash. We actually get paid on the stuff now. Just under 2% currently, but that's better than zero. Cash is always our default position, as it's risk-free.

With rates rising, bonds face a bit of headwinds, given that bond prices decline as rates rise. We have very short maturities, so we should be protected from the majority of negative effects from rising rates. And we should be able to buy more bonds at higher income levels over the next year as rates further rise.

The stock market presents the toughest challenge. We're clearly in highly valued—overvalued in some areas—territory. We see that in the hundreds of companies we follow. But our holdings are generally reasonably priced, some even ridiculously cheap. Do we abandon an expensive stock market, despite owning a focused portfolio of undervalued companies?

Should the stock market drop 10-15%, we'll likely not be spared. We'd like to think that investors will rather quickly determine that our undervalued stocks have become even cheaper and bid prices up. But that might be wishful thinking, at least in the short run. In the long run, the market rewards business results with increased stock prices.

For each investment, we must assess the upside potential and the probability of achieving this, versus the downside and its associated probability. This needs to be done in the context of the wider world and all of its risks. If the odds seem to be in our favor, we should invest, regardless of our concerns about external factors. Weighing all the visible risks, we like what we own.

Economic Conditions

The decade-long U.S. economic expansion continues to grind on. The classic signs of recession are not yet apparent. The one thing we do know is this economic expansion is one of the longest on record, and nothing continues forever.

In short, we're closer to the end than the beginning. I saw a recent comment from Fed Chairman Jerome Powell saying he thought the economy could grow for the next two years. Which reminds me of Ben Bernanke, a former Fed Chairman, who remarked that he thought housing was in good shape—in 2006, shortly before the housing crisis commenced.

Don't believe everything you hear.

We know that another recession is out there somewhere. Economies expand, eventually overheating, or until demand starts to wane. We see no reason for these universal laws of economics to be repealed. It's a matter of time. Our cautious view of the economy means we want to play defense at this point in the economic and market cycle. But we need to do that while making sure that we're not overpaying for defense, as some investors mistakenly do.

Another concern of ours is inflation. It's been non-existent for a very long time. But now it's stirring. The list of pot-stirrers is growing. Trade tariffs are one factor. Shut out the flow of goods into the country, and domestic producers raise prices. Low unemployment rates and a shortage of workers in some industries is causing employers to pay up to hire or steal employees from others. Minimum wage rates are going up all over the country. Lower immigration exacerbates the labor shortage. Higher oil prices add to inflation pressures. Deficit spending by Federal and State governments pour more fuel on the inflationary fires. Tax cuts also stimulate demand, raising prices.

The big questions are yet to be answered. How much inflation is in the pipeline, yet to emerge? Where will inflation rates peak? Will the Federal Reserve need to raise rates beyond their well-anticipated rate increases, to account for unanticipated inflation? How spooked will markets get should inflation turn out to be a bigger problem than the consensus expects? We hope we're wrong about higher inflation but want to be prepared if we're not. It's another major variable in the investment equation.

Investment Conditions

While the first nine months of the year have been pretty good, October is proving to be very difficult. The usual culprits are at work: global political and economic concerns, trade policies, weakness in emerging economies, slowing growth in China, and higher U.S. interest rates.

Investors are understandably jittery. There's a lot to ponder, and few clear signs of the future direction. This wouldn't be a problem were it not for high asset prices and a very long-running economic growth phase that will wind down at some point.

Our process amidst all this noise is to focus on each investment one at a time. The big variables of global growth, interest rates, inflation, etc., are just too unpredictable to place bets on. We aim to find good businesses run by capable managers and invest when the prices are attractive for long-term purchase. It's as simple as that.

Company Commentaries/Spotlight

Each quarter we highlight a few of our current holdings to help clients understand our initial reasons for investing in companies.

Franklin Resources

Franklin Resources is a leading global investment manager, managing over $700 billion in stock, bond and alternatives assets for institutional and individual investors.

Franklin has been in business for decades and is controlled by the founding Johnson family, which collectively owns about 35% of the shares. The company operates under the well-known Franklin/Templeton brands.

We like the company's long-term growth prospects, especially in international markets. And their financial strength is appealing, with over $6 billion of available cash and very little debt. We like investing with smart owner-operators such as Franklin.

The shares have been out of favor, as Franklin is a value investor in a growth world. Nevertheless, the shares seem attractive to us, trading for less than 10 times estimated 2018 earnings, roughly half the overall stock market valuation.

Colfax

Colfax is an industrial manufacturer operating primarily in 2 areas. Air and Gas Handling makes pumps, valves, fans, heat exchangers and compressors used in a wide variety of applications for power generation and oil and gas production. The Fabrication Technology group manufactures welding equipment and related supplies.

The company operates globally, with a large presence in emerging economies, where growth should be above-average over the next decade.

Colfax is also controlled by owner-operators, the very successful Rales Brothers, who have a demonstrated track record growing other public companies. We like their large 20% stock ownership and disciplined focus on operational excellence, smart acquisitions, and strategic use of capital.

Axalta Coating Systems

Axalta—formerly owned by DuPont—is a global leader in coatings for automotive and industrial markets. Primary markets include cars and trucks, both new and body shop refinish coatings. Axalta also makes coatings for wood, metal, and energy markets. In business over 100 years, the company is number one or two in many of its businesses.

Paints and coatings are usually a relatively small part of the total product cost, but highly visible and therefore important to customer satisfaction. Axalta develops sticky relationships with its customers and works closely with them to ensure high quality, environmental compliance, and increased productivity.

We expect Axalta to grow for many years given its strong market position and global growth through expansion and acquisitions. China in particular offers strong long-term growth prospects as the auto population expands and further industrialization occurs.

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
October 23, 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

Past performance does not guarantee future results. Results are presented net of fees and include the reinvestment of all income. The opinions expressed herein are those of Triad Investment Management, LLC and are subject to change without notice. Consider the investment objectives, risks and expenses before investing. The information in this presentation should not be considered as a recommendation to buy or sell any particular security and should not be considered as investment advice of any kind. You should not assume that any securities discussed in this report are or will be profitable, or that recommendations we make in the future will be profitable or equal the performance of any securities discussed in this presentation. The report is based on data obtained from sources believed to be reliable but is not guaranteed as being accurate and does not purport to be a complete summary of the available data. Recommendations for the past twelve months are available upon request. In addition to clients, partners and employees or their family members may have a position in any securities mentioned herein.

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 September 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.

%	3Q18	YTD	1 Year	3 Year	5 Year	Inception*
Concentrated All-Cap Equity Composite	3.9	10.0	11.9	7.5	1.4	6.7
S&P 500 Index	7.7	10.6	17.9	17.3	14.0	9.7

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