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INVESTMENT MANAGEMENT

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1st Quarter 2019 Investment Review

"The fact that people will be full of greed, fear, or folly is predictable. The sequence is not predictable."

Warren Buffett, Chairman, Berkshire Hathaway

Investment Thoughts

It was only 3 months ago that we wrote our Q4 2018 Quarterly Review and were discussing the sudden sharp drop in the stock market. And now we find ourselves on the positive side of a sudden sharp upward move in the stock market during the first quarter and year-to-date. What to make of this market wisdom? Or is it really market silliness?

Bear markets are defined as a 20% or more stock market decline. I believe this most recent decline was just short of the 20% mark. So, it's a "*correction*" as the pundits like to say. What's the difference between 19% and 20%? Nothing. Also, does correction mean the market is "*correcting*" for previous overvalued stocks? Just asking.

Bear markets are normal, we get one about every 3 or 4 years. They last about 9-10 months, and stocks usually lose about 30-35%. Bear markets are usually thought be a warning of impending recession, but that's not always the situation. Over time, there have been more bear markets than recessions.

Now according to some, we haven't had a bear market—meaning 20%+ decline—since the Great Recession of 2008-2009. And so, the thinking goes, we're overdue for a bear market. I have a slightly different perspective. We had a 19.9% decline in 2011. And we just endured an almost 20% decline in the fourth quarter of last year. So, while technically not bear markets, it sure felt that way to me. And more importantly, declines tend to reduce animal spirits and speculative fervor to some extent. And that's not a bad thing given how long the market has gone without a big decline.

The wonderful aspect of a bear market is this: most merchandise goes on sale. It's usually a great time to make changes to stock portfolios as volatility can create temporary bargains. This past episode was no different. We made a number of changes in late 2018 that we believe will help our portfolios over many years.

You might be thinking, why didn't these guys see this decline coming? We've never been good at predicting what the masses will do in the short-term. My guess is most investors didn't predict the fourth quarter decline. And probably most didn't foresee the first quarter 2019 rebound. We're humble enough to count ourselves in these groups with imperfect market eyesight.

A little simple math demonstrates the market timing problem. Let's say you can correctly predict market declines 3 out of 4 times, or 75% of the time. That would be considered excellent in my view. And let's assume you can predict when to jump back into the market the same 75% of the time. Since we need to be right about both getting out and getting back in, we need to multiply 75% times 75% to get the correct probability. And what does that give us? About a 50% chance of being right on both the buy and the sell decision. In other words, no better than a coin flip. And that's before factoring in taxes and transaction costs. The good news is none of this market timing is necessary. Just buy well-run businesses at sensible prices and let the magic of compounding work for you over the long-term.

Economic Conditions

I guess the Federal Reserve Board, our official arbiter of all things interest rate-related, got spooked. What looked like a pretty sure 2 or 3 interest rate hikes in 2019 has morphed into—wait for it—no hikes at all. Apparently, the economy is cooling off enough that the monetary mandarins don't feel the need to step on the brakes. Perhaps their actions will forestall a recession. Perhaps their actions will further fan the flames of monetary excess, creating an even larger speculative asset bubble down the road. So far, our fears of bubble-bursting have proved misplaced. All I know is that money is cheap today. And when money is cheap, people tend to eventually do stupid things with that money. We have our helmets on but we're hoping the economy doesn't get driven into a ditch. Eventually the economy will tire all on its own, and the Fed will be dealing with another recession. We can only hope it's a relatively garden-variety recession without a lot of nasty weeds.

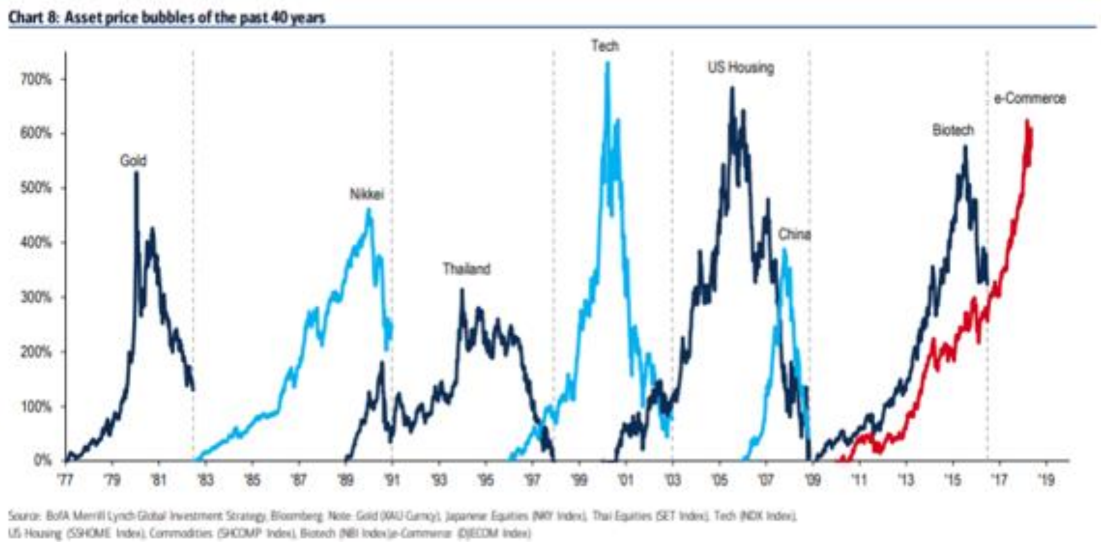
Investment Conditions

The stock market confounded many investors by rebounding in the first quarter, recovering much of the 4th quarter declines. Pop quiz: is American business collectively worth what it sold for in December or today's roughly 20% higher value? Why does the value of Microsoft, Procter and Gamble, Merck, Honeywell and the rest of corporate America bounce around so much in Mr. Market's crazy stock market? The short answer: because it can. Easy trading access via computers and cheap commissions makes it easy to trade constantly. And that's what some investors do. Buy in the morning. Sell in the afternoon. Rinse and repeat. It's the American way. Apparently.

As alluded to, the fourth quarter 2018 downdraft did create more favorable conditions for us. While stocks have rebounded significantly, including many of ours, not all shares have recovered. And so, we find the field a bit more fertile for investment values. With low interest rates seemingly on tap for the rest of this year, and the economy holding up reasonably well, we're encouraged with our present investment portfolio.

On the income side, it's still a challenge to find high-quality decent yielding bonds. Municipal bonds are very pricey, with 10-year municipals yielding around 2-2.5% and corporate investment grade bonds only a little better. We have owned some lower rated corporate bonds but we're keeping the maturities very short and watching them closely, as the economic cycle gets long in the tooth. We have found good values in selected REITS, BDCs and LPs focused on corporate loans, commercial and residential property, and infrastructure assets. We'd welcome a higher level of interest rates as it should dampen speculation and provide more income-oriented opportunities. But we'll be patient and wait.

There's been much discussion of an investment bubble, with fans on both sides of the debate. We could be in a "new era" but just when I think that's possible, I pull out a chart such as the one below, and I question the sanity of some investors. Remember that automobiles and electricity were booming growth industries at one time. But most of the rewards eventually accrued to the consumer. The most recent episode is the near vertical red line:

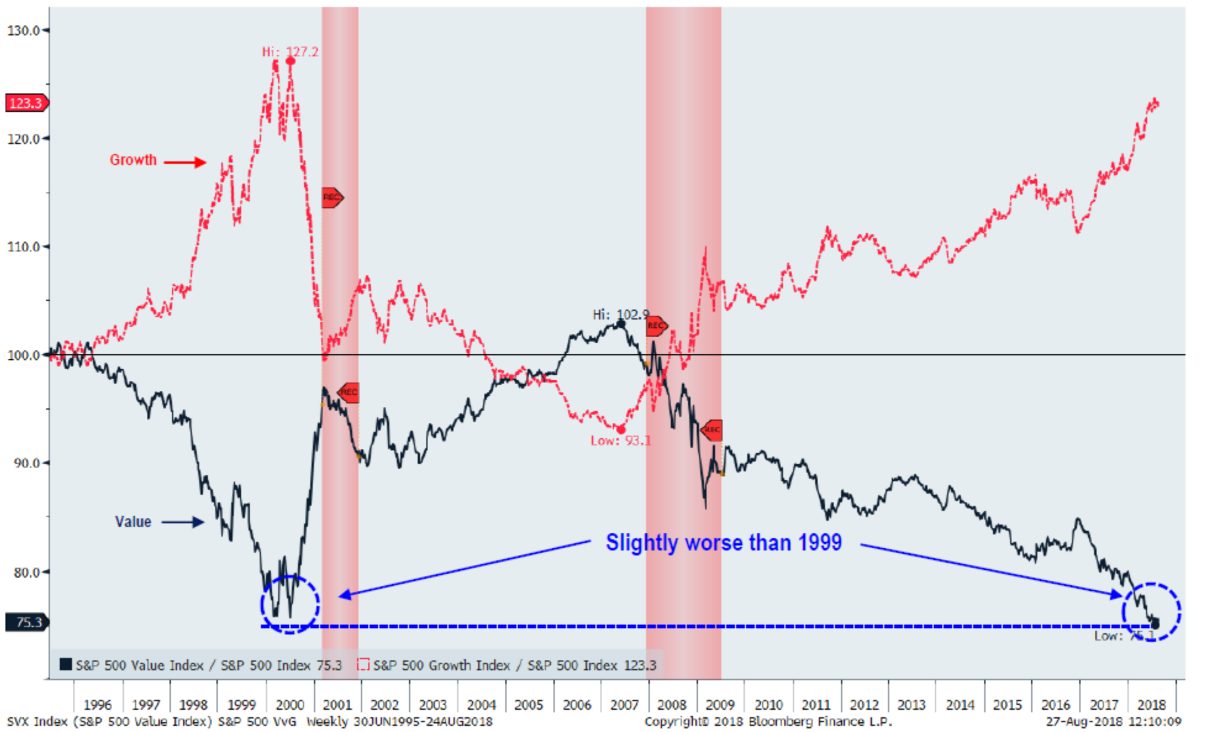


The next chart is one of my favorites, as it also illustrates the current enormous disparity between Growth and Value indices. The only other time that Value-oriented strategies underperformed so dramatically was during the late 1990s Internet/Dot-Com Bubble. We know what happened next. The bubble kept inflating as investors sold cheaply valued stocks to put more money into highly valued stocks. This went on for 5 long years. At the point of maximum underperformance of Value, in late 1999, investors were dumping the Old Economy, to buy the New Economy, the Dot-conomy. What happened next? The growth bubble popped in early 2000 and the New Era suddenly didn't look so new. So-called Old Economy Value stocks went on to rule the stock market for the next eight—yes eight!!—years.

This chart demonstrates the sobering reality that trends can continue in one direction for a long time. It also shows the difficulty of remaining disciplined and resisting the siren call and temptation to join the crowd when trends get elongated and it seems obvious that the action is where you're not. As economist John Maynard Keynes famously observed long ago: "***Markets can remain irrational longer than you can remain solvent***." Irrational markets have been with us a long time, and human nature isn't likely to change much in the next 100 years.

Many investors have made the mistake in the past to capitulate and abandon a particular strategy that isn't currently working. Investors are most susceptible at the point of maximum tension when others are enjoying higher returns, and the temptation to join the easy money party overwhelms good sense. When relative valuations get to extreme levels, as it appears to us in some areas now, some investors start to think that "***This time is different***." Which can be the four most expensive words in the investment business:

Figure: S&P 500 Growth and Value relative price performance (vs S&P 500) past 25 years
Price ratio: Style / S&P 500. Since 1995



Source: Fundstrat, Bloomberg

Company Commentaries/Spotlight

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

Allison Transmission Holdings

Allison dominates the market for fully automatic heavy-duty truck transmissions. The company has been in business for decades and over time has developed a very sophisticated set of technologies that are employed to make transmissions run smoother, more efficiently and reliably, and with lower emissions. It's the gold standard in the metro truck market, which is urban areas where automatics are preferable, given the start and stop nature of deliveries. Allison is very profitable, very shareholder-oriented, and has good long-term growth opportunities, especially in emerging markets where most transmissions are still manual shifted, but will transition to automatics as prosperity improves.

MRC Global

MRC is one of the largest global distributors of pipe, valves and fittings (PVF) to the energy industry. MRC serves all the main players including Chevron, Exxon, Royal Dutch Shell, etc. It has one national competitor in the U.S. and a bunch of smaller regional players. As the energy market continues to recover, one of the first actions is to order parts and supplies to repair, replace and renovate much equipment that has been underutilized. MRC is there to serve those needs. The company has significant long-term growth potential in international markets as the major energy companies like to deal with the same company globally. The management team has made some smart acquisitions during the recent downturn and we expect strong results from the company over the next 3 to 5 years.

Thor Industries

Thor was the largest recreational vehicle manufacturer—motorhomes and travel trailers—in the United States. I say was because Thor recently bought a large German RV manufacturer, Erwin Hymer Group, and is now the largest RV company on the planet. Thor has successfully grown its business over many decades in the U.S. and is now poised to continue that growth around the world. The demographics are on their side as Baby Boomers retire and hit the road. As well, Millennials have shown an affection for the RV lifestyle and are coming into the prime RV-buying age range over the next decade. Thor has one significant competitor, a subsidiary of Berkshire Hathaway. We see many years of growth and success ahead for the company, and we're happy to be along for the ride—pun intended.

What all three of these companies have in common is this: they are either the global leader in their industry or one of a small number of leaders. We like to invest in businesses where the companies control their destiny through market leadership.

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
April 15, 2019

"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 December 31, 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.

%	1Q19	YTD	1 Year	3 Year	5 Year	Inception*
Concentrated All-Cap Equity Composite	12.61	12.61	(5.04)	1.19	(3.28)	4.68
S&P 500 Index	13.65	13.65	9.50	13.60	11.09	9.11
Russell 3000	14.04	14.04	8.77	13.60	10.57	9.14

As of March 31, 2019. Periods over one year are annualized. Results presented net of management fees.
*Inception date April 30, 2008

The Standard & Poor's 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The Russell 3000 Index is a market-capitalization-weighted equity index maintained by the Financial Times Stock Exchange Group (FTSE) that provides exposure to the entire U.S. stock market. The index tracks the performance of the 3,000 largest U.S.-traded stocks which represent about 98% of all U.S incorporated equity securities. All indices are unmanaged and may not be invested into directly.