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3rd Quarter 2019 Investment Review

Investment Thoughts

"***I take comfort in the duration of the underperformance and that so few people are true value investors anymore. This reminds me of 2000, but the difference is there aren't as many value advocates.***"

Steven Galbraith, former Morgan Stanley Strategist, quoted in Wall Street Journal, 09/06/2019

"***Our mission is to elevate the world's consciousness***" WeWork Initial Public Offering Prospectus

WeWork apparently isn't working so well. Whether it succeeds in elevating the world's consciousness—the jury remains in deliberation. The putative technology company—it's a real estate company dressed up as a tech company—was scheduled to go public. Then the wheels sorta fell off the WeWork-mobile. We's maximum valuation in the private markets was $47 billion. Now it looks like something around $10 billion might be more realistic. Or zero. We is burning buckets of cash and if it doesn't get a cash infusion soon it might be game over.

Who cares about a private company that was barely known three years ago? Well, $47 billion is a large number, and that's the valuation that presumably sophisticated institutions were willing to place on WeWork. Look, all WeWork does is sign long-term leases on office space, which it leases on a shorter-term basis to individuals and businesses. Let's not forget the free coffee, beer, food, and endless opportunities to make new friends and not get much work done. Not exactly rocket science. Not exactly low-risk. We is on the hook for years of lease payments, yet its own customers rent short-term, often month-to-month. Yet the prospect of unending global growth got investors excited. And whenever you get investors excited, a high-and-going-higher valuation is likely to follow. Disappointment can be just around the bend.

Ask Uber and Lyft. These "new age" taxi companies take advantage of their drivers' poor understanding of vehicle depreciation and maintenance, health insurance, retirement plan contributions and other expenses. Investors hungry for growth couldn't wait to get their hands on the shares of both companies. Despite underpaying their drivers, both companies continue to lose money. Uber went public in May at $45 per share. It's now $32. Lyft sold shares at $72 in March. Now? $42 per share. It's likely to be a long, hard slog for both.

I don't mean to pick on these companies. There are plenty of other high-flyers still in orbit that need to come back down to earth. Recently, some have started to descend. But there is still plenty of froth in many of these companies. True value in my view is quite a bit further south for many stock prices. Stay tuned.

As for Mr. Galbraith, I guess he's just an old fuddy-duddy who focuses on anachronistic measures such as sales, earnings, dividends and free cash-flow?

So do we.

Economic Conditions

Judging by the strong performance of certain high-flyer stocks, you'd never think the world is full of concerning headline news. One recent morning I decided to note the headlines for major economic news as I was reading the Financial Times. Here's what I found:

"Surprise fall in U.S. retail sales raises concerns over growth"

"Low interest rates fuel financial risk-taking, IMF (International Monetary Fund) warns"

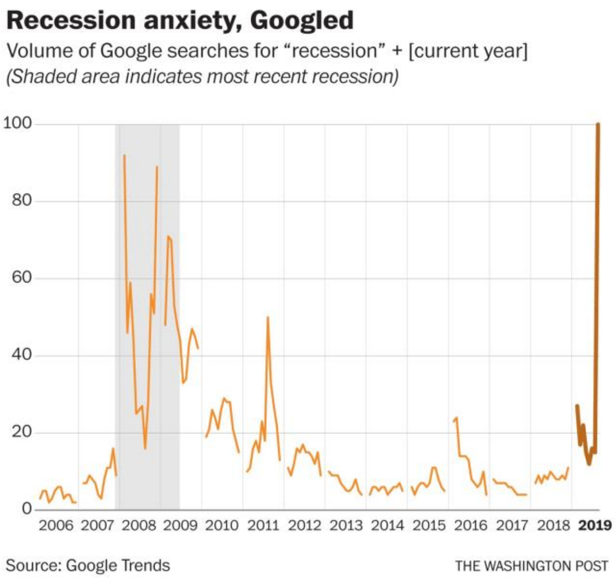
"Eurozone inflation drops to lowest level in almost three years"

"South Korea cuts interest rates to record lows in growth search"

"Hong Kong in recession as Lam silenced"

"China's central bank pumps $28 billion into financial system amid fears on liquidity"

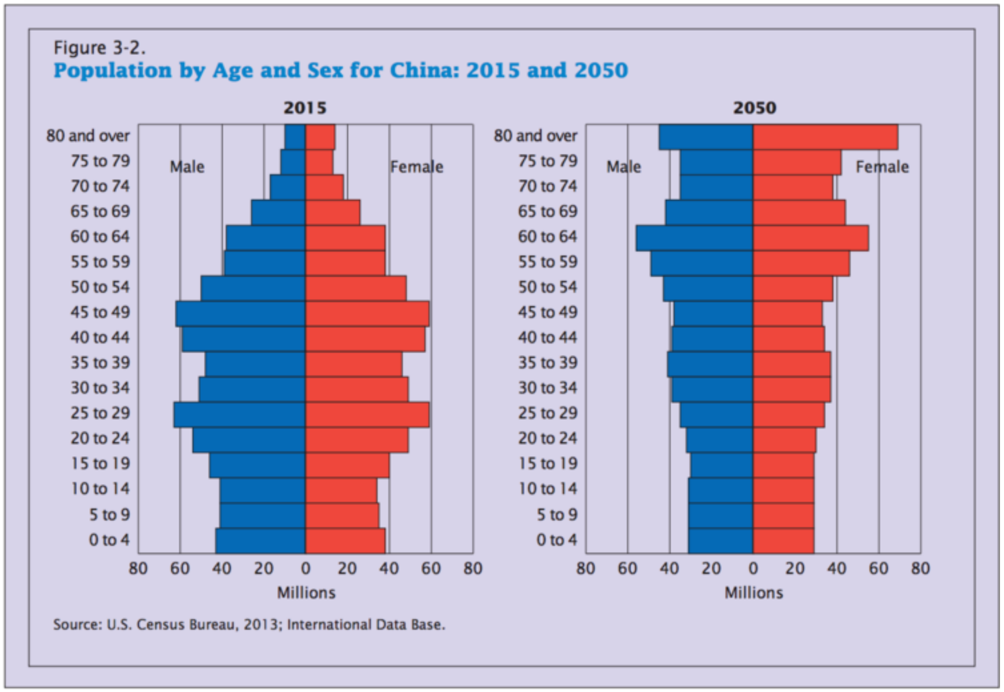
See any good news in that? Yeah, neither did I. Mind you, this was an unscientific, spur-of-the-moment thought to catalog the major headlines about the economy from one newspaper, on one morning. Had I picked a different day, it could have been a different result. But I don't think so. The news lately has been more dreary than sprightly, even after adjusting for newspapers' bias toward negative news. In the news business, if it bleeds, it leads. This chart below from the Washington Post shows the number of Google searches for recession:



As is plainly shown, recession is very much on people's minds, spiking to the highest level since the Great Financial Crisis of 2008-2009. Increased concern doesn't guarantee a recession, although consumer behavior can change in ways that create a self-fulfilling prophecy.

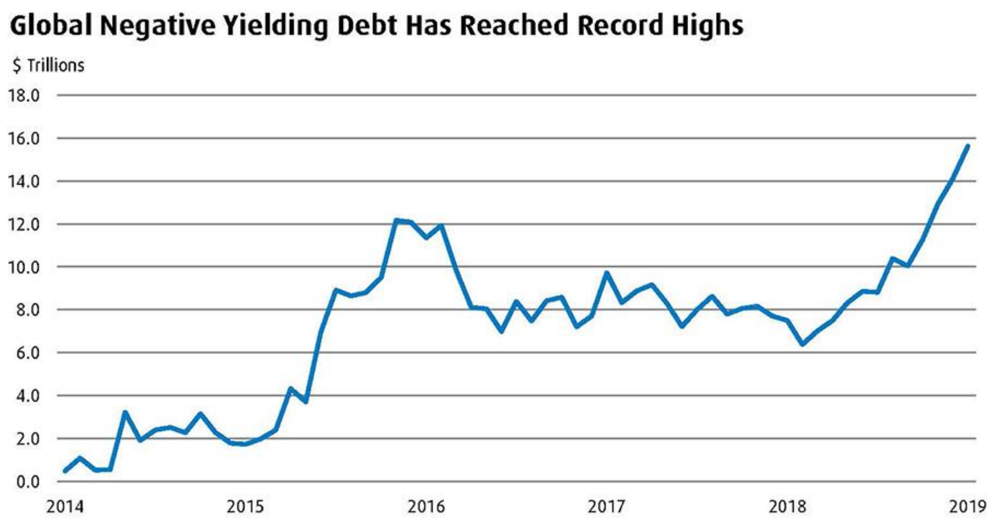
To be fair, we have conflicting signals on the recession front. Unemployment is under 4% and job growth continues. Consumer confidence is reasonably good. Interest rates are low; car and home sales continue at relatively high levels. But then we've got Impeachment proceedings adding to uncertainty, while massive Federal government budget deficits will eventually have to be reined in, removing additional stimulus to the economy.

But, the rest of the world raises doubts. The IMF forecasts that 2019 global growth will be the lowest since the Financial Crisis of 2008. Europe is particularly weak, and the Brexit saga isn't helping matters. Meanwhile China's economic growth continues to trend lower. Incidentally, while everyone is concerned that China will take over the world, China has its own issues. I remember reading a few years back about China getting old before it gets rich. How could that be? Demographics. China's decades-long "one child" policy has resulted in fewer young people, and plenty of aging people. This graph does a good job of explaining the Chinese predicament:



I'm not sure I'd want to be a Millennial in China right now, given the demographic trends of the next 30 years. They'll be paying for their parents and grandparents for decades to come. There's not much the Chinese government can do. The cake is baked, so to speak. But I digress. Back to our own worries. Trade wars with China, Europe, Mexico, Canada. Who aren't we fighting with? The Middle East? Right, but they're fighting with themselves.

One sign of global unease is the now $15 trillion of bonds trading in this world at negative yields. That means whatever you pay for the bond, when the bond matures, you lose money. Guaranteed. Investors have signed up for $15 trillion of this stuff. Why would anyone invest at a guaranteed loss? I don't know. Why would an investor buy a stock just because it's been going up? That I also don't know. It's a strange world we inhabit and are attempting to navigate our way through.



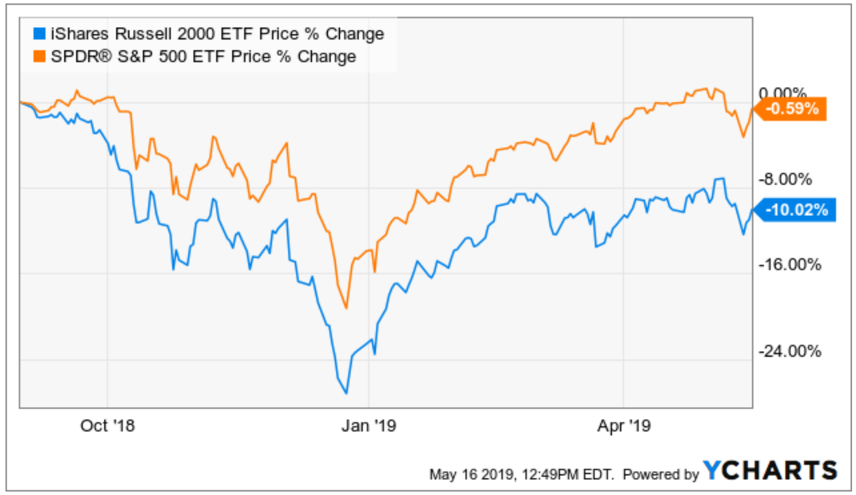
Source: BMO Global Asset Management and Bloomberg. Represents the Bloomberg Barclays Global Aggregate Negative Yielding Debt Index. Investments cannot be made in an index.

Investment Conditions

According to a recent Barron's article, almost $400 billion has flowed into bonds this year. Approximately $200 billion has been redeemed from stock investments. Meanwhile, the S&P 500 dividend yield is around 2%, while the 10-year U.S. Treasury bond yields around 1.7%. Germany is similar if only worse; German 10-year government debt yields -0.50%--that's negative half a percent, while the German stock market yields 3% or so.

Let me see if I've got this right? Some investors are choosing to sell higher-yielding stock funds and put that money into lower-yielding bonds? In our view, stocks aren't cheap, but bonds seem even less attractive. Why do this? Call it the Global FUD factor. Fear, Uncertainty, Doubt. And yet we still have segments of the stock market trading as if their current good times will continue for the next 10 or 20 years. You know whom I'm talking about. High-flying technology stocks. The disruptors with seemingly few risks to their rosy long-term future. Nothing lasts forever. General Motors was once a hot growth stock. Ditto electric utility stocks. So too, Polaroid and Eastman Kodak. Polaroid is now dead, and Kodak is on life support. Things change.

The chart below depicts the FUD factor at work in the stock market. Fear is driving investors to buy the well-known, well-loved, larger household names. Avoid just about everything else. Large company stocks have gone nowhere over the past year—the orange line. Smaller company shares—the blue line—have lost about 10% or so. The spring winds tighter and tighter. When it releases we don't know. The longer it tightens, the more powerful the release.



While we continue to whine about high valuations for stocks, it's in the bond world where we marvel at the returns that investors are willing to endure. Why would anyone sign up for these very low yields? After factoring inflation and taxes into the equation, the picture looks worse. The following words from last quarter's review are still relevant:

Low interest rates continue to make our job challenging in finding income producing investments such as corporate or municipal bonds. Municipal bonds are very pricey. Ten-year municipals yield around 2%. A twenty-year muni gets you 3% yields. Corporate investment grade bonds offer only a little better income at around 4-5%, but that's taxable. We have owned some non-investment grade corporate bonds as yields are higher at 6-7%, but we're keeping the maturities very short and watching them closely, as the economic cycle gets longer in the tooth. We've also found reasonable levels of income 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 might dampen speculation in high growth stocks and safety stocks, while providing more income-oriented opportunities. But it's out of our hands, so we just have to be patient and wait. The opportunities have a way of showing up when you least expect them.

While we've had a decent rebound in the first nine months of 2019, we're just recovering from last year's decline. We're still disappointed that many of our common stocks behave like wallflowers at the high school dance. In fact, large chunks of the stock market seem to be ignored by investors. Partly it's due to investor fears about a recession, as many cyclical stocks have declined in price since September 2018. The good news is even if a recession is imminent, some stock prices have already declined in anticipation of the actual event. It's common for the stock market to lead the real economy. As Warren Buffett has remarked, "***Be fearful when others are greedy, and be greedy when others are fearful.***" Fear is driving many investors to buy the big, known, safe companies, resulting in higher valuations. We're cautious about these areas. Other sectors offer good value where investors are fearful about the impact of recession on economically-sensitive companies. The bargains in the feared areas seem more attractive to us.

Company Commentaries/Spotlight

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

KAR Global

KAR isn't a household name, but is one of two main providers of global whole car auction services, selling over 3.5 million vehicles valued at over $40 billion in over 200 countries. The company provides physical facilities and online platforms for customers including franchised and independent car dealers, finance companies, commercial fleets and rental car companies to buy and sell. The company takes a small slice of the transaction value, averaging around $600 per vehicle. KAR provides ancillary services including financing, body repairs, lock services, transportation etc. KAR plans to grow through new digital services including data analytics and international expansion. The company has a solid business model and has grown sales and earnings over the longer term. Recession fears have put a temporary cloud over the shares and given us the opportunity to invest at a very reasonable valuation.

SS&C Technologies

Hey, it's a technology company! Who says we'd never buy tech? SS&C is a leading provider of mission-critical cloud-based software for financial and healthcare industries. We've used their software for years and can attest to the quality and indispensable nature of their software. We use the software daily and simply couldn't manage our business without it. It's a "sticky" product as users get accustomed to the software and are very reluctant to switch providers. Founded in 1986, with 22,000 employees in 100+ offices worldwide serving over 18,000 clients, SS&C is one of the largest providers of software and services to its niche markets. The company has grown through new product introductions and acquisitions, given the fragmented nature of the industry. We expect more acquisitions globally, and look forward to years of growth ahead for SS&C.

WestRock Company

WestRock is one of the largest paper and packaging businesses in the United States. Corrugated—think cardboard boxes—is about 2/3 of the revenues, and consumer packaging—food and beverage cartons, etc.—accounts for the balance. WestRock has made several large acquisitions and the result is a consolidated U.S. industry with relatively high barriers to competitive entry. However, the global industry offers significant room for expansion. WestRock works closely with customers to design packaging that fits their particular needs. The company should benefit from the e-commerce trends to use cardboard boxes, along with more acquisitions and continued focus on cost improvements. WestRock has been smart about capital allocation, including acquisitions, share repurchases, and consistent dividend increases. Recession fears are also providing an opportunity to invest in a global leader at an attractive valuation.

What all three of these companies have in common is this: they are among the ***global leaders*** in their industries. We like to invest in businesses where the companies control their destiny by virtue of their significant market share. In addition, we like ***management teams that own a personally significant amount of common stock***. We like to see "***skin in the game***" when it's time to invest. We prefer "owners" to "agents." Lastly, they have a ***long runway of future growth*** in their businesses.

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 21, 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**

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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 September 30, 2019. 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.

%	**3Q19**	**YTD**	**1 Year**	**3 Year**	**5 Year**	**Inception***
Concentrated All-Cap Equity Composite	(4.68)	13.24	(15.89)	1.63	(3.15)	4.52
S&P 500 Index	1.70	20.55	4.25	13.45	10.85	9.25

As of June 30, 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. All indices are unmanaged and may not be invested into directly.