SIRE LINE
Capital Management

FIRST QUARTER 2014

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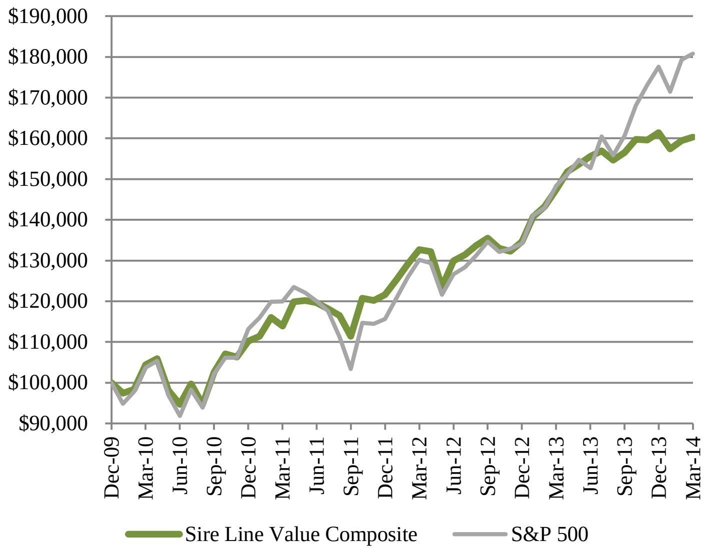
Performance Report from
Daren Taylor, Portfolio Manager

Figure 1: THE VALUE OF A $100,000 INVESTMENT IN THE SIRE LINE VALUE COMPOSITE FROM INCEPTION (1/4/2010) TO PRESENT (3/31/2014) AS COMPARED TO THE S&P 500 INDEX (UNAUDITED)



NOTE: Accounts included in this product composite are fully discretionary taxable and tax-exempt portfolios. They are managed under our value style, which invests primarily in high-quality businesses that 1) are simple to understand, 2) have a consistent operating history and favorable long-term prospects, 3) are managed by honest and able managers whose interests are aligned with ours and 4) can be purchased at a significant discount to intrinsic value. The performance of the Sire Line Value Composite is net of fees. All performance figures in the chart above begin as of the close on January 4, 2010.

Performance Measurement

The primary objective for all of our portfolios is to achieve the maximum long-term total return on capital that is obtainable with minimum risk of permanent loss. The chart above (Figure 1) shows a comparison of a $100,000 investment in the Sire Line Value Composite and the S&P 500 Index (S&P 500) since inception. The S&P 500 is an unmanaged, market capitalization weighted index that measures the equity performance of 500 leading companies in the U.S. today. Firms included in the S&P 500 account for approximately 75% of the value of all U.S. stocks. Therefore, it acts as a fairly good proxy for the total market. Clients could easily replicate the performance of the S&P 500 by investing in an index fund at little cost. For discussion purposes, I will focus on this benchmark to address our relative performance.

Our Performance

The Sire Line Value Composite (SLVC) experienced a small loss of 0.69% in the first quarter, while the S&P 500 increased by 1.81%. The small decline in our portfolio during the quarter was mostly driven by the severe correction in one stock: Weight Watchers International (WTW). In February, WTW reported a large earnings miss for the final quarter of 2013 and provided forward earnings guidance that was significantly lower than what Wall Street had been anticipating. The company also put its dividend on hold and announced a major restructuring. The shortfall in business activity at WTW is mostly being driven by an ineffective marketing campaign, heighted competition from free apps and activity monitoring devices and a sluggish employment environment. The investment story for WTW has changed from "a high return on capital business with a strong brand name in a growing industry" to "a highly leveraged, restructuring play." Since we tend to stay far away from both highly leveraged and restructuring stories, I have sold our position in WTW and embraced the idea that you don't have to make it back the same way you lose it. Our portfolio has outperformed the market since the end of the first quarter and as of this writing is back in positive territory on the year.

The following table (Figure 2) summarizes the historical performance of the S&P 500, the Dow Jones Industrial Average (Dow) and the Sire Line Value Composite (SLVC):

Figure 2:	TOTAL RETURN (1)		
Annual	S&P 500 (2)	Dow (3)	SLVC (4)
2010	13.2%	12.4%	**10.3%**
2011	2.1%	8.4%	**10.3%**
2012	16.0%	10.2%	**10.7%**
2013	32.4%	29.7%	**19.9%**
2014 YTD	1.8%	-0.2%	**-0.7%**
Cumulative:			
2010	13.2%	12.4%	**10.3%**
2010-2011	15.6%	21.8%	**21.7%**
2010-2012	34.1%	34.3%	**32.7%**
2010-2013	77.6%	74.1%	**61.4%**
2010-2014 YTD	80.8%	73.8%	**60.3%**
Annual Compounded Rate:	14.9%	13.9%	**11.7%**

(Footnotes to table above)

(1) All performance figures begin as of the close on January 4, 2010.

(2) Based on changes in the value of the S&P 500 plus dividends (reinvested) that would have been received through ownership of the Index during the period.

(3) Based on changes in the value of the Dow Jones Industrial Average plus dividends (reinvested) that would have been received through ownership of the Index during the period.

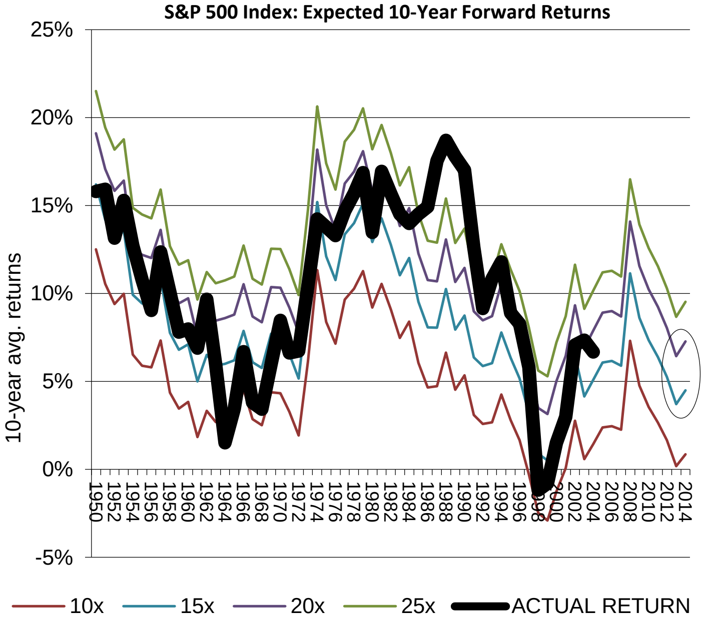
(4) Based on changes in the value of the Sire Line Value Composite including dividends and after all fees and expenses.

The reason that our portfolios have underperformed recently is because I have become very conservative over the last couple of quarters. This has had a negative impact on our relative performance. However, I continue to believe that having a conservative profile on our portfolios in the current environment is the prudent thing to do. I view the current environment as being similar to the environment that the U.S. faced going into the year 2000. In 2000, there was a large segment of the stock market (mostly tech and internet stocks) that was significantly overvalued, while other segments of the market represented attractive value for long-term investors. I was managing a small investment partnership back then and actually made good money in both 2000 and 2001, years in which the S&P 500 Index lost significant value. Today, while there are many ridiculously priced stocks, there are pockets of value that I am finding to invest our assets. I will speak more about some individual names in our portfolios in the semi-annual report.

U.S. Equity Markets: Cheap or Expensive?

One measurement that I follow closely to gauge the current investment environment is the expected 10-year average forward rate of return for the S&P 500 Index. Average annual forward rates of return can be implied by using (1) current valuations as a starting point, (2) a conservative assumption of earnings growth going forward, and (3) a range of P/E multiples in the final year. A 10-year time period is used to make sure that the model captures an entire economic cycle.

Figure 3:
S&P 500 Index: Expected 10-Year Forward Returns

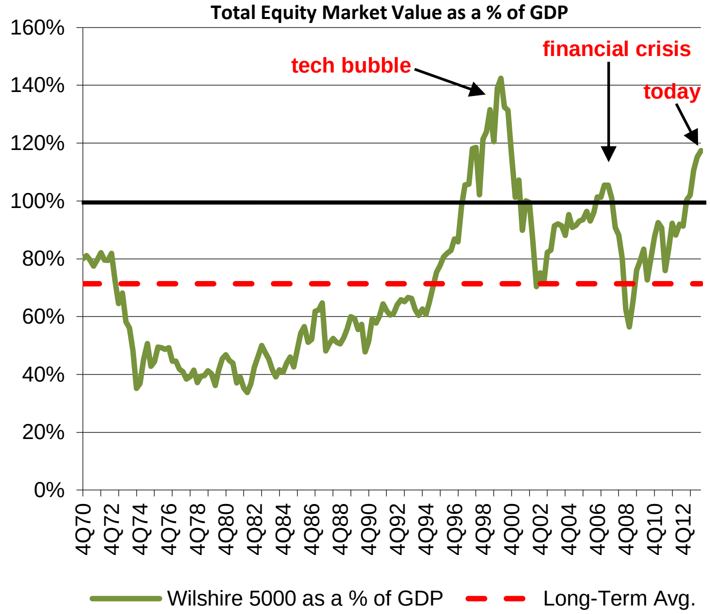


In the previous chart (Figure 3), the thin colored lines represent expected 10-year forward rates of return for the S&P 500 Index assuming future earnings grow at a 4% average annual rate (6% pre-2010) and a range of P/E multiples (10x, 15x, 20x and 25x) in the final year. The heavy black line shows the actual 10-year forward rate of return experienced for the S&P 500. Based on this analysis, the current 10-year forward rate of return for the S&P 500 Index is expected to be in the range of 4.5%–7.3%, assuming a final P/E multiple of between 15x and 20x (circled on far right of the chart).

Another measurement that I believe is a good indicator of whether U.S. equity markets are cheap or expensive is the value of the Wilshire 5000 Index relative to U.S. GDP (gross domestic product). Think of this as the total equity market value of all U.S. stocks vs. the total value of all goods and services produced in the U.S. (the price-to-sales ratio for the total stock market, if you will).

With the Wilshire 5000 Index recently valued at $20 trillion and current GDP of roughly $17 trillion, the current ratio is around 117%. This is significantly higher than the long-term average of around 71%. In addition, as you can see in the following chart (Figure 4), there have only been two prior periods since 1970 when the Wilshire 5000 Index traded above 100% of U.S. GDP—once during the tech bubble of the late 1990s and again in 2007, just before the global financial crisis.

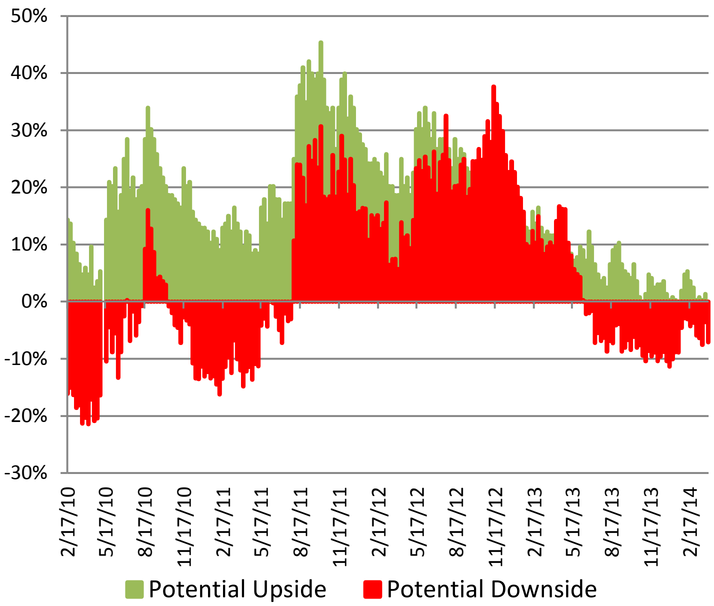
Figure 4:
Total Equity Market Value as a % of GDP



And finally, another measurement that I track closely is the relationship between the yield on U.S. investment grade corporate bonds and the earnings yield for the equity market (represented by the stocks in the Value Line Investment Survey). The reason that this relationship is important is because bonds and stocks are always in competition for investor dollars. Investors will always gravitate toward the asset class that offers a higher risk-adjusted return.

Based on the historical relationship between these two yields, the current relationship implies that there is zero upside for stocks at current valuations. More specifically, the current relationship implies that there is 0% upside and 7% downside risk for stocks given current valuations. You can see this better in the following chart (Figure 5).

Figure 5:
Implied Upside/Downside for Stocks (relative to bonds)



It is important to remember that the Fed is currently working very hard to force interest rates lower than they naturally would be. If interest rates in general were to rise just one percentage point from current levels, the potential downside for stocks would be twice what is shown in the chart.

Given that these and other broad valuation measurements that we follow continue to look overextended, combined with my concerns over slower future economic growth for our country as well as much of the developed world, our portfolios will remain conservatively positioned until conditions improve. Let me reiterate again that the stocks we continue to hold in our portfolios represent high-quality, high-value investments. I would be comfortable owning them in almost any environment.

As always, thank you for your continued loyalty and trust. It is an honor for me to be able to help you protect and grow your hard-earned assets.

With appreciation,

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