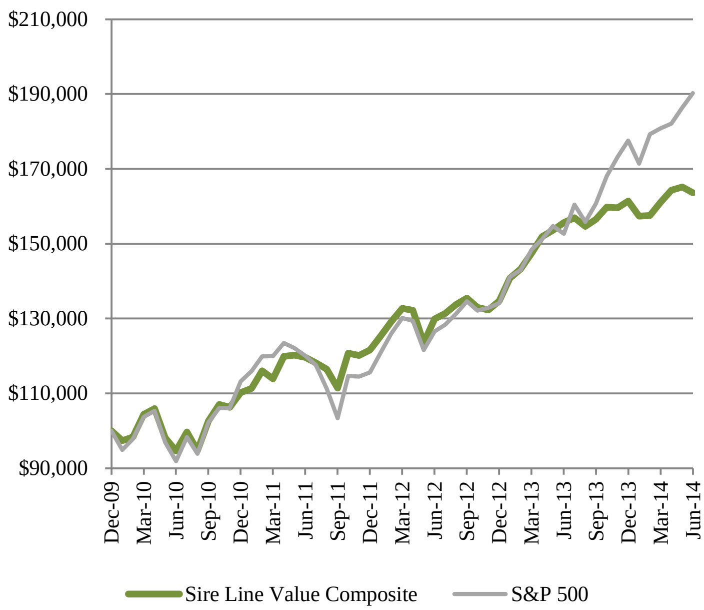
159 Madison Avenue, Suite 10i, New York, NY 10016 | (646) 526-8403 | info@sirelinecapital.com | www.sirelinecapital.com

August 5, 2014

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 (6/30/2014) 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) increased by 1.6% in the second quarter vs. an increase of 5.2% for the S&P 500 (the Dow increased 2.6%). For the first six month of 2014 the SLVC is up 1.4% vs. a gain of 7.1% for the S&P 500 (2.7% for the Dow). And finally, the SLVC has returned an average of 11.6% per year since its inception, while the S&P 500 returned an average of 15.4% (13.8% for the Dow) over that same period. Although our recent performance has not kept pace with these benchmarks, I am quite happy with our absolute risk-adjusted returns.

As you will see in more detail later in this report, broad equity valuations are close to historical highs. The huge rally in the stock market has been fueled by the Federal Reserve's decision to keep interest rates at historical lows. Valuations have been manipulated by the Federal Reserve's monetary policy over the last few years. I am concerned about the unintended consequences of this artificial stimulus. When the Fed keeps interest rates low, as they have been doing since the Great Recession in 2008/2009, they are basically forcing investors into riskier assets. This "forced" demand creates higher current valuations in equity securities. However, because it is not "true" or "natural" demand, the higher valuations are usually transitory. Only a long-lasting surge in economic activity will justify current equity valuations. However, even after six years of this artificial stimulus by the Fed, the U.S. economy is anything but robust. There are many different statistics I could give you to reflect this fact, but there are two important statistics that stand out for me. Statistic #1 is that real U.S. household incomes are still below where they were before the financial crisis. Statistic #2 helps explain why that is so and that is the fact that the current employment participation rate for men ages 25-54 has not been this low in over 60 years. Our economy is simply not producing enough full-time jobs for the heart of our workforce. That has more to do with fiscal policy (Washington) rather than monetary policy (the Fed). But the Fed is overcompensating for this.

The television show *60 Minutes* recently did a story on active volcanoes of the world. I was most interested when they began to talk about Mount Vesuvius in Italy and how some 3.5 million people actually live in the immediate area surrounding the volcano. The scientist who they interviewed for the show said that when the volcano has another major eruption similar to the one in A.D. 79 (not a question of if, but when), there would be no way to evacuate the 3.5 million people in time.

To be fully invested in the current stock market with heightened risk of a sizable market correction is similar to living close to a volcano like Mount Vesuvius. Yes, life is good in that part of the world and the soil is rich with nutrients, which is good for crops. And yes, a major eruption has not happened since 1631 and may never happen again in our lifetime. However, the risks are just far too great! The same is true for the stock market today. The Fed's low interest rate policy over the last few years has provided rich soil for growing an investment portfolio and it has now been six years since the last significant bear-market "eruption." However, higher current valuations means lower forward rates of return. As I mention on the first page of every quarterly report, my primary objective for our portfolios is to achieve the maximum long-term total return on capital that is obtainable with minimum risk of permanent loss. I will not lower our investment criteria to try to keep up with a runaway stock market when I cannot find suitable investments with attractive risk-adjusted forward rates of return.

To protect our portfolios from what I perceive to be heightened systemic risk, I have built up a sizable short position in small cap stocks (mostly via the Russell 2000 Index) and increased our cash holdings. Our large short position has lost value as the general stock market has continued to climb higher. But I expect these losses, which are mostly unrealized, to reverse when valuations normalize. Small cap stocks are the most overvalued segment of the market and our short position is a type of insurance policy to protect our investments (long positions) from a broad market selloff. In addition, I have money sitting in cash earning nothing rather than in bonds because bonds are also richly valued (historically low interest rates also means historically high bond prices). When interest rates normalize to higher levels from their current historical lows (which eventually they must), we would lose principal capital on any bond we owned unless we held it to maturity. Cash gives us some dry powder in case of a market selloff.

Given our disciplined, value-oriented approach to investing, you should expect our portfolios to outperform in bad years for the stock market and slightly underperform in boom years. Since our inception in January of 2010, it has been an almost nonstop bull market for stocks. The only weak calendar year for the stock market was 2011 when the S&P 500 Index was flat for the year (and the average U.S. mutual fund lost 3%). In that year, our portfolios increased by over 10%. Despite the continued bull market, we did a good job of keeping pace until the fall of last year when attractive opportunities became scarce and I became much more conservative with our investment portfolio. Since then the bull market has continued its momentum to the upside.

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	5.2%	2.6%	**1.6%**
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	90.3%	78.7%	**63.7%**
Annual Compounded Rate:	15.4%	13.8%	**11.6%**

(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.

Changes to Our Portfolio

In the first six months of 2014 I initiated two new holdings, eliminated seven and significantly added to our cash and short positions.

We are new investors in Credit Suisse Group and Citigroup. Based in Switzerland, Credit Suisse Group is engaged in private banking, asset management and investment banking. It is the second largest bank in Switzerland and one of the largest wealth managers in the world. In May the bank plead guilty and paid over $2.6 billion to settle with U.S. authorities over tax evasion charges. The bank has been reducing leverage, cutting expenses and taking actions to focus more on its valuable private banking & wealth management businesses. The settlement lifts a dark cloud that had been hanging over the company and the shift in focus to the private banking & wealth management businesses should help to highlight the underlying value that is not currently being recognized by the markets.

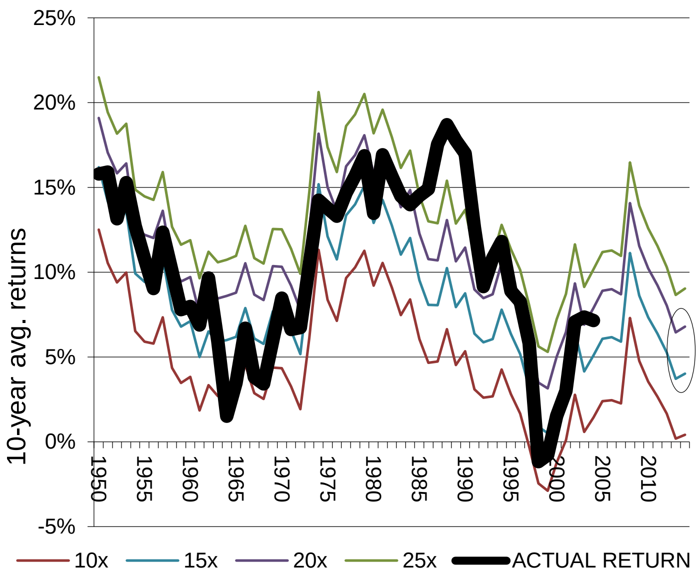
Citigroup is a U.S.-based diversified financial services company that provides a broad range of financial products around the world, including consumer banking and credit, corporate and investment banking, securities brokerage and asset management. In March the Federal Reserve surprisingly rejected the company's Capital Plan to return value to shareholders through dividends and share repurchases due to "deficiencies in its capital planning practices." Citigroup has plenty of capital and a healthy balance sheet. That is not the issue here. In addition, they have one of the most attractive global franchises in all of banking. The company's stock trades for less than 8x normalized earnings and roughly 85% of tangible book value. There are also hidden assets on the balance sheet that are not being fully appreciated by the market. The issues they are having with respect to internal processes and planning are fixable. Once these improvements are made and the Fed gives them the go ahead to return capital to shareholders, Citigroup's stock should react positively.

In the first half of 2014 I eliminated our holdings in Google, Walgreens, Medtronic, Apple, Bank of NY Mellon, Western Union and Weight Watchers. Google, Walgreens and Medtronic, all successful investments for us, were sold as their valuations had increased close to my estimate of intrinsic value. The rest were sold because I no longer felt confident in my original thesis.

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

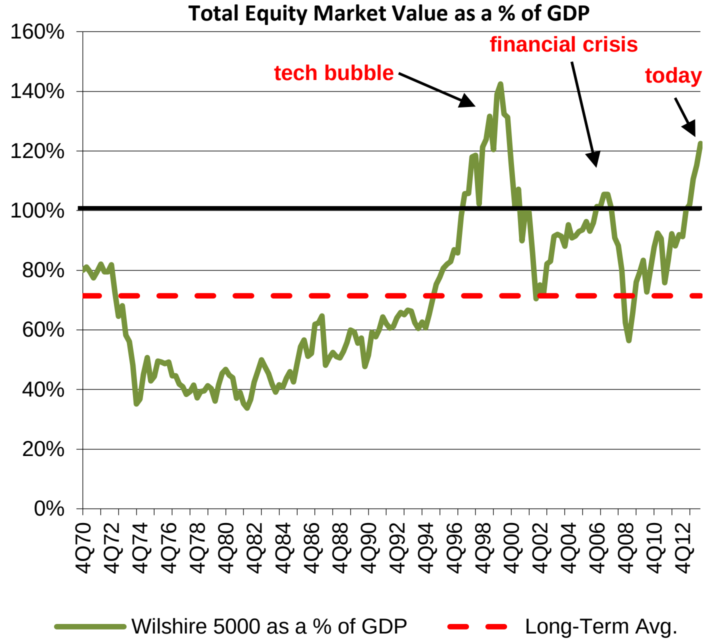


In the chart above (Figure 3), the thin colored lines represent expected 10-year forward rates of return for the S&P 500 Index assuming future earnings grow at a 4% average annual rate (6% pre-2010) and a range of P/E multiples (10x, 15x, 20x and 25x) in the final year. The heavy black line shows the 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 4.0%–7.0%, assuming a final P/E multiple of between 15x and 20x (circled on far right of the chart). While these expected returns do not sound bad on the surface, they are actually the 2nd lowest projected returns that this model has produced since 1950. The lowest was during the tech bubble in the late 1990s.

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 over $20 trillion and current GDP of roughly $17 trillion, the current ratio is around 122%. This is significantly higher than the long-term average of around 71% (long-term median = 65.8%). 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.

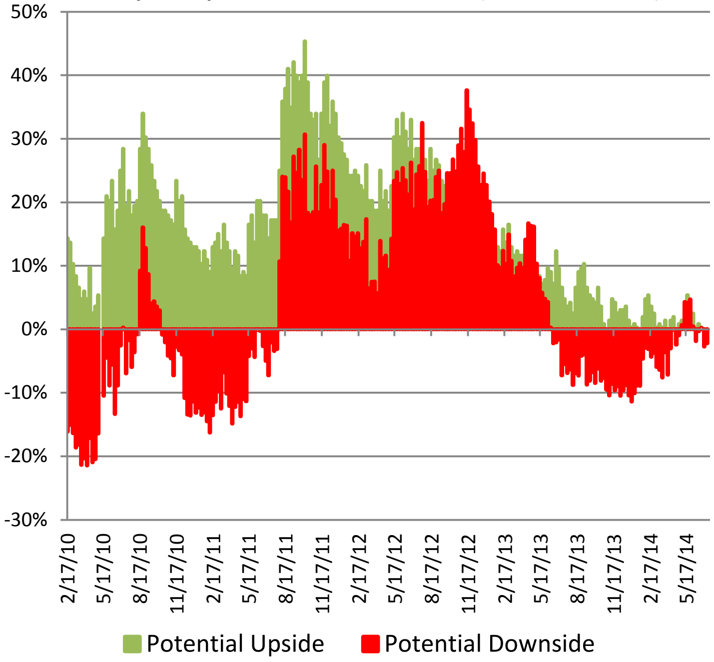
Figure 4:
Total Equity Market Value as a % of GDP



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 0% upside for stocks in general at current valuations and -7% downside risk for stocks relative to bonds given current valuations. You can see this better in the following chart (Figure 5).

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



Given that these and other broad valuation measurements that I follow continue to look overextended combined with my inability to find suitable investments with attractive risk-adjusted forward rates of return, the Nearco Value Fund will remain conservatively positioned until conditions improve.

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,

Daren Taylor, CFA
dtaylor@sirelinecapital.com