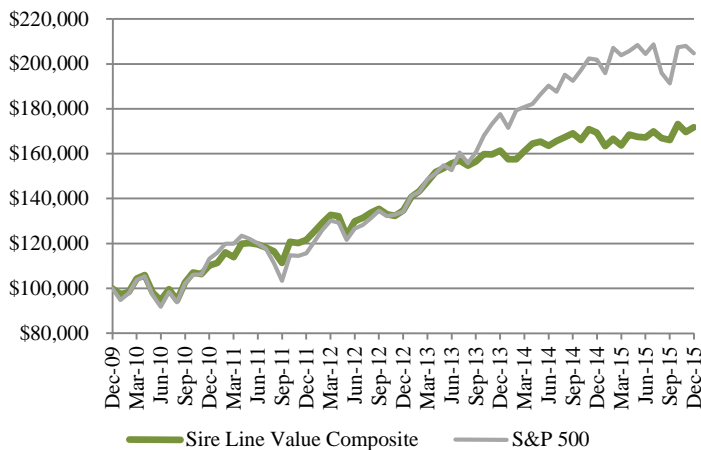


January 31, 2016

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 (12/31/2015) 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. Although all of Sire Line Capital's portfolios are managed for absolute performance, for discussion purposes below I will focus on this benchmark to address our relative performance.

Our Performance

The Sire Line Value Composite (SLVC) experienced a net gain of 3.5% over the three-month period ending in December vs. a gain of 7.1% for the S&P 500 (and a 7.7% gain for the Dow Jones Industrial Average). For the calendar year 2015 the SLVC increased in value by 1.4%, matching the 1.4% gain for the S&P 500 (and beating the 0.2% gain for the Dow). Our relative "risk-adjusted" performance was actually better than the headline number suggests as our portfolios were significantly hedged for the entire year (we matched or beat the indices while being exposed to much less downside risk). Our portfolios also performed better than the average U.S. diversified equity mutual fund, which declined in value by 2.1% in 2015.

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:

Annual	TOTAL RETURN (1)		
	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	13.7%	10.0%	5.0%
2015	1.4%	0.2%	1.4%
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	101.9%	91.6%	69.4%
2010-2015	104.7%	92.0%	71.8%
Annual Compounded Rate:	12.7%	11.5%	9.4%

(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.

Our relative underperformance over the last two years is primarily a result of the losses that we have experienced in our short positions (protective hedges) offsetting some of the gains in our long positions. Remember that I began to hedge our portfolios in late 2013 when I felt uncomfortable with the increasing level of market risk. As it turns out I was a little early to hedge the portfolios. The Russell 2000 Index of small-cap stocks, which has

been the primary focus of our hedging over that time, continued to increase in value through 2014 and our short positions lost value as a result (the value of a short position is inversely correlated to the price of the underlying security). However, our patience started to pay off in 2015 as small-cap stocks significantly underperformed large-cap stocks.

Microsoft (+19%), AIG (+11%), PepsiCo (+6%) and JPMorgan (+6%) contributed the most to the Fund's performance in 2015. The Fund holdings that detracted the most were Twenty-First Century Fox (-29%), Credit Suisse Group (-14%) and Berkshire Hathaway (-12%).

Warning Lights Are Flashing!

"We consider the 2008 – 2009 contraction to be a one in 50 or a one in 100 year event—similar to the 1930s in the U.S. and Japan since 1990." -Prem Watsa, Chairman & CEO of Fairfax Financial Holdings

While many U.S. economic indicators are still holding up reasonably well, global economic fundamentals have been deteriorating. And since we are all now more connected than we ever have been before, it is critical to look at the global economy, not just what is going on domestically. The best place to start is by looking at interest rates across the globe. What is shocking to me is that countries that account for roughly 25% of global GDP are now experiencing some form of negative interest rates. That means that rather than getting paid to lend the government your money, you have to pay them to lend them money! Slow growth and deflation are spreading across the globe like a virus.

Corporate-debt defaults in 2015 were the highest they have been since the financial crisis in 2009. Companies in emerging markets are for the first time in years defaulting more than U.S. firms.

Oil prices declined 30% in 2015 and are now down over 70% from recent highs. Other commodities have experienced similar declines. The super-cycle in commodities from 2001 through 2011 was mostly driven by China, which consumed roughly half of the world's industrial metals, energy and other commodities. Most people don't understand how large and unsustainable the Chinese boom has been. One statistic that I found completely mind-blowing is that over a five-year period toward the end of this super-cycle, China consumed (used) more cement than the U.S. had consumed in the entire twentieth century. Think about that for a moment. This level of consumption is unquestionably unsustainable. With that in mind, it is much easier to understand that, as China's economic growth slows, commodity prices will continue to fall.

Historically, large, unsustainable economic booms don't end well, and China's is the largest anyone has ever seen before. I suspect that before too long, China will experience a debt crisis as bad loans begin to surface.

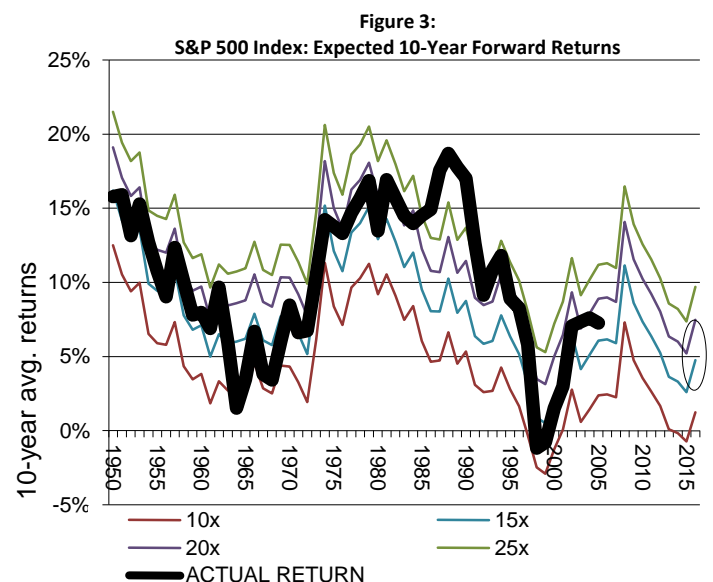
In the most recent quarter, U.S. manufacturing, which makes up roughly 12% of the US economy and has traditionally been the canary in the coal mine when it comes to economic growth, experienced its weakest reading since the current expansion began in 2009.

My biggest fear is that with interest rates at virtually zero, the Federal Reserve can no longer influence investor and corporate behavior by manipulating interest rates. In addition, the U.S. government is drowning in debt and other future liabilities. So when the next recession arrives, I am not so sure that monetary or fiscal policy will be able to save our economy. Hence, the reason I began this section with the quote from Prem Watsa.

We have turned into a society that expects entitlements and ever-increasing wealth. Nobody expects a depression like the one the U.S. experienced back in the 1930s. Let me be clear in that I am not predicting that the U.S. will experience a depression over the next few years. However, a 1930s-style depression will happen again in the U.S. at some point in the future. I believe it is simply a question of when, not if. And it is more likely to happen when the Fed and the U.S. government are not in a position of strength.

U.S. Equity Markets: Cheap or Expensive?

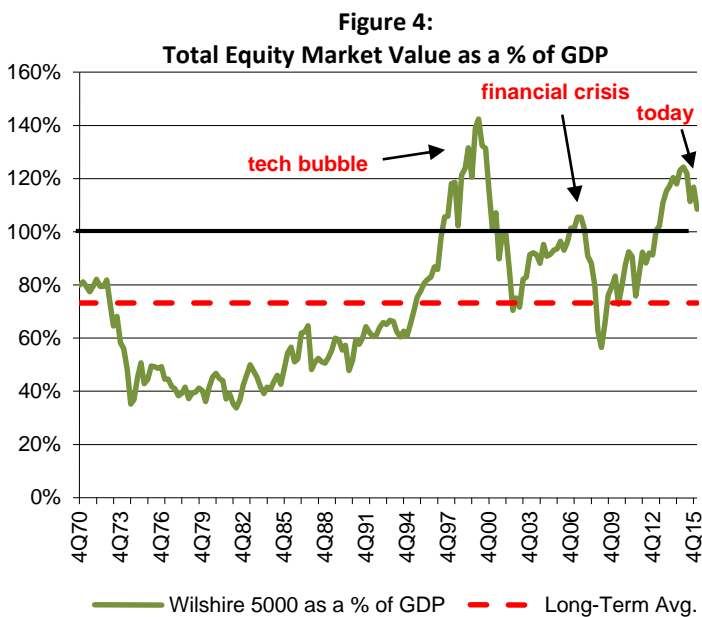
One measurement that I follow closely to gauge the current investment environment and the overall level of risk in the stock market is the expected 10-year average forward rate of return for the S&P 500 Index. Average annual forward rates of return can be implied by using (1) current valuations as a starting point, (2) a conservative assumption of earnings growth and dividends 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.



In Figure 3 on the previous page, 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 4.7%–7.5%, 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 all that bad, they are actually the second lowest projected returns that this model has produced since 1950 (the lowest was during the tech bubble in the late 1990s). In addition, given that the dividend yield on the S&P is currently 2%, it implies a price return of just 1.0%–3.5% per year going forward.

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).

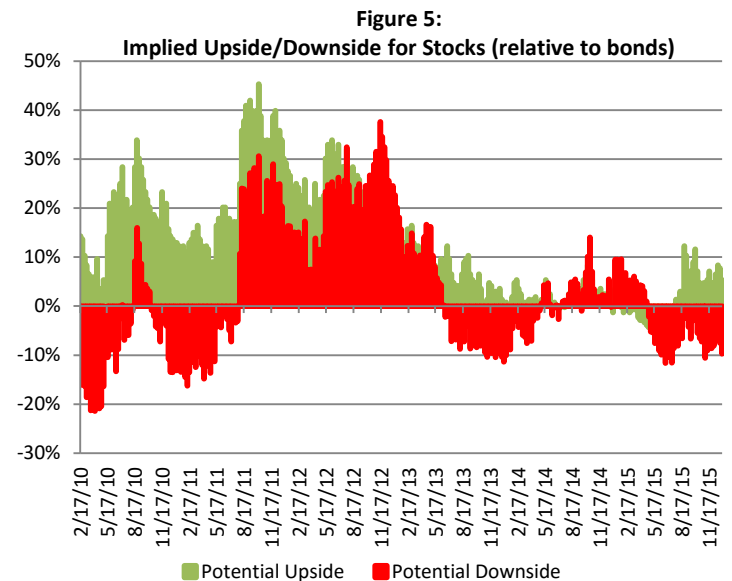
With the Wilshire 5000 Index currently valued at over \$19.6 trillion and current GDP of roughly \$18.1 trillion, the current ratio is around 108%. This is significantly higher than the long-term average of around 73% (long-term median = 67%). In addition, as you can see in the following chart (Figure 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.



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 and following the recent selloff in stocks in the third quarter, the current relationship implies roughly 5% upside and 10% downside risk for stocks. You can see this more clearly in the next chart (Figure 5).

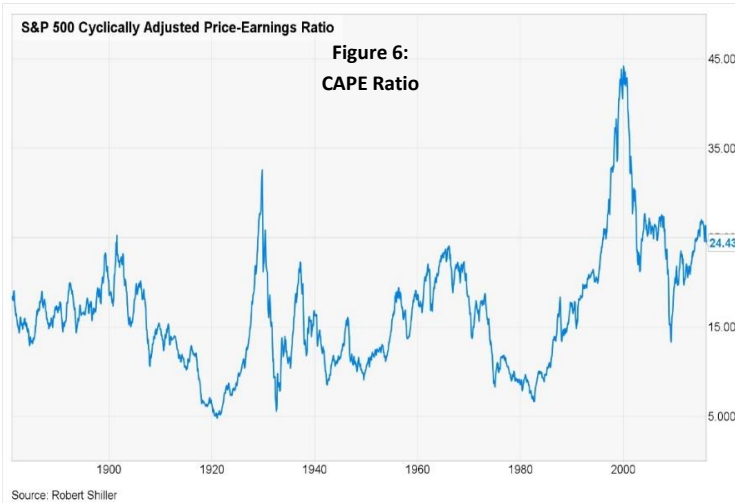


And finally, the most common valuation metric used by those investors that continue to believe current equity valuations are attractive is the price-to-earnings (P/E) ratio for the S&P 500 Index using forward earnings. The argument goes that the recent P/E ratio of roughly 16x is only slightly higher than its historical average. Therefore, they say, stocks in general are not overvalued but “appropriately” valued. However, there are a couple of reasons why I take issue with this argument.

First of all, the S&P 500 Index is a market-cap-weighted index, meaning the largest companies in the index hold higher weight. Many of the largest names in the index currently are in the financials, energy and “old tech” sectors, all of which are currently trading at relatively low multiples. The median P/E ratio for the S&P 500 is currently above 20x, well above the cap-weighted P/E ratio. It is also interesting to note that at the peak of the tech bubble in 2000, the median stock traded at a 35% discount to the cap-weighted multiple.

The other big complaint I have with forward P/E multiples is that it is based on short-term earnings, which can be highly volatile and easily manipulated by managements. Yale University Professor Robert Shiller has taken Ben Graham’s original idea that

a company's stock should be valued against its average earnings over a long period of time, and has come up with what he calls the cyclically-adjusted price-to-earnings ratio—or CAPE for short—which measures the price of the S&P 500 Index relative to its average of ten years of earnings, adjusted for inflation. The next chart (Figure 6) shows the history of this measurement going back over 100 years.



Based on this measurement, the current value of 24.4x has only been eclipsed in two prior periods looking back over the last hundred years—in 1929 and 1999.

Given that these and other broad valuation measurements continue to look overextended, all of the portfolios that Sire Line Capital manages 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

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