November 11th, 2013

MARKET SUMMARY

With the close of the 3rd quarter the S&P 500 achieved a 5.2% return and is now up 19.8% on the year. During the same period, the Russell 3000, a broader based index comprised of some smaller companies by market capitalization returned 6.4% for the quarter and 21.3%, respectively. The bull market marches on.

For our part, Alamar was up net of fees 10.3% in 3Q and 27.1% YTD. Further, we experienced something of a watershed moment in the early innings of the 4th quarter, as investors who had been with us since our inception on January 1, 2010, witnessed their initial investment double after fees. Granted, with the equity markets now having provided almost 4 full years of attractive returns, our timing has been fortunate. We have exceeded our own expectations and do not anticipate providing the same level of returns going forward. That being said, we are pleased with our progress on an absolute and risk adjusted basis and remain both realistic and optimistic about the future.

At Alamar, we have the opportunity to meet with a lot of individual and institutional investors to discuss the positioning of their portfolios. We have noticed that many are frustrated of being too conservatively positioned for the market's recent rally, while at the same time skeptical of the rally itself. As a result, we've been thinking a lot about the concept of market sentiment lately and the powerful role it plays in investing. As bottom up fundamental investors, the idea that many investors are scared when they should be greedy and greedy when they should be scared has always intrigued us, namely because we try to profit from it. It's also what convinces us that markets are inefficient, sometimes more so than others. We thought we would touch on market sentiment with this market summary, and share with you how we respond to it at Alamar, and lastly, offer a suggestion that might be appealing to some investors. We continue to believe that investors must engage in risk assets with at least a portion of their assets.

MARKET SENTIMENT

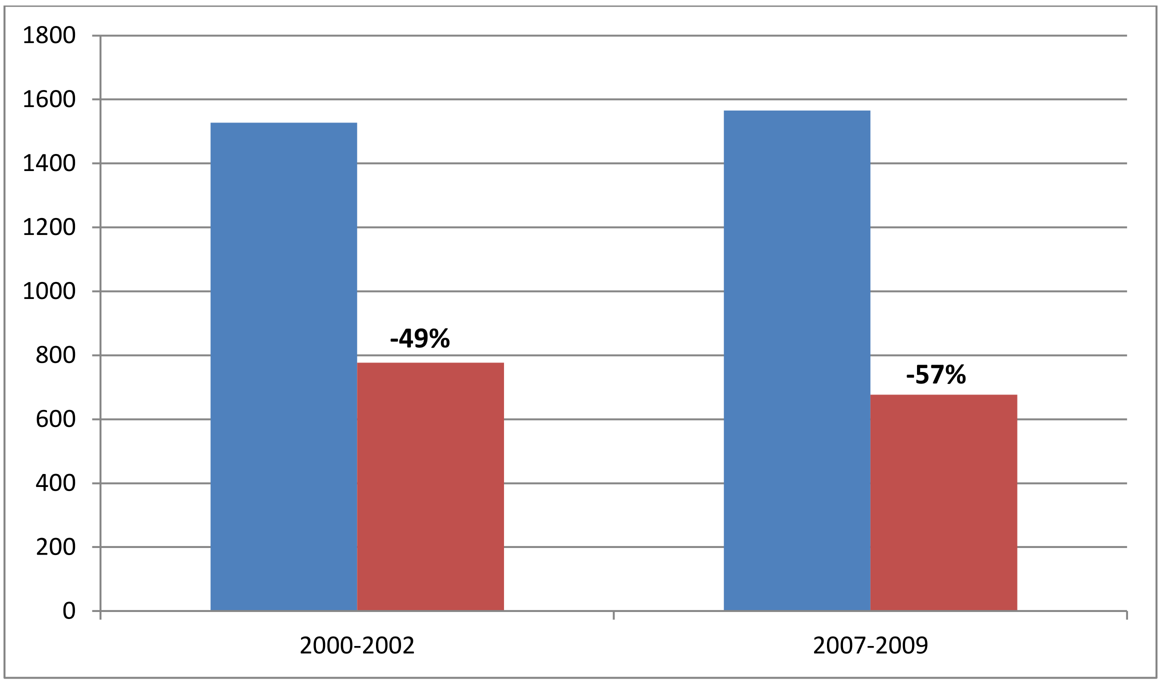
Market sentiment is defined as the overall attitude of investors toward a particular security or larger financial market. It is the tone of a market, or its crowd psychology, as revealed through the activity and price movement of the securities traded in that market. For example, rising prices would indicate a bullish market sentiment, while falling prices would indicate a bearish market sentiment. The takeaway is that market sentiment is based on feelings not fundamentals.

Let's start first with a question - Was our country more or less safe on September 12th 2001? The tragedy of 9/11 convinced all of us that the world could be a very dangerous place, but it also brought into question our perception of safety in the days leading up to the tragedy itself. While at the same time, one could argue that our collective adjustment and heightened alert, made us safer in some respects on 9/12, though it sure didn't "feel" that way. Of course none of us will ever forget the horrific events that unfolded that morning, but perhaps we think about them a bit less with each passing day.

This same concept can easily be applied to investment markets. Market sentiment is what allows us to sometimes look at the same financial data point in incongruent ways. For instance, it is how the S&P 500 trading at 40x earnings can seem cheap in one context, while a 12x multiple can feel expensive in another. Obviously, earnings growth, interest rates and other variables play a large role, but you get the idea that we have a tendency of thinking both the good and the bad times are going to last forever.

Here is a helpful chart that we think speaks directly to the notion of Market Sentiment**.**

FIGURE 1: S&P 500: PEAK TO TROUGH CORRECTIONS



In general, many investors felt comfortable with their financial affairs in March 2000 and October 2007, but in hindsight of course, they shouldn't have. They were made aware of this by two painful crises that by October 2002 and March of 2009 saw peak to trough corrections of 49% and 57% respectively. Clearly these traumatic events had a strong impact on the psyche of investors, which changed their perspective on the environment around them. Unfortunately, more often than not investors readjust their portfolios more conservatively in reaction to a crisis, as opposed to in preparation for one

Sure, it would be great to be able to time the market in order to avoid these corrections and many are tempted to do so, but it turns out that it's really tough to time human emotion. This is because the periods of euphoria last longer than many of us imagine possible, while the corrections are often almost instantaneous *(Remember the housing boom?*).

We believe the 2007-'08 crisis and its relationship to the dot com correction, provides an interesting parallel for our current market environment and aptly displays the role that market sentiment is playing in investors lives today.

2007 – PRESENT DAY

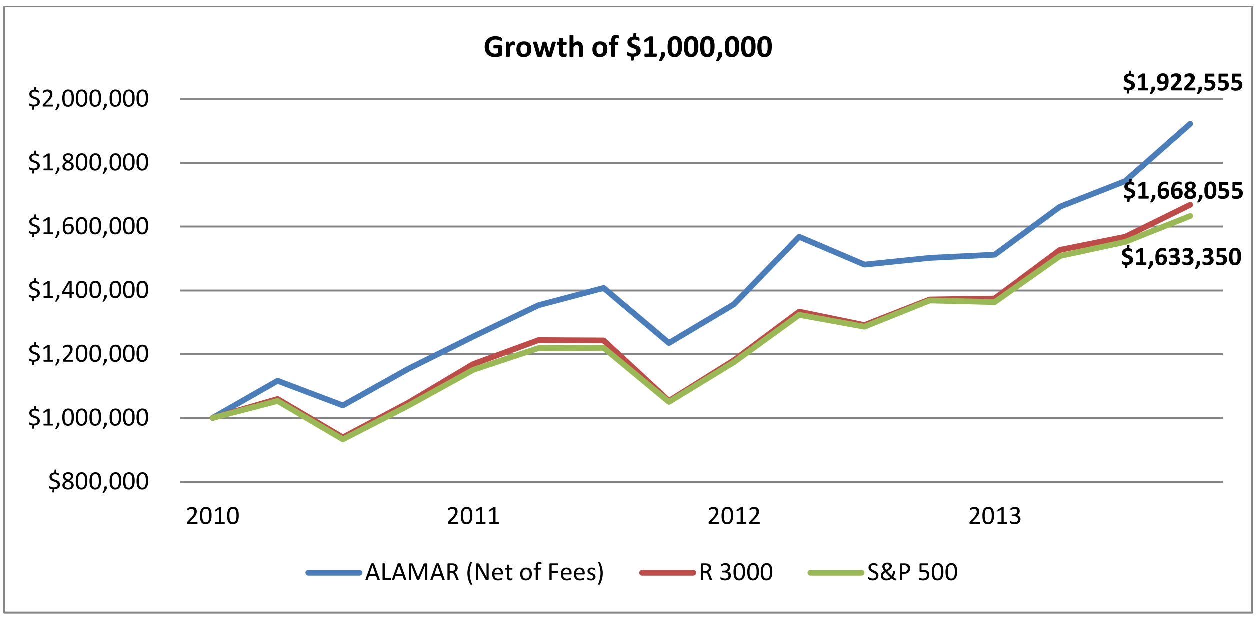
It seems apparent now that the benign investment environment and outsized returns from 2003-2007 had numbed investors senses and reduced their fears associated with the dot com bust years earlier. Further, low interest rates and excessive leverage encouraged many to extend their risk profiles and reach for yield. Of course, in an effort to stimulate the economy, the Fed played a role in all of this by keeping rates too low for too long (sound familiar?). In essence, people slowly forgot about the painful correction from 2000-2002 and greed took hold. Unfortunately, periods like these often provide the greatest reward to market participants taking the most risk, which creates something of a negative feedback loop. Oftentimes, it seems as though it is not until the last investor joins the party that the underlying risk in the system, or in this case default rates, reveals itself. As a result, some risk-averse investors enjoy few of the markets gains, while experiencing a lot of its downside. This serves as a reminder that how we feel about the market should have little to no relevance as to whether or not we should be invested.

The crisis that began in 2007 was particularly painful for three reasons. First, its sheer size and magnitude was something that no one alive at the time had ever witnessed before. Second, it forced many younger investors back into the abyss at a time when they had finally recouped losses from the dot com era. Lastly, the large baby boomer demographic who had grown accustomed to the outsize returns in the 80's and 90's were caught unawares and overweight to risk, just as many were preparing to retire. As a result, market sentiment plummeted.

Additionally, the market's correction in 2008 and 2009 was extremely wide and deep, affecting almost all equity asset classes with equal ferocity. The merits of diversification proved helpless and were challenged as correlations amongst different asset classes approached 1 and all simultaneously fell precipitously, save fixed income. Many individual investors retreated to the safety of cash and bonds, and a lot of the investment advisors who serve them, responded as well. From what we can tell, it appears that some advisors attempted to preserve capital and their clients through exposure to increasingly risk-averse portfolios and an ever increasing number of mutual funds and ETF's (Exchange Traded Funds). As a result, portfolios that were not prepared heading into the crisis were subsequently now unprepared for its recovery, securing a permanent loss of capital.

The good news in all of this is that the negative sentiment created an opportunity in the form of a lot of low hanging fruit for long term investors, like Alamar, who were able to buy the shares of solid companies at extremely attractive valuations. Over time, along with an assist from the Fed (*again)*, and subtly improving fundamentals, the value of these shares has risen dramatically. This has not gone unnoticed by some former skeptics who have converted from a bearish to bullish stance and further bid up shares. You know how the rest of the story goes. At the end of the 3Q, the S&P 500 was up 150% since the March 2009 lows. Figure 2 below puts the extent of the recovery in dollar terms and shows the growth of one million dollars since Alamar's inception January 1, 2010. As we mentioned earlier, many investors have not participated in this rally to the extent they would have liked, while at the same time they have not forgotten the pain from the two prior corrections. Further, many Boomers in particular, feel they do not have the time to recover in the event they participate in yet another significant decline. To make matters worse, after 30 years of relative calm, a recent interest rate shock has reacquainted them of the risk in an asset they had come to view as risk-less, dramatically changing market sentiment on the bond market in the process.

FIGURE 2: GROWTH OF $1mm (January 1, 2010 – September 30, 2013)



Without question, we are coming out of a period of extreme negative investor sentiment and for good reason. What investors now have to decide is given the recent run up, has the market raced ahead of the fundamentals yet again, or can it be justified at these levels by an economy in recovery.

ALAMAR'S VIEW

In looking at the data Alamar does not believe that current market prices reflect too much investor enthusiasm. In our estimation sentiment has turned from a previously unheard of negative to something closer to middle of the road. Though we are not finding nearly as many bargains as we used to, we are still finding some, which is a sign to us that the market is normalizing.

At Alamar, we formulate our own independent views on the macro economy by reading the annual and quarterly reports of 100's of individual companies each year. We believe that this approach works to insulate us from the Wall Street herd. When we can't find ideas, cash levels rise in our portfolio, and when we grow concerned about valuation risk in the businesses we own, we sell shares. Currently, our cash position is around 15% - a bit cautionary but still participating in the market.

As a result of our approach, ideally we will come into frothy markets holding more cash, meaning we will not capture as much of the later stages of a market rally. Conversely, the excess cash acts as a valuable source of capital preservation and can also be put to work when valuations become more attractive down the road. Further, when we grow particularly concerned about the fundamentals of the economy, we purchase put options as a means to insure against downside risk. We do not currently own any put options at this time. We believe that all this results in an investment process that, on the margins, is more proactive than reactive. Again, we do not think it is possible to completely time the market.

The companies in our portfolio are currently in the midst of reporting their quarterly earnings, and we are quite pleased with their performance so far. We now anticipate profit growth in 3Q of over 10%, which is significantly higher than the overall economy and our initial expectations. Also, the uncertainty in the market is healthy and probably a good thing over the intermediate term.

However, in some respects the signals remain mixed. We continue to struggle with many of the problems that have plagued us in the past, an indication that we are not properly acknowledging and dealing with them – a bad sign. Even worse, our elected officials appear incapable of providing true leadership, and delivering difficult and unpopular policies on issues we must eventually confront such as the national debt, social security, and pension reform – also a bad sign. So given all of this, what should a thoughtful investor do?

HORSE RACE

In recent months Alamar has come to recognize that several of our newer clients have elected to hire us as an addition to, or hedge against, investments they hold elsewhere. This scenario creates something of a horse race between their current positioning, and our collection of stocks and in some cases high yield bonds. We think this idea makes for an attractive compromise for investors yearning for more market participation.

CONCLUDING REMARKS

In summary, Investors face a conundrum heading into 2014. Alamar strongly suggests that investors not allow emotion to be their guide. Reading the news gives cause for concern. There are the known unknowns - political dysfunction in Washington DC and the Fed taper to name a few. Plus, the truly unexpected that may come out of the blue. It's tempting to avoid these risks by investing in the perceived safety of bonds, and holding lots of cash.   However, this investor pays a heavy price for the illusion of safety. Investing a portion of your savings in risk assets should be considered.

Thanks for taking the time to read our report. We welcome your thoughts and feedback. Also, please feel free to forward our writings to others you feel might like to read them.

Sincerely,

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Disclosures

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