

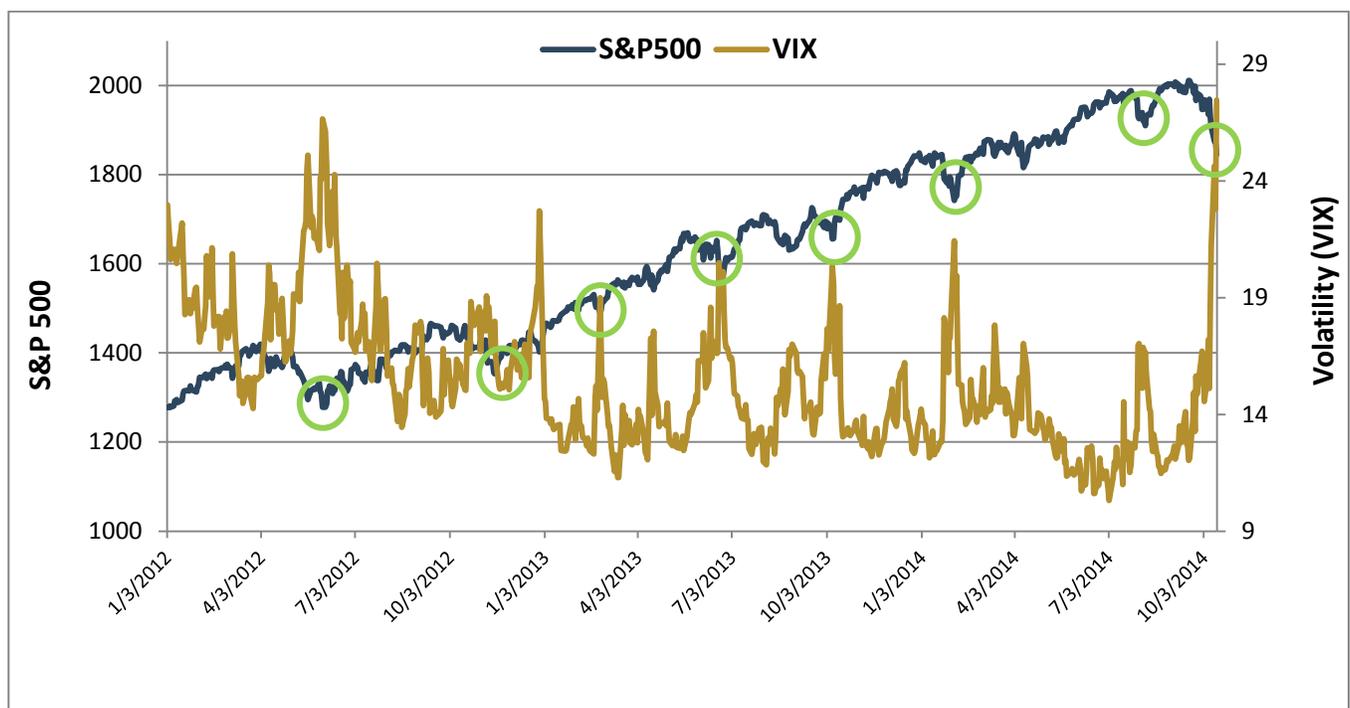
Overview

Since October 1, the market has declined approximately 8% off its all-time highs. Our portfolio management team has provided three (3) key elements to the recent correction and what it possibly means moving forward.

1. Putting the recent pullback into perspective

The VIX Index (~ fear Index) is at its highest point over the past two years and makes incursions into this territory about once per quarter. In each instance, the market pulled back before resuming its ascent once the fear subsided and the VIX came back to a normal level.

This specific metric is part of our cash scaling model.



2. “Gut Feeling” investing can be harmful - rely on a data-researched investment process

Selling when the market is going down and buying when the market is going up is a technician’s approach to the market. The problem with a technicals-only approach is that it often has an investor selling at short lows and buying at short highs. As explored in our cash scaling whitepaper, this simple trading rule has substantially trailed the market over the past 24 years, even when fine-tuning the parameters. (<http://www.northcoastam.com/whitepaper-cash-scaling.pdf>)

The table below highlights the cumulative return difference over a 24 year period between a simple tactical investment rule and the S&P 500.

Re-invest after market bounce											
	0%	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
0%	-724%	-728%	-794%	-804%	-835%	-839%	-827%	-818%	-822%	-812%	-805%
-1%	-665%	-720%	-796%	-805%	-822%	-825%	-822%	-825%	-816%	-805%	-800%
-2%	-622%	-619%	-716%	-691%	-764%	-808%	-811%	-802%	-788%	-751%	-780%
-3%	-441%	-564%	-674%	-650%	-752%	-793%	-798%	-801%	-782%	-757%	-779%
-4%	-502%	-584%	-684%	-627%	-760%	-781%	-784%	-798%	-769%	-749%	-744%
-5%	-492%	-549%	-651%	-574%	-719%	-736%	-735%	-761%	-752%	-701%	-673%
-6%	-456%	-484%	-554%	-488%	-622%	-615%	-591%	-647%	-639%	-531%	-558%
-7%	-481%	-444%	-494%	-449%	-552%	-519%	-531%	-590%	-572%	-448%	-517%
-8%	-435%	-436%	-470%	-484%	-541%	-496%	-462%	-480%	-416%	-311%	-363%
-9%	-371%	-390%	-393%	-409%	-485%	-382%	-453%	-445%	-346%	-169%	-147%
-10%	-369%	-313%	-386%	-342%	-368%	-112%	-140%	-152%	-73%	143%	37%

Data Source: Bloomberg. Date range is 2/8/1988 – 1/10/2012.

Buying-and-holding the S&P 500 over this timeframe would have garnered a portfolio return of +787%.

The table highlights the negative impact of “timing” the market with structured sell-stop and buy-back investment rules.

*For example, if you were to invest into the S&P 500 index fund and sell each time it corrected -8% then bought back in after a +5% rally; your performance would significantly trail a “buy-and-hold” method over that same time period by **496%**.

3. Forward Looking

Investing is never without risk and will experience pockets of volatility. The most critical decision when managing a portfolio for the long term is to choose a well-researched, sound investment methodology and to apply it consistently.

Market Outlook:

We are monitoring the data across four broad dimensions (Valuation, Macroeconomic, Technical, and Sentiment) to generate an informed opinion on the market outlook. Valuation is now neutral (from slightly negative), Macroeconomic and Technical indicators are strongly positive, while Sentiment is slightly positive. The current decline can be characterized as a “healthy correction”, a roughly 10% pullback that occurs, on average, at least once per year. It is providing more attractive entry points.

You can point to recent history where similar declines occurred – April 2012, October 2012, June 2013, January 2014, and July 2014. All were short-term corrections, eventually leading to new market highs. Even more so, the decline in August/September 2011 led to an **S&P 500 rally of +20.3% in a two-week timeframe (10/4/11-10/27/11)**.

Sell Stops:

Volatility is different today than it was 30 years ago. Portfolio diversification allows individual stocks more flexibility without significant portfolio performance impact (A key reason our stock portfolios hold approximately 30 positions, with position weights between 2-4%) . Overtime, wider stops lead to higher annual rate return with enhanced risk metrics. The table below highlights the performance differences overtime by executing sell-stops at different percentages.

Performance Simulation					
Sell Stop Percentages: 2001 - 2013					
	8% Stops	10% Stops	15% Stops	20% Stops	30% Stops
Annualized Return	16.2%	16.3%	17.3%	18.4%	17.7%
Annual Standard Deviation	21.3%	21.5%	21.9%	22.6%	22.9%
Relative Daily Drawdown	-21.3%	-21.0%	-23.9%	-17.2%	-18.2%
Number of Trades	1797	1604	1339	1214	1064
Average Days Held	69	78	97	108	125
Turnover Rate	3.75	3.35	2.79	2.47	2.18
Information Ratio (IR)	1.26	1.31	1.42	1.56	1.51

Past performance is not indicative of future results. All investments involve risk, including loss of principal.

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