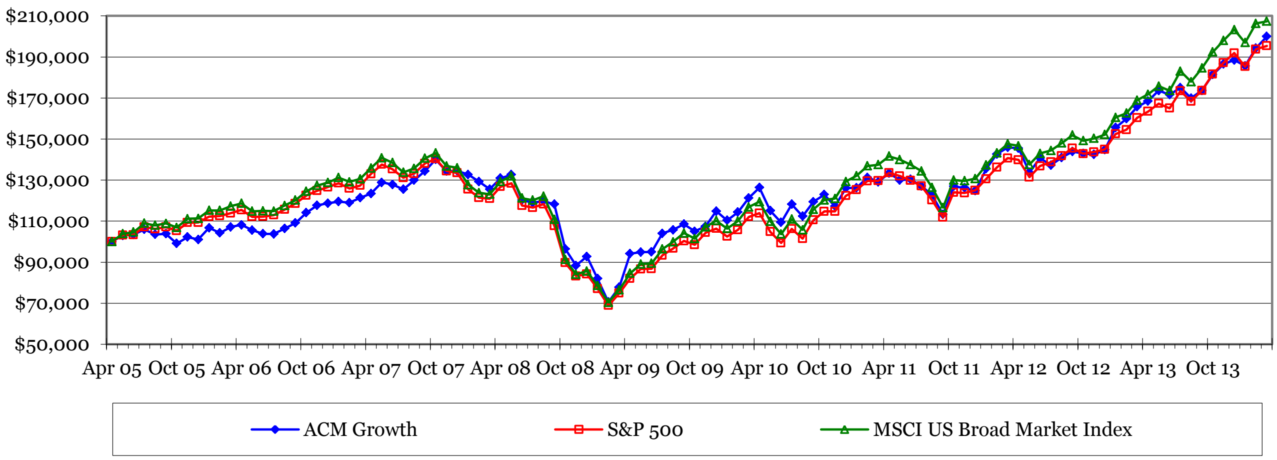
ATHENA CAPITAL MANAGEMENT

Cumulative Growth Performance

Performance as of 3/31/14	Year to date	3 years	5 years	7 years	Since inception (4/30/05)
ACM Growth	6.10%	54.86%	157.23%	64.77%	99.98%
S&P 500	1.81%	50.73%	161.06%	53.42%	95.40%
MSCI US Broad Market Index	2.00%	50.83%	171.27%	58.87%	107.38%

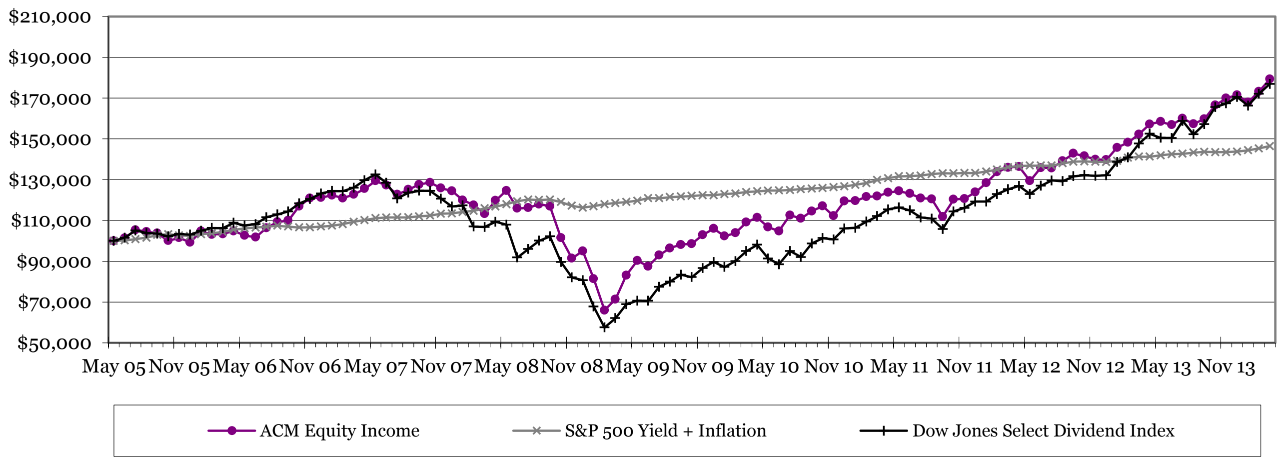
Comparison of the change in value of $100,000 investment in ACM growth versus S&P 500 and MSCI US Broad Market Index



Cumulative Equity Income Performance

Performance as of 3/31/14	Year to date	3 years	5 years	7 years	Since inception (5/31/05)
ACM Equity Income	4.51%	47.14%	151.37%	46.12%	79.30%
S&P 500 yield + inflation	1.90%	12.86%	23.58%	33.97%	46.48%
Dow Jones Select Dividend Index	3.75%	57.87%	185.22%	40.39%	76.93%

Comparison of the change in value of $100,000 investment in ACM equity income versus S&P 500 yield plus inflation and Dow Jones Select Dividend Index



Past performance is no guarantee of future results. As in all equity investing, there is a risk for potential loss. Performance results were calculated after deduction of all management and trading fees. Portfolios were valued daily, trade date accounting was used, accrual accounting was used for dividends. Time-weighted rates of return that adjust for significant cash flows were used. Returns from cash were included. For ACM growth accounts, the S&P 500 was used as benchmark because it was deemed the most readily available and widely known growth composite. It should be noted that ACM growth accounts were more concentrated, sometimes had higher cash investments, included international investments, and were invested in companies with different market capitalizations and characteristics than the S&P 500. Although these differences existed, the accounts shown were invested for growth and not set to achieve any particular market capitalization or exposure. ACM equity income accounts used S&P 500 yield plus inflation because this combination of the most readily available equity yield and growth with inflation was deemed the most relevant benchmark for equity income accounts. These accounts are designed to provide an equity yield for income plus growth to maintain purchasing power over the impact of inflation. Both out- and under-performance of accounts shown were due both to individual security selection and to concentration of investments. Neither market nor economic conditions contributed significantly to account performance relative to benchmarks. ACM growth and equity income portfolios include all portfolios under management during all periods of management and include portfolio performance as of the first day of management. The accounts depicted used no leverage or derivatives. The S&P 500 and S&P 500 yield plus inflation returns shown do not reflect commissions, trading expenses, or management fees, which would have reduced both benchmarks' results.

Athena Capital Management

April 16, 2014

After a rip-roaring 2013, 2014 started out more tamely: the S&P 500 was up only 1.8% this quarter. Our portfolios, in contrast, did much better, with growth up 6.1% and equity income up 4.5%.

In this quarter's letter, I'll review our growth and equity income performance, provide my usual commentary on markets and the economy, and finish with some guidance on how to set and reach retirement milestones with confidence.

Performance this quarter

Growth portfolios beat the S&P 500 over all periods except five years. We did much better than the market this quarter because other investors seemed to recognize what I've highlighted in the past: our holdings are doing better than other businesses in general. We did not experience outstanding performance from any particular sector or investment, but overall good returns from a broad range of our holdings. I can't promise that this will continue in any particular quarter or year, but I do expect the trend to continue over time.

Growth's out-performers this quarter were **Ryanair** and **Microsoft**.

Ryanair, Europe's lowest cost airline, benefited from better than expected quarterly earnings and improving economic growth within Europe. Ryanair will grow its fleet by 6-7% each year over the next 5 years, so strong unit growth seems assured. The question is whether competition will drive down airfares, and if higher fuel prices will reduce profitability. As the airline with the lowest cost structure, I believe Ryanair is well positioned to continue succeeding for years.

Microsoft, the largest software company in the world, grew strongly this quarter on announcements about its new CEO, products and services. Investors seem optimistic that a new leader can reinvigorate Microsoft's businesses, and move the company from its legacy past into the new mobile and cloud-based future. I, too, am more optimistic, and expect that we'll see more good news and innovative products and services announced soon.

POSCO and **Comcast** were growth's under-performers this quarter.

POSCO, the largest Korean steel manufacturer, continues to suffer from over-abundant steel supply out of China and high prices for iron ore and energy. Although it's hard to see what will make China reduce its production of unprofitable steel, it's also impossible to keep up such uneconomic behavior forever. When China reduces output or global demand picks up, I think POSCO's underlying profitability will shine through as it has in the past.

Comcast went from hero to villain this quarter. Its stock price was up 6.3% in mid-February on high quarterly profits and news it would buy out the next largest cable company, Time Warner Cable (TWC). Then, its price dropped 10.6% over the rest of the quarter after news that Google Fiber might enter 9 new metro areas, and doubts emerged that regulators would approve Comcast's TWC purchase. Behind these price swings is a solid company that can handle competition, and doesn't need to buy another cable company to succeed. I believe the market will calm down and recognize these strengths over time.

Equity income portfolios continue to out-perform our long-term benchmark over all periods, and beat our short-term benchmark over all periods except three and five years. It was our particular holdings more than the market in general that led to this quarter's results, which is a better way to succeed. Although our bond holdings pulled down returns this quarter, they also provide protection against short term volatility and market panics. We will continue to invest prudently and opportunistically to generate income and returns above inflation.

Equity income saw out-performance from **Wells Fargo** and **Microsoft**. Please see my comments above on Microsoft.

Wells Fargo was up this quarter on news of better than forecast earnings, and predictions that it would raise its dividend and increase stock buybacks. Despite a slowing mortgage market, Wells Fargo managed to report strong earnings as loans increased and its wealth management business grew. Added to this, the Federal Reserve granted Wells Fargo permission to increase dividends and buy back more stock after concluding the bank was sound enough to take these actions. I expect more of the same going forward.

Philip Morris International and **Comcast** were equity income's under-performers this quarter. Please see my comments above on Comcast.

Philip Morris International, a company that sells cigarettes outside the U.S., suffered this quarter on declining unit sales, currency headwinds, and regulatory threats. I don't believe these threats will go away quickly, but I do think some of these problems are temporary and others have existed for decades. Philip Morris will most likely exercise its marketing and distribution prowess to continue growing per share earnings and effectively responding to market changes to which it's accustomed.

Athena Capital Management

Market and Economic Outlook

The S&P 500 returned 1.8% this quarter. Below trend returns in the past mean higher returns in the future, as reflected in the table below. The improvement is small, to be sure, and that's why we aren't limiting ourselves to investing in the whole market, but in specific companies that offer above average value.

Projected annualized returns over the next 6 years	
S&P 500 (growth benchmark)	-5.0% to 6.6%
S&P-500-yield-plus-inflation (equity income benchmark)	3.5% to 6.5%

How do I arrive at these numbers? See my 2Q2005 article.

The global economy continues to improve. The developed economies of the world—the United States, Canada, Western Europe, Japan, South Korea, Australia, New Zealand—seem to be transitioning from slow growth back to more normal growth. The developing economies—Brazil, Russia, India, China, Mexico, Turkey, Eastern Europe, etc.—are facing stiffer economic headwinds than a couple of years ago, but are still growing faster than the developed economies.

This background provides a good context for investment growth. Central bankers aren't aggressively raising interest rates to cool growth, which means asset values—whether bonds, stocks or real estate—aren't sinking accordingly. Nor is the global economy facing big enough difficulties to incite reactive government measures to revive growth. For this reason, markets should be trading more on underlying fundamentals, and that appears to be the case.

There are, of course, always potential risks that could upset the apple cart. A trade war due to Russian intervention in Ukraine, a credit collapse in China (my biggest worry), the U.S. Federal Reserve acting too fast or slow to remove monetary stimulus, for example, are just a few of the things that could go wrong. Although such threats clearly exist, none seem dire at present. This seemingly benign environment makes me nervous, though, because it has made investors optimistic and that leads to high asset prices and complacency.

That is why I'm focusing intently on high quality businesses. Such companies are selling at historically cheap prices as investors chase tech darlings like Tesla, Twitter and Facebook. Over the long run, what matters is per share value growth, not hype, so we're investing with businesses that can, are, and will generate increasing earnings over time. I look forward to reporting on our progress.

Retirement Milestones

Everyone wants to know how much savings they need to retire. As I hope to show, there are some simple, widely used rules to help guide you. Adapting these rules to *your* situation and risk tolerance can help you triangulate on even better guidance.

Fidelity Investments came out with a recent study highlighting **how much savings you should have at specific ages**. Like all such studies, it was based on some important assumptions:

- At 25, you start saving 6% of your annual salary and ramp that up to 12% by age 31
- You grow your salary at 1.5% per annum
- You generate 5.5% annual returns over time
- You retire at 67 and spend 85% of what you were making before you retired
- You receive social security benefits
- You live to 92

Given those assumptions, you should have saved up:

- 1x salary at 35 years old
- 3x salary at 45
- 5x salary at 55
- 8x salary at 67

Pretty nifty, huh? I highly recommend the article above and the web-based tool they have within the article for adjusting assumptions.

What are the main lessons from the study? **Start saving early, save consistently over time, and get good returns**.

These are excellent lessons and a good framework, but I'd recommend adapting them to *your* situation and risk tolerance. If any part of your situation is different than the assumptions above, those milestones won't work for you.

For example, the chance of one of two 67 year old spouses living past 92 is currently around 34%. But, do you really want a 1/3 chance of one spouse running out of money? Also, will *you* receive Social Security benefits in retirement? Social Security is grossly under-funded, so I tend to assume that people with more savings will get less (or none) of what they expect (especially for those younger versus older). I could question each assumption above, but you get the idea: **you probably want to adjust the numbers to fit your situation and risk tolerance**.

To start, I prefer using annual spending in retirement rather than pre-retirement salary as a guide. I also favor thinking in terms of a safe withdrawal rate during retirement as a guide to spending. For example, if you assume a 5% withdrawal rate that has a small—but nontrivial—possibility of running out, and no social security, the numbers would be:

- 2x annual spending at 35
- 5x annual spending at 45
- 10x annual spending at 55
- 20x annual spending at 67

Or, if you assume no social security and a 3 1/3% withdrawal rate that is *very likely* to hold up against the harshest environments, then the numbers below apply (this is the one I personally use):

- 3x annual spending at 35
- 7x annual spending at 45
- 15x annual spending at 55
- 30x annual spending at 67

By the way, the 20x and 30x numbers above work at *any* retirement age (you don't have to wait until 67). So, if you have 30x annual spending at age 45 and feel comfortable with a 3 1/3% withdrawal rate and don't expect social security benefits, you can retire at 45.

To repeat, the milestones you choose should depend on your situation and risk tolerance. If you agree with Fidelity's assumptions, then go with the 8x salary at 67. If you agree with my harshest environment assumptions, then use 30x annual spending.

If you've compared your current savings to the milestones above and you are right on track, congratulations! If not, then you'll want to find a way to get on track. Higher returns are the most appealing way to get there, but aren't something you can truly control. **The most realistic way to get on track is to increase your savings rate or reduce your spending expectation in retirement.**

Investing milestones can help you reach your retirement goals with confidence. Pick the milestones that match *your* situation and risk tolerance—not someone else's. If you're hitting your milestones, keep up the good work. If not, you now have a way to get and stay there. **Most importantly, if you want help figuring out your retirement goals and how to reach them, I'd be very happy to assist you**.

Until next quarter

As always, thank you so much for your business, and please contact me if you have any questions, comments or feedback for me. I look forward to hearing from you.

Best regards,
Mike

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