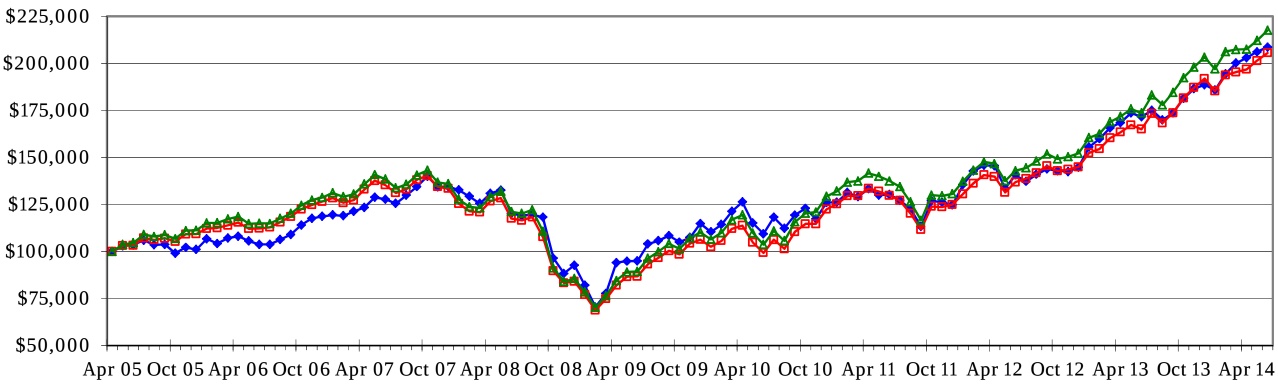
Athena Capital Management

Cumulative Growth Performance

Performance as of 6/30/14	Year to date	3 years	5 years	7 years	Since inception (4/30/05)
ACM Growth	10.61%	60.10%	119.69%	63.21%	108.66%
S&P 500	7.14%	58.47%	136.98%	51.91%	105.63%
MSCI US Broad Market Index	7.04%	58.27%	143.42%	57.13%	117.62%

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

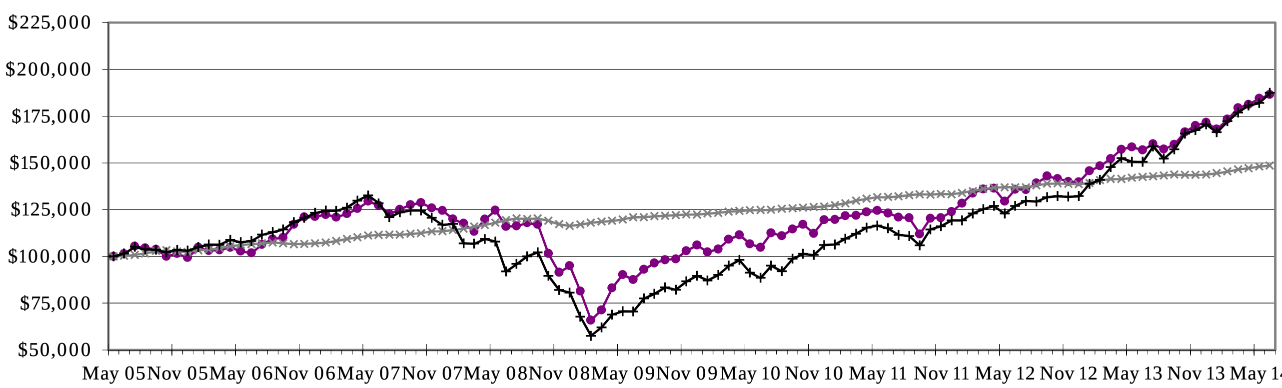


ACM Growth | S&P 500 | MSCI US Broad Market Index

Cumulative Equity Income Performance

Performance as of 6/30/14	Year to date	3 years	5 years	7 years	Since inception (5/31/05)
ACM Equity Income	8.67%	51.45%	113.08%	46.50%	86.46%
S&P 500 yield + inflation	3.31%	12.73%	22.81%	33.24%	48.51%
Dow Jones Select Dividend Index	9.87%	63.01%	165.61%	45.97%	87.36%

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



ACM Equity Income | S&P 500 Yield + Inflation | 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

July 22, 2014

The slow first quarter market morphed into solid performance in the second, mostly due to an improving economy. Although our returns slightly lagged the market this quarter, we continue to beat our benchmarks by over 3% year to date.

This quarter's letter will review our growth and equity income performance, provide commentary on markets and the economy, and end with the perils of trying to time the market.

Performance this quarter

Growth portfolios beat the S&P 500 over all periods except five years. We somewhat lagged the market this quarter, but not by enough to undo our year to date out-performance. I've been shifting our portfolio from lower to higher quality businesses as the stocks of low quality have done better than high quality. In time, I believe this rotation will generate excellent returns as stock prices move to match underlying fundamentals.

Growth's out-performers this quarter were **Markel** and **Coca-Cola**.

Markel, a specialty insurance company, is benefiting from growth due to its Alterra acquisition and good returns from its investments in bonds and stocks. Markel paid an excellent price for Alterra, and the upside of that acquisition should continue flowing to investors as its integration process unfolds. Bond and stock returns may not always provide the tailwind they have recently, but Markel's investment team is significantly above average, and should continue to out-perform over the long run.

Despite facing tough headwinds from international currency declines and falling soda consumption in North America, Coca Cola still generated good earnings growth. The market reacted positively to this news, perhaps having under-estimated the power of Coke's brand, its opportunities to reduce costs, and the tailwind of growing emerging markets. Coke's growth may prove bumpy, but its product strength seems to make increasing profits very likely over time.

Leucadia and **Pfizer** were growth's under-performers this quarter.

Leucadia, a holding company, is facing tough headwinds in its major holdings (which are each very sensitive to economic growth): investment banking, beef processing, lumber, and construction plastic. Market participants are understandably shying away from cyclical businesses operating near the trough of the cycle, but those businesses are quite likely to improve in time, perhaps dramatically. At that point, the same investors who ran away will come rushing back to own Leucadia's cyclical businesses again.

Pfizer, a very large pharmaceutical company, dropped heavily on news it was trying to buy competitor AstraZeneca for $120 billion. Investors were unimpressed with Pfizer's high price offer. They also acknowledge the tendency for such acquisitions to destroy value for shareholders. It will take time for Pfizer to rebuild trust with investors, but the task is not impossible considering its intelligent asset allocation decisions before this move, and the high potential of Pfizer's drug pipeline.

Equity income portfolios continue to out-perform our long-term benchmark over all periods. Although we are doing well, our portfolio isn't performing as strongly as the Dow Jones Select Dividend Index because we are holding some bond positions that reduce portfolio volatility and provide solid income even if markets pull back. I will continue to favor lower volatility and consistent income over maximizing principal upside because the stock market is likely to pull back at some point. When that happens, equity income accounts can be adjusted to benefit from higher bond prices and lower equity prices.

Equity income saw out-performance from **Fairfax** and **Wells Fargo**.

Fairfax, a specialty insurance company, is benefiting from wise investment choices and a hedged portfolio of investments. Investors were recently punishing Fairfax for not taking enough risk, but are now rewarding its superior risk management strategy. Fairfax continues to play the long term investing game intelligently, and I expect that investors will like the results this generates over the long haul.

Wells Fargo, the fourth largest U.S. bank by assets, continues to out-perform its larger peers who are bogged down by investment banking operations, and its smaller peers who have less diversified portfolios of banking business. In addition, investors clearly over-estimated the danger of Wells Fargo's mortgage operations slowing down and under-estimated its ability to grow consumer and business loans. I expect Wells Fargo will continue surprising skeptical investors.

Pfizer and **Leucadia** were equity income's under-performers this quarter. Please see my comments above on both.

Athena Capital Management

Market and economic outlook

The S&P 500 returned 5.2% this quarter and 7.1% year to date. This above-trend performance means below-trend returns over the next 6 years. Although market returns may look weak, our holdings appear to have much better prospects due to above average economics and below average valuations.

Projected annualized returns over the next 6 years	
S&P 500 (growth benchmark)	-5.5% to 6.0%
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 U.S. economy slowed in the first quarter, but picked back up again in the second. An unusually cold and difficult winter was mostly to blame for the slowing, but it's possible something more fundamental is at work. For instance, the housing market has slowed more than can be explained by weather alone. China's slower growth, and geopolitical problems in Russia/Ukraine and Iraq have many investors worried, too. In a global economy, issues far from the U.S. impact growth at home because U.S. companies participate everywhere.

This slowing did not stop stock markets from hitting record highs. Although a strong pullback occurred in speculative securities like Facebook, Tesla, and Twitter, business mergers and acquisitions have driven up the price of stocks more broadly. Part of the credit goes to low interest rates that make such buyouts feasible. Slow growth also leads companies to look for cost cuts, and buying your competitors is a great way to spread more revenue over a fixed cost base.

How long will the market creep-up continue? No one knows, but I would not be surprised if it continued for some time. Markets move up and down with momentum as more people jump first on, then off, the bandwagon. At some point, the upward momentum peters out, but not until things have gone much farther than many expect (see my article below on market timing, for example). Better instead to focus on fundamentals.

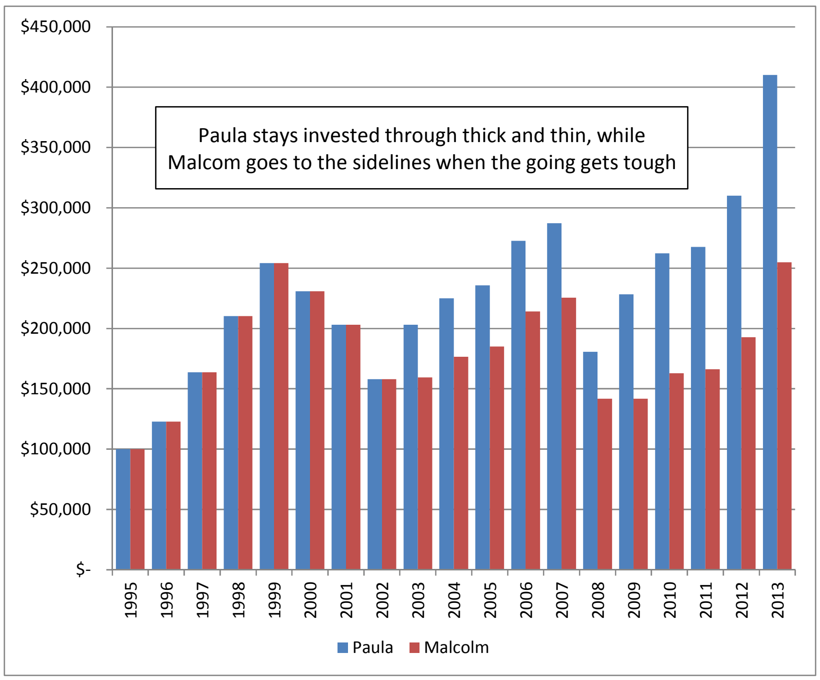
As usual, I'm doing just that: **focusing on specific companies where valuation is out of synch with underlying fundamentals.** How do valuations and fundamentals end up out of whack? It can be due to short term cyclical factors, like how weather and government policies are impacting the farm sector at present. Or, it could be caused by broader secular shifts, like technology's move to the cloud and mobile. Either way, I'm on the hunt for ideas where short-termism has pulled prices below long term fundamentals. From there, all that's required is patience until prices and fundamentals come back into synch again.

The siren song of market timing—don't do it!

Investors, in general, get worse results than the funds they invest in. This may sound confusing: how can investors do worse than what they invest in? The answer is market timing.

To illustrate what I mean by market timing, let me provide the example of Paula Prudentia, who wisely invested her money 18 years ago in a low cost index fund. Over that time, the S&P 500 provided 8.28% annual returns, and after paying a low 0.12% annual fee to the index fund, Paula generated 8.16% returns, turning her initial $100,000 investment into $410,114. Ah, the smell of compounding in the morning.

Paula's boyfriend, Malcolm Maltimeri, on the other hand, didn't keep a steady hand over those 18 years. He was frightened out of the market during all of 2003 and 2009, and "went to the sidelines" when the going got tough, thus missing two years of fund returns. **Malcolm invested in the same index fund as Paula, but he didn't get the same returns because he sold when he got scared and invested only when things felt safe.** Instead of a Paula's 8.16% return, Malcolm received 5.33% returns over 18 years, turning his $100,000 initial investment into $254,847 (making him 38% worse off). The chart below paints a stark picture.



Many investors try to buy and sell based on what they think the market or a particular investment will do. The problem is that their timing generally stinks. They tend to buy *after* investments have gone up and sell *after* they fall (although they may not realize this because they don't track their investments that closely). Instead of buying low and selling high, they buy high and sell low.

Also, basic human psychology leads people to sell when scared and buy when happy. But, prices are expensive when everyone feels good and cheap when people feel terrible. **That is why Warren Buffett counsels to be fearful when others are greedy and greedy when others are fearful.**

Market timing causes investors to do 1.5% to 2% worse per annum. Assuming annual returns of around 7% for stocks over the long run, market timers get approximately 5.25% returns (all else equal). That means:

- At 10 years, market timers end up 15% worse off
- At 20 years, 28% worse off
- At 30 years, 39% worse off
- At 40 years, 48% worse off

To put that last number in perspective, **a market timer retires with roughly half the standard of living as the non-market timer.** The numbers are truly staggering.

Given this, how does one avoid such a fate? The answer seems obvious: don't time the market. Instead, stick with intelligently chosen investments over the long run. But, that's easier said than done. Research pointed out the market-timing problem *decades* ago, and yet investors—both individual and professional—still try to do it. **Highlighting the problem has not been enough.**

The solution, I believe, is that many investors need more than research and planning: they need crisis support. Just like pilots have checklists for dealing with emergencies, **some investors need crisis support they can consult when their emotions run high.**

One option is to write yourself notes now, when things are calm, that will keep you from trying to time the market. Make one note to consult when things are going swimmingly, like they were in 1999 or 2007, reminding you that doubling down on the stock market when prices are high is not a good idea. Make another note to review when things look terrible, like they were in 2003 or 2009, reminding you that selling during a market panic severely damages results. Make sure the wording of both notes will work for you when the time comes.

Another option is to consult research like this article, or call your crisis hot-line: me. Regardless of what you do, it's important to have concrete steps to take during the next market euphoria or panic. The market *will* go up 100% and down 50% in the future, I can practically guarantee it. To be prepared, have your crisis support ready ahead of time.

I must admit, you don't seem to exhibit market-timing characteristics, or at least I haven't seen you pull money during panics or try to get fully invested during market peaks. Perhaps you are less susceptible to such tendencies. Or, perhaps—I flatter myself—my client letters have succeeded in dampening euphoria in expensive markets and boosting enthusiasm when the market looks cheap. Regardless of the cause, **I'd like to thank you for keeping an even keel during such emotional times.** Over the long run, your higher net worth will be its own thanks.

Until next quarter

If you have any investing or financial planning questions you'd like me to answer in these letters, please feel free to send them my way. If you'd rather a one-on-one conversation about such topics, I'm more than happy to answer that way, too.

Warmly,
Mike

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