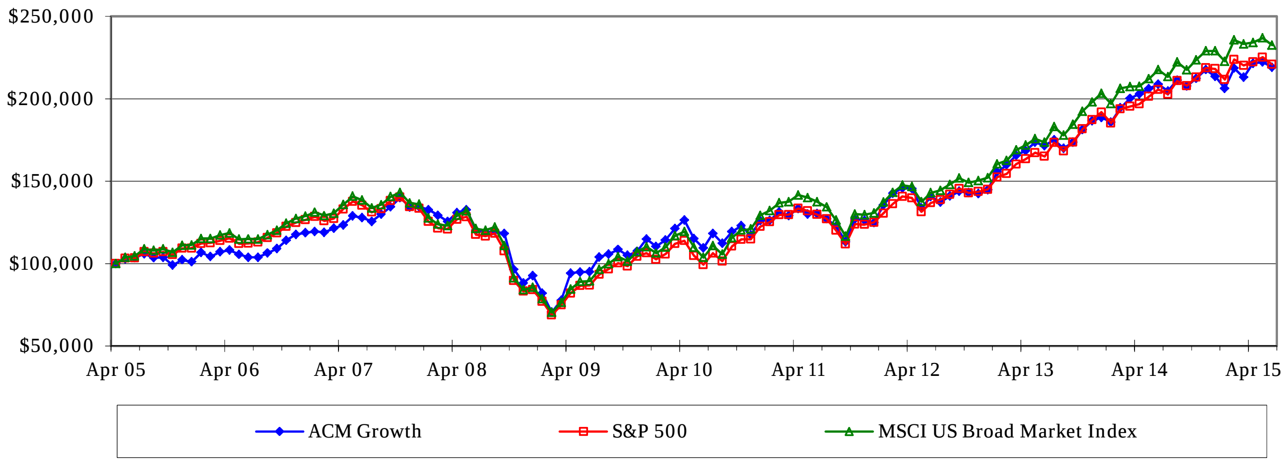
ATHENA CAPITAL MANAGEMENT

Cumulative Growth Performance

Performance as of 6/30/15	Year to date	3 years	5 years	7 years	Since inception (4/30/05)
ACM Growth	2.62%	55.79%	100.39%	82.34%	119.21%
S&P 500	1.23%	61.43%	122.47%	87.83%	120.89%
MSCI US Broad Market Index	1.53%	62.69%	124.69%	91.89%	132.56%

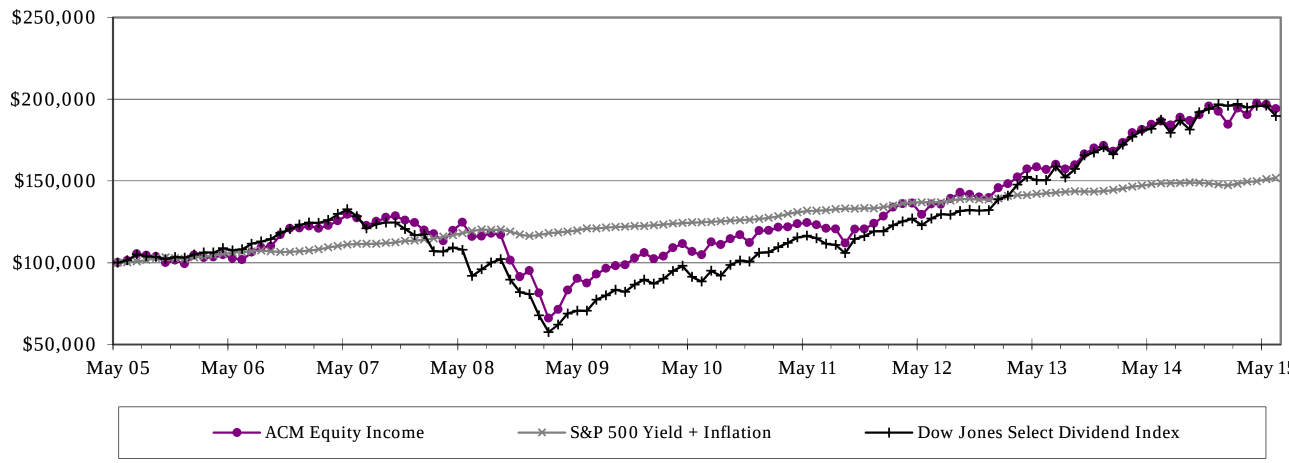
Comparison of the change in value of $100,000 investment in ACM growth
versus S&P 500 and MSCI US Broad Market Index



Cumulative Equity Income Performance

Performance as of 6/30/15	Year to date	3 years	5 years	7 years	Since inception (5/31/05)
ACM Equity Income	0.80%	42.91%	85.24%	67.39%	94.08%
S&P 500 yield + inflation	2.67%	10.84%	21.69%	27.10%	51.77%
Dow Jones Select Dividend Index	-3.57%	49.36%	114.41%	106.57%	89.70%

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

July 17, 2015

After a slow 1st quarter, the stock market grew even slower in the 2nd, generating a mere 0.28% return. Our portfolios fared much better, with growth portfolios beating the market by over 2.6% and equity income by over 1.6%.

In this letter, I describe our performance this quarter, what I see going on with markets and the economy, and an after action report on another of our successful investments: Ryanair.

Performance this quarter

Growth portfolios out-performed year to date, but under-performed over all other reporting periods. Our portfolios did well this quarter both because of individual company out-performance, and due to investor's rediscovery of valuation risk. This trend may continue or stop cold, but as long as our underlying holdings increase in value faster than the market, prices will eventually follow. I expect that progress to be lumpy but persistent.

Philip Morris International and **John Deere** were growth's out-performers this quarter.

Philip Morris International (PMI), the largest non-Chinese tobacco business in the world, demonstrated—with better than expected 1st quarter earnings—that underlying demand for its products is stronger than headwinds from currency declines, regulatory challenges, and tax increases. PMI's worries are not at an end, and probably never will be, but the power of their products in the minds of consumers can continue to overcome most obstacles and generate strong profit growth over time.

John Deere, the world's largest producer of farm equipment, benefited from worse than expected weather in North America. Farmers buy new equipment when they make fat profits on crops, which tends to happen with low supply relative to demand. Poor weather in the Midwest led to worries about this year's crop, causing big increases in the price of corn, soybeans and wheat. I don't know if this recent trend will continue, but I do know that Deere is the best and most profitable farm equipment company and will do well over the long run.

Growth saw under-performance from **Fairfax Financial** and **POSCO** this quarter.

Fairfax Financial, a specialty insurance company based out of Canada, was penalized this quarter for investments it made in troubled Greece. Fairfax has an excellent track record of investing in troubled situations, but their bets suffered this quarter as Greece inched toward default. I'm not concerned about this short-term move both because its Greek bets are small relative to the rest of its investment portfolio, and because Fairfax owns many other investments that will thrive if Greece defaults.

POSCO, the 5th largest producer of steel in the world, continues to suffer because of too much steel supply out of China and too little worldwide demand for steel products. Until world demand picks up or China cuts steel production (to stem massive profit losses), POSCO will continue to face difficult headwinds. But, as *the* lowest cost steel producer in the world, POSCO stands to benefit tremendously if/when the end market for steel finally recovers.

Equity income portfolios under-performed year-to-date, but out-performed our long-term benchmark over all other periods. Perhaps more interestingly, we have beaten our short term benchmark, the Dow Jones Select Dividend Index, by over 4% so far this year. The reason: high yield investments have suffered disproportionately as interest rates started to rise. This is the problem with focusing exclusively on yield and not on how robustly that yield can be maintained. I think our portfolios will trade in line with the stock market—up and down—but our yield should steadily climb faster than inflation due to the quality of our underlying holdings.

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

Microsoft, the largest software maker in the world, experienced a dandy rebound after declining in the 1st quarter. As you may remember, investors became nervous last January when Microsoft reported weaker than expected revenues and profits from its legacy Windows and Office products. That sentiment rapidly reversed, though, with its surprisingly good April earnings report. Microsoft's challenges in transitioning from legacy licensed software to cloud software services aren't over, but I think they have an excellent chance of being one of the transition's big winners.

Equity income saw under-performance from **Fairfax Financial** and **Investment Grade Corporate Bonds**. Please see my comments above on Fairfax.

Investment grade corporate bonds declined this quarter as interest rates rose, and are expected to continue rising. The vast majority of our portfolio will do well in a rising rate environment, and that is why we also own investment grade corporate bonds: just in case interest rates go down or stay flat. Corporate bond under-performance is not unexpected, and actually indicates our portfolios are behaving as designed: generating good returns regardless of what happens with unpredictable interest rates.

MARKET AND ECONOMIC OUTLOOK

The S&P 500 returned 0.28% in the 2nd quarter and 1.23% so far in 2015. Such low returns have mildly boosted my expected returns over the next six years, but still not enough to become excited. Investment selectivity continues to be all-important when confronted with this type of environment.

Projected annualized returns over the next 6 years	
S&P 500 (growth benchmark)	-4.3% to 12.4%
S&P-500-yield-plus-inflation (equity income benchmark)	2.1% to 8.1%

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

Same story, different quarter: while the world economy muddles along, the U.S. economy leads the pack. Chinese growth continues to slow. Japan's growth is higher, but still far behind the U.S. Europe is facing another round of fear due to Greece's potential exit from the E.U., and hints that Great Britain is considering an exit, too. To top it off, there is little good news coming from Latin America, Eastern Europe, or Africa. Besides the U.S., only India and Southeast Asia provide positive examples of global growth.

Such an environment is not necessarily bad news for business growth and profitability, and thus stock prices. Yes, the rising U.S. dollar has been hurting U.S. based businesses' profitability, but that trend has moderated and companies have been rapidly adapting to the situation. Added to this, the demand for U.S. brands and know-how has not diminished, and this is translating into steady underlying growth.

Strong businesses are using this time to prepare for future growth. Global growth will pick up at some point, and smart companies are preparing for that by growing their supply chains, marketing to both current and potential customers, and adding value to products that will fuel future growth. Successful businesses use slow periods to move ahead of weaker competitors.

We are invested in many such strong businesses. Our portfolio includes powerful global brands like Coke and Philip Morris International that hold dominant positions in global markets. We also hold technology businesses like IBM and Microsoft that are building the next wave of information technology infrastructure that businesses will need to flourish. In addition, we own dominant domestic businesses like Wells Fargo and Comcast that will benefit from above average U.S. growth.

On the whole, we are well positioned regardless of how the global economy does. Whether or not Greece exits the E.U., or Chinese stocks rise or fall, our holdings will continue to solidify their dominant positions and increase in value. The market may not recognize that strength right away, but over time it will, as it always has.

AFTER ACTION REPORT: RYANAIR

When I go shopping, I have a hard time choosing. **Should I buy the adequate merchandise selling at a ridiculously low price, or should I buy the quality product selling at a reasonable price?** With Ryanair, I chose the latter and it worked out splendidly.

Research

When oil prices took off in 2007, I started researching Ryanair—a company whose greatest expense is fuel (it helps to shop when there's pessimism). Ryanair is and was Europe's lowest-cost airline. This is because Ryanair intelligently followed the Southwest Airlines playbook that worked so well in the U.S.

This means a fleet of only Boeing 737's, which keeps training and maintenance costs down, and carries more passengers than competing Airbus 320's (used by most of Ryanair's competitors). It also means flying point to point to secondary airports with cheaper usage fees instead of hub-and-spoke to costly major airports. Perhaps most important, **the Southwest model requires fast turn-around times on the ground**—jets and pilots only make money flying, so keep them flying as much as possible. All of these tools work to keep costs rock-bottom: low prices are much more important to passengers than free meals and reserved seating (passengers say they want such things, but they vote differently with their wallets).

In 2007, Ryanair's stock price was beaten down mostly on the threat of higher oil prices, but also on growing competition from low-cost airlines like EasyJet. What investors seemed to forget was that oil prices impact all airlines equally over time, and that Ryanair has a huge cost advantage over competitors (expenses as little as one-half!). Lowest cost wins in commodity markets.

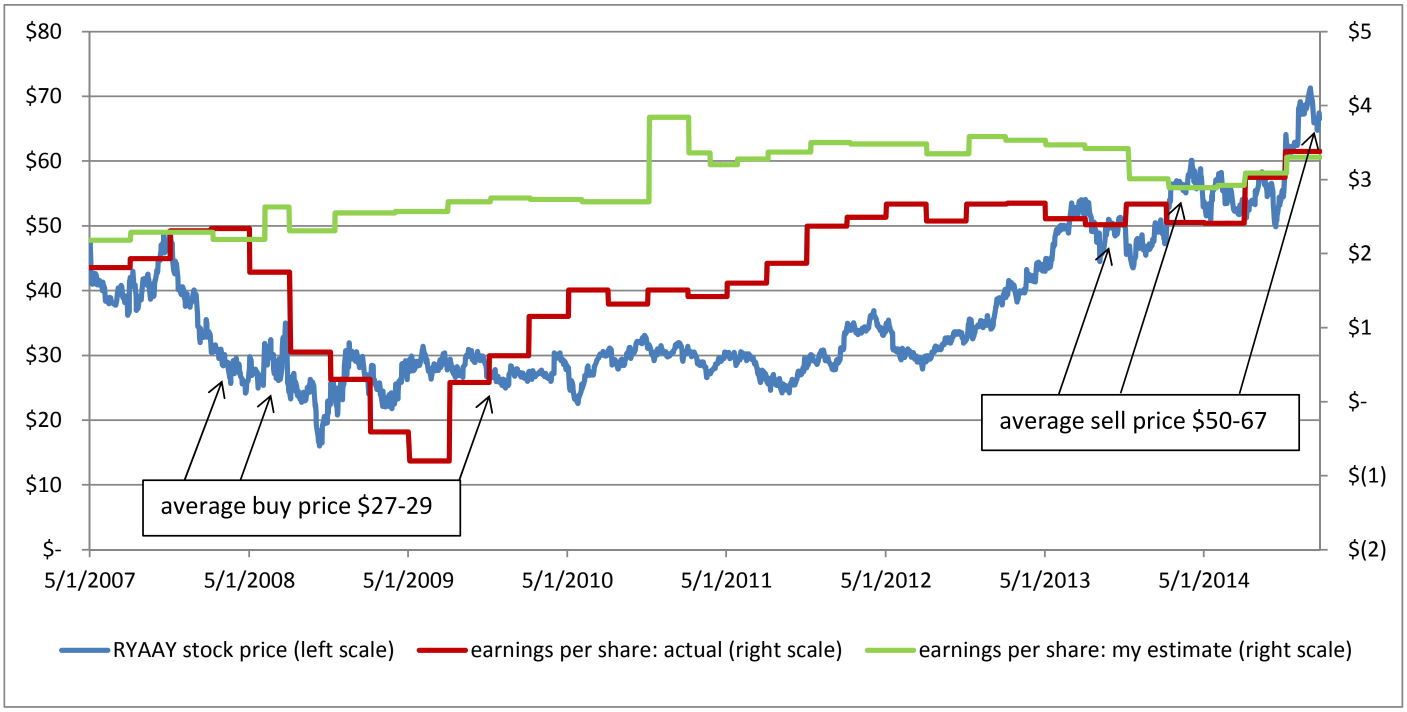
More crucially, that low-cost position is sustainable because **Ryanair has a culture steeped in perpetually cutting costs**, and it has been smart enough to drive hard bargains with Boeing during recessions and when Boeing had production problems with the 787.

Buying the position

I bought Ryanair between May 2007 and May 2010. I first started buying a small position in the $30's, and then bought with gusto as the stock price fell into the $20's.

Holding the position

Ryanair's price bounced between $23 and $36 per share from May 2010 through January 2013 (see the blue line in the graph below) as earnings per share climbed from $1.50 to $2.40. During that same time, my estimate of normalized earnings climbed from $2.75 to $3.60 per share. **Ryanair's earnings and sales growth were flying higher even as its price was range-bound.**



Ryanair was earning $1.80 per share when we first bought, but those earnings plunged to -$0.80 during the 2008-2009 recession (see the red line in the graph above). However, my normalized estimate of earnings was around $2.20 per share, and that estimate climbed to around $2.75 into 2010 (see the green line in the graph above). **It is important to value a business based on normalized conditions** instead of those of recession or economic boom, otherwise valuations become too erratic to be useful.

Using my estimates, it looked like we were buying Ryanair with a 6% earnings yield in the $30's and a 10% earnings yield in the $20's. That may not sound exceptional until you consider that Ryanair was growing sales and profits at underlying rates of over 10%! Ten percent growth plus 6% to 10% earnings yields can produce 16% to 20% returns. **We were paying a fair price for a high quality company.**

Between 2010 and 2013, I worked hard to even better understand Ryanair's economics and those of its competitors. I wanted to know what its upside could be. **Although Ryanair was performing well, it seemed unlikely that oil costs were going to return to the lows of the early 2000's**, or that the competitive situation would be as benign as it had been in the past. It's important to question my assumptions regularly to make sure I'm not missing anything, and that my valuation is still valid.

Selling the position

In 2013, Ryanair's stock price took off. It climbed from $36 per share in January 2013 to over $70 per share in December 2014. Over that period, earnings per share climbed from $2.40 to $3.40. Price was moving up significantly faster than earnings. My estimate for normalized earnings crept down from $3.60 to $3.40 as it became clear that Ryanair's profit margins were unlikely to return to historical averages (based on my analysis of fuel prices and competition).

From October 2013 to January 2015, I sold at prices from $50 to $67 per share. I was selling Ryanair at earnings yields of 5% to 6%, but with a growth expectation at 7.5% versus more than 10% in the past. My projections for Ryanair were slightly diminished at the same time its price was hitting all-time highs.

Ryanair is still an outstanding company—and I would happily buy it again at the right price—but **in early 2014 the price had grown to reflect these qualities** (and new opportunities with even better characteristics were then available).

Conclusion

Ryanair was a successful investment because it had strong and sustainable underlying growth, and we were able to buy it at a reasonable price. This fair price came about due to temporarily high fuel costs and increased competition. At the higher price Ryanair reached in late 2014, though, we would not have been able to generate the same returns going forward, and that's why it was time to sell.

Until next quarter

As usual, if you have any questions or comments for me, about the economy, markets, financial planning, performance, or specific investments, please don't hesitate to contact me. I love hearing from you.

Assiduously,
Mike

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