SNV Focus Portfolio Update

May 8, 2014

The SNV Focus Portfolio (SNVP, or the Portfolio) is underperforming the S&P 500's YTD performance by 3 pts (-1% SNV vs. 2% S&P). That is not indicative of the quality of the fund by any means, but it does reveal the volatility and beta of the portfolio in a bearish market environment. There has been a negative correlation recently, especially after the Q1 earnings reports. A lot of our stocks, particularly consumer, discretionary goods/retail stores tanked following the reporting e.g. AEO, HGG, GME.

We see Buffett's wisdom in this market. Critics of the SNVP may point to the underperformance of the stock. However, we are seeing the importance of placing the benchmark on the operational piece of the business, not the value placed by the market.

For example, a company may have generated $100MM in operational cash flow in 2013, but developed their business so that their operational cash flow grew to $200MM. However, if there is a secular variant such as the economy which has dampened the market sentiment so that the market multiple decreased from 10x Operating Cash flow to 5x Operating Cash flow, although the Co. may have double their operating cash flow, the market value, or the tradable price for each share, is unchanged. What may seem like a dud in the market, is actually a well run company. **So the key points are, 1) we must <u>focus on the underlying business development</u>, and 2) <u>use the market multiples to our advantage</u>.**

Unfortunately, the SNVP doesn't have a benchmark nor a metric in place to track the growth of operational cash flow of the portfolio companies. Thus, our investment psychology is hinged on the market price fluctuation, which has a superficial implication. However, we are unfortunately influenced by such metrics, when we are fully aware of the poison underlying the market data.

We must work on developing a metric which will track operational cash flow growth. This is critical to our success as investors, not traders.