MADIRON CAPITAL

January 31, 2019

Dear Esteemed Clients and friends,

In 2018, our fund returned 3.6% after enduring a decline of 17.3% in the fourth quarter. The market environment was very unfavorable to stocks. On a relative basis, the fund outperformed its benchmarks and most major indexes. The S&P 500 index that we benchmark utilizing the ETF ticker: SPY declined 4.4% while our global benchmark ETF (ticker: ACWX) declined 14.5% in 2018.

One can say the proverbial Santa Claus rally was met with a large lump of coal in December.

We only had two stocks that contributed positive returns in Q4, HMHC and NXPI. Our worst performing stocks were VIAB, ETM, and GME which all dropped 20%. Our best ideas simply got cheaper, and the relative gains were wiped by systematic price declines. Our conservative cash allocation provided us the opportunity to add to our positions that should set up for a good 2019.

While we wait for stock prices to rise to our estimated intrinsic values, the underlying businesses that make up our stock portfolio will distribute satisfactory dividends. I believe the silver lining is the majority of the 17% drop was systematic and not representative of the fundamentals of companies we own. We had a couple of clunkers, which included our new investment in a company called Flex Ltd (ticker: FLEX).

Overall, I believe we had a relatively successful year of investing. The adjustments I made in portfolio construction and allocation in Q4 of 2017 looks to have paid off in 2018. I look forward to meeting and discussing your portfolio in the coming weeks. Until then, I wish everyone a happy and healthy 2019.

MADIRON EQUITY FUND PERFORMANCE (GROSS-OF-MANAGEMENT FEES)

	Q1	Q2	Q3	Q4	YTD	S&P 500[1]	ACWX [2]	Cash Exposure
2018	(2.56%)	13.00%	10.39%	(17.27%)	**3.6%**	(4.4)%	(14.5%)	20%
2017	8.97%	1.39%	1.14%	6.72%	**18.2%**	21.8%	27.2%	20%
2016	7.08%	0.14%	10.91%	4.96%	**23.1%**	11.9%	4.5%	23%
2015	8.41%	(2.85%)	(14.67%)	4.96%	**(6.6%)**	1.4%	(5.7%)	18%
2014	2.23%	8.82%	(3.58%)	2.57%	**10.0%**	13.7%	(3.9%)	21%
2013	-	(0.76%)	9.83%	9.30%	**18.4%**	18.7%	11.8%	28%
				Total	**66.7%**	63.0%	19.4%	24%

1 S&P 500: The SPDR® S&P 500® SPY ETF Trust seeks to provide investment results that, before expenses, correspond generally to the price and yield performance of the S&P 500® Index. SPY cumulative performance of quarterly SPY TR results provided by Morningstar.

2 ACWX: The iShares MSCI ACWI ex U.S. ETF seeks to track the investment results of an index composed of large- and mid-capitalization non-U.S. equities.

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Riding the IOT Wave

Flex Ltd. [ticker: FLEX]
Flex Ltd, formerly known as Flextronics, was a traditional contract electronics manufacturer that evolved into a diversified manufacturer in a dozen industries. In the last five years they have invested large amounts of money to enter new categories and built innovation centers to assist clients with R&D, marketed as the 'Sketch to Scale' platform. The idea is to leverage the company's core competencies and collaborate with traditional product manufacturers. Many of them need to create 'smart' products in the emerging world of IOT. In theory, the business developed from Sketch to Scale initiatives will earn higher profit margins. Sketch-to-Scale now contributes 27% in total revenue in 2018. Flex believes revenues derived from Sketch-to-Scale will grow to 40% of total revenue by 2020. Today, Flex generates over $1 billion dollars of revenue in twelve different industries.

After Flex's Q2 earnings lets just say, the jury is out, and investors have fled. They announced the departure of its CEO of 12 years and the shuttering of its joint-venture with Nike. To add insult to injury, electronic component supply constraints hampered production and the ramping of new manufacturing capacity in India is taking longer than expected. In short, Flex missed expectations and the stock market drove down Flex's stock price 36%.

I believe some failure should be expected within the large portfolio of industries that Flex is working in. While Nike is a disappointment, the upside was tremendous if it became successful. Coming from a textile manufacturing background, personally, I thought the joint venture was doomed to fail. In apparel, the competition is fierce. If you are not one of the lowest cost producers, do not expect to be a producing for long. Labor overseas is still just way too cheap, and the machine technology is still too slow.

As a prudent investor, I am continuously examining if the failure at Nike is indicative of the balance of projects in the portfolio or a one-off. A positive take on the Nike failure is that management did not fall victim to the sunken cost fallacy on a project level. This is where additional resources would be invested in a losing project when better investments are available. Perhaps they sobered up as the project fell behind schedule and the forecasts of ultimate returns became less favorable.

A more pessimistic view can also be constructed utilizing the sunken cost fallacy on the firm level. Perhaps the CEO who is the architect of the Sketch to Scale platform is too encumbered by prior decisions and reluctant to cut losses. This 'agency' problem can be debilitating to a company. Therefore, the Board of Directors plays such an instrumental role for shareholders. At best, they work independent from executive management and will be unbiased in the evaluation. When strategy problems emerge, they are tasked to remove executives and find new leaders not burdened with mental accounts of sunk costs. This will allow them to evaluate current opportunities with a clear head.

If we take a more high-profile example with GE, the sunken cost fallacy could have been the reason why Larry Culp replaced John Flannery as CEO in under one year. John Flannery is exceptionally qualified and was on the right track for a GE turnaround. However, maybe his career spent within GE created the mental accounts and biases that would limit the large transformation necessary. Larry Culp, on the other hand, is unencumbered by GE's famous cultivation of personnel and biases that develop from such. He will have a fresh and sobered approach to all of GE's opportunities and challenges.

Does Flex have a similar problem? If the new strategy is working, I don't find it reinforcing when a company does not hire from within and the departure of the current CEO felt somewhat abrupt. The lack of succession planning might signal a possible departure from the current strategy. To protect ourselves from troubling unknowns, the price we paid for our shares plays a key factor. I believe we are positioned in Flex at a fair price and added after the implosion occurred in late October.

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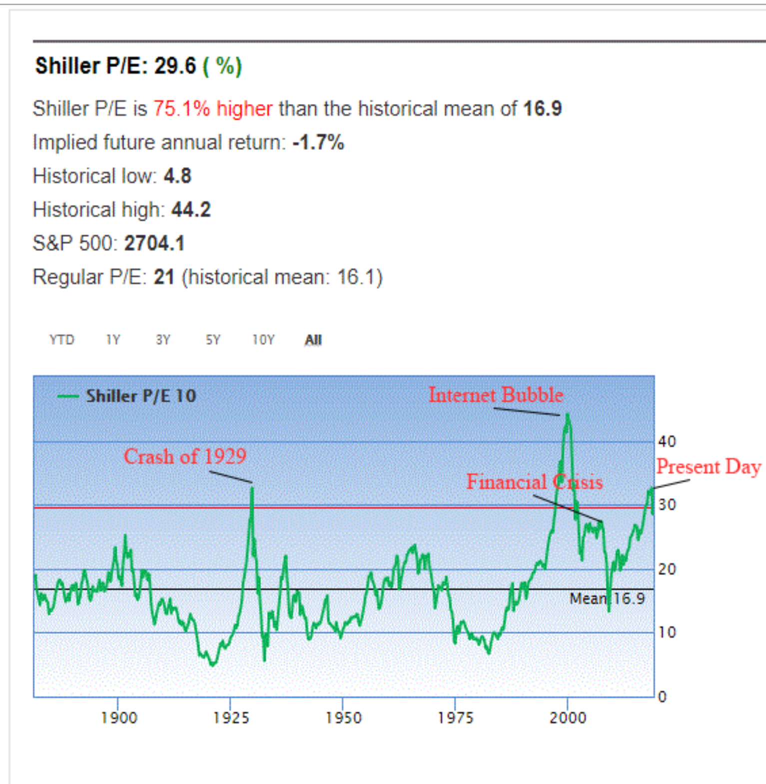
If you were watching trading on Flex throughout the year, I struggled with our initial allocation. I sold the position twice before committing to it and we averaged below $10/share after buying and selling it around $14 per share. My deliberation had to do with the likely negative outcome of the Nike project. The news came sooner than I expected and was compounded with the other negative developments. I am glad I was patiently accumulating a stake.

Flex is not expensive. At the end of the Q4, shares traded at $7.60 with a P/E ratio of 6.7x. Near-term operations are likely to be challenging but business fundamentals should continue to improve over the next 3-5 years. Flex is riding a large secular wave of smart devices in every industry category. With shares trading ~30% below its average earnings ratio, adding more shares at this level is very attractive.

Market Commentary & Prospects in 2019

2019 will make for a very interesting and challenging year for money managers like myself. By no means is the market cheap. According to [Shiller's P/E](), it around 29.6 vs. its historical average of 16.9.



There are stock market experts that have called Shiller's PE useless or simply ignore its relevance. This market indicator has its limitations but it provides a very good guidepost. Shiller's PE hit ~32 at the end of the third quarter last year. Based on this indicator, a pullback was warranted. Not for the events presented to us by the 'experts'. Maybe the explanation lies with the statistical phenomenon of regression to the mean, which [requires no causality]().

Volatility

Market experts and prominent news outlets define volatility as risk and only associate it with declines in the market. At this firm, we do not define volatility as risk only random short-term oscillations of market values.

Our definition of risk is a combination of the price paid (and its implied margin-of-safety), our exposure to risky assets, and the time-horizon afforded to me and our partners.

Volatility being associated with only declines in market prices is fundamentally wrong. Volatility has two-sides, the upside, and the downside. The human condition seeks causality and this condition is further perpetuated by the experts and the news cycle. If the market is rising, everyone is winning, and things must be going well. If the market is going down, everyone is losing, and fear dominates.

So, the million-dollar question, what caused the large decline in the fourth quarter of 2018 and what does 2019 have in store for us?

The honest answer is, I don’t know, and no one really does. What was good for the market by the end of Q3 was no longer good in Q4 of 2018. As I write this letter, the market has rebounded and eliminated last year’s decline in less than one month. Mr. Market is manic and bi-polar.

When was last time you heard an *expert* on TV say, ‘I don’t know’? They get paid to think up reasoning that is digestible and captivating to the masses. My iPhone is littered with daily notifications of why the market was up or down that day. I find it quite humorous.

If we stay disciplined, rational, and focused, the fund will benefit from advantageous selling and buying opportunities. Thus, provide above-average market returns in the long-term. This is not an easy thing to do. Our human-instincts have large behavioral inconsistencies (the emotions of fear and greed) that detract from disciplined and rational decision-making.

The important thing is to try to gauge and understand where we are in the market and credit cycle. Estimating this is inexact but so is our estimation of the intrinsic value of the companies we buy. I hope by being approximately right will provide good results.

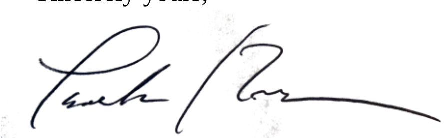
Competition for Capital

In a free-market, competition for capital creates the invisible hand for efficient pricing. Since the Great Recession, interest rates have been artificially low due to monetary intervention. Therefore, bonds and fixed income instruments have had a hard time competing with stocks. However, if interest rates rise, bonds become appealing and will draw capital away from stocks. This competition will reprice stocks downward as capital flows away.

In my view, this last credit cycle has not resembled anything close to a free-market for price seeking. Central bankers have been the accommodative buyer, thanks for their ability to print money. This has created an illusion of risk-containment and economic smoothing built on an unstable foundation. That four-letter word, debt.

Therefore, we all must right-size our proportion to this luring risk and be defensive. This is not a helpful marketing campaign for myself, however, I believe the survival of a person’s life savings is more important than the rapid growth of this fund’s AUM.

Sincerely yours,



Ted Rasa Jr.
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