Intrepid Capital
MANAGEMENT INC.

Index Returns	
7/1/2016 to 9/30/2016	
Dow Jones:	2.78%
S&P 500:	3.85%
NASDAQ:	10.02%
Russell 2000:	9.05%
MSCI EAFE:	6.43%

PRESIDENT'S LETTER

October 2016

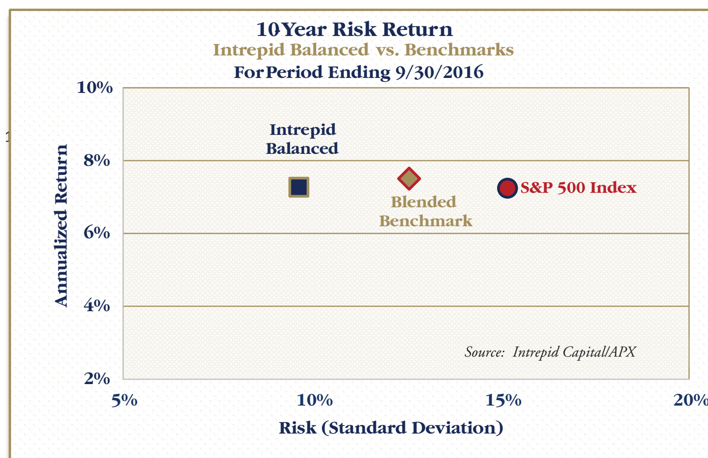
"Look for the ridiculous in everything, and you will find it."

— Jules Renard

Dear Friends and Clients,

We are pleased to announce the Intrepid Balanced Portfolio (the "Portfolio"), ended the third quarter of 2016 with an increase of 3.91%, net-of-fees, compared to 3.85% for the S&P 500 Index, a capitalization weighted index of larger U.S. companies, and 4.51% for the Blended Benchmark (60% S&P 500/40% BAML HY Master II), which consists of stocks and bonds. As an outsider looking in, one might review the close proximity of outcomes and suspect a "closet indexer," but in our case, nothing could be further from the truth. It's just pure coincidence. The Portfolio is designed to seek attractive risk-adjusted returns over time by holding stocks, bonds, and cash. As of September 30, 2016, the Portfolio consisted of 49.6% equities, 28.4% bonds, and 22.0% cash.

We find it interesting that by *going our own way*, our balanced portfolio has out-performed the higher-risk, all-equities S&P 500 with a return of 7.27%, net-of-fees, compared to the index's return of 7.24% with significantly less volatility, for the ten-year period ended September 30, 2016. The Blended Benchmark barely outperformed the Portfolio over the same time period, with a 7.51% increase, but did so with more volatility than the Portfolio.



As has been the case for several years now, we find ourselves confronting high equity prices, both here and abroad. On a trailing 12-month basis, the S&P 500 is trading at a Price-to-Earnings (P/E) ratio of 24.5. Some might say, "well, that is an 'earnings yield' of ~4%, which is competitive with the 10 Year US Treasury at 1.60%." However, investors can replicate that "yield" in the U.S. bond market with a superior claim to that of an equity investor, so we see little additional return potential to compensate for the higher risk inherent in stocks.

As the lead pilot of Intrepid Capital, like those at Delta, American, United, and Southwest, I think after 7 ½ years of a bull market, it would be prudent to review safety features that we believe are important to address before the advent of the next bear market.

1. **Consider holding some cash.** In over thirty years in the industry, I can count on one hand, with some fingers left over, how many investors I have met who were truly comfortable and committed to a 100% stock portfolio. If you wouldn't be able to sleep at night knowing you owned a cashless portfolio, or worse, not be able to watch your savings decline 30-50%, I would consider cash or a ladder of treasuries equal to a multiplier of six months to two years of your monthly expenses.

2. **Expand the scope of your equity investments.** At Intrepid Capital, looking across the globe in developed markets for companies with equity market capitalization north of $250 million gives us approximately 15,000 possibilities. U.S. stocks represent approximately 30% of the total value of global markets. Consider that the results of the market cap-weighted S&P 500 are essentially dominated by the share price performance of the largest 100 U.S.-based companies.

3. **Consider the position sizes in your portfolio.** Hopefully, the position sizes are neither too small (0.0010%) nor too large (10%). In the aftermath of the last two major bear markets (2000-2002 and 2008-2009), most investors have opted for what we call "di-worsification" with very diluted and diffused equity holdings. We encourage the "Goldilocks" (Just Right) mix of 2.5% to 4.0% positions at cost, resulting in a portfolio of 25-40 individual holdings. This results in a more intimate understanding of each holding, allowing quick deployment from cash reserves (see #1) if prices become disconnected from long-term value.

4. **Be prepared to hang on.** Rome wasn't built in a day, and the next bear market may not be over quickly either. Please keep in mind that turning over a portfolio regularly, like many tend to do, leads to high frictional costs in the form of commissions, bid/ask spreads, and for holdings held less than a year, higher taxes.

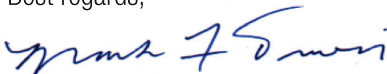
5. **Hold shorter maturity/duration bonds.** Don't reach into longer-maturity bonds just to grab a few extra basis points of yield. We are concerned that global central bank rate suppression has turned many of the "savers" of yesterday into the "investors" of today. Starved and groping for income in all the wrong places, they are now invested in long-duration assets (bonds and stock) that are most susceptible to an increase in interest rates when that day comes.

6. **Focus on "absolute" positive returns.** When the market only goes up, as it has for the last several years, many think only of return and forget about the evil twin sister, risk, until it is too late. Don't get caught up in how your portfolio is performing relative to the market. Focusing only on looking good against a benchmark index may be good for a fund manager's job security, as he's unlikely to be fired for being down 18% when the market is down 20%, but it has little practical benefit for individual investors. You can't eat relative performance, particularly if it is negative!

So there you have it, a pre-flight checklist that should help you survive the next bear market; oh, by the way, the life vest is under the seat!

Thank you for trusting us with your hard-earned capital. If there is anything we can do to serve you better, please don't hesitate to call us.

Best regards,



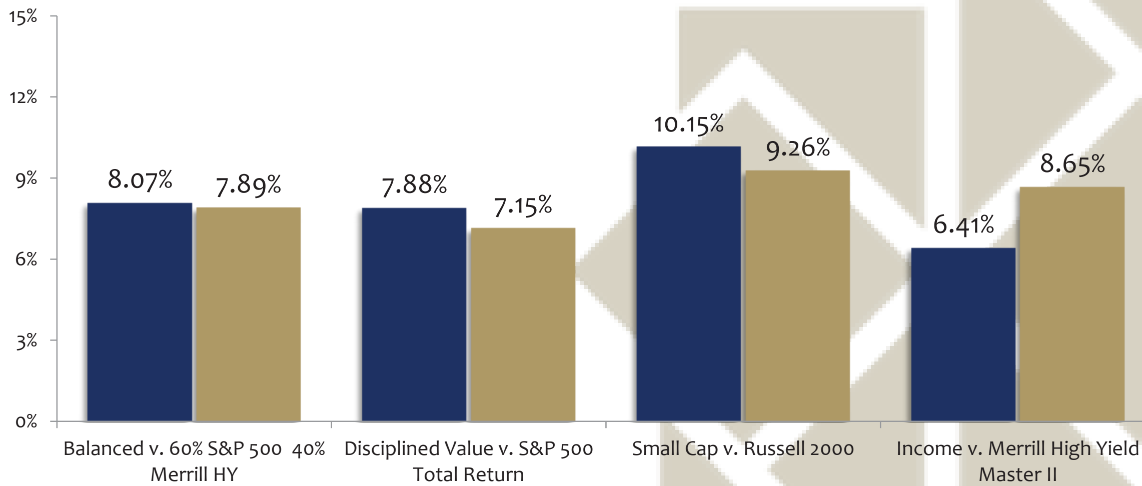
Mark F. Travis
President/CEO

Annualized Performance

Intrepid Capital

Trailing 15 Year Annualized Performance

September 30, 2001 to September 30, 2016



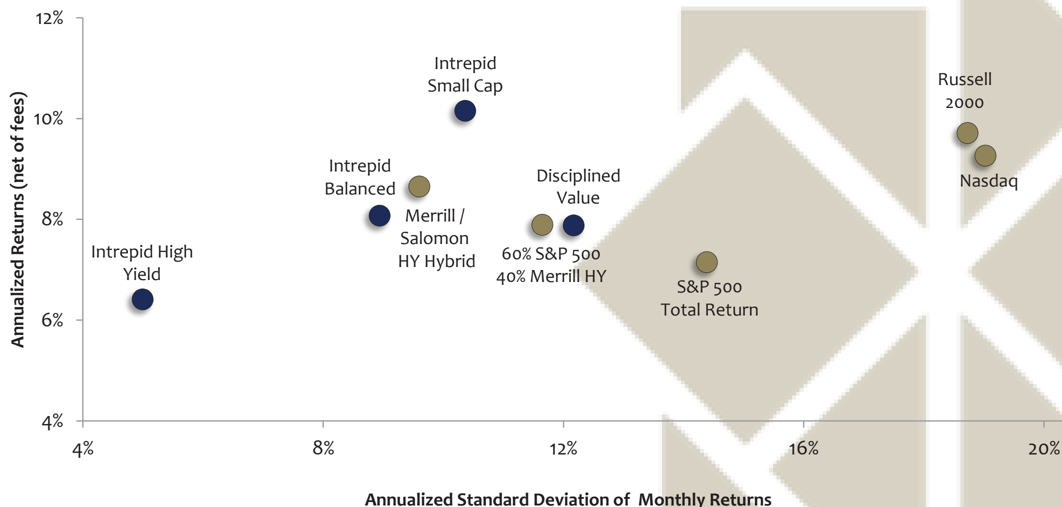
- Past performance is no guarantee of future results. Intrepid composite returns are presented net of investment advisory fees and all returns are presented annualized for the 15-year period ending September 30, 2016. Returns reflect the reinvestment of dividends and other earnings. The volatility of the listed benchmarks may differ materially from the volatility of any Intrepid composite. As of December 31, 2004, the firm changed its fixed income benchmark from the Salomon High Yield Short-Term Index to the Merrill Lynch High Yield Master II Index.

Risk Adjusted Returns

Intrepid Capital

Trailing 15 Year risk/return

September 30, 2001 to September 30, 2016



- Past performance is no guarantee of future results. Intrepid composite returns are presented net of investment advisory fees and all returns are presented annualized for the 15-year period ending September 30, 2016. Returns reflect the reinvestment of dividends and other earnings. The volatility of the listed benchmarks may differ materially from the volatility of any Intrepid composite. As of December 31, 2004, the firm changed its fixed income benchmark from the Salomon High Yield Short-Term Index to the Merrill Lynch High Yield Master II Index.