# Intrepid Capital Fund

*Discipline Makes the Difference.*


3rd QUARTER 2012 COMMENTARY

## PERFORMANCE

**Average Annualized Total Returns as of September 30, 2012**

| | Inception Date | 3 Month | YTD | 1 Year | 3 Year | 5 Year | Since Inception |
|---|---|---|---|---|---|---|---|
| Intrepid Capital Fund - Inv. | 1/3/05 | 5.69% | 10.59% | 18.63% | 10.95% | 7.94% | 7.11% |
| Intrepid Capital Fund - Inst. | 4/30/10 | 5.75% | 10.78% | 19.02% | - | - | 7.91% |
| S & P 500 Index | | 6.35% | 16.44% | 30.20% | 13.20% | 1.05% | 4.52% ^ |
| Russell 2000 Index | | 5.25% | 14.23% | 31.91% | 12.99% | 2.21% | 4.91% ^ |
| B of A Merrill High Yield Master II Index | | 4.64% | 12.02% | 18.94% | 12.62% | 9.07% | 8.12% ^ |
| US OE Moderate Allocation | | 4.57% | 10.55% | 17.93% | 8.51% | 1.56% | 4.18% ^ |

^Since Inception returns are as of the fund's Investor Class inception date. Since the inception date of the Institutional Class, the annualized return of the S&P 500 Index is 10.67%, Russell 2000 Index is 8.10%, B of A Merrill Lynch High Yield Master II Index is 9.91% and US OE Moderate Allocation Index is 6.79%.

**Performance data quoted represents past performance and does not guarantee future results.** *Investment returns and principal value will fluctuate, and when sold, may be worth more or less than their original cost. Performance current to the most recent month-end may be lower or higher than the performance quoted and can be obtained by calling 866-996-FUND. The Fund imposes a 2% redemption fee on shares held less than 30 days. Performance data does not reflect the redemption fee. If it had, returns would be reduced.*

Per the Prospectus, the Fund's annual operating expense (gross) for the Investor Shares is 1.47% and for the Institutional Class is 1.22%. The Fund's Advisor has contractually agreed to waive a portion of its fees and/or reimburse expenses such that the total operating expense (net) is 1.41% and 1.16% through 1/31/13, respectfully. In addition, the Fund's Advisor has contractually agreed to waive a portion of its fees and/or reimburse expenses such that the total operating expense, excluding Acquired Fund Fees and Expenses, (expense cap) does not exceed 1.40% and 1.15% through 1/31/13, respectfully. Otherwise, performance shown would have been lower.

October 2, 2012

Dear Fellow Shareholders,

*"The power of holding two contradictory beliefs in one's mind simultaneously, and accepting both of them… To tell deliberate lies while genuinely believing in them, to forget any fact that has become inconvenient and then, when it becomes necessary again, to draw it back from oblivion for just as long as it is needed, to deny the existence of objective reality and all the while take account of the reality which one denies"*
— *Doublethink – George Orwell "1984"*

We are living in strange times; where up is down and down is up. Poverty is growing, incomes are falling, the economy's growth is slowing to a snail's pace, joblessness is growing in more than half the country, and the President is talking to us in Orwellian "doublethink" (see definition above). The Obama campaign tag line is "Forward." Well, I sure would hate to see backward! The level of employment in this country in January of 2009 was roughly 133 million; today it is no greater. In fact, in August of 2012, more people went onto food stamps (175,000) than found a private sector job (96,000). The Obama campaign uses the counterfactual arguments that the economy would have been much worse without the massive stimulus, or that the administration's decisive action "saved" GM, etc. etc. The perennial favorite is that everything is George W. Bush's fault – a valid argument to a point, but not four years later.

To add to the toxic financial brew, Ben Bernanke announced a third round of quantitative easing (QE3), which caused a spike in financial assets. Early in his career, he was given the moniker "Helicopter Ben" when he publically stated that the Fed could print money and drop it from a helicopter if conditions were dire enough. With the Fed's recent decision to print money and expand its balance sheet indefinitely (leading many to refer to QE3 as "QEternity"), I have christened him "Buzz Lightyear" from the animated classic, Toy Story. In this movie, Buzz, a plastic toy with wings, jumps out of a window with his wings extended, shouting "to infinity and beyond" right before landing in the shrubs below the window.

The "free" interest rate Mr. Bernanke is offering to the market is doing two things that I view negatively. First, short-term interest rates in theory represent the price, or opportunity cost, of borrowing money and should be set by the market. The suppression of this rate over time contributes to a misallocation of capital, as everything looks viable from an investment standpoint (e.g. Tech Bubble, Housing Crash) when borrowed capital is virtually free. Second, this low-cost borrowing enables our government's financial profligacy to continue unchecked. When – not if – the Fed has to shrink its balance sheet and short-term rates rise, the Federal government's budgetary problems will explode like those of Greece, Spain, and Portugal (see "What We Pay" chart below).

**What We pay…**

| | Net Interest Rate % | Net Interest Expense/ Total Receipts % |
|---|---|---|
| 1940s | 1.8 | 9.3 |
| 1950s | 2.3 | 7.8 |
| 1960s | 3.4 | 7.2 |
| 1970s | 5.7 | 8.2 |
| 1980s | 8.6 | 15.2 |
| 1990s | 6.7 | 16.4 |
| 2000s | 4.7 | 9.4 |
| 2010 | 2.4 | 9.1 |
| 2011 | 2.4 | 10 |
| 2012e | 2.1 | 9.1 |
| **and would pay if…** | | |
| 2012 @ 3% | | 13 |
| 2012 @ 4% | | 18 |
| 2012 @ 5% | | 22 |
| 2012 @ 6% | | 26 |

source: Office of Management and Budget

| Top Ten Holdings | (% of net assets) |
|---|---|
| Bill Barrett Corp. | 3.2% |
| Newmont Mining Corp. | 3.1% |
| Berkshire Hathaway, Inc. - Class B | 3.0% |
| Molson Coors Brewing Co. | 2.7% |
| Patterson-UTI Energy, Inc. | 2.7% |
| Aspen Insurance Holdings Ltd. | 2.4% |
| American Greetings Corp. | 2.3% |
| Bank of New York Mellon Corp. | 2.3% |
| Potlatch Corp. | 2.2% |
| Bio-Rad Laboratories, Inc. | 2.2% |

Top ten holdings are as of September 30, 2012. Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any security.

On a more positive note, I am pleased to announce the Intrepid Capital Fund (the "Fund") completed its fiscal year end on September 30, 2012 with a total return of 18.63% for the trailing year versus the S&P 500 and the B of A Merrill Lynch High Yield Master II of 30.20% and 18.94%, respectively, for the same time period. The Fund's calendar year-to-date return is 10.59% and it rose 5.69% in the third quarter compared to the increases of 6.35% and 4.64% for the S&P 500 and the B of A Merrill Lynch High Yield Master II, respectively, for the quarter.

Once again, the Intrepid Capital Fund received an overall 5-Star Morningstar Rating, the highest rating for risk-adjusted returns, out of 771 Moderate Allocation funds for the period ending September 30, 2012 (derived from a weighted average of the fund's three- and five year risk-adjusted return measure). We are also pleased to report that for the period ending September 30, 2012, Morningstar ranked the Intrepid Capital Fund in the top 44%, 10% and 1% out of 894, 771 and 670 Moderate Allocation funds for the one-, three-, and five-year periods, respectively, based on total returns.

The top 5 contributors to the Fund's return over the last year were: CSG Systems International (ticker: CSGS), CoreLogic (ticker: CLGX), Oshkosh (ticker: OSK), Regis (ticker: RGS), and Aspen Insurance (ticker: AHL). In comparison, the bottom five detractors were: Dell (ticker: DELL), ManTech (ticker: MANT), Bill Barrett (ticker: BBG), Newmont Mining (ticker: NEM), and Tellabs (ticker: TLAB).

As of September 30, 2012, the allocation of the Fund was 59.7% in equities, 23.1% in corporate debt, and 17.3% in cash. The Intrepid Capital Fund is the most flexible product that we offer. The Fund can invest in stocks of any market capitalization and debt of any credit quality. Historically, the firm has focused on less popular corners of the capital markets, which include small cap stocks and high yield bonds. Despite the Fund's allocation to these "riskier" asset classes, the Fund has exhibited no more volatility than peer fund averages over time, as measured by the fund's three year annualized standard deviation of 9.6 versus the Fund Peer Average annualized standard deviation of 10.3 (consisting of 620 funds per Bloomberg's Balanced Classification). Many of these peer funds in the Bloomberg Balanced group invest exclusively in large cap stocks and investment grade and government bonds. We attribute our risk control to our cash flexibility as well as our preference for basic, boring businesses with predictable cash flow streams and below-investment-grade debt with better credit quality and shorter duration.

Shareholders occasionally ask about the overlap across our products. Nearly all of the Intrepid Capital Fund's ideas are sourced from our other strategies (Berkshire Hathaway, Newmont Mining, and Royal Gold are current exceptions), the All Cap Fund, Small Cap Fund, and Income Fund. The Fund is blessed because it has the broadest contribution of ideas from our investment team, but our other funds also benefit from analytical synergies. We are fortunate that many high yield issuers are small cap companies. Since we consider the entire capital structure when we analyze a company, ideas that first pique our interest from a credit perspective may become an equity holding, and vice versa. For example, in 2007 we first bought the bonds of Rent-A-Center, which had a maturity under 3 years but were paying a 10% yield at the time—several hundred basis points in excess of the high yield index. Within a month, we bought Rent-A-Center's stock after a temporary drop in price, and we also bought the equity of competitor Aaron's. All of these investments were fruitful for the Fund, and we have owned both stocks more than once.

In a few cases, the Fund owns the stock and bonds of the same company simultaneously, such as is currently the case with Speedway Motorsports (ticker: TRK), FTI Consulting (ticker: FCN), Cott Beverage (ticker: COT), Bio-Rad Labs (ticker: BIO), and Bill Barrett (ticker: BBG). None of these individual companies' securities represent more than 5% of assets on a combined basis. Half of the bond names in the Intrepid Capital Fund at the end of the third quarter have also been equity holdings at some point in the past. We hope it's clear that we derive maximum benefit from our analytical resources through sharing ideas across products.

The markets have delivered above-average returns over the last three years. Through September 30, 2012, the S&P 500 has a three-year annualized return of 13.22% and the Bank of America Merrill Lynch High Yield Master II index posted a return of 12.61% over the same time period. These strong returns have made it harder to find investment candidates that meet our criteria, although our sizable cash balance will allow us to act quickly when the analyst team at Intrepid Capital detects a disconnect between price and value.

Thank you for entrusting your hard earned capital to us. It is not a position we take lightly. With the exception of Berkshire Hathaway shares that I have held for years, all of my immediate family's investment and retirement accounts are invested in the Intrepid Capital portfolios.

Best regards,

Mark F. Travis

Mark F. Travis
President
Intrepid Capital Fund Portfolio Manager

**Mutual fund investing involves risk. Principal loss is possible. The Fund is subject to special risks including volatility due to investments in smaller companies, which involve additional risks such as limited liquidity and greater volatility. The Fund is considered non-diversified as a result of limiting its holdings to a relatively small number of positions and may be more exposed to individual stock volatility than a diversified fund. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer term debt securities. Investments by the Fund in lower-rated and non-rated securities present a greater risk of loss to principal and interest than higher rated securities.**

The S&P 500 Index is a broad based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. The Bank of America/Merrill Lynch High Yield Master II Index is Merrill Lynch's broadest high yield index, and as such is comparable with the broad indices published by other investment banks. US OE Moderate Allocation is a group of moderate allocation funds that seek to provide both capital appreciation and income by investing in three major areas: stocks, bonds, and cash. These funds tend to hold larger positions in stocks than conservative-allocation funds. These funds typically have 50% to 70% of assets in equities and the remainder in fixed income and cash. Russell 2000 Index consists of the smallest 2,000 companies in a group of 3,000 U.S. companies in the Russell 3000 Index, as ranked by market capitalization.

You cannot invest directly in an index.

Duration is a commonly used measure of the potential volatility of the price of a debt security, or the aggregate market value of a portfolio of debt securities, prior to maturity. Securities with a longer duration generally have more volatile prices than securities of comparable quality with a shorter duration. Market cap is the market price of an entire company, calculated by multiplying the number of shares outstanding by the price per share. Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income. Basis point is a unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument.



Morningstar Rankings represent a fund's total-return percentile rank relative to all funds that have the same Morningstar Category. The highest percentile rank is 1 and the lowest is 100. It is based on Morningstar total return, which includes both income and capital gains or losses and is not adjusted for sales charges or redemption fees. Morningstar ranked the Intrepid Capital Fund in the top 44%, 10% and 1% out of 894, 771 and 670 Moderate Allocation funds for the one- , three- and five-year periods ending 9/30/12, respectively.

The Intrepid Capital Fund was rated 5-Stars and 5-Stars against the following numbers of U.S. domiciled Moderate Allocation funds over the following time periods: 771 and 670 funds in the last three- and five-years, respectively.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating (based on a Morningstar risk-adjusted return measure that accounts for variation in a fund's monthly performance, including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star.

Opinions expressed are subject to change, are not guaranteed and should not be considered investment advice or recommendations to buy or sell any security.

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