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- Largest **winning** position in April: KFS +47.78%
- Largest **losing** position in April: WMIH -7.69%
- New additions to portfolio: KFS, SPNS
- New liquidations in portfolio: IWSY
- Portfolio exposure as of April 30th: 95% long/5% cash

- Long Positions as of April 30th: **WMIH, BFCF, HH, KFS, SPNS**

Portfolio Highlights For April

- In an otherwise listless month of trading, the newest position in the portfolios shined. I began accumulating shares of **KFS**, which primarily deals in auto insurance, for all managed accounts in March, at prices in the low-4 range. The accumulation of shares continued throughout April, with new buys as high as 5.30 before we were able to gather the large position that I set out to make KFS from the onset. The shares kept rising throughout April, settling the month at $6 per share.

  If you haven't already read the research, it is available for viewing by clicking here.

  The opportunity in KFS can best be summarized as structural in nature, with a highly competent activist investor leading the path forward. What I mean by “structural” is that the former KFS consisting of inefficient operating entities and a reckless management team has been replaced by a management team that is dedicated to creating efficiencies while operating within a company that is almost entirely transformed.

  The structure of the company is such that it can be quickly scaled up through acquisition in order to take advantage of a tax efficient operating structure that comes in the form of nearly $1 billion in NOLs.

  Management has been on an acquisition spree over the past couple of years, but there have no game changing acquisitions of note to date. A series of small acquisitions have been taking place while management has been steadily reducing debt from a high of $350 million to just over $100 million, at present.

The insurance industry presents an extremely favorable environment for the type of structure that KFS possesses. KFS is a company possessing multiple revenue streams through both insurance service and underwriting that can then be reinvested in various outside investments including real estate, publicly traded equity and bridge loans with equity upside. This is within a revenue structure that will be essentially operating tax free. It is the type of scenario where the gains that can be achieved have the potential to spiral up within a virtuous cycle.

Given the tax efficient operating structure, restructured operations, and reassembled management that has made a significant degree of progress within a relatively short amount of time, it is only natural that I would be drawn to this opportunity. The investment takes on additional certainty, with a significant margin of safety, when such an operation is being cultivated within the insurance industry due to the potential for layered gains.

This is a position that will almost certainly be a staple within the portfolios for some years to come. I rarely make that type of statement, only choosing to do so with opportunities that are unique in their ability to create long-term value for investors. KFS certainly qualifies.

- **SPNS** was re-initiated as a long position late in the month in the 7.80 range. This has become the “trader” for the portfolios, acting as a reliable fill in whenever I desire increased exposure to equities. The company is extremely reliable, with a very conservative management team at its helm.

  The increase in exposure I desire is directly linked to the resiliency the broader market showed in the face of one of the key legs of the bull market being incinerated. That leg, of course, being the momentum names such as FB, NFLX, AMZN, GOOG etc.

  The choppy conditions we are facing in 2014 should give way to upside during May as the punishment in growth certainly does not fit the crime. Optimism has been rinsed, for the most part, allowing for stability over the next month, if not substantial short-term gains as the stocks retrace a percentage of their losses.

  With that said, adding equity exposure comes with much less risk than at any other time this year.

<u>Portfolio Lowlights For April</u>

- **WMIH** saw it shares decline in low volume trading of the disinterested type. The next obvious step here is some type of M&A announcement, led by KKR. Until then the shares should continue to meander about.

  Beyond what I discussed as the M&A possibilities in last month's report, there isn't much to do here but sit tight, as has been the practice for much of the past 22 months since we have been involved in this opportunity.

The next course of action with WMIH as an investment will come when the M&A is announced. Should the company find itself in the insurance/reinsurance business, as I suspect it will, then the position may well be with us for some years to come.

- **BFCF** saw it shares decline close to 4% during April on generally low volume trading. Late in the month, the merger was approved by shareholders with BBX, as expected. Of course, that doesn't matter until the pending SEC litigation is cleared up.

  The company remains substantially undervalued here, with the value of their Bluegreen unit alone being enough to consider the current stock price a bargain, without taking into account their additional operating units and vast real estate holdings, much of which are to be developed, further enhancing future value.

- **HH** finished the month more or less unchanged on low volume, sideways trading. The company remains a long-term proposition, with the added benefit of being resilient through a variety of economic conditions due to their principal business being healthcare.

  At current levels, given the substantial changes that have taken place at the company over the past years, risk remains minimal. On the upside, we should begin to see the fruits of management's labor before the end of the calendar year. Certainly, I expect the stock to be a performer for the portfolios well before the year is up.

- **IWSY** was liquidated as the desire to reduce risk during the month took precedent over any upside that IWSY could provide over the short to intermediate term.

  The stock was sold above $2 for a small profit during the first half of the month, well before the substantial decline that saw shares go as low as $1.60.

Looking Ahead To May

As we swiftly approach the mid-point of 2014, I would like to look back at previous points that were highlighted and discussed so that we may have accurate reference for which to look forward. This exercise in documenting my thoughts over the past few years has led to over a thousand articles posted, numerous analytical studies of all types and twenty research reports on micro/small-cap opportunities. One of the many reasons I participate in this exercise of transparency is so that I can have a reference of my own thoughts to refer to when I need clarity.

Clarity as an attribute in finance is highly underrated, instead being forfeited for an abundance of information that is perceived relevant. Simplicity is the only avenue towards the clarity needed to see the markets and situations for what they are instead of what an investor wants them to be. The components or DNA that make up abundant information and simplicity are in direct contradiction to one another. There is no means of achieving one while maintaining another.

To achieve clarity for the purposes of this "Looking Ahead" section of the monthly summary I would like to look back at two separate pieces of information: The first from a study I discussed during the January 2014 Monthly Summary and the second from the performance of growth names during the 90s technology boom.

We will begin with this quote from the snippet from the January Monthly Summary:

Allow me to present some data: I went back to 1980, looking over years where the S&P 500 had a gain in excess of 25% (we were up 29% in 2013) for the year. I then looked at whether January was up or down in the following year after that type of outstanding performance.

25% plus years: 1980, 1985, 1989, 1995, 1997, 1998, 2003, 2013

Of these years, there were only two Januarys that were negative following such a strong year: January 1981 & January 1990.

1981 & 1990 were the only years that finished down -9.73% & -6.56% respectively out of all those years.

Yes, January is important for how the year fares. This by no means equates to a powerful drop occurring in the market anytime this year. In fact, I think the volatility will be generally contained within a 10% range. However, that 10% range will be mostly on the downside. In other words, we fluctuate between flat and down 10% for a majority of the year.

2013 experienced a negative January, of course. We are now chopping along the path of mediocrity with a negative return for the S&P a much more significant possibility than was previously thought.

If you are to search for a reason within the macro arena, you can point to numerous pieces of data, none of which can provide firm ground to stand on as an investor. The same reasons that are being cited as evidence of bearish consequences to come were easily ignored or put aside when the market was perfectly content with moving up for much of 2013.

You can point to Ukraine and Russia. You can blame housing. You can say that overvaluation is playing a part. You can claim that earnings have hit a peak. You can say that unemployment is set to tick up. You can think that China is set to implode.

All of these points of concern are legitimized by the market as opposed to the market legitimizing the concern. In other words, there will always be negative concerns that investors become preoccupied with. It is only when the market begins to decline that these concerns gain any legitimacy, which essentially makes them an aftereffect of price action.

Soros referred to this as reflexivity. The idea that price influences fundamental outcomes instead of what is traditionally thought of fundamental data exerting influence over price behavior. Further, Soros states when price begins to influence fundamentals they begin a self-reinforcing cycle that reinforces both, further enhancing the trend.

What we have thus far in 2014 is a market that is searching for fundamental excuses when none are needed, whatsoever. In fact, all that is happening in the market is a classic case of digestion. Yes, the same digestion that we are faced with when out to dinner, with an overabundance of meats, poultry, seafood, sides and topped off with an extravagant dessert. The body needs time to digest the grandeur of the meal that was.

Similarly, investors have enjoyed a largesse of capital gains over the past several years. The markets have steadily risen, making for a comfortable, if not excessively spoiled investor class. This is the same investor class that is a child of the financial crisis, which will not soon be forgotten. Any and every pullback to come for the remainder of this decade will provide a stark reminder that markets can cause ruin, misery and agony. This reminder is so fresh in the minds of the general public that even with the consistent record highs in the major indices, the markets are still perceived as a fools bet.

This type of psychological backdrop paired with a market that has grown increasingly volatile and disproportionate in its appetite for punishment will cause the paring of risk to come swiftly as we have seen with the recent sell-off in growth names.

If nothing else, we have been taught by previous technology led markets that volatility in growth names is to be expected, if not encouraged, as a means of transferring ownership from the hands of irresponsible shareholders who are short-term minded and over-leveraged to the hands of responsible shareholders who are long-term minded and conservatively allocated. This transfer sets the stage for the next leg up to begin.

It is by no means an elegant process. It is punishing in nature. Excessively and purposely confusing. Dramatic yet effective in fulfilling its purpose. And that purpose is to remove greed and instill fear.

Here are some snippets of data from the last great technology led market during the 90s showing how far the popular growth names of the time will go to make sure the pressure leaves only the most dedicated, responsible shareholders to enjoy the next leg up. All of these pullbacks were followed up with new all-time highs, in most cases being reached in a matter of a couple months:

- CSCO: 1995 -29% pullback; 1997 -40% pullback; 1998 -41% pullback
- YHOO: 1997 -41% pullback; 1998 -43% pullback; 1999 -44% pullback & -55% pullback
- AMZN: 1997 -33% pullback; 1998 -56% pullback; 1999 -63% pullback

Bear in mind, all of these pullbacks saw the stock reach new all-time highs within months. In each case, the top was perceived to be "in" for these names.

There are many takeaways from studying past growth stories such as CSCO, YHOO and AMZN during the 90s. The primary takeaway should be the destructive power of margin as a vehicle for enhancing gains. Invariably, with the use of leverage, an investor will be unable to

have the staying power necessary to participate in growth shares. There is no exception. Margin and growth do not mix except for very short-term trading, which has a negative expected long-term value for a vast majority of individuals.

Secondly, you will notice that the pullbacks become more voracious in their appetite for ruinous behavior as the bull market progresses. This is a direct result of the excessive participation in the names causing the train to shift unpredictably and often times, violently. It is no different than a crowded train shifting along the tracks in Kolkata. As the train carries more weight it becomes increasingly dangerous, volatile and prone to disastrous consequences.

As this bull market continues, growth will experience increasingly violent pullbacks. What we have experienced thus far in 2014 is child's play compared to the later stages. Momentum comes with a steep price that can only be combated with a vast amount of intestinal fortitude that few investors possess. Tread wisely. Tread softly.

While I comment on growth names with some regularity, the managed portfolios will never consist of traditional, crowded growth names. There are more accommodating means available to cultivate capital gains, without sacrificing the quality of those gains as a result of feverish volatility.

The fact that I am able to find opportunities such as KFS at this stage of the secular bull market bodes well for future discovery. Opportunities in restructured companies with tangible paths towards tremendous profitability, within an efficient operating structure continue to exist. My duty as a steward of investor capital is to not only discover such opportunities and allocate a portion of funds in that direction, but to allocate assets properly.

Within the process of what I deem as proper allocation comes quite a few methods that run contradictory to conventional wisdom. It is and will always be my philosophy that with conventional wisdom you will be forced into conventional results. Convention is something that T11, as a firm, seeks to divorce itself from with every opportunity that is encountered.

With the small asset base that I currently have the privilege of investing, comes the distinct advantage of being able to maneuver our small, fast boat along the vast, choppy seas of the financial markets. This philosophy of disciplined agility within a methodology (restructuring/special situations) that traditionally counts on staunch rigidity to achieve long-term results is unique to T11 and responsible for our substantial outperformance relative to peers and any relevant benchmark.

Those of you who have communicated with me in the past know that my goals for this firm are not to shoot for the stars, gathering a vast amount of assets that ultimately ends up sacrificing our quality of gains. This is and will always be a small firm that counts on superior performance to be the ultimate mark of success, not the number of investors or amount of assets. Shooting for the stars in my case comes from the number of basis points we can exceed our benchmark during any given month, quarter or year.

The approach to achieving performance will continue along the path of an unvarying, tested process of discovery, research, execution, concentration and discipline. The *process* is my responsibility. The rest falls into place naturally along the way.

Regards,

Ali Meshkati