Kirr, Marbach & Company, LLC

Registered Investment Adviser

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"If you're going through hell, keep going"
—Sir Winston Churchill
(British Prime Minister)

Q4-2018 Update
January 8, 2019

Dear Clients:

Investors endured a brutal fourth quarter of 2018, with the S&P 500 losing 13.5% (at one point a whisker shy of a bear market decline of 20% from its September 20 peak), as anxiety increased over the Federal Reserve raising short-term interest rates too quickly, the threat of the tariff spat with China morphing into an all-out trade war, a possible slowdown in global economic/earnings growth and the inability of our political leaders to avoid a government shutdown.

Fortunately, the Federal Reserve subsequently fixed its previously ham-handed approach to communicating/signaling when Chairman Powell calmed investor jitters by assuring them the Fed is "listening carefully to the markets." While some economic ***survey*** indicators have softened (i.e. December Institute for Supply Management's Purchasing Managers' Index), actual ***reported data*** remains generally robust (i.e. December jobs report). We're hopeful on trade and the situation in Washington, but brinksmanship appears to be the favored playbook for now.

As always, the financial media stood ready to stoke the flames of fear with headlines blaring about December 2018 being the worst December for stocks since the Great Depression, Christmas Eve 2018 being the worst in history and 2018 the worst year since the Global Financial Crisis a decade ago.

After an abnormally calm 2017, volatility returned with a vengeance in 2018 and seemed to reach a crescendo in the final week, with the Dow Jones Industrial Average suffering its aforementioned worst Christmas Eve and experiencing it first 1000 point up day and largest intra-day point swing in its 120-year history on consecutive trading days (December 24, 26 and 27).

As shown in the table below, there was literally no place or sector to hide during the fourth quarter and 2018 as stock markets around the globe and commodities were pummeled.

The bad news is our investment performance for the fourth quarter and 2018 was poor, both on an absolute and relative basis. As portfolio managers, we own our performance. Because we are heavily invested alongside you, we share your frustration.

Asset Class Performance YTD 2018, Q4, and December - Total Return (%)

ETF	Description	Dec.	Q4	YTD 2018
SPY	S&P 500	-8.79	-13.52	-4.56
DIA	Dow 30	-8.48	-11.29	-3.74
QQQ	Nasdaq 100	-8.65	-16.73	-0.12
IJH	S&P Midcap 400	-11.33	-17.28	-11.18
IJR	S&P Smallcap 600	-12.19	-20.18	-8.49
IWB	Russell 1000	-8.91	-13.74	-4.88
IWM	Russell 2000	-11.97	-20.29	-11.11
IWV	Russell 3000	-9.14	-14.25	-5.41
IVW	S&P 500 Growth	-8.46	-14.68	-0.19
IJK	Midcap 400 Growth	-11.29	-17.69	-10.52
IJT	Smallcap 600 Growth	-12.06	-19.77	-4.39
IVE	S&P 500 Value	-9.38	-12.06	-9.19
IJJ	Midcap 400 Value	-11.39	-16.89	-12.04
IJS	Smallcap 600 Value	-12.38	-20.64	-12.84
DVY	DJ Dividend	-7.98	-9.74	-6.32
RSP	S&P 500 Equalweight	-9.54	-13.90	-7.82

ETF	Description	Dec.	Q4	YTD 2018
FXB	British Pound	0.06	-2.19	-5.75
FXE	Euro	1.12	-1.51	-5.30
FXY	Yen	3.43	3.52	2.31
XLY	Cons Disc	-7.95	-15.20	1.59
XLP	Cons Stap	-8.91	-4.97	-8.07
XLE	Energy	-12.43	-23.57	-18.21
XLF	Financials	-11.12	-13.08	-13.04
XLV	Health Care	-9.35	-8.66	6.28
XLI	Industrials	-10.65	-17.33	-13.24
XLB	Materials	-6.88	-12.22	-14.87
XLK	Technology	-8.36	-17.35	-1.66
XLC	Comm Services	-7.98	-15.47	--
XLU	Utilities	-3.99	1.37	3.92

ETF	Description	Dec.	Q4	YTD 2018
EWA	Australia	-3.88	-9.62	-12.02
EWZ	Brazil	-2.56	14.98	-2.57
EWC	Canada	-8.55	-15.35	-17.16
ASHR	China	-5.19	-12.40	-28.44
EWQ	France	-5.12	-15.13	-12.88
EWG	Germany	-5.55	-14.76	-21.37
EWH	Hong Kong	-1.05	-4.53	-8.73
PIN	India	0.82	1.91	-7.55
EWI	Italy	-3.43	-11.35	-17.19
EWJ	Japan	-7.69	-15.19	-14.09
EWW	Mexico	3.06	-18.87	-14.59
EWP	Spain	-4.10	-7.69	-15.32
RSX	Russia	-3.64	-8.60	-7.10
EWU	UK	-4.58	-12.10	-14.28

ETF	Description	Dec.	Q4	YTD 2018
EFA	EAFE	-5.35	-12.62	-13.81
EEM	Emerging Mkts	-3.50	-7.64	-15.31
IOO	Global 100	-7.43	-12.26	-6.22
EEB	BRIC	-5.65	-6.48	-11.34
DBC	Commodities	-3.99	-18.31	-11.62
USO	Oil	-9.97	-37.76	-19.57
UNG	Nat. Gas	-33.79	-0.48	5.96
GLD	Gold	4.94	7.53	-1.94
SLV	Silver	9.01	5.75	-9.19
SHY	1-3 Yr Treasuries	0.76	1.30	1.46
IEF	7-10 Yr Treasuries	2.80	3.86	0.99
TLT	20+ Yr Treasuries	5.85	4.59	-1.61
AGG	Aggregate Bond	1.98	1.85	0.10
BND	Total Bond Market	1.87	1.64	-0.11
TIP	T.I.P.S.	0.53	-0.52	-1.42

Source: Bespoke

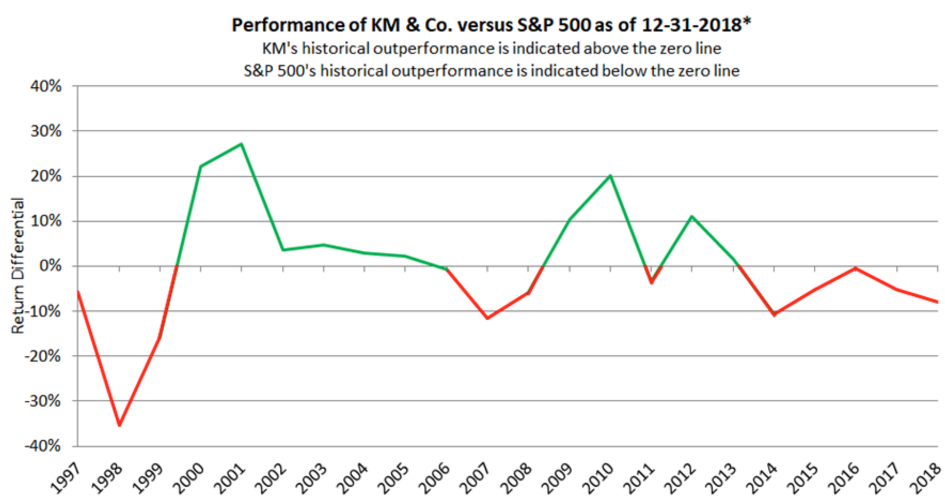
The good news is we believe we're starting to see some "green shoots" of what we consider a long-overdue return to favor of our "value" investing style. As we'll explain in detail, we've been through a number of droughts for "value" over our past 43+ years in business. All were painful and we looked extremely foolish right until the moment they reversed. Past performance is not a guarantee of future results, but past droughts did eventually reverse and we were rewarded for sticking to our discipline.

In addition, according to our own rigorous analysis of the fundamentals of the ***businesses*** owned in our portfolio, the ***stocks*** of those businesses are ***as undervalued and have more overall upside potential than at any time in the last 10 years***. In other words, ***we believe there is a major disconnect between the performance of the businesses we own and their stock prices***. There are no guarantees and only time will tell if 1) our business value estimates are accurate and 2) the market recognizes and rewards this with higher stock prices, but as big believers in "eating our own cooking," we are hopeful the table is being set for a more enjoyable meal than we've served over recent years.

Long periods of underperformance are normal, even for managers with good long-term performance.

Many fund managers avoid talking about their performance and are reluctant to even "show their numbers." Ours is a very quantifiable business and we've always believed our clients are entitled to transparency, in good times and especially in challenging times. So, we'd like to try to 1) put our recent period of underperformance is perspective, 2) explain why it happened and 3) offer a possible look ahead.

We underperformed the S&P 500 for the fifth consecutive year in 2018. Five years has undoubtedly made for an uncomfortably long walk through the performance desert, but it's happened before to us and other managers with strong long-term performance.



	KM Equity Composite	S&P 500 Index (Dividends Reinvested)	
2014-2018*	4.9%	50.3%	Underperformed
2007-2013	***66.6%***	***51.6%***	
2009-2013	210.9%	128.2%	Overperformed
2007-2008	-46.4%	-33.5%	Underperformed
1997-2005	***117.2%***	***94.1%***	
2000-2005	73.2%	-6.5%	Overperformed
1997-1999	25.4%	107.6%	Underperformed

*2018 Performance Preliminary

Performance data quoted represents past performance and does not guarantee future results. The S&P 500 Index is an unmanaged, capitalization-weighted index generally representative of the U.S. market for large capitalization stocks. This Index cannot be invested in directly.

The graph and table above are meant to depict our experience during our prior two most recent periods of underperformance, the "Technology Bubble" of 1997-1999 and the Global Financial Crisis (GFC) of 2007-2008. Again, past performance does not guarantee future results, but our periods of painful underperformance eventually reversed to the extent our subsequent performance more than made up the difference.

Much like during the "Technology Bubble" of 1997-1999, our most recent period of underperformance has been dominated by the strong performance of a group of mega-capitalization, high-momentum technology stocks. This time, the five "FAANG" stocks (Facebook, Apple, Amazon, Netflix and Google's parent company, Alphabet) whose market capitalizations (i.e. number of shares outstanding multiplied by stock price) and valuations soared to stratospheric levels on the promise of certain growth, regardless of the state of the economy, interest rates, tariffs or other factors impacting "mere mortals" of corporate America drove performance.

The reason this is important is the FAANGs were "one-decision stocks" you should buy, no matter how expensive, and hold forever. Indeed, according to Bespoke Investment Group, in 2017 the FAANGs all soared 30% or more and added $851 billion in market capitalization. This stellar performance continued in the first half of 2018, as the five FAANGs boosted their market capitalization by $523 billion, while the 995 next largest capitalization stocks added just $183 billion.

According to Goldman Sachs, just 10 stocks accounted for more than 100% of the S&P 500's 3% return for the first half of 2018, with the five FAANGs contributing 81% of the total. Amazon rose 45% and alone accounted for 36% of the S&P 500's return. Apple gained 10% and contributed 15%, Netflix jumped 106% and contributed 15%, Facebook rose 11% and contributed 8% and Alphabet increased 7% and contributed 7%.

The FAANGs have been priced for perfection, as if their business models and execution will be infallible. In other words, investing in "momentum" stocks like the FAANGs is predicated on the belief that winners will keep winning. For most of the last decade, this momentum investment approach has been golden while value has significantly lagged. Just like during the Technology Bubble of the late 1990s, the valuation of the FAANGs don't make sense to us. Also like then, we can attest not owning them has made for a long, lonely walk through the performance desert.

The explosive performance of the FAANGs couldn't have happened without another phenomenon, the rise of passive index investing that has come to dominate the investment industry since the GFC.

It is well-known that active managers have underperformed their benchmarks since the GFC. Passive index funds offer to match benchmark performance, minus fees (which are much lower than for active management). We certainly understand the elegant simplicity of the index fund sales pitch, which investors have responded to in droves. Passive strategies have doubled their market share of assets under management since the end of the GFC to around 40%, at the expense of active, stock-picking strategies. ***It is estimated passive strategies currently account for as much as a whopping 85-90% of daily trading volume.***

Passive index investing "machines" mechanically and mindlessly "invest" this torrent of cash pouring in by buying stocks in the same proportion as in the indices they happen to track, with no regard for company fundamentals or stock valuation. Thus, every index fund tracking the S&P 500 will buy enough Amazon every day to make it a 3.0% position (AMZN's current weighting in the S&P 500), regardless of its P/E of 60x earnings for the last twelve months or prospects going forward.

Our fear is this "virtuous circle" of constant buying leading to higher stock prices leading to more buying will continue—until the music stops at some point for whatever reason. The resulting index fund outflows could cause the virtuous circle to turn vicious as indiscriminate buying turns to indiscriminate selling. Index funds haven't been tested under extreme market stress since they've reached gargantuan size.

In fact, trades from passive strategies were likely key contributors to the extreme volatility in December. Lipper reported investors yanked $75.5 billion from U.S. mutual funds and exchange-

"Even in the presence of skill, there can be long periods of underperformance. Standard performance evaluation periods—three, five, even 10 years—are far too short to make well-informed judgements about a manager's skill or lack thereof. Performance is just not a reliable guide to assessing managers unless one extends the time frame to decades. Active investing is a long game."
-- Morningstar

traded funds in December, the largest monthly flow ever dating back to 1992. Trading liquidity is like air—you take it for granted, until it's not there. With index funds simultaneously selling the same positions, the question becomes—sell to whom?

Passive index investing is a pure form of follow-the-crowd behavior. We can't say if passive index investing is a fad, but the herd mentality of investors has certainly caused it to become a crowded trade. We've seen many fads over the past four decades plus. All have ended badly.

Finally, last fall Morningstar published a report, ***"How Long Can a Good Fund Underperform?—Winning long-term managers trail their benchmark for a decade on average."*** Morningstar examined active funds' returns over the 15-year period from January 1, 2003 through December 31, 2017, a period long enough to measure long-term performance and provide a sizable sample of funds (5,500 funds). The study found for the 3,790 funds (about two-thirds) that beat their benchmarks, ***the average period of underperformance within the 15-year period of outperformance was nine to 11 years!***

The study concluded, "This, then, is the nature of active management. Even in the presence of skill, there can be long periods of underperformance. Standard performance evaluation periods—three, five, even 10 years—are far too short to make well-informed judgements about a manager's skill or lack thereof. Performance is just not a reliable guide to assessing managers unless one extends the time frame to decades. Active investing is a long game."

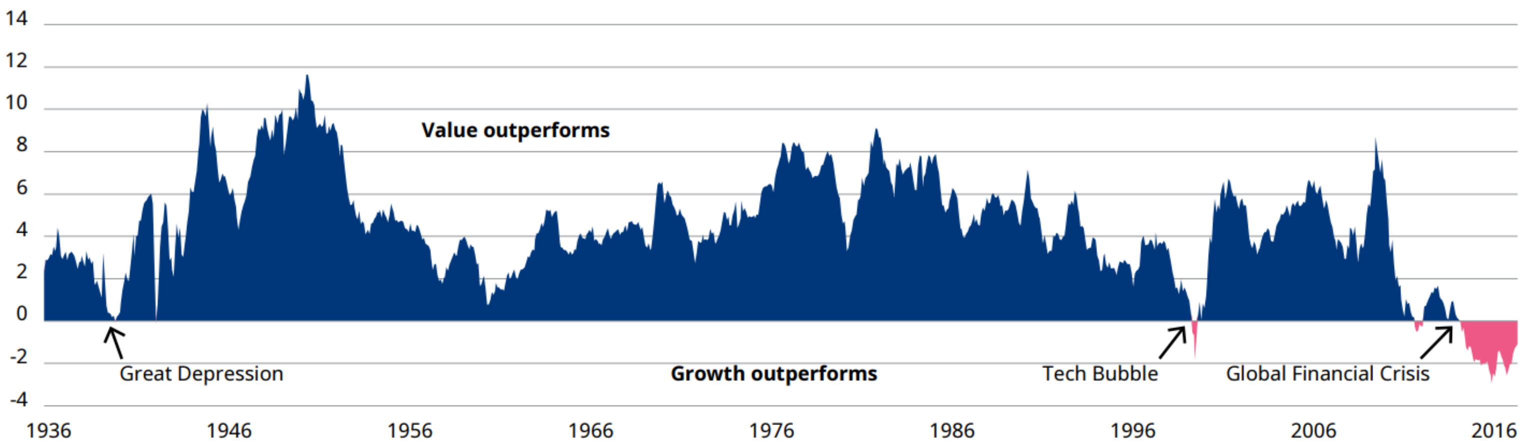
As Warren Buffett said, "Charlie (Munger) and I would much rather earn a lumpy 15 percent over time than a smooth 12 percent." In other words, ***it's not the ride that's important, it's the results.***

We know we sound like a broken record, but believe "Value" is poised for a rebound.

As shown in Figure 1 below from asset manager Schroders' study, "Where's the value in value investing," "value" has historically ***nearly*** always outperformed "growth." Schroders cited the work of leading academics Eugene Fama and Kenneth French, which showed there have been only three significant bear markets for "value" in the past 90 years: the Great Depression of the 1930s, The Technology Bubble of the 1990s and the post-GFC period of the last 10 years. They noted the length and depth of the most recent episode is the most extreme on record and has pushed the valuation gap between "value" and "growth" to its widest level in many years.

Figure 1: Value has nearly always outperformed growth - until recently

Rolling 10-year annualised return of Fama-French Value Factor, %



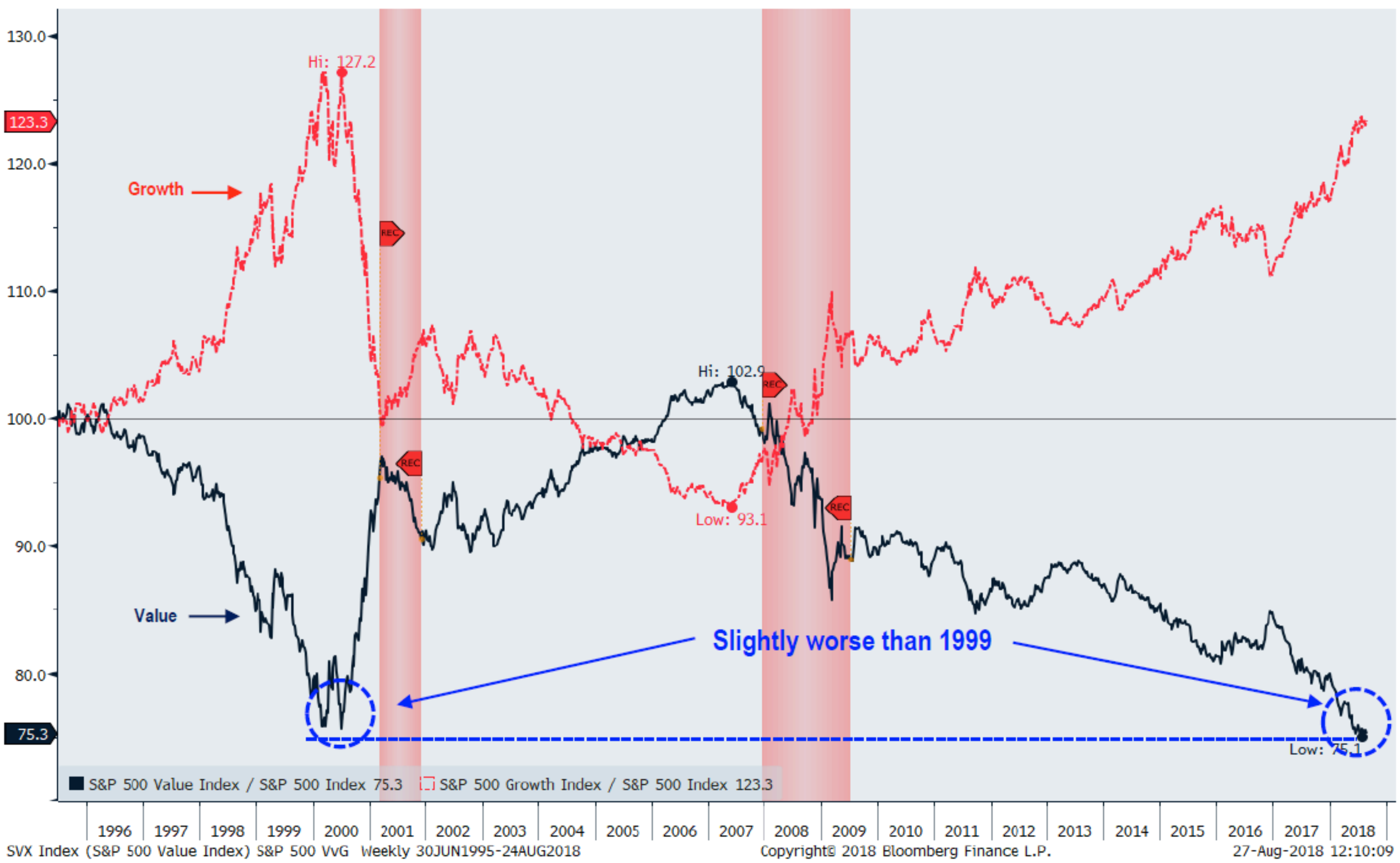
Past performance is not a guide to future performance and may not be repeated.

Based on monthly returns of the US Fama/French HML (High Minus Low) Factor. HML is the return on the "high" portfolio minus the return on the "low" portfolio, where book to market is used as the value metric. Source: Kenneth French's Data Library and Schroders. Data from 31 July 1926 to 29 December 2017.

According to Schroders, "ultimately such divergence cannot last forever, as in the past, differences of this magnitude have correlated with significant value outperformance over the subsequent years."

The graph below from Smead Capital Management depicts the relative performance of "value" and "growth" over the past 25 years. According to Smead, the relative performance differential is even larger than it was at the height of the "Technology Bubble" in 1999 and "buying 'value' stocks is the easiest mean reversion trade since 2000."

Figure: S&P 500 Growth and Value relative price performance (vs S&P 500) past 25 years
Price ratio: Style / S&P 500. Since 1995



Source: Fundstrat, Bloomberg

We believe "value" investing outperforms ***because*** it is hard. You have to have the imagination to see what "the crowd" doesn't see and courage to buy and own what's out of favor and unpopular. It requires patience for the market to recognize value and conviction to be comfortable looking clueless for an extended period of time. It definitely isn't "sexy" or exciting or make for interesting talk at the cocktail party, but we believe over time, "value" wins and hope Schroders and Smead are right!

We believe focusing on Process leads to better long-term Outcomes.

Because investing is a probabilistic endeavor, we believe it's important to focus on ***process, not outcome***. Investors focus on outcome because that's what you can see and spend. It's relatively easy to assess results and difficult to evaluate process. However, over the short-term you can do everything "right" and still get a bad result and vice-versa. While luck determines short-term outcomes, ***skill and process*** determine long-term success.

As Buffett said in Berkshire-Hathaway's 2017 annual report, "Charlie and I view the marketable common stocks that Berkshire owns as interests in ***businesses***, not as ticker symbols to be bought or sold based on their 'chart' patterns, the 'target' prices of analysts or the opinions of media pundits. Instead, we simply believe that if the businesses of the investees are successful (as we believe most will be) our investments will be successful as well. Sometimes the payoffs to us will be modest; occasionally the cash register will ring loudly. ***And sometimes I will make expensive mistakes.*** Overall—and over time—we should get decent results. In America, equity investors have the wind at their back."

We also evaluate stocks as if we're buying the entire business. We look for financially strong companies with good businesses and shareholder-oriented management whose stocks are trading at a significant discount to our determination of "intrinsic value," which is its various possible future values, weighted by the probabilities of those outcomes. For value investors like us, the skill is in accurately assessing the possible outcomes and probabilities and the process is assembling a portfolio of stocks trading at a significant discount to intrinsic value.

Like Buffett, we've made our share of expensive mistakes over the years. There's nothing we can do about them in hindsight, but we've tried to learn from each one. As stated at the beginning of this letter, our fundamental valuation analysis indicates our overall portfolio is trading at its ***largest discount to intrinsic value and has the greatest upside potential in a decade.***

We've had some recent anecdotal evidence of stocks in our portfolio actually trading at significant discounts to intrinsic value. When a company is bought out, it's typically at a premium of 20% or so over where its stock was previously trading. On January 7, **Luxoft Holding** agreed to be acquired by DXC Technology at an 86% premium. Last November 8, **ARRIS International PLC** agreed to be acquired by CommScope at a 27% premium.

Our strategy will continue to be to focus on our process for finding fundamentally strong, undervalued businesses (which we can control) and not worry about short-term outcomes (which we can't control). ***Stock prices are volatile, but intrinsic values are not.*** Using a baseball analogy, we'll try to hit singles and doubles and let the "miracle of compound interest" put runs up on the scoreboard. It's not as exciting as swinging for home runs every time, connecting occasionally and striking out more often, but we believe that's the way you win the game.

Summary

While we're always appreciative and humbled by the trust and confidence you've placed in us by allowing us to manage your precious assets, this is magnified during challenging times like the past several years. We're heavily invested alongside you, so while we understand and share your disappointment, we're actually quite excited about the prospects for our portfolio and business in the years ahead. We thank you!

Regarding volatility, Buffett said "Moreover, the years ahead will occasionally deliver major market declines—even panics—that will affect virtually all stocks. No one can tell you when these traumas will occur—not me, not Charlie, not economists, not the media. During such scary periods, you should never forget two things: First, ***widespread panic is your friend*** as an investor, because it serves up bargain purchases. Second, ***personal fear is your enemy***. That's the time to heed Kipling's If." We've included a copy to the right for you to review the next time the Chicken Littles are screaming about the sky falling.

Regards,

Kirr, Marbach & Company, LLC

Kip Wright, CFA retires after a distinguished career at KM

Kip joined KM in 1996 and wore many hats during his career. Most recently, he was KM's Fixed Income Portfolio Manager and a Senior Client Service Officer, but filled many additional important roles over the years. He retired effective December 31, 2018. We thank Kip for his dedication to KM's business and our clients. We will miss his professionalism and insights. Kip and Liane intend to move back to Iowa sometime during 2019 and we wish them a healthy and happy retirement.

Zach Greiner and Maggie Kamman join KM as Associate Directors of Client Service

When Kip informed us last summer of his intention to retire, we used it as an opportunity to take a fresh look at our client service effort. Because we think of our business as being client-centric and everything we do as ultimately for the benefit of our clients, we decided to try to raise our level of client service. This led us to hiring Zach Greiner (zach@kirrmar.com) and Maggie Kamman (maggie@kirrmar.com), who joined our business as Associate Directors of Client Service last October and November, respectively.

We are confident our now 3-person Client Service Team led by Director of Client Service Matt Kirr (matt@kirrmar.com) will raise client service to the highest level in our more than 43 years in business. Matt, Zach and Maggie will be looking for ways to improve how we interact with clients, so stay tuned.

To that end, it would be helpful if you would ***share your email address*** with us (if you haven't already). We intend to be respectful of your Inbox and time, but occasionally we'll want to distribute time-sensitive information (such as the update we sent Christmas Eve) and email is quicker than the USPS.

Zach earned a B.S. in Business Finance from Indiana University in 2010. He was a Financial Advisor with Raymond James and a Commercial Banker and Credit Analyst with MainSource Bank. He is a graduate of Leadership Bartholomew County and has been active with Sans Souci, Turning Point Domestic Violence Services, Columbus Young Professionals and United Way. Zach and his wife Caitie have two children.

Maggie earned a B.S. in Applied Statistics and Applied Mathematics/Business Mathematics from Purdue University in 2013. She was an Extended Coverage Costing Manager with Cummins Engine Business and Product Coverage Analyst with Cummins Emissions Solutions. Maggie has been active with Heritage Fund—the Community Foundation of Bartholomew County and First Presbyterian Preschool. Maggie and her husband Kyle have two Golden Retrievers.

If—
BY RUDYARD KIPLING

If you can keep your head when all about you
  Are losing theirs and blaming it on you,
If you can trust yourself when all men doubt you,
  But make allowance for their doubting too;
If you can wait and not be tired by waiting,
  Or being lied about, don't deal in lies,
Or being hated, don't give way to hating,
  And yet don't look too good, nor talk too wise:

If you can dream—and not make dreams your master;
  If you can think—and not make thoughts your aim;
If you can meet with Triumph and Disaster
  And treat those two impostors just the same;
If you can bear to hear the truth you've spoken
  Twisted by knaves to make a trap for fools,
Or watch the things you gave your life to, broken,
  And stoop and build 'em up with worn-out tools:

If you can make one heap of all your winnings
  And risk it on one turn of pitch-and-toss,
And lose, and start again at your beginnings
  And never breathe a word about your loss;
If you can force your heart and nerve and sinew
  To serve your turn long after they are gone,
And so hold on when there is nothing in you
  Except the Will which says to them: 'Hold on!'

If you can talk with crowds and keep your virtue,
  Or walk with Kings—nor lose the common touch,
If neither foes nor loving friends can hurt you,
  If all men count with you, but none too much;
If you can fill the unforgiving minute
  With sixty seconds' worth of distance run,
Yours is the Earth and everything that's in it,
  And—which is more—
  you'll be a Man, my son!

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Past performance is not a guarantee of future results.

The S&P 500 Index is an unmanaged, capitalization-weighted index generally representative of the U.S. market for large capitalization stocks. This index cannot be invested in directly.

The Dow Jones Industrial Average ("DJIA") is an unmanaged index comprised of common stocks of thirty major industrial companies. This index cannot be invested in directly.