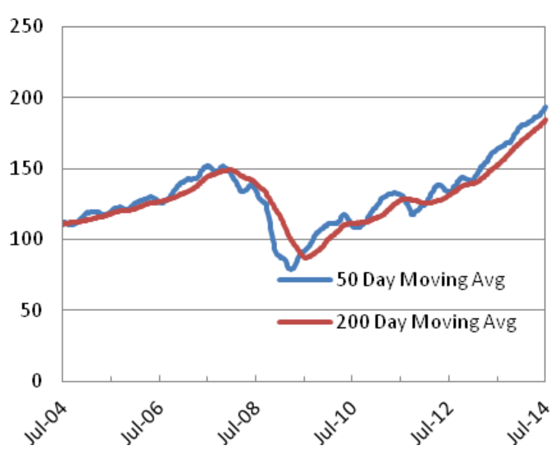
7/9/14

Dear Clients & Friends,

Financial markets continued their advance in the second quarter. The S&P 500, Dow Jones Industrial Average, and the Russell 2000 indices advanced 7.1%, 2.7%, and 3.2% respectively through June 30th, 2014 with similar gains in global equities and fixed income. The reasons for such gains have been attributed to improving employment, tame inflation, and low interest rates. As I'll explain, our outlook for the S&P 500 and Russell 2000 going forward is mixed, but we feel very optimistic about our individual investments which will be the focus of this letter.

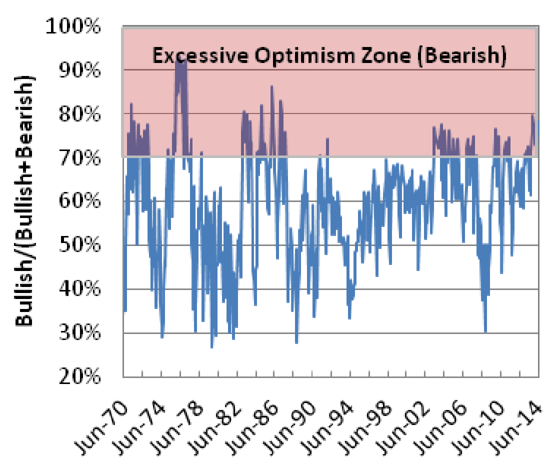
What's our broad market outlook for the rest of the year? Our most reliable macro indicators that we use to forecast future market direction are sending mixed signals. The current market is very favorable from a momentum & monetary (low interest rates) standpoint, but negative from a valuation & investor sentiment standpoint. See Charts A & B below:

Chart A: S&P 500 Index Trend is Good



S&P 500 Index Performance When Analysis Dates *Nov* 1929 thru July 15th, 2014	
50-Day Moving Average Is:	% Gain/Annum
Above 200-Day Moving Average	9.10%
Below 200 Day Moving Average	-1.10%

Chart B: Too Much Investor Optimism



Dow Jones Index Performance When Analysis *Nov* 1970 thru July 15th, 2014	
Bulls/(Bulls+Bears)	% Gain/Annum
Above 69%	0.8%
Between 53 and 69%	7.6%
53% and Below	12.0%

The result is that investors who rely on "technical analysis" have never seen a better market. Conversely, value investors who look to valuation and investor sentiment are forecasting disappointing future returns stemming from above-average P/E ratios, high corporate insider selling, and too much optimism from institutional investors. Historically, when the market experienced such levels of positive momentum combined with excessive optimism, the S&P 500 has gained approximately 5% per year versus the average of 10%. In short, we expect modest returns for the broad market going forward until sentiment normalizes. The good news is that some of our best periods have occurred when we find great individual investments in the face of difficult market conditions.

Continued on Back -- >

We continue to find new investments that we are excited about and are optimistic about our client's portfolios. This may come as a surprising statement given that the S&P 500 and Russell 2000 indices have climbed to record levels, but the rising market has given us a great opportunity to sell companies that have reached our price targets and make new investments that fit our criteria. For instance, we recently sold our positions in Alaska Airlines (ALK) and Atlas Financial (AFH). When we met with management of Alaska Airlines (ALK) in January 2013, we were extremely impressed and thought we would own the stock for many years; however, it more than doubled in an year, so we ended up exiting the position due to valuation and the possibility of a price war breaking out in the Seattle market between Alaska and Delta. Similarly, we exited our position in Atlas Financial (AFH). After a larger insurance conglomerate experienced troubles, their profitable taxicab insurance company was spun out as Atlas Financial. With a strong niche business, great management, and trading at just below book value, it was exactly the kind of company we look for. They executed brilliantly and we exited our position after the stock increased to fair value around 1.9x tangible book value. Should either of these stocks decline substantially in price, we would certainly consider buying them back again.

In the next section, I'll outline a couple of our investments including Micron, one of our largest holdings that we think should rise further. These examples should give a flavor for what we are looking for and why we remain optimistic. We are confident that a portfolio of such securities gives us the best probability of achieving superior risk-adjusted returns going forward.

If you have any questions or ideas for future letters, please contact me at tom@eidelmanvirant.com.

Sincerely,

Tom Eidelman, CFA
Vice President

Holdings Update:

Micron (Ticker: MU) – Price $32.95

Micron is the second largest manufacturer of memory (DRAM), the short-term memory for electronics such as computers, cars, and mobile phones. Similar to the airline industry, DRAM has been fraught for decades with oversupply and volatile demand resulting in disappointing financial results. It is our belief that the industry supply/demand dynamics have now changed and investors do not yet fully appreciate the quality and earnings power of Micron's assets. The competitive landscape has shifted from many DRAM suppliers down to just three including Samsung, Micron, and Hynix after Micron acquired Japanese competitor Elpida last year. Conversely, demand for DRAM continues to grow 30% per year as Samsung, Apple, and others try to outdo each other with their latest smartphone capability. The result is our belief that Micron will continue to experience margin expansion and could earn over $4 per share in earnings. We expect earnings to grow into the foreseeable future versus the consensus opinion that Micron is benefiting from a temporary supply/demand imbalance. Micron is also taking shareholder friendly actions by buying back in-the-money convertible bonds, which is essentially the same as buying back stock. Such action indicates management confidence in the stock and cleans up the balance sheet structure. Industry skepticism can be seen by Micron's current low P/E ratio of just 10x earnings compared to the electronic technology industry average of 18x. We think shares could be worth in excess of $50/share as investors recognize the sustainability of their profitability and reward Micron with a valuation ratio closer the industry average.

Telephone & Data Systems (Ticker: TDS) – Price $26.11

Telephone & Data Systems operates the fifth largest domestic wireless carrier (U.S. Cellular) with 4.7 million subscribers in 23 states and a smaller cable and broadband offering with another 1.1 million subscribers. We believe TDS has an undervalued portfolio of assets that could soon be realized by the market. The company is in the process of selling non-core wireless spectrum and cell towers in Chicago and St. Louis where they are unable to compete with larger players such as Verizon and AT&T to focus on their core rural areas where they have the highest quality networks, less competition, and better economics. Total proceeds from these divestitures are expected to be used to strengthen their balance sheet and fund their $250 million stock buyback program. After experiencing subscriber losses due to a frustrating billing issue, the company expects a resumption of growth by the end of 2014. Lastly, while the company has reportedly rebuffed offers from potential acquirers for over a decade due to reluctance from the founder, LeRoy T. Carlson, we believe newly elected board members and potential estate planning decisions of the 98 year-old patriarch creates a reasonable probability of being acquired. Based on price paid per subscriber in recent wireless acquisitions such as the T-Mobile/Metro PCS deal, the wireless business alone could be worth over $40 per share versus the current stock price of $25.