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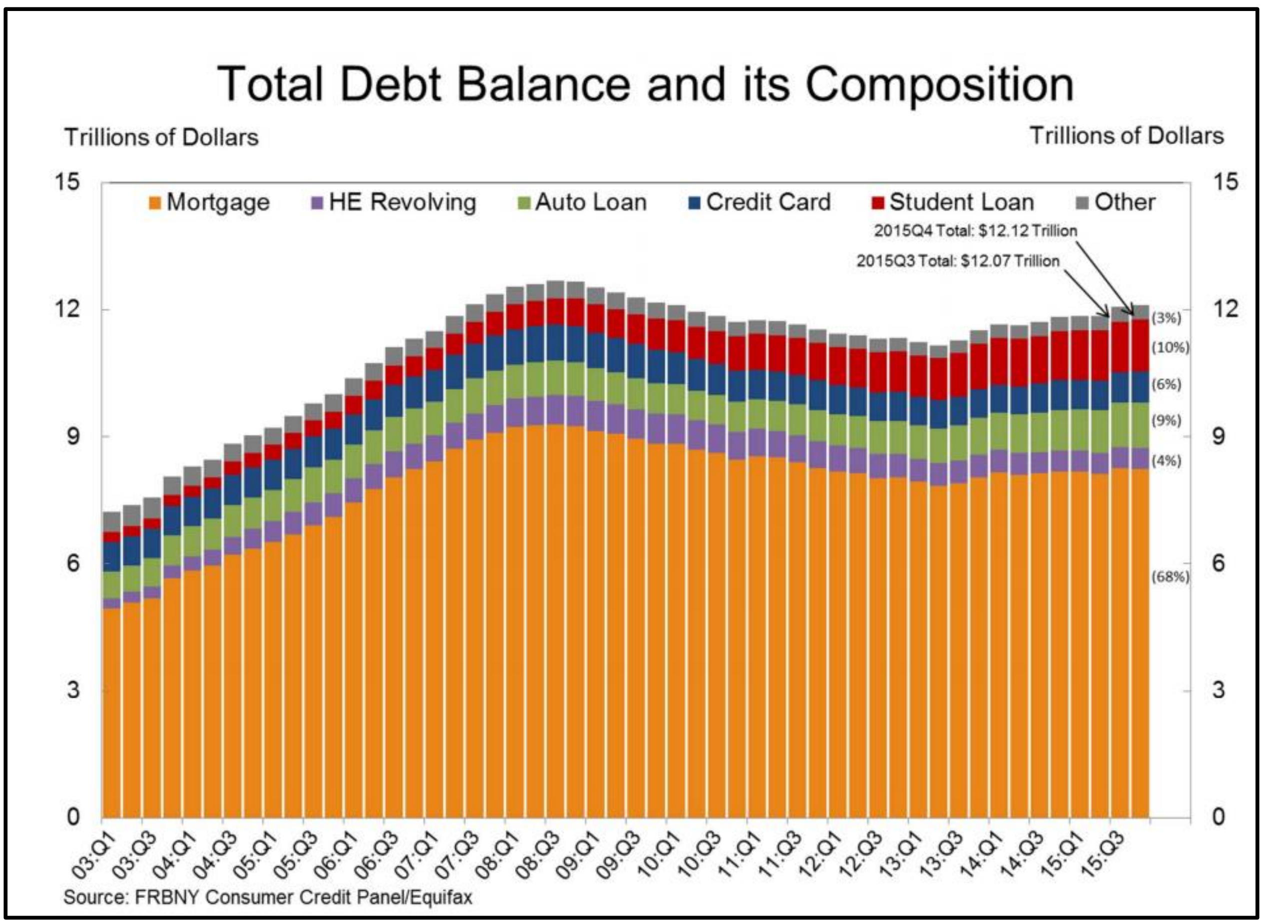
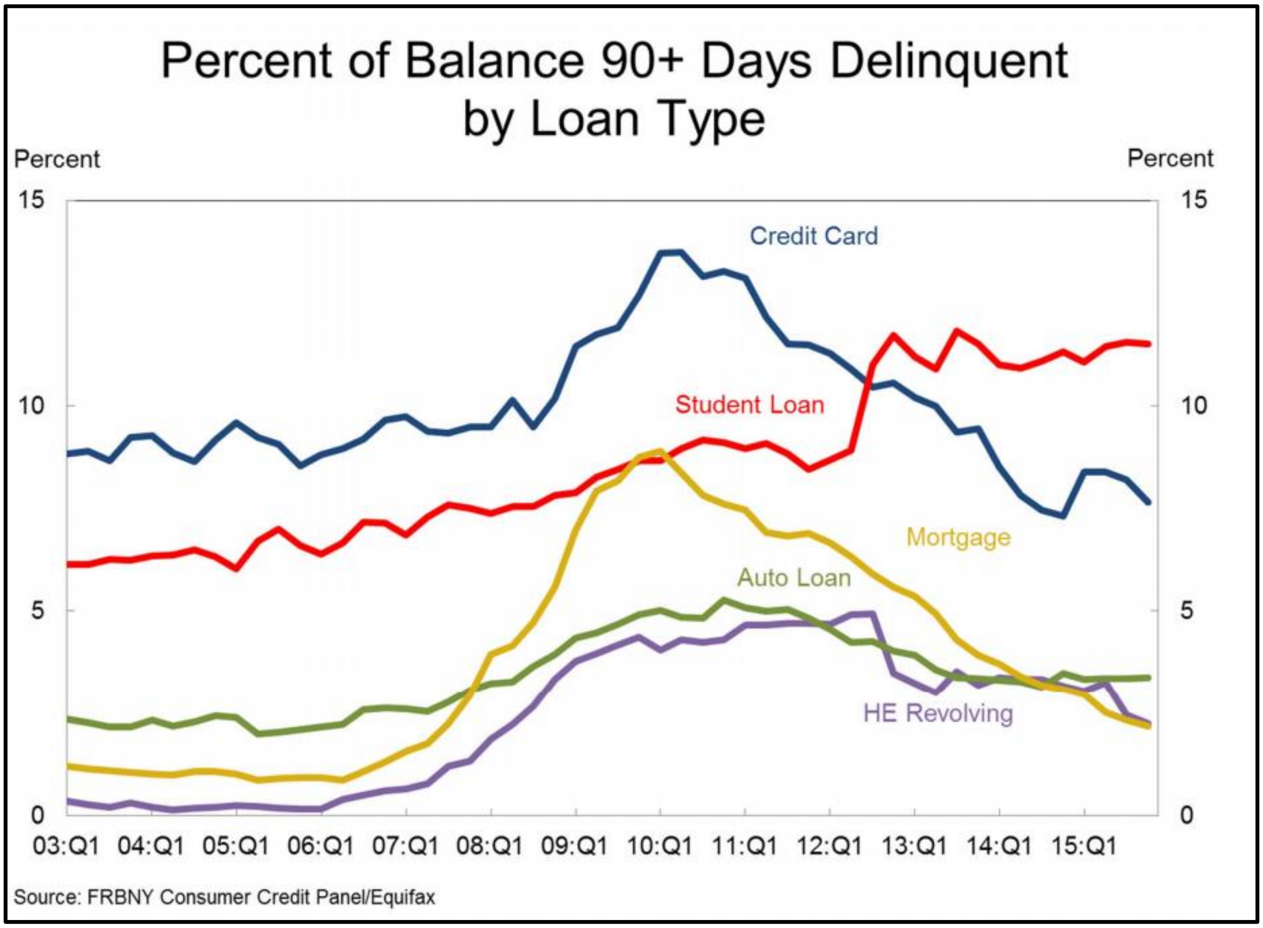
Every few days you will find a front page article on how subprime auto loans are a huge bubble in search of a pin and upon bursting will drag the US economy into a 2008 style deflationary collapse. We wanted to take a look for ourselves as we began to evaluate potential investments related to the auto finance (dealerships: GPI/PAG/SAH) and auto lending space (lender: CACC).

Analyzing the first hand data and putting it into the proper scale and perspective paints a different and less gloomy picture than the mainstream media headlines. Most investors are not capable of interpreting data (macro or micro) correctly as it pertains to capital markets pricing and the subprime auto loan worries are another case in point of this.

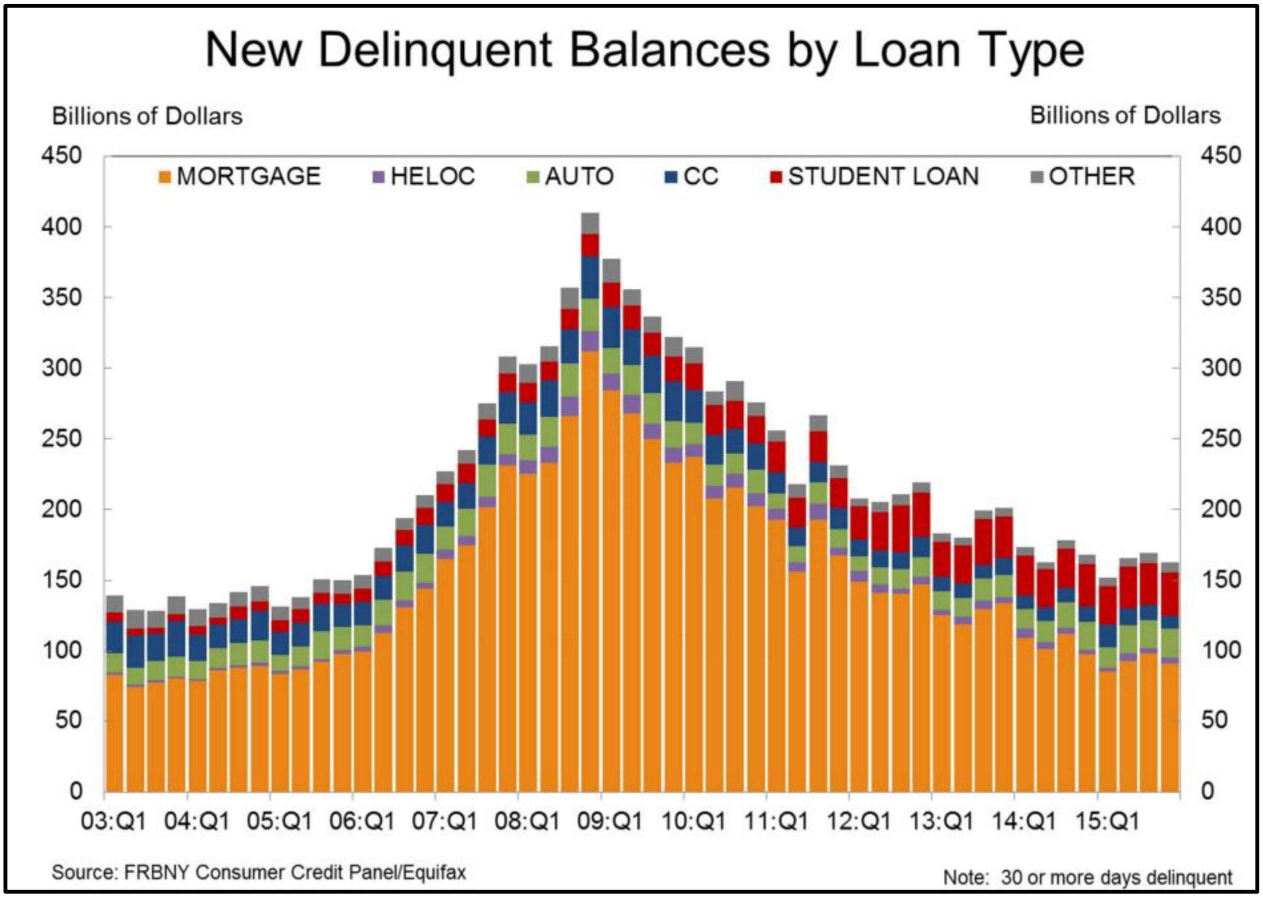
- Household auto loan balances have topped $1 trillion for the first time in history, making for a wave of sensational headlines that arbitrarily anchor to a nice round number. This $1 trillion balance is ~20% above the previous 2008 peak.
- At the end of 2015, US banks held a total of $12.1 trillion in consumer loans so auto loans are ~8.3% of total consumer loans.



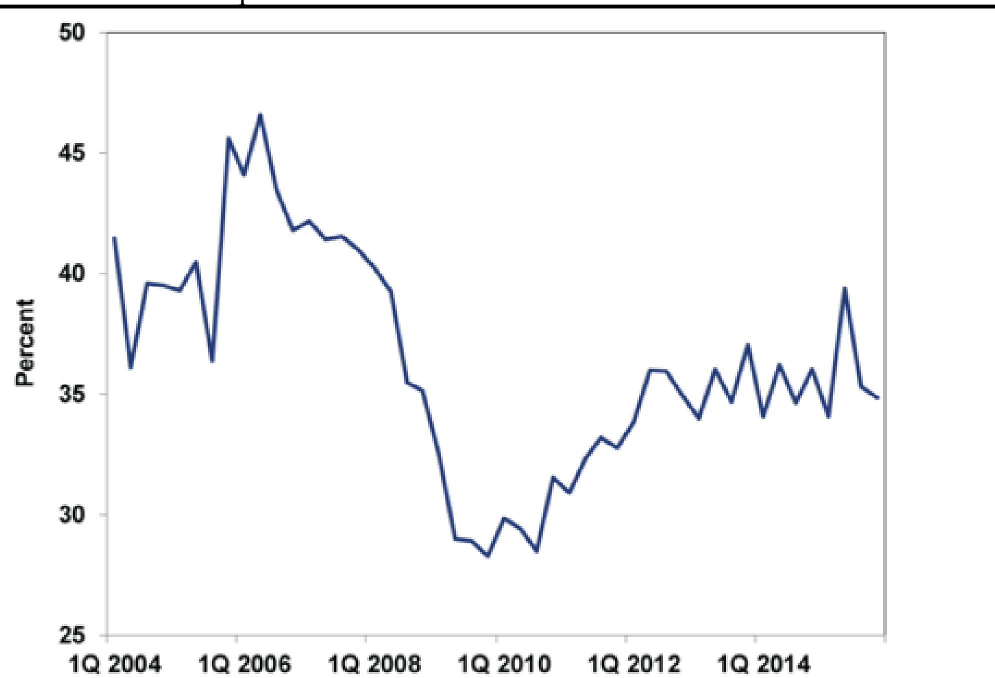
- US Auto loan delinquencies are at their highest level since 1996 at >5% in February. The economy and market did quite well in 1996 and for the next several years thereafter. This higher loan delinquency number by itself does not foretell doom or a peak in stocks.
- More severe delinquencies, as measured by 90+ days delinquencies, are lower for all auto loans at the end of 2015 than they were from 2009-2014.



- The dollar amount of auto loans that are delinquent still pale in comparison to mortgage debt delinquencies and even student loan delinquencies:

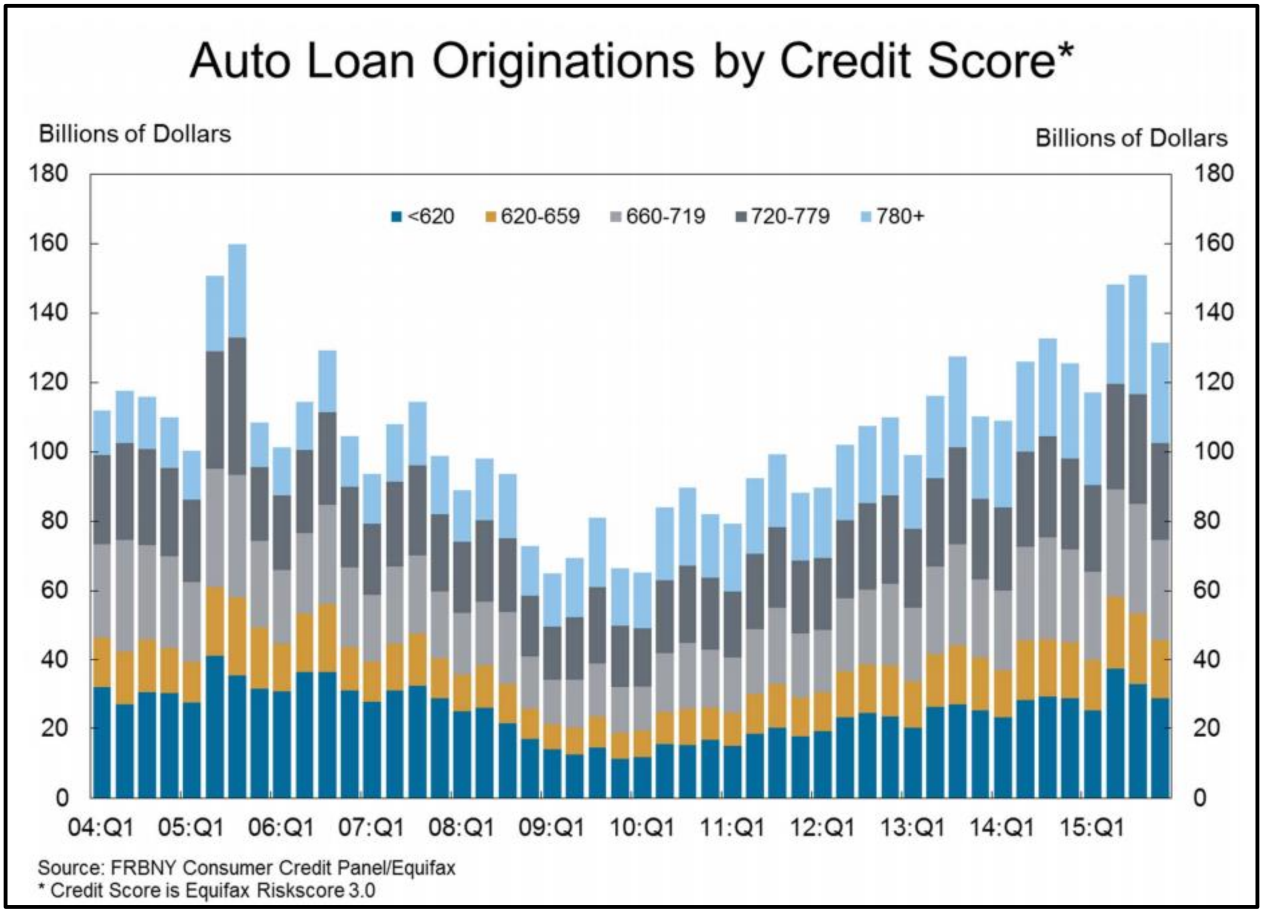


- The percentage of total auto loan originations that are to sub-prime consumers remains well below that of the entire 2004-2008 time period:



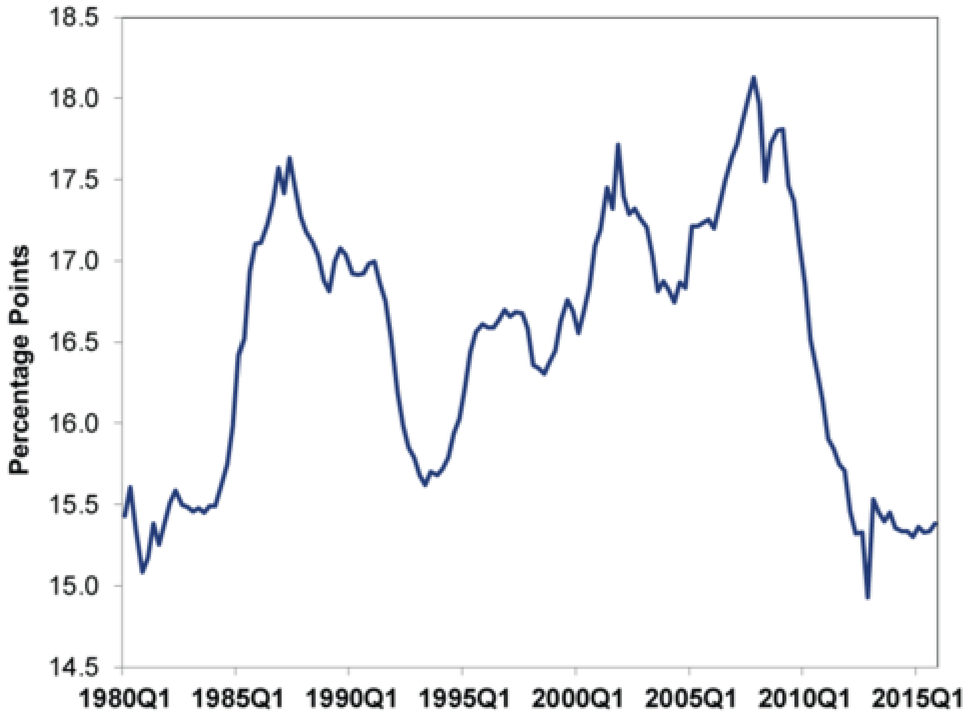
Source: Federal Reserve Bank of New York Consumer Credit Panel/Equifax. Subprime auto loans as a percentage of all auto loan originations, Q1 2004 – Q4 2015. Auto Loan Originations by Credit Score, Q1 2004 – Q4 2015. *Credit Score is Equifax Riskscore 3.0.

Auto loan origination broken down by FICO score further puts into perspective the fact that sub-prime lending as a percentage of total auto loans remains well within, or even below, historical levels:



- This particular segment of the US banking market is simply too small to cause systemic banking collapse or major economic slowdown all by itself.
- Of the $1 trillion in auto debt, ~20% is to sub-prime customers, or ~$200 billion. This $200b could go to zero (100% loss) and the US economy would be okay.
- Auto loan default resolution is much quicker than mortgage defaults, as lenders can simply go and repossess the car. Home foreclosures have a longer drawn out legal process and can linger on bank balance sheets, sometimes for years.
- Bankers in 2005-2007 made risky sub-prime mortgage loans under the assumption that house prices would continue to soar. The same banker mindset is unlikely for autos, as it is well known they depreciate as soon as you drive them off the e dealer lot. Additionally, home equity lines of credit were an issue in the housing finance bubble and are a non-issue for autos.
- Lastly, there is no sign that US consumers are either stretched too thin or struggling. Consumer financial obligations as a percentage of disposable income are as low as they have been since 1980.

Consumer Financial Obligations as a % of Disposable Income:



Source: Federal Reserve Bank of Saint Louis, as of 3/21/2016. Consumer financial obligations as a percentage of disposable income, Q1 1980 – Q4 2015.

We want to maintain maximum exposure to consumer spending within the portfolio, and avoid the more cyclical business investment/capital expenditure exposed companies and industries.

To continued Alpha,

Travis

Performance Metrics (October 2011 - April 2016)	Russell 2000	Russell 2000 Value	iShares MicroCap	Credit Suisse HF L/S Index	Credit Suisse AllHedge Index	Voss
Annualized Alpha	-0.01	-0.01	-0.01	0.05	0.02	**0.13**
Beta	1.16	1.09	1.13	-0.12	-0.07	**0.44**
Beta +	1.19	1.10	1.14	-0.30	-0.19	**0.45**
Beta -	1.17	1.00	1.15	0.08	0.09	**-0.12**
R-squared	0.75	0.73	0.63	0.04	0.04	**0.16**
Correlation to S&P 500	0.86	0.85	0.79	-0.20	-0.20	**0.40**
Active Premium	0.00	0.00	0.00	-0.10	-0.12	**0.05**
Information Ratio	0.03	-0.06	0.03	-0.67	-0.95	**0.41**
Annualized Sharpe Ratio	0.72	0.71	0.68	0.19	-0.27	**1.27**

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