BANYAN CAPITAL MANAGEMENT

April 27, 2015

Dear Client:

Banyan's equity composite was up 1.99% in the first quarter 2015, outpacing the S&P 500 return of 0.96%. Returns for your individual account will differ from the composite due to variations in account holdings and other client-specific circumstances. (Explanation of how composite is compiled) Remember your performance will inevitably deviate from the broad market indices, especially over shorter time periods. Banyan manages your portfolio for long-term results, so we encourage you to evaluate performance over a multi-year time frame as shown on your performance summary report.

A brief discussion of risk

When it comes to investing, risk is a topic that is often misunderstood. In this letter, we are going to address some of the more difficult issues surrounding risk.

Risk is the likelihood of permanent loss of capital. Many investors confuse risk with volatility. In fact, most in the academic realm think the two words are synonymous. Risk and price volatility are not the same thing. Fluctuations in stock prices do not in and of themselves make stock ownership riskier. A common mistake is to place too much emphasis on changes in stock prices, especially short-term fluctuations, as an indicator of risk.

It is impossible to have a meaningful discussion about risk without also attaching a time frame. While the price of a particular security may be more volatile than another, this alone does not make it riskier. For example, if you invest in the common stock of Berkshire Hathaway knowing you must turn the investment into cash the following month, you would be taking substantial risk due to the short horizon. It is the time frame that makes this a risky proposition not the security itself or the asset class. On the other hand, if you own

Berkshire Hathaway with the idea of holding it for 10 years, it is virtually impossible to lose capital over the entire period. The value of the underlying enterprise is likely to grow **much** larger 10 years hence. Even if the price is aligned with fair value at the time of your investment and the underlying value of the enterprise doubles over 10 years, the price would surely escalate some. To properly assess risk, you must define a time frame.

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People almost always discuss risk in a generic sense. Actually, there are lots of very specific risks that can be identified, hedged, minimized or even eliminated. There is market risk, economic cycle, headline risk, interest rate risk, currency risk, management risk, governmental risk, balance sheet risk, specific business risk, environmental risk, weather related risk, litigation risk, purchasing power, technological risk and the risk of human misjudgment. Let's look at a few in more detail.

Purchasing power risk is the hazard many individuals completely overlook. Imagine those who are so fearful that they put money exclusively in short-term savings vehicles. In doing so, they think they are not taking on any risk. While clearly, they are not taking principle risk, they are, however, running the risk their purchasing power will erode. Imagine 20 years ago someone set aside $12,000 to buy a new car and during the entire 20-year period short-term interest rates remained at today's depressed levels. The original $12,000 is still there, but it will not buy a new car at today's prices. Warren Buffett makes this point most clearly in the 2014 Berkshire annual report to shareholders. I paraphrase from his letter:

> ...it now takes $1 to buy what could be bought for 13¢ in 1965 ... over that same period the S&P 500 is up 11,196% including reinvested dividends. There is an important message for investors in that disparate performance between stocks and dollars. The unconventional, but inescapable, conclusion to be drawn from the past fifty years is that it has been far safer to invest a diversified portfolio of common stocks than to put money in savings vehicles. ... This was also true in the preceding half-century. To one degree or another, this is almost certain to be repeated during the next century. Stock prices will always be far more volatile than cash equivalent holdings. Over the long term, however, it is the savings vehicles that are far riskier.

Properly assessing specific business risk is integral to our investment process. We spend most of our time searching for outstanding businesses run by shareholder friendly managers. This leads us to key questions. Can we invest capital in companies that have bullet proof business plans which virtually guarantee the size of the business will become larger? Is the stock price low enough that we can be relatively sure the gap between price and value will close given enough time? Our own thinking on this subject has evolved a bit. We prefer to purchase and hold a truly outstanding company at a fair price rather than a more marginal business at a low price. The enclosed report on one of our holdings, DaVita HealthCare Partners, is a good example of such an investment.

Finally, human misjudgment is easily the biggest risk of all. Will the investor incorrectly assess one or more of the risks? Will the investor become emotional and less rational at a critical moment? Will the investor simply lose patience or become too focused on short-term results? Most of the permanent loss in capital is wholly or partially a result of human misjudgment. Investors should take the time to assess each investment mistake to determine whether or not a risk could have or should have been foreseen. This exercise will minimize or eliminate a similar future loss. Often when a loss occurs, there is nothing aside from clairvoyance that would have prevented it. There is an element of randomness in investing. Sometimes randomness works in our favor and sometimes it works against us.

We wish to thank you again for trusting our judgment in assessing risk, however imperfect it may sometimes be. We are in search of those rare investments with minimal risk and generous upside potential. A portfolio of such investments is a solid platform toward our quest of building permanent wealth on your behalf.

Best,

Gary L. Watkins
President