BANYAN CAPITAL MANAGEMENT

May 4, 2018

Banyan's equity composite was down 0.88% in the first quarter 2018, while the S&P 500 was down 0.76%. 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 attached performance summary report.

With that in mind, we are pleased to reflect on our performance over a more extended period. For the past 27¼ years ending with the first quarter of 2018, Banyan's equity composite has compounded at 11.4% per year before management fees versus 10.2% for the S&P. In order to have any chance at market beating performance, there are a number of things to get right. Let's take a closer look at two of the more important characteristics.

**RATIONAL AND OPTIMISTIC**

All successful investors in the stock market are "rational and optimistic" - this according to Meryl B. Witmer, a successful investor herself, and member of the Board of Directors of Berkshire Hathaway. Undoubtedly, her responsibility to Berkshire shareholders post Buffett and Munger is to oversee those who manage securities portfolios for the company. Her description of successful investors is simple yet powerful. Let's have a closer look at what she means, starting with optimistic.

We have all known people who are sure the economy is on the brink of collapse, that the overwhelming majority of businessmen are crooks, or worse, and that the United States as a society is in inexorable decline. We can find no examples of people who see the world this way who become successful investors in the securities markets. How could one possibly be a success when every bump in the road, either real or imagined, is seen as confirmation of this pessimistic world view and reason to not remain invested for the long-term. In short, pessimists never stick with their investments long enough to be successful.

Of course, this is not to say the world does not have some problems. There certainly are problems - there always have been and there always will be. At the same time, humankind is better off now than ever before in almost every measurable way. Steven Pinker's newest book, Enlightenment Now, provides an exhaustive list of examples each supported by data. We see no reason why this trend should reverse itself. For hundreds if not thousands of years in fits and starts the world has been getting safer, more efficient, better connected, healthier and wealthier. It has and will continue to be profitable to be on the right side of this powerful trend.

With regards to being rational, successful investors are fact-based in making their decisions. They seek knowledge that is beyond the obvious, are willing to change their minds whenever appropriate and are willing to set aside their own bias more readily than most. They are less prone to anger, sadness or euphoria – they are rational not emotional.

With these traits in mind, please take a few minutes to study the attached chart showing historic S&P 500 returns beginning in 1872 through November, 2017. In particular, notice the period since the end of World War II, the more modern period of our economic history.

Observe from this chart that bull markets dwarf bear markets. Also note, not only are bull market upswings greater in percentage terms, but also in duration. If you invest in stocks to build wealth, the lesson from this data is obvious. You should get in the game and stay with it through thick and thin. If you are able to do just that, the odds are heavily stacked in your favor. However, even if an investor accepts the correctness of this concept intellectually, it is often difficult to actually implement. There are universal truths about the human condition that make this simple concept difficult to execute. Let's explore two such phenomenon.

First, we humans have an overwhelming tendency toward loss avoidance. Losing is **very** painful. According to research, a loss is two and one-half times more painful than the pleasure derived from an equal amount of gain. In other words, if a particular dollar amount of gain produces x amount of pleasure, the same dollar amount of loss produces on average 2½ x amount of pain. For some, the level of pain is five times the pleasure derived from an equivalent gain! For the careful long-term investor, losses are only temporary. If you have been an investor for some period, it is likely you are only temporarily giving back some portion of a prior gain. The rational investor knows that in a well-constructed investment plan, occasional setbacks are inevitable and ephemeral. Furthermore, those losses are not as bad as they feel.

Another reason humans are at times less than rational is a peculiarity known as the "availability heuristic". This powerful motivator was popularized by professors Daniel Kahneman and Amos Tversky who won the Nobel Prize for their work in behavioral economics. We cannot recommend their book, Thinking, Fast and Slow, more highly. Their work teaches us the tendency we all have to give information that is readily available much greater weight than that which may be equally true but less readily available. For example, it is hard to remember the correctness of being rational and optimistic when your portfolio is down 25%. Precisely when your portfolio is at this low ebb, the television is blaring ad nauseum about how awful everything seems, and everyone around you looks frightened. At times like this, information that is more readily available will likely be given much more weight than is deserved. This is the most important time to turn the television off and be reflective rather than reactive. After all, being reflective is a hallmark toward becoming wise.

Thank you again for your trust in Banyan Capital Management as we continue our quest to **build permanent wealth** for you and your family. Toward that end, we are and will remain optimistic about the future and endeavor to become increasingly rational.

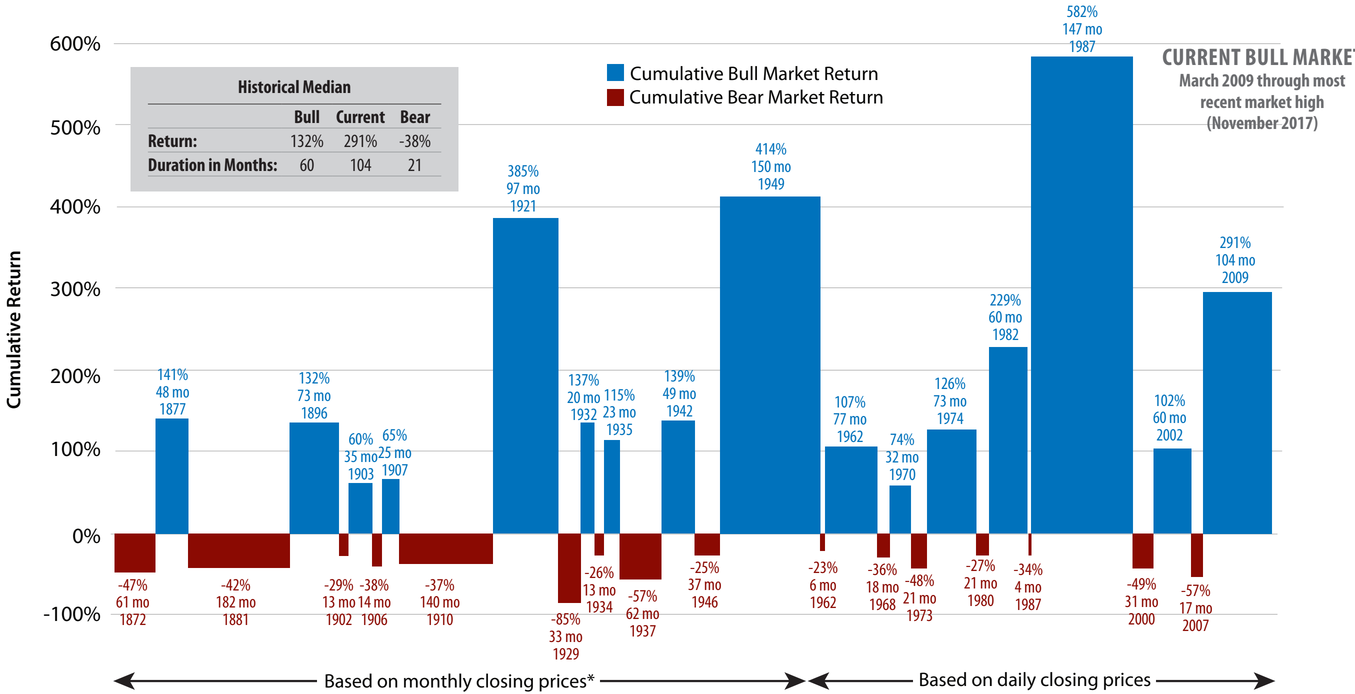
Sincerely,

Gary L. Watkins
President

Drew D. Estes
Portfolio Manager

# Bull and Bear Markets Since 1872

S&P 500® Index returns: January 1872 through November 2017




*Prior to 1962, S&P data was based on Robert Shiller's research.
Sources: Bloomberg, Robert Shiller – Yale University

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