CAPITAL MANAGEMENT

PERFORMANCE REPORT 2017

Dear Investors,

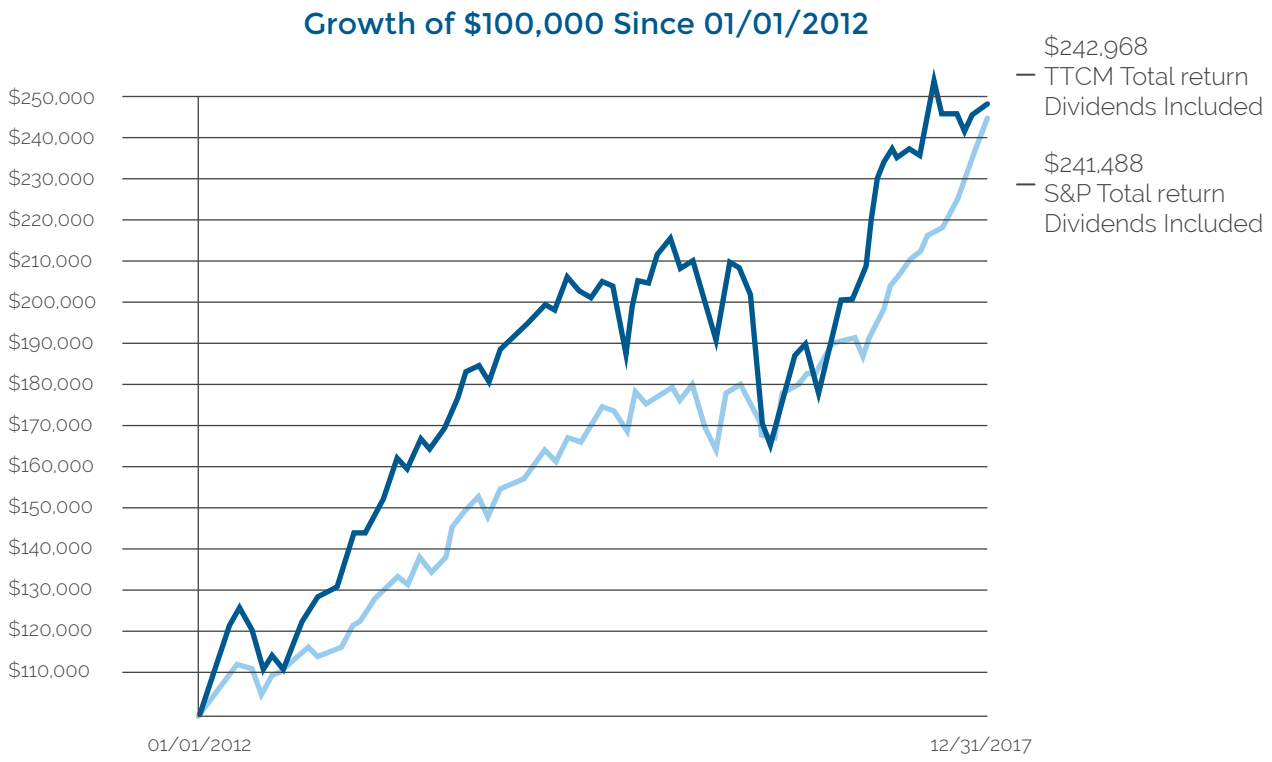
2017 was a mixed year for T&T Capital Management and most value investors in general. With the stock market already at very high valuations going into the year, we maintained some hedges that hurt our performance relative to the S&P 500 as a whole, but we still achieved reasonable absolute returns.

T&T Capital Management achieved an 8.69% return, which was decent on an absolute basis, but markedly trailed the S&P 500, which returned 21.84%. More important than any short-term result, I'm happy to say that over the last five years, T&T Capital Management has compounded money at a rate of 15.95% per annum, versus the S&P 500's total return of 15.83%.

Since January 1st, 2012, we have now returned 142.97%, versus the S&P 500's total return of 141.49%. We at TTCM feel that the overall stock market is trading at worrisome levels with respect to underlying earnings, assuming we see any significant increase in interest rates. To combat this concern, we are focused only on buying securities that meet our strict requirements of offering a large margin of safety to intrinsic value, and the ability to grow that intrinsic value over the next 3-5 years. We also use various strategies such as covered calls and cash-secured puts that help protect us from potential declines, but do sometimes reduce our upside potential relative to being 100% long stocks like the S&P 500. Predicting when stocks will severely correct is impossible to do, but our focus remains on maximizing risk-adjusted returns and we believe that we are well prepared for the current investment environment.

Sincerely,

Tim Travis
CEO/CIO



The chart above covers the performance history of T&T Capital Management (01/01/2012-12/31/2017). The performance numbers are comprised of all accounts held at TD Ameritrade, our primary custodian, which were funded and managed by T&T Capital Management beginning January 1st, 2012. No accounts funded after January 1st, 2012 are included in the above calculations. The performance calculation is cumulative of all clients funded prior to January 1st, 2012; individual account performance may be materially lower or higher than the overall performance. Clients' accounts funded after January 1st, 2012 may have performance materially lower or higher than the cumulative results. Performance information quoted above represents past performance and does not guarantee future results. The investment return and principal value of an account invested by T&T Capital Management will fluctuate so that when redeemed, the account may be worth more or less than their original cost. Current performance may be lower or higher than the performance information quoted above. Performance figures assume reinvestment of dividends and capital gains. Any questions you may have, including most recent month end performance, can be answered by calling Account Services at 949-734-4290. The S&P 500 Index is a broad-based measurement of changes in the stock market, is used for comparative purposes only, and is not meant to be indicative of T&T Capital Management's performance, asset composition or volatility. Given the wide scope of securities held by the S&P 500, it should be inherently less volatile. Our results may differ markedly from those of the S&P 500 in either up or down market trends. The performance of the S&P 500 is shown with all dividends reinvested into the index and does not reflect any reduction in performance for the effects of transaction costs or management fees. Investors cannot invest directly in an index. All T&T Capital Management fees are included in these calculations; calculations are net of all fees. The investments made in the account performance shown were comprised of equity stocks, equity options and bonds with a view towards capital appreciation.

Investing in the financial markets involves risks. Past performance is not indicative of future results. Options are not suitable for all investors.

While we are likely towards the tail-end of a historically long bull market that stemmed from the ashes of the Great Recession in 2009, we are strong believers that we should be able to continue to outperform over the long-term, while generating strong absolute returns. With that said it is important not to put undue importance over any one quarter or one year, but instead we must understand that with our strategy we are investing over market cycles, so it can take a few years for the whole investment thesis to play out.

Deep Value Investing Philosophy

As you are aware, at TTCM, we are deep value investors. This means that we only buy securities that are trading at very large discounts to our estimates of intrinsic value. When we find opportunities where despite rigorous analysis of worst-case scenarios, we cannot fathom losing money and instead we see a high likelihood of large profits, we invest big.

This means that we take concentrated positions with the most money going to our best ideas, as opposed to the way many mutual and exchange traded funds work where they have hundreds of tiny positions.

We will never be advocates of putting the same amount of money into our 50th best idea as our best idea, or blindly following an index even when it seems clear that the index is jumping off the bridge, as we feel given current market conditions.

- How does one really know what they are buying when buying an index fund such as the S&P 500?
- Have they done research on all of those companies?
- Do valuations just not matter?

It is my opinion that we are in a passive investing bubble, as many market pundits would say that none of these issues should dissuade an investor from investing in an index or index-like investments. Similar arguments were made in the late 1990's when stocks were exploding higher towards increasingly stratospheric levels, but for the investor that bought the S&P in 2000 and had to wait about 13 years to get back to even, the allure of indexing might not be so great.

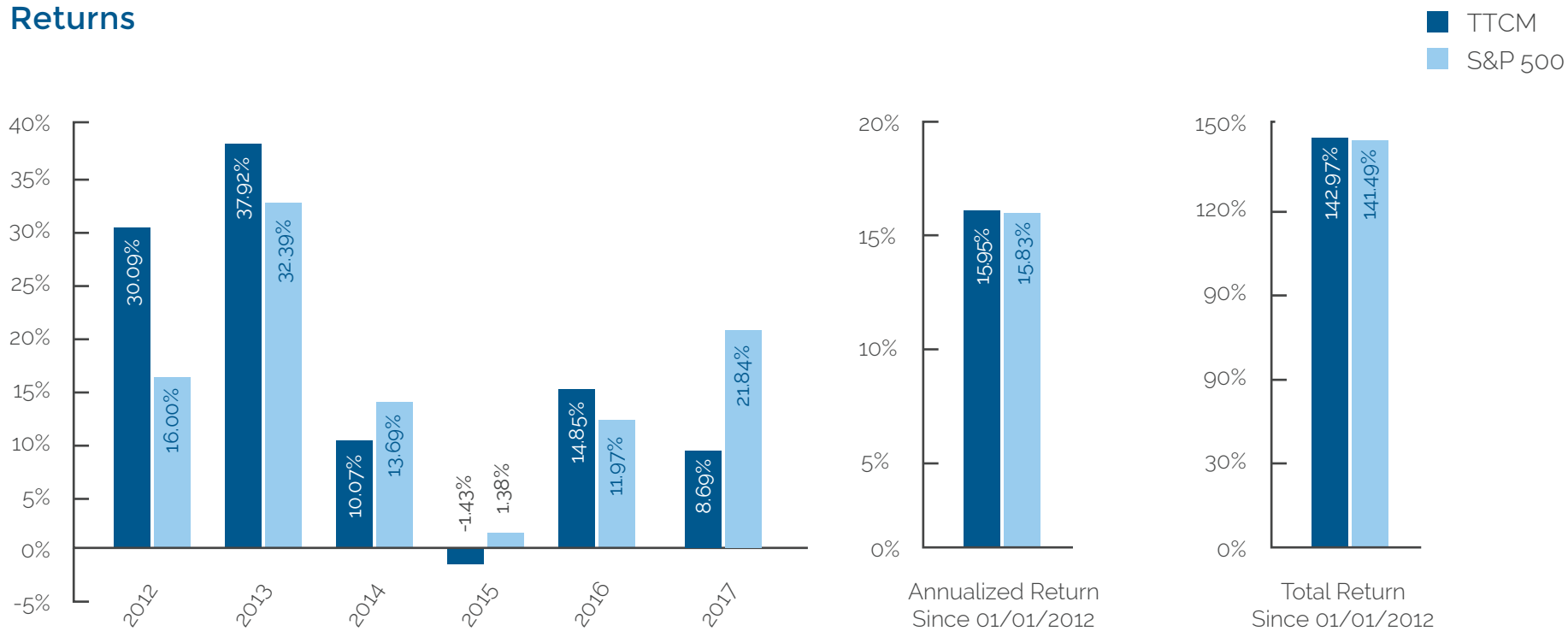
Let me be clear, investing in an index fund and not touching it for 50 years is likely a great idea. The reason being that over the long-term, stocks will go much higher. The biggest mistakes market participants make is that they try to time the market by buying when everyone is optimistic and selling when everyone is pessimistic.

Almost all mutual funds have dramatically different results experienced by the actual investors than the funds themselves due to this performance-chasing mentality. Having been in this industry working with clients for 16 years now, I have extreme skepticism that these performance-chasing habits are going to stop as index funds have become so in vogue. Does the average market participant hold when everyone is telling them the world is going to fall apart again? I highly doubt it and in fact the vast majority of trading is in index funds, it is clear that they are being used more as trading vehicles more than actual long-term investment platforms.

While the investor that has been constantly long the market over the last 50 years has done very well, many value investors and their clients have done many multiples better than the average index.

If it was only a couple that had outperformed over several decades, I'd say it might be a coincidence but there are quite a few that practice the same type of investing that we do. Look at the track records of Bruce Berkowitz, Carl Icahn, Warren Buffett and countless others that all use a similar value-based strategy, and you'll see why we frankly believe that we would be silly to not employ a similar method in our own investment activities.

Returns



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Research & Analysis

At TTCM, we don't make an investment until we have performed extensive research and analysis about a company. When you are building concentrated positions in stocks it is important to think of the shares that you own as though you own the entire company. What are the risks, where are the opportunities? Despite rigorous research, it is impossible to know every detail in any enterprise but by focusing on no more than 12-15 securities, we are able to keep very close tabs on our investments. When we feel that a company might be missing an opportunity to improve its capital allocation, or when we have concerns, we do not hesitate to contact management directly. While we are still a small firm, I believe we do have a good reputation based on our published research, track record, and from relationships that we have built. We have received positive responses from various management teams.

As we get larger in size, this could become a bigger part of our strategy so stay tuned.

Proven Track-Record of Value Investing

There are numerous studies that show over the long-term, deep value investing outperforms. It has been widely documented that these last five years have been among the most difficult for the value investing profession. Evidence of this has been the disintegration of the Hedge Fund industry where just about all asset flows go to the few largest enterprises, and the shift towards passive investment programs such as index funds.

While it has always been true that most active managers underperform the market, it has also been true that deep value investors have been able to outperform over the long-term.

Over the last 5 years, record-low interest rates have driven up just about every asset without respect to valuations. As rates go up, the same tailwinds, which have propelled stocks and bonds higher, becomes a headwind.

2018 T&T CAPITAL MANAGEMENT INVESTMENT OUTLOOK

I'm excited and hopeful for 2018 and I believe that we could see some exciting changes in the U.S. economy and markets across the globe. At T&T Capital Management, we are focused on protecting and growing your hard-earned capital. We understand that your money is a means to a comfortable retirement, your child's education, and a better standard of living. Our role as a fiduciary is an obligation that we take with the utmost seriousness, and we prove this by investing our own money in the same way that we do for clients.

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Investing is all about maximizing risk-adjusted returns over the long-term. It is not trying to replicate an index or follow the crowd as they jump of a cliff. The surest way to achieve long-term investment success is by buying securities at large discounts to intrinsic value. There are very few stocks in the Dow or the S&P 500 that meet our standards of selling at a 20-30% discount to a conservative estimate of intrinsic value, matched with the ability to grow that intrinsic value by 10% per annum over the next 3-5 years. That doesn't mean that those expensive stocks can't do well, as we saw in 2017. 2017 was a year where growth trounced value investing. These periods come from time to time, but over the long-term, value investing has always been the best way to grow capital. I see incredible parallels between the late 1990's and 2017, as baristas are posting technical analysis on crypto-currencies on social media to prove their investing genius, similarly to when day trading became an acceptable profession for the masses. Remember what Warren Buffett says, "It's only when the tide goes out that you learn who's been swimming naked."

"Over the long-term, value investing has always been the best way to grow capital."

As we move into 2018, it is helpful to start with a look at valuations. The S&P 500 ended the year at 2673.61, which is 26 times earnings, or 62.5% higher than the historical mean of 16. On an inflation-adjusted basis, the Shiller P/E is 32.6, which is 94% higher than the historical mean of 16.8. 2017 was a year in which the global markets saw virtually no major selloffs, which is exceptionally rare. Investor optimism is at all-time highs and expectations are that the stock markets should continue to do well. Volatility has been low for longer than just about any could have anticipated. I don't need to be Nostradamus to tell you that this won't last forever.

2018 T&T CAPITAL MANAGEMENT INVESTMENT OUTLOOK

The U.S. economy is picking up growth as is Europe, while China is still seeing above-average growth, despite worrisome debt levels. Nearly 10 years removed from the Financial Crisis, Central Banks are finally starting to dial down the monetary stimulus, and interest rates should continue to move higher. I believe that if we begin to see higher wages and ultimately inflation starts to emerge, financial markets could potentially be rattled due to the end of the nearly 40-year bond bull market. North Korea is the most obvious geopolitical risks with its constant military threats, but markets haven't appeared to be too shaken by the increasingly dire rhetoric.

The overall market to me is horribly unattractive. If you must own mutual funds in a 401K or something like that, I'd recommend being very conservative. For TTCM clients, we are taking an incredibly disciplined approach and are ecstatic to have found some of the best value opportunities I've seen in my career; but to be clear, there are just a handful of them. In 2017, we had a number of major long-term investment victories from which we were able to profit, including C, BAC, MS, ALLY, QCOM, GM, DAL, AAL, VOYA, etc. These victories were somewhat overshadowed when the hurricanes that devastated the United States caused major selloffs in some of our larger insurance positions, particularly our bond insurance investments that have exposure to Puerto Rico.

Keep in mind that these stocks were major reasons we outperformed significantly in 2016 and we locked in millions of dollars in profits on AGO, MBI, and AIG in early 2017. We did this via owning the stock and having it called away at much higher prices than what we bought it for. Most of the year, the stocks continued to do well until the hurricanes and other natural disasters caused the most destruction we have seen in decades. As these stocks came down in price in late 2017, we were able to add materially.

"Keep in mind that these stocks were major reasons we outperformed significantly in 2016 and we locked in millions of dollars in profits on AGO, MBI, and AIG in early 2017."

We bought very little stock initially but instead sold substantial amounts of put options to manufacture cheaper entry prices. This strategy allows us to generate very attractive double-digit income yields if the options expire as worthless, or allows us to own the stock at better prices than if were just to buy them outright, if the options expire in the money. Now with some of those stocks so incredibly cheap and offering some of the best value we have seen, we are also aggressively buying the stock outright, particularly on Assured Guaranty.

A lot of our winners on which we have been able to profit have freed up cash that we have deployed towards these most attractive opportunities. Surely, the late-year declines in the stocks hurt us in 2017, especially considering such a buoyant (and overvalued) overall market, but long-term it will lead to far greater returns, setting the stage for future outperformance. Did Assured Guaranty's business perform poorly, or why did the stock end the year at a 52-week low, nearly 28% below its highs?

"The business has literally never been stronger, more profitable, or more undervalued!"

2018 T&T CAPITAL MANAGEMENT INVESTMENT OUTLOOK

Needless to say, we are buying aggressively with the stock trading below $34. Surely, there will be short-term negative headlines due to a politically toxic and public bankruptcy process that is unfolding on the hurricane-ravaged island. As Sir John Templeton said, "Invest at the point of maximum pessimism." We are there or close to there for Assured Guaranty, MBI, AMBC and frankly bonds in Puerto Rico. Prices are absurd and are impossible to justify. The bear case is basically that all rules of law that are the foundation of municipal markets, will no longer matter, so severities on losses will be greater than any responsible analyst could ever justify. I've spent an enormous amount of time and effort on understanding the financial, political, and legal realities of this situation. I believe that the stage is set for us to make a tremendous amount of money. In a market where we are not nearly as sanguine as the consensus, these fertile grounds offer a tremendous reprieve!

"I think it is as clear of an opportunity to grow wealth over the next 3-5-year period, as I've seen."

Outside of a few specific investments like those that I've mentioned where we feel the opportunities are extraordinary, we are structuring our strategies conservatively. We've discussed a few of our high-yield REIT investments that we are optimistic about as we see mean reversion in the retail space, from depression-like prices that have arisen from the dominance of Amazon's impact on the industry. There are some undervalued healthcare names that we believe offer very attractive long-term potential as they restructure. At some point, there will be far better buying opportunities for the overall market than there are right now. Patience will be rewarded. Greed will be punished. Strong financial analysis and understanding of basic investment principles will matter, as they always have over the long-term.

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Conclusion

I'll conclude this letter with what I'd want to know if I were in your shoes. I personally am adding materially to my account and my investments in these opportunities that I've been discussing. I think it is as clear of an opportunity to grow wealth over the next 3-5-year period, as I've seen. Not everyone will agree, but I've yet to see anything that gives me a concern that our analysis is not correct on these key positions.

At T&T Capital Management, we are not interested in following the crowd. We don't believe that ignoring stretched valuations and rising interest rates is a smart move. I don't want to see the devastation that so many endured to their investment accounts during 2000 or 2008 happen to any of you, or me! At the same time, when we have investments where we can't blow them up despite the most dire scenarios we can imagine, we want to buy in bulk. It is not uncommon for us to look quite silly for a few months or even a year, but as the fundamentals play out, the big money is made. We are incredibly thankful for your trust and faith in us with your hard-earned capital and we will not let you down. Those of you that have been with us for nearly a decade know that we play a long-term game.

"We are incredibly thankful for your trust and faith in us with your hard-earned capital and we will not let you down."

We don't believe it is possible to outperform every quarter or every year, and attempting to do so is actually counterproductive to maximizing long-term performance. If your goals are building and protecting wealth in a smart and disciplined approach with a firm that has enormous skin in the game, you will not be disappointed. Here is to an excellent 2018 and future!

Sincerely,

Tim Travis
CEO/CIO

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