Intrepid Income (ICMUX)

A Mutual Fund Observer 'Star in the Shadows' Fund

By David Snowball, Publisher

Mutual Fund Observer

Fund name Intrepid Income (ICMUX)

Objective and Strategy The fund is pursuing both high current income and capital appreciation. The fund primarily invests in shorter-term high-yield corporate bonds, bank debt, convertibles and U.S. government securities. They have the option of buying a wider array of income-producing securities, including investment-grade debt, dividend-paying common or preferred stock. It shifts between security types based on what the manager's believe offers the best risk-adjusted prospective returns and is also willing to hold cash. The portfolio is generally very concentrated.

Adviser Intrepid Capital Management of Jacksonville Beach, Florida. Intrepid, founded in 1994, primarily serves high net worth individuals. As of December 30, 2013, it had $1.4 billion in assets under management. Intrepid advises the four Intrepid funds (Capital, Small Cap, Disciplined Value and Income).

Managers Jason Lazarus, with the help of Ben Franklin, and Mark Travis. Messrs. Franklin and Lazarus joined Intrepid in 2008 after having completed master's degrees at the University of North Florida and Florida, respectively. Mr. Travis is a founding partner and has been at Intrepid Capital since 1994. Before that, he was Vice President of the Consulting Group of Smith Barney and its predecessor firms for ten years.

Strategy capacity and closure The managers estimate they might be able to handle up to $1 billion in this strategy. Currently the strategy manifests itself here, in balanced separate accounts and in the fixed-income portion of Intrepid Capital Fund (ICMBX/ICMVX). In total, they're currently managing about $300 million.

Management's stake in the fund All of the managers have investments in the fund. Mr. Lazarus has invested between $50,000 – 100,000; Mr. Franklin has invested between $10,000 – 50,000 and Mr. Travis has between $100,000 – 500,000. That strikes me as entirely reasonable for relatively young investors committing to a relatively conservative fund.

Opening date You get your pick! The High-Yield Fixed Income strategy, originally open only to private clients, was launched on April 30, 1999. The fund's Investor class was launched on July 2, 2007 and the original Institutional class on August 16, 2010.

Minimum investment $2,500. On January 30, 2014, the Investor and Institutional share classes of the fund were merged. Technically the surviving fund is institutional, but it now carries the low minimum formerly associated with the Investor class.

Expense ratio 0.90% on assets of $106 million. With the January 2014 merger, retail investors saw a 25 bps reduction in their fees, which we celebrate.

Comments There are some very honorable ways to end up with a one-star rating from Morningstar. Being stubbornly out-of-step with the herd is one path, being assigned to an inappropriate peer group is another.

There are a number of very good conservative managers running short-term high yield bond funds who've ended up with one star because their risk-return profiles are so dissimilar from their high-yield bond peer group. Few approach the distinction with as much panache as Intrepid Income:

Why the apparent lack of concern for a stinging and costly badge? Two reasons, really. First, Intrepid was founded on the value of independence from the investment herd. Mr. Lazarus reports that "the firm is set up to avoid career risk which frequently leads to closet-indexing. Mark and his dad [Forrest] started it, Mark believes in the long-term so managers are evaluated on process rather than on short-term outcomes. If the process is right but the returns don't match the herd in the short term, he doesn't care." Their goal, and expectation, is to outperform in the long-term. And so, doing the right thing seems to be a more important value than getting recognized.

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Second, they recognize that their Morningstar rating does not reflect the success of their strategy. Their intention was to provide reasonable return without taking unnecessary risks. In an environment where investment-grade bonds look to return next-to-nothing (by GMO's most recent calculations, the aggregate US bond market is priced to provide a real—after inflation—yield of 0.4% annually for the remainder of the decade), generating a positive real return requires looking at non-investment-grade bonds (or, in some instances, dividend-paying equities).

They control risk—which they define as "losing money" or "permanent loss of capital," as opposed to short-term volatility—in a couple ways.

First, they have adopted an absolute value discipline—that is, a willingness both to look hard for mispriced securities and to hold cash when there are no compelling options in the securities market—in order to avoid the risk of permanent impairment of capital. That generally leads them to issuers in healthy industries, with predictable free cash flow and tangible assets. It also leads to higher-quality bonds which yield a bit less but are much more reliable.

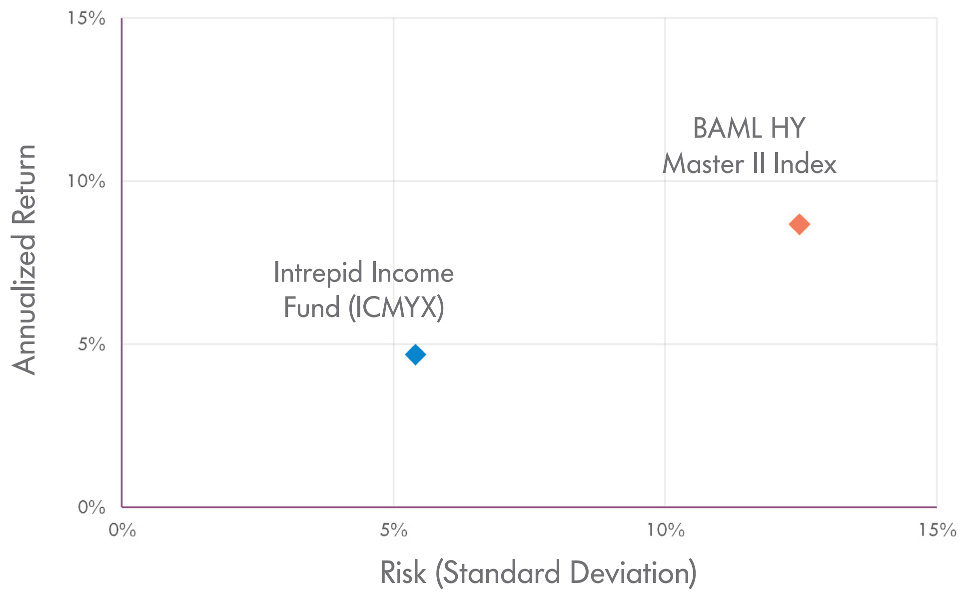
Second, they tend to invest in shorter-term bonds in order to minimize interest rate risk.

Together those offer the prospect of an attractive risk-return profile. Because they've never had a bond default and they rarely sell their bonds before they're redeemed (Mr. Lazarus recalls that "I can count on two hands the number of core bond positions we've sold in the past five years," though he also allows that they've sold some small "opportunistic" positions in things like convertibles), they can afford to ignore the day-to-day noise in the market.

In short, you end up with Intrepid Income, a fund which might comfortably serve as "a big part of your mother's retirement account" and which "lots of private clients use as their core fixed-income fund."

The fund's risk-adjusted performance is, in our judgment, excellent. We can look at its record against both its benchmark index and its Morningstar peer group.

RISK/RETURN Since Inception 07/02/2007



From inception through the end of 2013, Intrepid's annual return of 4.68% is about 55% of the index's while its volatility (a standard deviation of 5.4%) is 43% of the indexes. Over the period, Intrepid posted negative returns in 17 months with an average drawdown of 1.27%. The index was negative in 22 months, with an average loss of 3.16%.

Here's Intrepid Income charted against its high-yield peer group.

Over the 40-month span through February 2014, Intrepid posted negative returns in seven months with an average drawdown in those months of 0.37%. Its peers posted nine negative months, with an average loss of 1.91%.

While this is not a cash management account, it seems entirely appropriate for conservative investors who are looking for real absolute returns and have a time horizon of at least three to five years.

By every measure, that's a picture of very responsible stewardship of their shareholders' money. The fund's beta is around 0.25, meaning that it is about one-fourth as volatile as its peers. Its standard deviation from inception to January 2014 is just 5.52 while its peers are around nine. Its maximum drawdown – 14.6% – occurred over a period of just three months (September – November 2008) before the fund began rebounding.

Bottom Line The fund's careful, absolute value focus—shorter term, higher quality high-yield bonds and the willingness to hold cash when no compelling values present themselves—means that it will rarely keep up with its longer-term, lower quality, fully invested peer group.

And that's good. By the Observer's calculation, Intrepid Income qualifies as a "Great Owl" fund. That's determined by looking at the fund's risk-adjusted returns (measured by the fund's Martin Ratio) for every period longer than one year and then recognizing only funds which are in the top 20% for every period. Intrepid is one of the few high-yield funds that have earned that distinction. While this is not a cash management account, it seems entirely appropriate for conservative investors who are looking for real absolute returns and have a time horizon of at least three to five years. You owe it to yourself to look beyond the star rating to the considerable virtues the fund holds.

Fund website We think it's entirely worth looking at both the Intrepid Income Fund homepage and the homepage for the underlying High-Yield Fixed Income strategy. Because the strategy has a longer public record and a more sophisticated client base, the information presented there is a nice complement to the fund's documentation.

INTREPID INCOME FUND *the constant pursuit of value*

as of March 31, 2014

TOTAL RETURNS AS OF MARCH 31, 2014

					Average Annualized Total Returns			Expense Ratios		
	Inception Date	3 Month	YTD	1 Year	3 Year	5 Year	Since Inception	Gross	Net*	Expense Cap**
Intrepid Income Fund - Inst.^	8/16/2010	1.47%	1.47%	3.97%	4.66%	8.11%	4.85%	0.98%	0.90%	0.90%
BofA ML High Yield Master II Index		3.00%	3.00%	7.53%	8.71%	18.19%	8.82%^			
Barclays US Aggregate Bond Index		1.84%	1.84%	-0.10%	3.75%	4.80%	5.21%^			

MORNINGSTAR RATINGS AS OF MARCH 31, 2014

Fund Name	TICKER SYMBOL	MORNINGSTAR CATEGORY	OVERALL RATING	OVERALL # FUNDS	3-YEAR RATING	3-YEAR # FUND	5-YEAR RATING	5-YEAR # FUND
Intrepid Income Fund - Inst.^	ICMUX	High Yield Bond	★	550	★	550	-	-

The Overall Morningstar Rating for a fund is derived from a weighted average of the funds. three- and five-year Morningstar Rating metrics, which are based on risk-adjusted return performance.

^Institutional Class shares of the Intrepid Income Fund commenced operations on August 16, 2010. Performance shown prior to August 16, 2010 (5-Year and Since Inception) reflects the performance of Investor Class shares, which commenced operations on July 2, 2007, and includes expenses that are not applicable to and are higher than those of Institutional Class shares.

Effective January 31, 2014, the Investor Class shares of the Fund were closed, and any outstanding Investor Class shares were converted into Institutional Class shares.

**Per the prospectus, the Fund's annual operating expenses (gross) for the Institutional Share Class is 0.98%. The Fund's Advisor has contractually agreed to waive a portion of its fees and/or reimburse expenses such that the total operating expense (net) is 0.90% through 1/31/15, respectively. In addition, the Fund's Advisor has contractually agreed to waive a portion of its fees and/or expenses such that the total operating expenses, excluding Acquired Fund Fees and Expenses, (expense cap) does not exceed 0.90% through 1/31/15, respectively. Otherwise, performance shows would have been lower.

Performance data quoted represents past performance and does not guarantee future results. Investment returns and principal value will fluctuate, and when sold, may be worth more or less than their original cost. Performance current to the most recent month-end may be lower or higher than the performance quoted and can be obtained by calling 866-996-FUND. The Fund imposes a 2% redemption fee on shares held less than 30 days. Performance data does not reflect the redemption fee. If it had, returns would be reduced.

The Intrepid Capital Management Funds are non-diversified, meaning they may concentrate their assets in fewer individual holdings than a diversified fund. Therefore, the Funds are more exposed to individual stock volatility than a diversified fund. The Intrepid Capital and Small Cap Funds invest in smaller companies, which involve additional risks such as limited liquidity and greater volatility. The Intrepid Capital, Income and Disciplined Value Funds invest in debt securities, which typically decrease in value when interest rates rise. This risk is usually greater for longer term debt securities. Investment by these Funds in lower-rated and non-rated securities presents a greater risk of loss to principal and interest than higher-rated securities. The High Income fund is non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the fund is more exposed to individual securities volatility than a diversified fund. The Fund may invest in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating (based on a Morningstar risk-adjusted return measure that accounts for variation in a fund's monthly performance, including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. The Intrepid Income Fund (ICMUX) was rated 1-Star against the following numbers of U.S. domiciled High Yield Bond funds over the following time periods: 550 funds in the last three-years.

Morningstar® peer group is a group of funds of a similar category given by Morningstar to help investors compare funds. Beta is a measure of volatility of systematic risk, of a security or a portfolio, in comparison to the market as a whole. Standard Deviation is a statistical measure of portfolio risk used to measure variability of total return around an average, over a specified period of time. The greater the standard deviation over the period, the wider the variability or range of returns and hence, the greater the fund's volatility. Maximum Drawdown is the peak-to-trough decline during a specific record period of an investment, fund or commodity. A drawdown is usually quoted as the percentage between the peak and the trough. Martin Ratio is a measure of volatility, but only volatility in the downward direction, i.e. the amount of the drawdown or retracement occurring over a period.

The BofA ML High Yield Master II Index is an unmanaged portfolio constructed to mirror the public high yield debt market. This index includes US dollar publicly issued corporate bonds and includes PIKS (payment-in-kind-notes) and deferred interest bonds that are not yet accruing a coupon. Bonds rated in default, or that are not rated are excluded from the index. Barclays Capital U.S. Aggregate Bond Index is an index representing about 8,200 fixed income securities. To be included in the index, bonds must be rated investment grade by Moody's and S&P. You cannot invest directly in an index..

The Fund's investment objectives, risks charges and expenses must be considered carefully before investing. The statutory and summary prospectuses contains this and other important information about the investment company, and it may be obtained by calling 866-996-FUND. Read it carefully before investing.

Opinions expressed are subject to change, are not guaranteed and should not be considered investment advice or recommendations to buy or sell any security.

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