



February 17, 2015

Dear Clients:

The firm’s strategies returned, on average, the following in 2014¹:

	<u>EQUITY (TAXABLE)</u>	<u>EQUITY (NON-TAXABLE)</u>	<u>INCOME</u>
2014Q1	4.7%	2.7%	1.7%
2014Q2	1.6%	2.6%	0.3%
2014Q3	-1.5%	-2.7%	-3.4%
<u>2014Q4</u>	<u>4.9%</u>	<u>3.5%</u>	<u>-10.1%</u>
TOTAL	9.9%	6.1%	-11.5%

The Vanguard Total Stock Market Index Fund rose +12.4% for the year. The Vanguard Bond Market Index Fund rose +5.8% for the year.

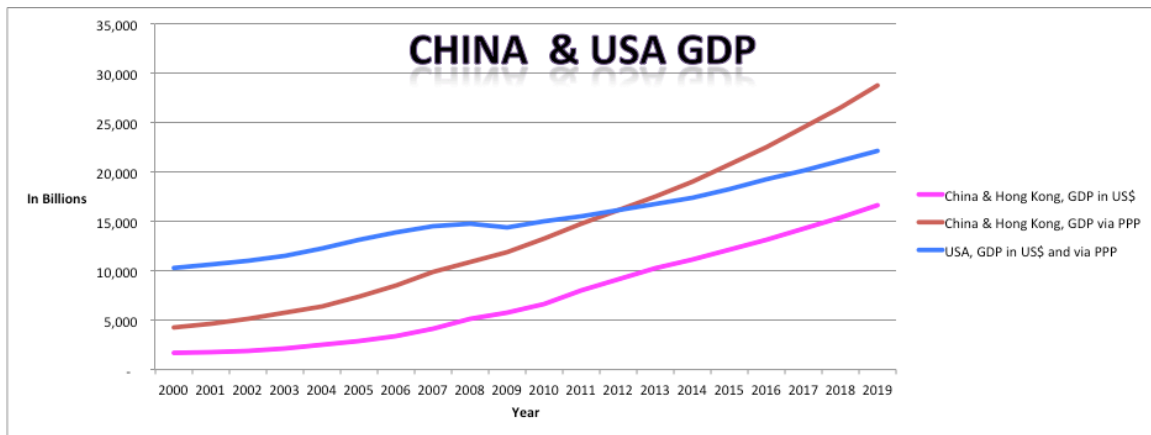
For details about the Equity strategy, please read Appendix I; for the Income strategy, please read Appendix II; and for individual positions, please read Appendix III (which is being sent only to clients).

An updated copy of Part 2 of Janian’s ADV will soon be posted to Janian’s website.

Not much changed in Janian’s business in 2014. The most meaningful item, I believe, is that the client list lengthened slightly. The most important thing: the business of planning for, protecting and growing your savings remains a great privilege.

¹ The track records above are for all client accounts with values greater than \$45,000 that existed as of the first day of the pertinent quarter. The returns shown are net of all costs and fees EXCEPT Incentive Fees, which are excluded from the calculation. The Incentive Fees payable by the firm’s Qualified Clients are, annually, 25% of any positive sum of a client account’s annualized three-year return less the annualized three-year return of the Benchmark. The Benchmark for Equity accounts is the Vanguard Total Stock Market Index Fund. The Benchmark for Income accounts is the Vanguard Bond Market Index Fund. The return shown is the average (mean) return of all client accounts’ returns for the quarter.

In the wider economic world, a big change happened in 2014. China's economy was estimated to have become larger than the USA's. The data below is from the IMF²:



All else being equal (which of course it is not), this means that the pool of profits potentially available is now and will continue to be bigger in China than in the U.S.

There are several reasons why this is probably not true for investors like us. Government regulation (or lack thereof), inaccurate government-published data, and the inability or unwillingness of other investors to value the potential profit pools in the same manner come immediately to mind. Nonetheless, the fact that I cannot speak or read Mandarin, Cantonese, or any of the other native languages or dialects in Greater China means that Janian is missing out³.

I am considering how to address this. I currently believe that adding an employee or partner who is a Chinese native and educated in financial analysis is likely to be the best path for Janian. For that matter, adding a similar person who can help do business in Germany⁴ also makes sense. If you know of anyone who might be a good match for Janian, please let me know.

Best wishes for a happy, healthy and productive 2015.

Sincerely,

James W. Hague

² Please see imf.org for definitions, the raw data, etc.

³ Not totally missing out, though. So far Janian has made one long investment in China (which was a loser) and two short investments (winners).

⁴ Greater Germany (Austria, Germany and Switzerland) has a combined 2013 GDP via PPP of ~\$4.7 Trillion, ~28% of the U.S.' It has a vibrant business community and Oktoberfest for good measure. So far Janian has made two long investments in Germany, which are winners to date.

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Appendix I: Equity Strategy 2014 Performance and Portfolio Construction

The year's estimated return for Janian's proprietary Equities (Taxable) strategy, to which all such customer accounts are very similar, was comprised of the following:

LONG EQUITIES:	+8.6%
SHORT EQUITIES:	+3.4%
LONG PUTS ON EQUITIES:	-1.0%
MACRO:	-0.1%
<u>YIELD:</u>	<u>0.0%</u>
TOTAL	11.0%

Quarter-end exposure⁵ for the account was as follows:

	<u>2014Q1</u>	<u>2014Q2</u>	<u>2014Q3</u>	<u>2014Q4</u>
LONG EQUITIES:	82.1%	80.4%	81.5%	83.8%
SHORT EQUITIES:	-24.7%	-15.4%	-29.8%	-39.4%
LONG PUTS ON EQUITIES:	0.5%	0.4%	0.0%	0.7%
MACRO:	0.2%	0.1%	0.0%	0.0%
<u>YIELD:</u>	<u>-0.9%</u>	<u>0.0%</u>	<u>0.0%</u>	<u>0.0%</u>
TOTAL	57.2%	65.5%	51.7%	43.7%

Janian produced market-like returns despite being only ~55% net invested on average during the year⁶. If Janian had been 100% net invested in the same portfolio, it would have produced even higher returns - but caution lead to the lower exposure.

Why the caution?

⁵ The %s are of account NAV, measured on a dollar basis.

⁶ The Equities (Non-Taxable) strategy's exposures are similar to the Equity (Taxable) strategy, with the important differences of no shorting and no purchases of securities in non-US\$ currency in the former. IRS regulations prohibit IRAs from borrowing, so they cannot execute either type of transaction. The net effect is that the Equities (Non-Taxable) accounts have a lower gross and higher net long exposure.

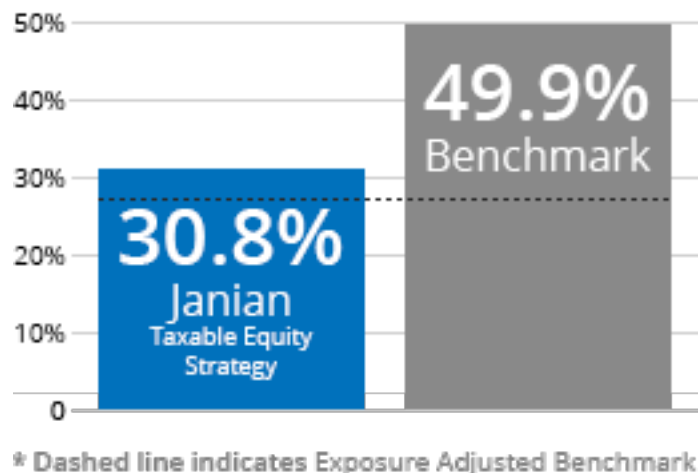
For the same reasons as stated in last year's annual letter. I'll repeat:

"First, that's generally how Janian invests: with a hedged approach that aims to limit potential losses. As you know, it's much easier to climb out of a shallow hole than a deep one, and the 9th Wonder of the World, compounding, makes that very powerfully true – and so Janian hedges.

Second, the U.S. government's debt, and securities' current valuations, leads me to believe that at present it is prudent to invest more cautiously, rather than less."

The U.S. government debt situation has not changed much. And securities' current valuations are, after another year of rising markets, on average somewhat higher than one year ago.

I am well aware that this caution has dampened profits the last two years. I am equally aware that Janian's fee schedule calls for Qualified Clients' accounts to pay a performance fee only if such an account's trailing three-year returns are higher than the stock market's⁷, and that to date they are not. Following the logic about limiting losses and compounding mentioned above, the metric that I am most concerned about is **exposure-adjusted**⁸ returns – and for 2013-2014 Janian is ahead of the benchmark using this measure.



⁷ And higher than a highwater mark, of course.

⁸ Alas, risk is only sometimes revealed, and usually only after the fact. Thus, Janian believes that attempting to measure how much risk Janian has taken produces only a crude approximation. The chart above is the best approximation that Janian can think of.

Janian anticipates that in 2015 it will continue to:

- invest less than 100% of capital in purchases of stocks;
- opportunistically establish small positions in macro and yield-like (often arbitrage) situations that are not directly related to the direction of the stock market;
- maintain a small sub-portfolio of puts on stocks, often ‘momentum’ stocks; and
- for the Equity (Taxable) strategy, maintain a sub-portfolio of short stocks.

Equity Strategy 2014 Taxes

A lot of the gains that Janian deferred in 2013 were realized in 2014. Assuming that your account was already established on January 1, 2014 (as Janian’s proprietary strategy was), the after-tax returns of your Janian account are estimated to be lower than the pre-tax returns reported herein⁹. Using these assumptions, Janian estimates the taxable returns for its proprietary taxable equities strategy, which is similar in construction to each of your accounts, are as follows:

	EST. PRE-TAX % ROR TO ACCT	TAX RATE	EST. AFTER- TAX % ROR TO ACCT
UNREALIZED GAINS	+5.6%	0%	+5.6%
NET CURRENT INCOME	-1.1%	-35%	-0.7%
REALIZED SHORT-TERM GAINS	+	-35%	+0.1%
REALIZED LONG-TERM GAINS	+	-15%	<u>0.0%</u>
TOTAL ROR	+11.0%		5.0%

Vanguard estimates that investors in the Vanguard Total Stock Market Index Fund paid 0.5% of capital in taxes for 2014 on shares held, not sold. As of December 9, 2014, Capital Group estimated that investors would pay (using the same assumptions herein) 8-10% of capital in taxes on what I consider to be its flagship equity mutual funds, which had very roughly the same pre-tax returns as Janian in 2014. Capital is a reputable buy & hold investor that manages many billions of dollars for individual investors¹⁰, so Janian is pleased to have delivered ‘extra’ after-tax returns versus its funds, even if one has to make various assumptions to identify those ‘extra’ returns.

⁹ Also assuming that you pay tax rates of 35% for ordinary income, 35% for short-term capital gains, and 15% for long-term capital gains.

¹⁰ You may know it as “American Funds.”

Appendix II: Income Strategy 2014 Performance and Portfolio Construction

The profits from 2013, which were much higher than the bond market's, were largely (but not entirely) lost in 2014, leaving the Janian Income strategy very slightly behind the market over the two years compounded.

	<u>2013</u>	<u>2014</u>	<u>Compounded</u>
Janian Income Strategy	+16.6%	-11.5%	3.2%
Vanguard Bond Market Index Fund	-2.3%	5.8%	3.4%

Janian's returns were produced with less than the market's exposure, however.

Quarter-end exposure¹¹ for the Janian Income strategy was as follows:

	<u>2013Q1</u>	<u>2013Q2</u>	<u>2013Q3</u>	<u>2013Q4</u>	<u>2014Q1</u>	<u>2014Q2</u>	<u>2014Q3</u>	<u>2014Q4</u>
Longs	64.2%	56.0%	39.3%	38.6%	31.1%	32.5%	43.8%	31.1%
Shorts ¹²	0.0%	-3.2%	-3.2%	-3.3%	-1.8%	-0.7%	-0.3%	0.0%
Total								
Long Exposure	64.2%	52.8%	36.1%	35.3%	29.3%	31.8%	43.5%	31.1%

While the end result over 2013-2014 is not terrible, it was terribly volatile getting there relative to the result. Janian will no longer entirely manage an Income strategy via direct security selection; instead, these accounts (including Janian's proprietary income account) will largely be allocated to several outside managers whose risk and return goals are similar to Janian's Income goals. Janian will consider these accounts to be entirely allocated to Funds and will reduce its fee accordingly.

¹¹ The %s are of account NAV, measured on a dollar basis. They represent the average of Janian clients' Income Account exposures during the time period in question.

¹² Includes long put exposure.