Kirr, Marbach & Company, LLC

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"Experience is a hard teacher because she gives the test first, the lesson afterwards."
--Vernon Law (former Pittsburgh Pirates pitcher)

April 6, 2017

Dear Clients:

We are pleased to report KM client equity portfolios continued to post gains in the first quarter. While our performance was positive on an absolute basis, we trailed our benchmarks for the quarter. In our last quarterly letter, we expressed optimism our very strong absolute and relative performance in the second half of 2016 marked a reversal of headwinds active managers, ***particularly value managers***, had faced for the past several years. Trends and reversals of trends never look like straight lines. In other words, there are bound to be setbacks along the way.

Successful investing is a marathon, not a sprint. We feel as if we've taken two steps forward (Q3-2016 and Q4-2016) and a half-step backward (Q1-2017). While we'd like to have strong performance every quarter, that's not a reasonable expectation. We're managing your (and our) assets for the long-term (i.e. thirteen plus ***years***), so try not to get too high or too low over the results for any short-term (i.e. thirteen ***weeks***) period.

Further, the positive investment thesis and outlook for 2017 we discussed in our last client letter remain firmly in place. We believe stock prices follow corporate earnings. The U.S. economy and corporate profits showed signs of accelerating ahead of the election, so we believe the ***post-election rally has been well-supported by improving fundamentals***. Some pundits have referred to the rally as a "Trump Bump," which presumably puts the stock market at risk of a significant correction if the new administration is unable to quickly deliver on campaign promises related to lower corporate tax rates, repatriation of cash trapped overseas, increased infrastructure spending and a less burdensome regulatory environment. While these initiatives would enhance profits, the U.S. and global economy have already been strengthening and the outlook for profits is improving.

Periods ending March 31, 2017
(Total Returns-Annualized*)

	Russell 3000 Index	**S&P 500 Index**
Three-months	5.74%	6.07%
One-year*	18.07%	17.17%
Two-years*	8.47%	9.21%
Three-years*	9.76%	10.37%
Five-years*	13.18%	13.30%
Ten-Years*	7.54%	7.51%

The Stock Market

What a difference a year makes! Stocks tumbled out of the starting gate in 2016, with the S&P 500 experiencing a harrowing plunge of 11% between New Year's Day and February 11 (the **Dow Jones Industrial Average ("DJIA") closed at 15660, a two-year low**), before a subsequent slingshot recovery of 13% to the end of March, finishing the first quarter essentially where it started.

Investors had plenty of reasons to have their confidence shaken in the first quarter of 2016, as headlines blared U.S. stocks had their worst start to the year in history. The possibility of an economic hard landing in China and further devaluation of the yuan, oil free-falling 50% and weak manufacturing data led to fears of a global recession. As usual, this brought market pundits trying to become famous for calling the next crash out of the woodwork. RBS, a major global bank, advised its clients to "sell everything," predicting a "fairly cataclysmic year ahead." Wow!

Fast forward to the first quarter of 2017, when the DJIA closed above 20,000 on January 25 and broke the 21,000 barrier on March 1. Oil and other commodity prices rebounded strongly off their lows. Not only was there no global recession, the world is now

in the midst of a synchronized growth spurt. Consumer and CEO confidence ("soft," attitudinal measures) have surged and "hard" economic data has started to confirm.

The DJIA closing above 20,000 and then 21,000 made for great headline fodder, but as shown in the data below, the first quarter celebration was mostly limited to larger-capitalization (the large-cap Russell 1000 outperforming the small-cap Russell 2000 by 3.6%) and growth stocks (all three Russell "Growth" indices outperforming their "Value" counterparts by about 5.5%).

Periods ending March 31, 2017

	Russell 3000 Index	Russell 1000 Index	Russell 2000 Index	Performance Gap (R1000-R2000)
3-months	5.74%	6.02%	2.46%	**3.56%**

	Russell 3000 Index	Russell 3000 Growth Index	Russell 3000 Value Index	Performance Gap (R3000 Growth-R3000 Value)
3-months	5.74%	8.62%	2.99%	**5.63%**

	Russell 1000 Index	Russell 1000 Growth Index	Russell 1000 Value Index	Performance Gap (R1000 Growth-R1000 Value)
3-months	6.02%	8.90%	3.26%	**5.64%**

	Russell 2000 Index	Russell 2000 Growth Index	Russell 2000 Value Index	Performance Gap (R2000 Growth-R2000 Value)
3-months	2.46%	5.34%	-0.13%	**5.47%**

We've presented graphs from Strategas Research Partners showing the outperformance of growth relative to value had reached the point where, *historically speaking*, the pendulum had started to swing back to value. We noted the last time this occurred was at the height of the bubble in technology/growth stocks in 1999-2000. We argued fundamentals and valuation do eventually matter and when that happened, value investors would be rewarded for their patience. **In other words, we were optimistic value investors would again have their time in the sun, but had no idea when that would happen.**

We asked Strategas to update the graphs (Exhibit A), which show Growth's relative performance hooked back up in Q1-2017 (after Value outperformed in the second half of 2016). Again, long-term trends never look like straight lines, so are not discouraged by value giving back a little ground in Q1-2017.

The large-cap outperformance in Q1-2017 can also be visualized in the graph from Bespoke Investment Group, which examined returns for the Russell 3000 Index by market-cap decile (Exhibit B). As you can see, performance dropped significantly after the largest two deciles (i.e. 600 stocks) and actually turned negative starting with the seventh decile (i.e. 1200 stocks). We think smaller-cap stocks are poised to do better, as they tend to 1) have less international exposure (a risk under threats to globalization) and 2) pay higher effective tax rates (they have fewer ways to shield income and should benefit if taxes are lowered).

We're not making excuses, but as Value managers with the majority of our holdings outside of the largest-caps, we were clearly swimming against the tide in Q1-2017.

Stock prices follow earnings. As shown in the graph from Charles Schwab (Exhibit C), S&P 500 earnings were in a recession lasting four consecutive quarters and ending in the third quarter of 2016. It is no coincidence stock prices recovered as earnings growth turned positive. Further, with S&P 500 earnings growth forecast to pick-up in 2017, our outlook for stock prices is also positive.

Even with stocks at record highs, valuation is reasonable. Liz Ann Sonders, Schwab's Chief Investment Strategist, looked at the "forward P/E" (i.e. Price/Next 4 Quarters of Earnings) for the S&P 500 under various inflation scenarios from 1958-2016 (Exhibit D). When inflation is high, earnings are worth less than when inflation is low. As you can see, the current forward P/E of 17.6 for the S&P 500 is right at the average for the past 58-years under our current 2-3% inflation environment. In other words, stocks would have to advance and/or earnings decline fairly dramatically to get to a worrisome condition.

Interest Rates and the Bond Market

The yield on the 10-year U.S. Treasury Bond was fairly stable until two weeks before the March 14-15, 2017 meeting of the Federal Open Market Committee (FOMC). During those two weeks, the yield rose sharply from 2.35% to 2.60% in anticipation of the FOMC raising short-term interest rates. Once the FOMC took the expected action, rates began to decline, with the 10-year closing the quarter at a yield of just under 2.40%. Current expectations are for two more rate increase in 2017. We think increasing short-term interest rates will have limited impact on longer-term rates, resulting in the "yield curve" (continuum of rates from shortest- to longest-maturity) flattening as the year progresses.

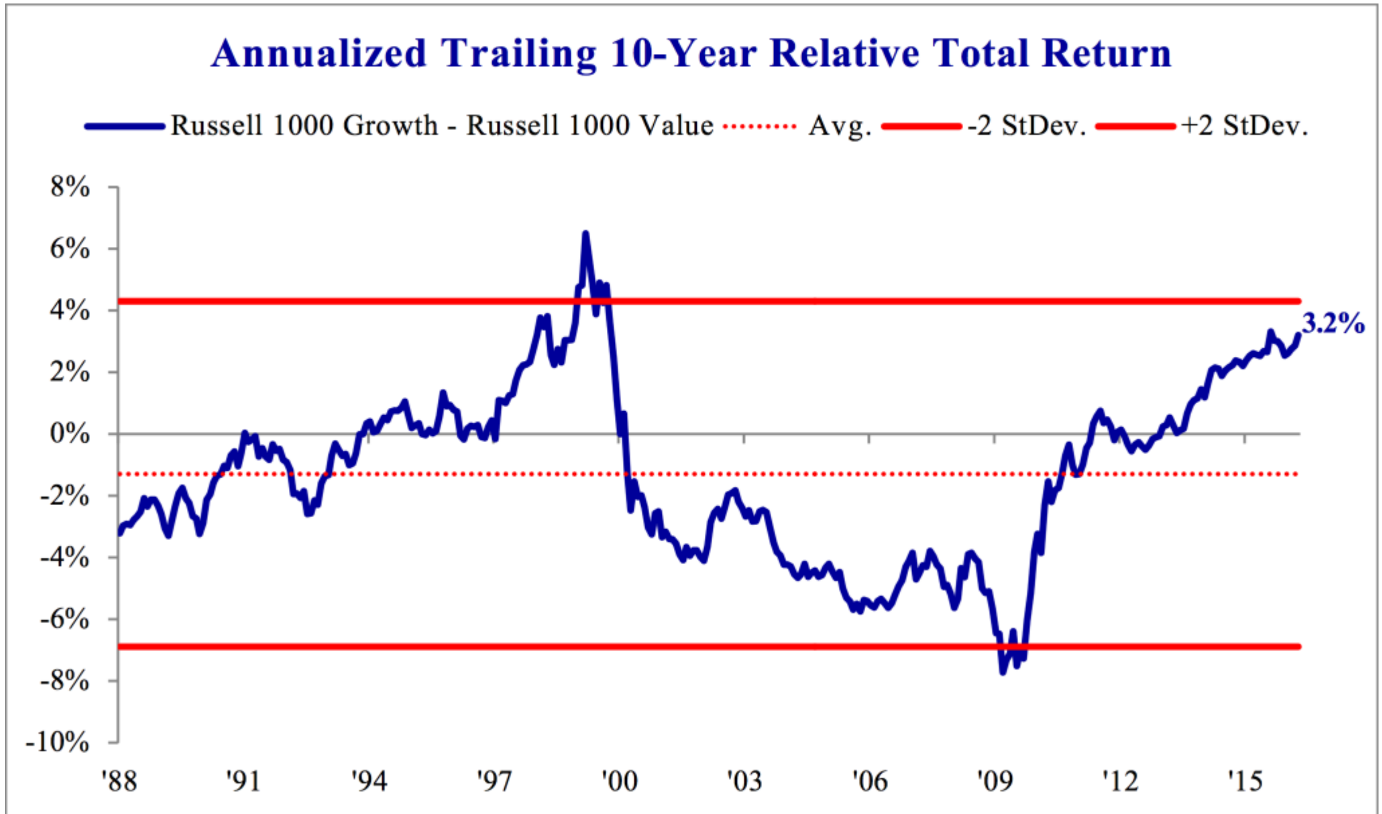
Summary

It's certainly been an interesting start to 2017. We recognize there are always risks, here and abroad, known and unknown. Global financial markets are subject to violent downdrafts for any or no reason. Still, we believe the preponderance of the evidence points to higher stock prices and decent returns for the year.

Regulatory Update

Kirr, Marbach & Company, LLC (KM) is registered with the U.S. Securities and Exchange Commission ("SEC"), which requires advisers to file Forms ADV-Part 1 and 2A ("Brochure")/2B ("Brochure Supplements") electronically on the Investment Adviser Registration Depository (www.iard.com). Registration of an investment adviser does not imply any level of skill or training. Form ADV-Part 2A is a narrative disclosure of an adviser's business, written in "plain English." The SEC mandated the headings, specific topics to be covered and the order of presentation.

Exhibit A



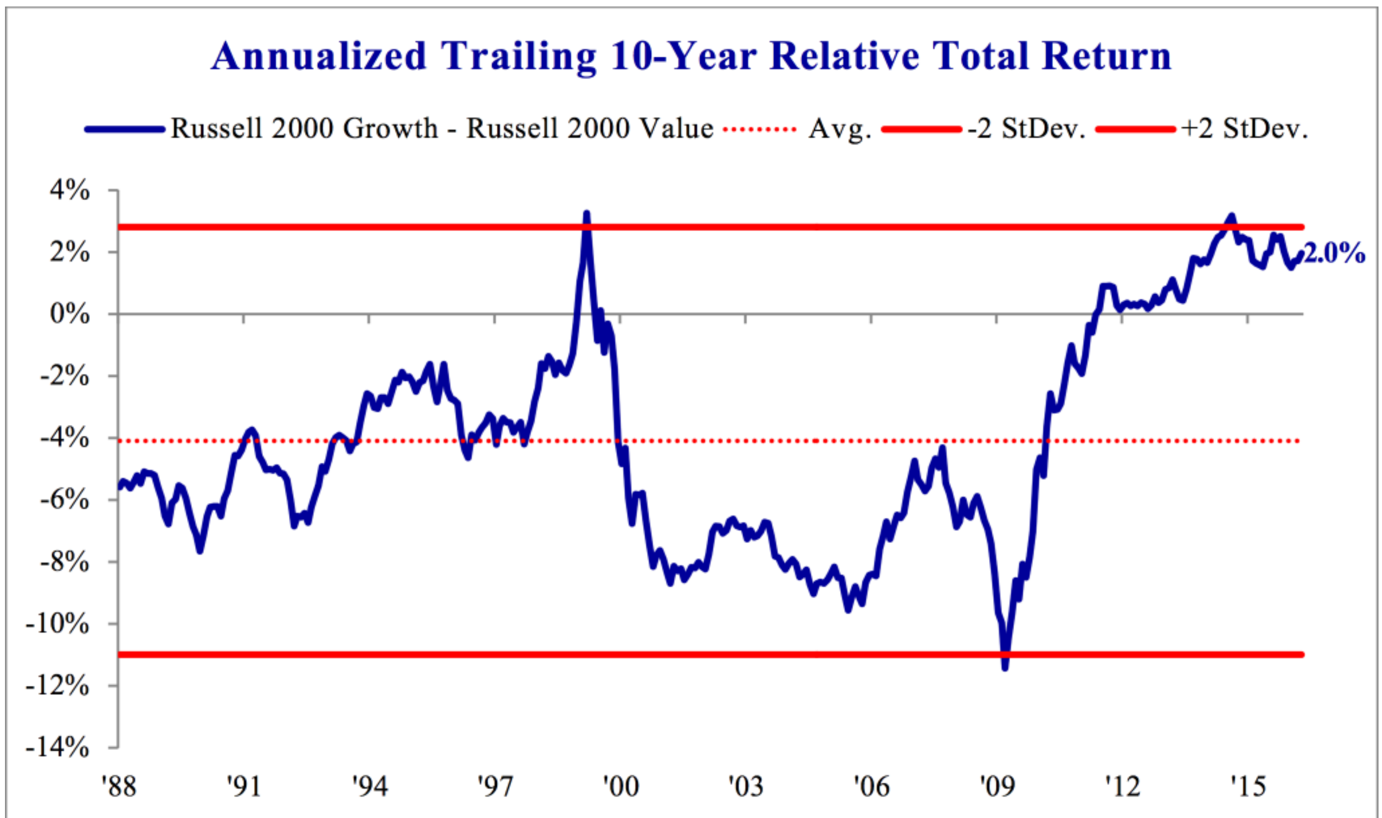
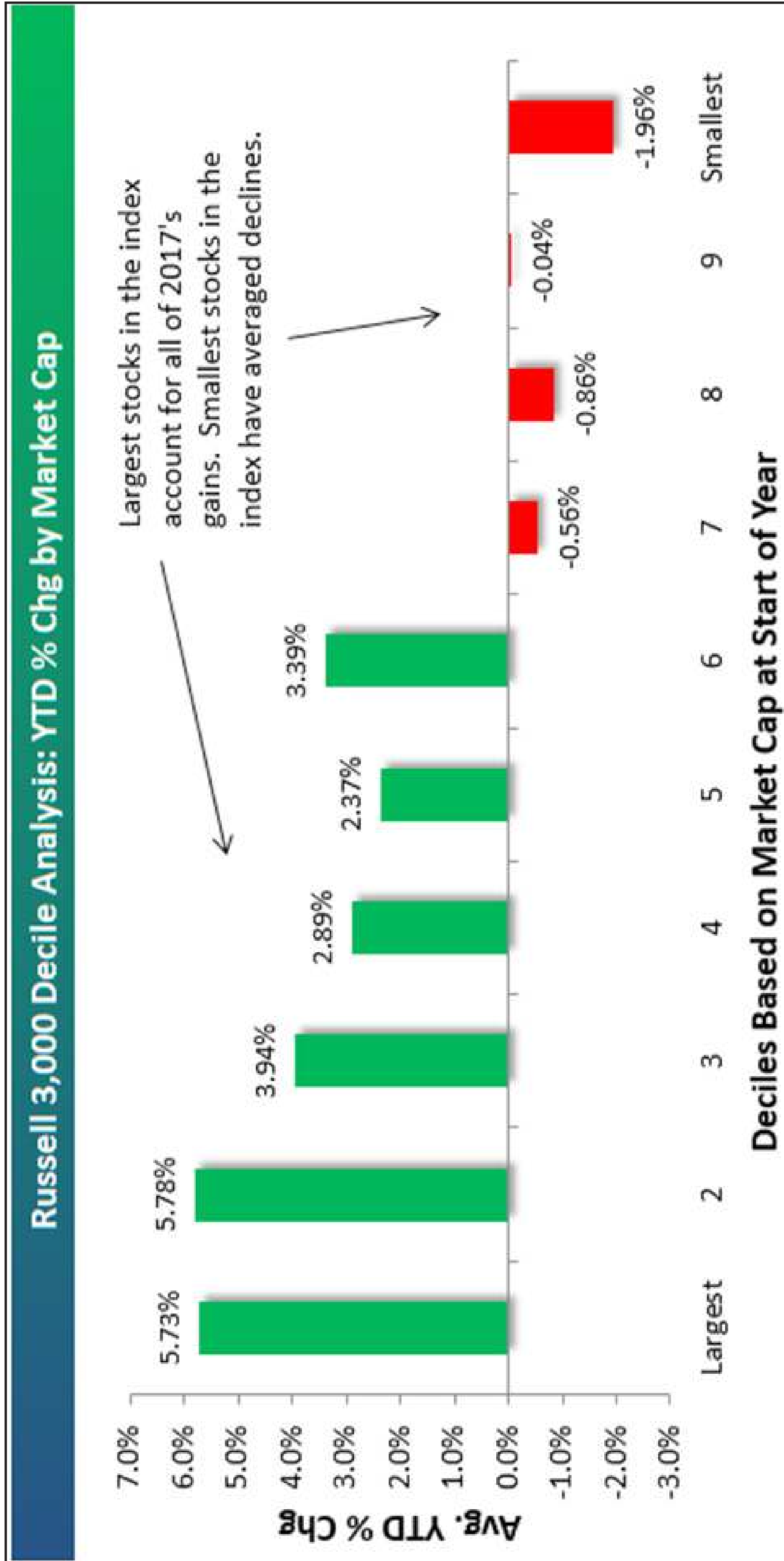


Exhibit B



KM filed its annual updating amendments to its Form ADVs with the SEC on March 24, 2017. Our standard practice has been to distribute the annual updating amendment to Form ADV-Part 2A to each client account with the first quarter mailing in April. We filed an amendment to Form ADV-Part 2A on December 19, 2016 with two Material Changes and distributed that version to all client accounts in January 2017. The version dated March 24, 2017 does not contain any Material Changes from the December 19, 2016 version, but if you would like a copy of the current version, we will be happy to provide it to you. Please contact Matt Kirr, Director of Client Service (matt@kirrmar.com) or Donna Katheeder (donna@kirrmar.com) by email or at 812-376-9444 or 800-808-9444. In addition, KM's ADV-Part 2A can be found on our website at www.kirrmar.com.

Regards,

Kirr, Marbach & Company, LLC

Past performance is not a guarantee of future results.

The Russell 3000 Index is an unmanaged, capitalization-weighted index generally representative of the U.S. stock market. This index cannot be invested in directly.

The Russell 1000 Index is an unmanaged, capitalization-weighted index generally representative of the U.S. market for large-capitalization stocks. It is a subset of the Russell 3000 Index. This index cannot be invested in directly.

The Russell 1000 Growth Index is an unmanaged, capitalization-weighted index that measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values. This index cannot be invested in directly.

The Russell 1000 Value Index is an unmanaged, capitalization-weighted index that measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values. This index cannot be invested in directly.

The Russell 2000 Index is an unmanaged, capitalization-weighted index general representative of the U.S. market for small-capitalization stocks. It is a subset of the Russell 3000 Index. This index cannot be invested in directly.

The Russell 2000 Growth Index is an unmanaged, capitalization-weighted index that measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000 Index companies with higher price-to-value ratios and higher forecasted growth values. This index cannot be invested in directly.

The Russell 2000 Value Index is an unmanaged, capitalization-weighted index that measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. This index cannot be invested in directly.

The S&P 500 Index is an unmanaged, capitalization-weighted index generally representative of the U.S. market for large capitalization stocks. This index cannot be invested in directly.

The Dow Jones Industrial Average ("DJIA") is an unmanaged index comprised of common stocks of thirty major industrial companies. This index cannot be invested in directly.

Exhibit C

Source: FactSet, as of February 10, 2017. P/Es are based on forward 12-month earnings.

Exhibit D

1958-2016			
Inflation	Average P/E	Highest P/E	Lowest P/E
0 – 1%	16.3	20.9	11.7
1 – 2 %	17.0	20.6	13.1
2 – 3%	17.6	26.7	10.8
3 – 4%	16.0	20.7	10.1
4 – 5%	14.0	21.0	9.5
5 – 6%	14.9	20.2	8.2
6 – 7%	11.6	17.9	7.2
>7%	8.4	11.5	6.6

We are here → (2 – 3%)

Source: Bureau of Labor Statistics, FactSet, as of December 31, 2016. Inflation is y/y % change based on core CPI. P/Es based on forward 12-month earnings.