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PORTFOLIO COMMENTARY : August 2017

At the bottom of the equity market meltdown in 2009, the 10-year total return for the S&P 500 was a loss of -37%. The three-year annualized return was -17%. That is essentially what investors could be facing here again in equity markets – negative long-term real returns. The real question at this stage, however, is what happens if bonds are also at a major top?

While our strategy has been difficult, we believe that much of its long-term value comes from not being inextricably tied to the performance oscillations associated with such extreme levels of risk. We have struggled to put up returns, but it's because we did not expect other markets to reach such extreme levels of risk (nor would we take such risks). We do not believe this environment is enduring; it is both surreal and likely to *eventually* collapse via some combination of price, inflation/deflation, and currency adjustments.

Our strategy aims to buy low and sell high, many times at the same time. This becomes a bit more complicated when almost every asset is overpriced and rises ever higher with no volatility. As such, our strategy has experienced an extensive bear market, as well as one of the worst relative-value investing periods we have seen in our careers. Yet, this is what makes the prospective trough in bear markets so enticing: the investment opportunities can be extensive. For our strategy, opportunity exists in four separate avenues that our portfolio can exploit. First, the opportunity for shorting could prove to be quite profitable. Valuations are some of the most excessive in history, and if the past 20-year central bank effect is any guide we may be looking at some incredible opportunities. Second, we see a significant performance gap between value and over-priced growth that has not been this large since the 1999-2000 bubble top. If value simply starts to outperform growth, our strategy should perform well. Third, volatility is at record lows and may be bottoming. Our strategy is intended to excel with higher volatility and this may enable opportunities to trade around short positions regardless of market levels. Lastly, certain areas of asset markets are already in extensive bear markets, most notably commodities. While we believe there could be some short-term room to the downside, the ratio between the GSCI Commodity Index and the S&P 500 is at levels last seen during the 2000 bubble and the early 1970s.

As always, fundamental bias, patience, and diversification are our discipline. Anyone with a similar philosophy has been punished by this environment. Passive investing and risk-parity strategies are the crowd favorites for this cycle. While many have chosen to maintain a passive bias, not one investor or advisor we've met with is actively betting client capital on another asset bubble. However, most investor portfolios are fully invested alongside a spectrum of heightened systemic risk due to a traditional view that equities can be "defended" by bonds. Today, this traditional investing paradigm means investors are essentially using an overvalued asset as the variable (bonds/interest rates) for pricing another overvalued asset (equities), while at the same time anticipating that one will bail out the other as levels of risk rise and fall. This may simply be traditional portfolio management at the wrong end of an interest rate cycle; however, we believe this imprudence is exaggerated by the fact that the entire idea has now been leveraged by an arena of "risk-parity" strategies and central bank manipulation. We know of no point in financial history where there has been such an artificial, global intrusion in price discovery along with a flood of assets from massively leveraged, risk-insensitive buyers. Masking this inherent price risk is one of the lowest levels of market volatility ever recorded. Will there be another post-cycle recognition of how simple and how obvious the risks were after the fact? Even we find it hard to fathom the consequences of normalization.

We continue to believe our disciplined approach is both rare and critically important in today's crowded financial market landscape. Very few traditional and alternative portfolios are providing any source of return outside of beta. Our strategy has already been through a significant bear market relative to major market indices, (an experience not dissimilar from that of value investors in the late 1990s). Yet, we have proven to perform consistently well during every down market over the past

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See Reverse for Definitions & Risks

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five years. The allocation math is quite simple. Even a small allocation to a strategy positioned for short-biased alpha like ours would provide much more diversification potential vs funds that provide correlated market performance. The potential for upside returns during critical drawdown periods cannot be understated during periods of historically high valuations. Our strategy is not designed to be permanently short-biased; this is a short-term view based on the overall market environment. However, if the current environment is indeed similar to 1999, then we could have a generational long/short opportunity at hand. When asset prices cheapen again, our portfolio will adjust as intended.

In summary, we currently believe we have a very favorable portfolio setup, similar to recent periods such as mid-2015 and early 2016, where there's a very large gap between our long and short portfolios. Cheaper securities with favorable fundamentals (current longs) are lagging overvalued, cap-weighted indices (current shorts). Specifically, the overall underperformance of value vs the S&P 500 is -6% year-to-date; this divergence is causing a significant lag in our overall portfolio. We think our current portfolio setup will be rewarded with performance opportunities once the latest cycle of abnormal market conditions exhausts itself.

***Definitions:** *The S&P 500 Index is a broad-based, unmanaged measurement of changes in stock market conditions based on the average of 500 widely held common stocks. The S&P GSCI (formerly the Goldman Sachs Commodity Index) serves as a benchmark for investment in the commodity markets and as a measure of commodity performance over time. It is a tradable index that is readily available to market participants of the Chicago Mercantile Exchange. Alpha is the measure of performance on a risk-adjusted (beta) basis. Alpha takes the volatility (price risk) of a fund and compares its risk-adjusted performance to a benchmark index. The excess return of the fund relative to the return of the benchmark index is a fund's alpha. Beta is the measure of a fund's relative volatility as compared to the S&P 500 Index which by definition is 1.00. Accordingly, a fund with a 1.10 beta is expected to perform 10% better than the Index in up markets and 10% worse in down markets. Correlation is a statistical measure of how two securities move in relation to each other.*

Additional Risks: Since the Fund utilizes a multi-manager strategy with multiple subadvisers, it may be exposed to varying forms of risk. The Fund's net asset value and investment return will fluctuate based upon changes in the value of its portfolio securities. There is no assurance that the Fund will achieve its investment objective, and an investment in the Fund is not by itself a complete or balanced investment program. For a complete description of the Fund's principal investment risks please refer to the prospectus.

The Fund may invest in foreign or emerging markets securities which involve special risks, including the volatility of currency exchange rates and, in some cases, limited geographic focus, political and economic instability, and relatively illiquid markets. The Fund may invest in debt securities which are subject to interest rate risk. An increase in interest rates typically causes a fall in the value of the debt securities the Fund may invest in.

The Fund may also invest in high yield, lower rated (junk) bonds which involve a greater degree of risk and price fluctuation than investment grade bonds in return for higher yield potential. The Fund's distressed debt strategy may involve a substantial degree of risk, including investments in sub-prime mortgage securities.

The Fund may purchase securities of companies in initial public offerings. Special risks associated with these securities may include a limited number of shares available for trading, unseasoned trading, lack of investor knowledge of the company and limited operating history. The Fund may leverage transactions which include selling securities short as well as borrowing for other than temporary or emergency purposes. Leverage creates the risk of magnified capital losses.

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Investors should carefully consider the Fund's investment objectives, risks, charges and expenses before investing. This and other information is in the prospectus, a copy of which may be obtained by calling (888) 992-2765 or visiting the Fund's web site: www.absoluteadvisers.com. Please Read the prospectus carefully before you invest.

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