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PORTFOLIO COMMENTARY : Third Quarter 2014

The unique qualities of the Fund could not be more apparent than during periods of central bank uneasiness and heightened levels of volatility. It is periods when reality subtly comes into focus that investors can recognize how addicted the markets have become to policy maker support. It has never been easier to invest in major indices and seemingly not need to worry about losing money. Almost no skill has been required. In fact, applying reason, logic, or any risk management techniques in this environment likely resulted in lower returns for many investment managers. Whether most investors want to admit it or not, they have simply been riding a global central bank liquidity wave for the past few years that is, in our opinion, nearing an important juncture. Conversely, it has been a difficult market for a fund focused on delivering a low-beta return stream that seeks to avoid large losses. Volatility has been non-existent and a fundamental bias has been penalized. Yet the Fund has generated positive returns year-to-date, and recently hit an all-time high of its own despite negative correlation to equity and credit markets, as well as to most hedge funds. As such, our positioning has proven to be highly distinct. While it may seem uninspiring to those who believe there is a levitating floor under the markets, we believe the Fund will perform quite well when central bank credibility and yield chasing wane. A financial bear market is not required.

With US markets at all-time highs and certain valuations (such as price to sales) at the highest in history outside of the 1999-2000 period, there is substantial risk that central banks are losing control. The market environment over the past few quarters appears to be going through some subtle changes and we are beginning to see several divergences that may be hinting at a return to fundamentals. As the reality of a slowing global economy and a rising US dollar finally sets in, many companies are offering forecasts that have not kept up with investor expectations. Smaller cap stocks and high yield credit are beginning to struggle, and European banks are starting to reveal some cracks. Stocks are finally being punished as some companies have simply run out of ways to create the illusion of growth via stock buybacks and financial engineering.

By far the biggest risk at the moment is the actions and words of global central bankers and the potential impact on emerging markets. As markets digest weakening global growth, central banks are beginning to appear quite desperate. The financial markets are completely dependent on monetary and fiscal support at a time when the global economy appears very fragile, (despite what you hear from the financial media, global growth continues to weaken, specifically in China, Emerging Markets, and Europe). Currencies are increasingly volatile and many global credit markets appear quite stretched and highly illiquid. Almost all commodity prices have collapsed and have been in price downtrends since 2011. Europe is dealing with the threat of another recession and deflation and is desperately trying to engage in some sort of quantitative easing. In the US, there continue to be calls from the financial community for incessant monetary support (6 years into the process) any time the equity market coughs. Even Federal Reserve Bank of St. Louis President James Bullard clearly and openly flip-flopped on the need for QE within a period of 20 days based on the direction of the S&P 500. Incredible, given that we have very low interest rates and equity markets trading near all-time highs and at some of the highest valuations in history. Corporations are using their balance sheets to meet earnings targets and are supporting their own stock prices by buying back incredible amounts of stock. Even companies with long histories of credit and liquidity problems are engaging in this scheme simply because earnings targets need to be met and investor appetites for yield appear endless.

There are real concerns that without central bank support, the global economy will go into a deep recession and markets will drop. Moreover, currency reactions to central bank motivations may cause severe consequences for emerging markets, which have been the real instrument for global growth. Many are now vulnerable to a real financial crisis. From a pure price and fundamental standpoint there are enormous risks to asset prices without constant stimulus or at least the threat of additional support. In a normal environment where markets are priced without policy maker intervention, our Funds would be positioned very well. A “normal” environment, however, appears detrimental to the markets. An atmosphere where central banks successfully raise interest rates seems downright impossible. There remain a couple of scenarios that need to be considered. If global growth continues to weaken and markets fall, central bank credibility or politics may prevent further action and the market environment could become incredibly volatile. On the other hand, if the monetary and fiscal credibility clock has a few ticks left, it is likely that policy makers will go “all in” with another dose of intervention if markets experience a serious correction. This move of desperation could create a final wave of asset price inflation (i.e. financial bubble), without the benefits of a structural economic advance. How this would end is anybody’s guess.

Given our views on the structural issues with the global economy and that debt/GDP is much higher than pre-2008 levels, we view these overall risks as probable. Under the scenario where central banks immediately lose credibility, our Fund would be positioned quite well. Under the “all-in” scenario, which seems likely should the markets sell off, the Fund’s positioning would likely adjust to volatility anyway. Overall, we are less inclined to dilute our exposures, especially since policy maker credibility is truly at risk here. Therefore we are looking at a variety of positions to provide a modest level of short term inflation protection (or insurance against further policy maker intervention) that are both low-priced and potentially positioned for new bouts of money printing and currency wars, or a cyclical pop from large fiscal

See Reverse for Definitions & Risks

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measures.

We fear that further efforts by policy makers at this point in the cycle may eventually have even larger unintended consequences. Currency wars, unsustainable and artificial asset prices, or increases in interest rates may threaten the global economy and financial system far beyond anyone's expectations. We also believe that these risks are more evident now than ever. The need to proceed further in an environment of all-time-high equity prices and historic income inequality after 6 years of massive intervention suggests complete desperation. Why is it so necessary? And what more can truly be accomplished? Regardless, asset allocation and diversification efforts need to take into account the historical precedent that money printing and currency wars have <u>never</u> ended well. And such intervention over the past 15 years (20 years for Japan), have yet to prove otherwise. Yet most asset allocators and investor portfolios appear almost entirely leveraged to a positive outcome with no risk of being wrong. How can they possibly be so sure?

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 HFRI Indices are equally weighted performance indexes, utilized by numerous hedge fund managers as a benchmark for their own hedge funds. It is not possible to invest directly in an index or average. 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.*

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 is non-diversified and may focus its investments in the securities of a comparatively small number of issuers. Concentration in securities of a limited number of issuers exposes a fund to greater market risk and potential monetary losses than if its assets were diversified among the securities of a greater number of issuers. The Fund may invest in small- and medium-sized companies which involve greater risk than investing in larger, more established companies, such as increased volatility of earnings and prospects,higher failure rates, and limited markets, product lines or financial resources.

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.

The Fund may also invest in derivatives which can be volatile and involve various types and degrees of risks, depending upon the characteristics of a particular derivative. The Fund may invest in options and futures which are subject to special risks and may not fully protect the Fund against declines in the value of its stocks. In addition, an option writing strategy limits the upside profit potential normally associated with stocks. Futures trading is very speculative, largely due to the traditional volatility of futures prices.

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.

ABSOLUTEstrategies FUND

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