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PORTFOLIO COMMENTARY : Fourth Quarter 2013

There is not much more we can add to our discussion of the global fundamental picture. We have tried to connect the dots of global stresses and risks through commentaries and one-on-one adviser presentations. We have illustrated how excessive valuations are across both stocks and bonds. For more details on our fundamental discussion and Fund positioning, please read the Fund's latest semi-annual report.

Our positioning is quite simple. We have never been more hedged and defensive and, hopefully, nimble. This commentary will review our investment thesis and philosophy and should also help to explain our recent performance and why we seem so conservative.

Our primary objective remains to seek to protect investor capital from large drawdowns, especially when asset markets become inflated and overvalued. We hire managers who are skilled at varying their capital at risk and who may seek to hedge or short securities in market environments where prices diverge from fundamentals. This strategy is very different from a traditional portfolio which is highly susceptible to market risks. On the other hand, we also seek attractive long opportunities that aim to offer sufficient potential returns and a "margin of safety." Sometimes our overall net long exposure is substantial; currently it is not. Simply put, we seek to buy low and sell high, sometimes at the same time.

We take our role as an investment adviser seriously. We define risk as a permanent loss of capital, not some vague number expressed by a model or benchmark. Our investment thesis is that valuation and fundamentals are the primary determinants of long-term returns. We do not play games with other peoples' wealth by chasing after prior market performance. We do not engage in asset allocation practices of substituting one expensive asset class for another one and then calling it "optimal" and pretending it's diversified. We also do not buy because we feel we have to or because our clients tell us to. If history is any guide, buying overpriced assets will at best provide low prospective returns and potentially very large losses. Today this practice relies on the hope that prices will again reach excessive valuation levels, (apparently we did not put a high enough probability on this happening for a 3rd time in 13 years). We will stick to our discipline and remain patient for when the odds are in our favor. We do not fear the role of contrarian whether it is near a market top or market bottom; this was the case for us in late 2008 to early 2009, when we were covering hedges and buying equities and distressed credit.

While speculative market environments are enticing, we do not suddenly change our investment thesis and start chasing beta or returns. It seems much of the financial community now views investing through the prism of price action, (this is further confirmed by asset flows). It has become simply a momentum game. Yet, eventually there will be a moment when the market's entire attitude will change. There will likely be no signal or catalyst for future market losses. There was no news or event that took place in March 2000 or October 2007, and, like today, very few acknowledged any risk at the time. Even Ben Bernanke himself top-ticked the equity market in October 2007, stressing he was in control and that "sub-prime risks were contained." Most others' attentions were focused on buying the next dip in asset prices. Only in hindsight do losses reveal their cause and the risks seem so obvious. Yet why are they ignored? In our view it's usually quite simple: a growing disconnect between price and fundamentals increases the risk of meaningful losses.

We are very confident that our collection of underlying managers allocate capital prudently and have the patience needed to invest across an entire market cycle. We currently maintain a strong discipline around hedging and low beta. We are even more excited about our overall positioning as price/fundamental divergences continue to grow, and short opportunities become more attractive. We would expect to fare quite well in a difficult market for stocks and bonds, but a bear market is not a requirement for performance. We would simply like an environment with a little more volatility, and one where finance leans a bit more toward capitalism and leans a bit less toward easy money speculation and distorted asset prices. Further, a re-pricing of risk will enable us to change our positioning, possibly to a large degree. We are not afraid to be aggressive when others are selling and the price is right.

At this point one can almost ignore all the macro economic data, however good or bad it may be. Overall valuation and price risk is extraordinarily high and has only been eclipsed by a few months surrounding the peak in 2000. *(Update: the Russell 2000 index P/E ratio ended 2013 at over 80x reported earnings and roughly 50x operating earnings placing it almost on par with Nasdaq 1999).* Numerous equity valuation metrics are now <u>double</u> their historical averages and NYSE margin debt is at an all-time high. For a traditional portfolio of stocks and bonds, we believe the potential permanent loss of wealth has never been higher.

See Last Page For Definitions & Risks

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Take a step back and think honestly about the last 15 years of boom-bust market drivers and examine long-time historical valuations. Do the math on valuations and profit margins reverting to the mean. Then imagine which portfolio impact is truly more life changing, a large loss or a missed gain. Maybe the investment discipline and strategy you seek isn't that dissimilar to ours.

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.

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