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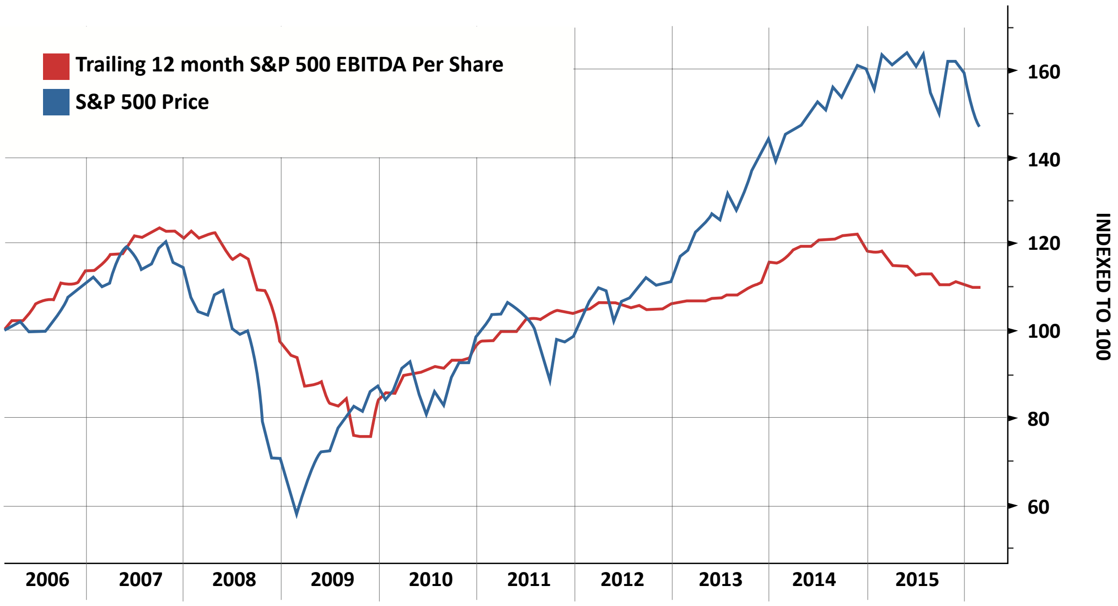
PORTFOLIO COMMENTARY : Fourth Quarter 2015

It has been excruciatingly difficult to remain patient over the last few years. With many unknowns, the financial environment has been very confusing and complex. We empathize with financial advisors and asset allocators - difficult decisions have blurred the lines between business and investment discipline. We understand the pressure to "keep up with the S&P 500." The media has also done an incredible job spreading false narratives, which has put undue pressure and business risk on financial advisors. However, we believe things are now becoming more certain, and there may be some time left (or short term market rallies) for advisors and asset allocators to right the ship of diversification and protect wealth.

Investors are finally beginning to realize the post-2011 investment thesis was entirely incorrect. This thesis, which we strongly disagreed with, was that QE would promote a rebound in inflation and a rebound in economic activity that would allow real GDP growth to compound at 4% or more. It was believed this would in turn provide a backdrop for strong revenue and earnings growth for US companies. We will be blunt -- this did not happen. Over the past few years, fear and confusion resulted in performance and yield chasing in risky assets. Our analysis of the macro-economic environment has actually turned out to be quite accurate.

The following chart provides a very real illustration of how all the attention around QE and the recovery over the past few years was nothing more than 1) media and financial industry propaganda, and 2) corporate financial engineering. Since 2011, EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization - see definitions) growth for the S&P 500 has not only been weak, it has been below the peak of the 2007 bubble. Revenue growth (see prior commentaries) has also been sadly missing. Yet the S&P 500 has increased in price far above fundamental trends. We believe it is only a matter of time before these gaps correct.



Source: Bloomberg

As the chart shows, if prices decline to meet EBITDA per share (as was the case at the 2007 peak) it could mean a drop to below 1500 for the S&P 500. Note that the chart also shows that it is not uncommon for prices to drop below fundamental trends. However, as we've noted previously, central banks are incredibly desperate and it's possible a panic button will eventually be hit should markets fall too far. Whatever their response, it is likely to be extremely irrational and illogical. The financial market response could be equally illogical, but any inspiration may be compressed in time. We have begun positioning some creative ideas to respond to this potential short-term market event as well as the potential for currency wars, or a complete unwind of central bank credibility (which we believe is inevitable).

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Corporations have flooded the public markets with credit instruments, much of which is junk and covenant-lite status. This debt was used mostly to buy back stock at very elevated prices. The cost of this debt is now rising, while stock prices have fallen. This creates a major headwind for companies that binged on the debt-for-stock buyback dogma.

In global markets, we will continue to repeat what we believe is the key to any remaining hopes. There is a major battle between central bank credibility and fundamental reality. This was well forewarned in our 3rd quarter 2015 commentary:

> *Over the past few months, investors received a clear wake up call for what is now quite obvious: global markets are extremely fragile and risky, and central bankers are in a daily scramble to discuss more stimulus ideas, QE and negative interest rates in an effort to rally markets back up. This, despite desperation by the Fed and others to convince the markets that the economy is doing great and it's time to raise rates above zero. You could not make this up.*
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> *Anyone using logic sees how delusional this all is. Markets are not about price discovery or fundamental growth. They are about QE hopes, debt-fueled stock buybacks, and algorithmic trading manipulation. In our view, as well as many others, we are nearing peak central bank mania, and everything is tethered directly to that outcome. The last few months have shown that very few investments will offer any true diversification or protection when the latest central bank bubble bursts. Yet, most investors have nearly their entire wealth bet solely on a positive central bank induced outcome. Aside from shorter-term market fluctuations or a final melt-up, we believe this environment is setting up quite well for our strategies.*
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> *There are very few ways for investors to protect or diversify portfolios from volatility and contagion. Say what you will about our approach, but we are committed to using reason and logic to protect investor capital from large losses in a highly uncertain environment. While our approach tends to be at odds with central bank flirtations, we also believe this is exactly what investors should be looking for to diversify portfolios as the 3rd quarter just illustrated. <u>To be precise, the entire systematic, reinforcing scheme that forced stock and bond prices higher, especially over the past 5-7 years, could very well be set to completely reverse.</u>*

We always choose fiduciary responsibility and investment discipline over business risk. We continuously debunked the 'recovery' thesis while witnessing a massive breakdown in asset allocation discipline. True diversification (which was well understood post-2008) was thrown out the window in favor of correlated beta strategies. Judging by the recent performance of some of our competitors, the pressure to speculate was just too much. On the other hand, our performance was hurt by 1) a refusal to speculate on a QE-inspired economic recovery, and 2) a significant underperformance of value-oriented securities. Fortunately these faults are purely cyclical, and in no way risk a permanent loss of capital. In fact, we believe the reversal of these trends could provide a very powerful reversion in our performance both long and short. Additionally, we also plan to be a bit more tactical at times in the future.

We believe the unwinding of risk is just beginning. Aside from oversold rallies, we believe equity and credit markets are very vulnerable. Our strategies are extremely well-suited for the environment that we expect to play out over the next 1-2 years. We are starting to witness a trend change in favor of "value," which from a long vs. short perspective is incredibly compressed. Our managers are also beginning to find new opportunities emerging both long and short. In fact, we are quite confident that for the first time in years both sides of our portfolio offer the potential for profitable outcomes.

See Last Page for Definitions & Risks

***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. EBITDA, Earnings Before Interest, Taxes, Depreciation and Amortization can be used analyze and compare profitability between companies and industries because it eliminates the effects of financing and accounting decisions.*

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.

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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