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PORTFOLIO COMMENTARY : February 2018

In our prior commentary, we stressed that much of the distortions in asset prices were being leveraged further by large momentum players betting on short volatility, which could contribute a spark for eventual market turbulence:

> *"We have witnessed historic financial market intrusions by central banks that has created extreme distortions in asset prices and caused volatility to collapse. A lack of volatility has led risk-parity strategies, quant funds and momentum players to bet further on these extremes. We are even witnessing a massive bet on "short volatility" which is essentially a replay of the "selling of insurance" gravy train that led up to the financial crisis. Is this a permanent new paradigm? Is it really different this time? Those questions have been repeated throughout history and the predictions have always proved incorrect."*

Comment on recent market volatility and positioning:
As stated above from our last commentary, we were positioned for this event. We have been hammering away at this risk routinely in our dialogue, and it should, at a minimum, serve as a warning for what could eventually materialize into a much larger problem. Sudden market unease begs the question, "Is this the beginning of the unwind, or will there be one final crescendo?" We do not know, but downside risks are as great as anything we can analyze historically. Our positioning remains flexible and we are seeking to take advantage of volatility. Should markets continue to fall, there may be a short term opportunity to reduce some of our net short exposure. Option positions have also been utilized opportunistically for both upside and downside tail risk and may exhibit larger than usual day-to-day volatility.

If markets are going to manage to recover and rally to new highs, it will need to happen soon. Either way, this latest event should serve as a glimpse of what is likely yet to come in the future. This is no different than the sub-prime and CDS crisis. It won't happen all at once. The progression just takes time.

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We have maintained a negative beta bias with our positioning due to what we believe are excessive market risks. Massive bets against volatility combined with hastily rising interest rates seem to be a potential problem when pitted against the enormous leverage that exists in risk-parity and quant strategies. Many of the funds operating in this area are leveraged 6-1 or more. The total amount of capital making similar bets on low volatility may be over $2 trillion, according to a recent Bloomberg article, with $1.7 billion going into two retail ETF products in January alone. It would not be a surprise to see the entire quant domain reverse course.

We also believe central banks have created a "make-believe" market environment that has generated extreme distortions in asset prices and volatility. Price, sentiment and volatility are the exact inverse of what was seen at the 2009 lows. The gap between price and fundamentals is well beyond what was seen in 1999, and we could be on our way to a 1929-type consequence. Many also seem blinded by the correlated risks associated with rising interest rates. The entire central bank scheme is built on too low, mispriced interest rates within global credit markets. They were pressed to an extreme. Nearly every corporation has loaded up on debt to buy back stock. As markets digest an increase in interest rates, the entire global liquidity meltup could eventually reverse. Everything is interconnected, and price/volatility will become a release valve.

More importantly, in addition to the price distortions created by quants and central banks, markets are experiencing one of the largest fundamental and economic delusions in history. In the face of rapidly rising interest rates (LIBOR rates have risen 4-5x since 2015), there has been very little growth in EBITDA (earnings before interest, tax, depreciation and amortization) and Revenues within US equity indices. Nearly the entire move in equity prices stems from financial engineering and multiple expansion combined with debt-fueled stock buybacks.

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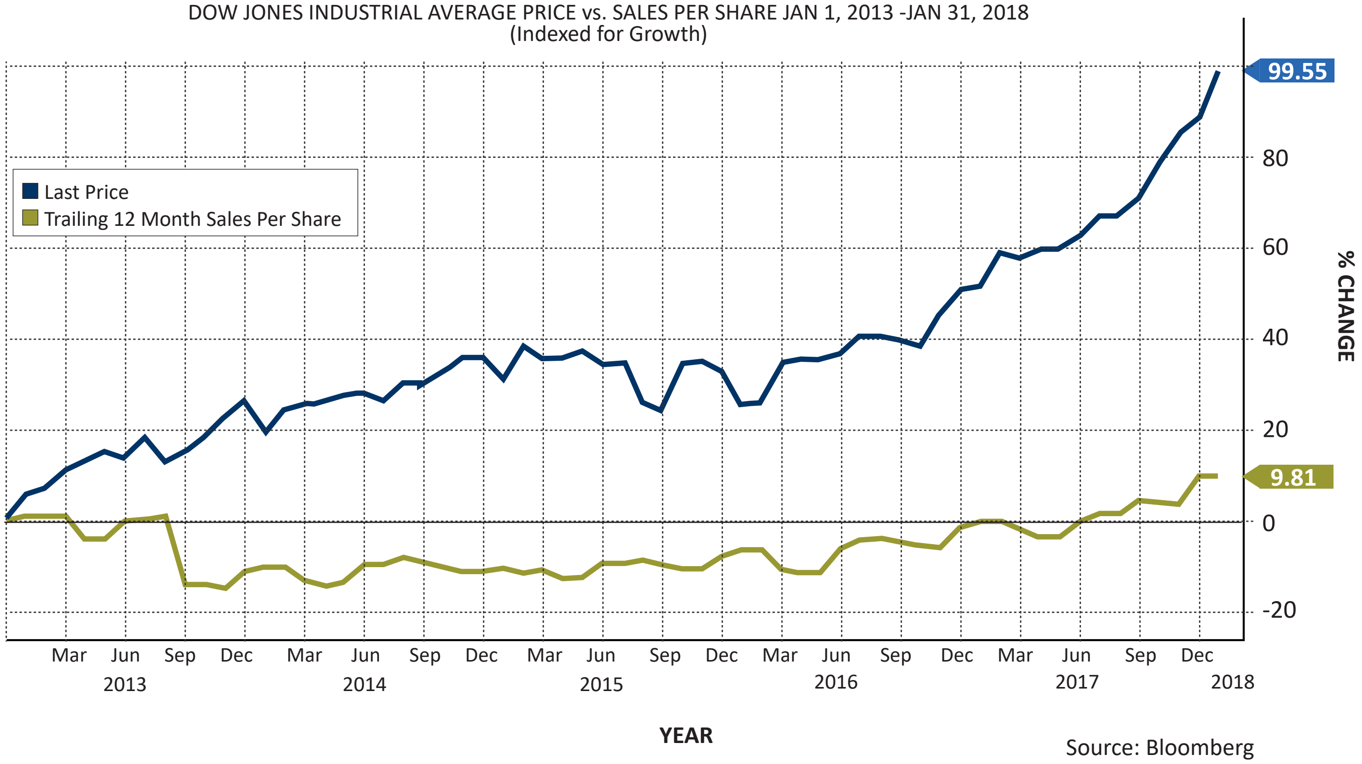
Perhaps the most glaring fundamental mismatch in equity indices is the Dow Jones Industrial Average. Since the end of 2012, revenue per share for the Dow has risen a grand total of 10%, while price has risen 100%. These numbers are per share and, thus, include the impact of stock buybacks. Without buybacks, revenue growth may be negative. The chart below illustrates that in order to correct this gap, revenue would need to suddenly jump 100% (near the end of a long economic cycle), or asset prices could drop 50% or more.



The Price/Sales ratio for the Dow is beyond excessive. It would need to fall 40% just to get back to the pre-2008 crisis PEAK. Over time, we expect the above gap that exists across all indices to be filled and we are positioned with a negative beta bias accordingly. Over the past 12 months, this positioning has been extremely difficult to maintain; yet the reality is the gap has only grown much, much larger.

As for market prices, we believe the only question is whether there is enough market momentum for one final leg higher, or are we finally near the end of the cycle. Either way, the ensuing unwind will be disorderly, and every snap-back rally will keep investors believing the worst is over.

Low volatility, one-way markets have been our worst enemy and, additionally, we were too early in adopting a negative stance. However, our strategy and expertise excels during more tumultuous times. We are well prepared for what's eventually coming. We have the tools, the managers, and the experience to take advantage of what could be a very turbulent few years. Passive, beta investments have done their job during the market melt-up. But, markets aren't always so kind, gentle and generous. The time may be near to put the passive genie back in the bottle.

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***Definitions:** *EBITDA, earnings before interest, tax, depreciation and amortization, is a measure of a company's operating performance used to evaluate a company's performance without having to factor in financing decisions, accounting decisions or tax environments. LIBOR is the London Inter-bank Offered Rate, which is the average of interest rates estimated by each of the leading banks in London that it would be charged were it to borrow from other banks. The Dow Jones Inductrial Average is a preice-weighted average of 30 stocks (traded on the New York Stock Exchange and the NASDAQ) that are considered to be major factors in their industries and that are widely held by individuals and institutional investors.*

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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