ABSOLUTE STRATEGIES FUND

# Quarterly Analysis - Q2 2016

Nathan Houser, VP, Portfolio Management

## FUND POSITIONING:

At Absolute, one of the main starting points to building the portfolio is constantly asking ourselves the question – **what can the Fund invest in that has the ability to generate returns that come from something other than just the broad markets going up?** In other words, where is there alpha potential? Sometimes that potential is in long biased strategies, sometimes in short biased strategies, and sometimes in relative value areas. The Fund's exposures change over time because these opportunities change.

It is not easy to find alpha in markets today. Many common hedge fund strategies appear crowded and highly correlated to one another. Time horizons seem to be getting more and more short-term oriented, causing beta and momentum to be more significant factors in hedge fund returns (and risks).

We have devoted much of our literature in the recent past to highlighting the growing disconnect between high prices and low growth. One reason for doing this is to point to mounting risk in beta oriented strategies. Another important reason is that this disconnect has created certain unique investment opportunities. Many of these are presently on the short side or in relative value/ hedged trades. There also appear to be some attractive longs in areas that have recently sold off such as small cap special situations or commodity related securities. It is important to note that we believe these opportunities to be concentrated in a small number of ideas, rather than in large areas/asset classes.

Overall, the portfolio has a balance of longs and shorts, avoiding a big bet in either direction (see below for more detail). With this positioning, the Fund is not designed to keep up during sharp market rallies. This positioning does provide the potential to generate what we believe are meaningful returns in a manner other than just betting on some part of the market going up, or betting on some new central bank policy.

## FUND PERFORMANCE:

For the second quarter of 2016, the Absolute Strategies Fund returned positive 3.08%, net of fees. By comparison, the S&P 500 returned +2.46% and the HFRX Global Hedge Fund Index gained 1.07%.

Many areas of the Fund contributed during the quarter. As groups, long biased equity strategies vs. index hedges, the global short biased equity strategy, and market neutral/hedged credit strategies all returned above 3%, gross of fees. Special situations/sector strategies lagged, producing a moderate loss.

It is worth noting that the Fund is up 6.24% through June 30th while maintaining a negative beta to the S&P 500 Index, which is up 3.84% over the same time period. **This highlights how performance is being generated in a manner that is unique, not just permanently bullish or permanently bearish.**

*Quarter-End Performance for ASFIX: As of 06/30/16, the 1 year, 5 year and 10 year annualized performance for the I- Share was 5.66% , 1.39% and 2.26% respectively.*

*Performance data quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. For performance current to the most recent month-end, visit the Fund's web site at www.absoluteadvisers.com. As stated in the current prospectus, the Fund's total annual operating expense ratio for Institutional Shares is 2.60%. Excluding the effect of expenses attributable to dividends on short sales and acquired fund fees and expenses, the Fund's total annual operating expense ratio was 1.81% for Institutional Shares.* Returns include the reinvestment of dividends and capital gains. Some of the Fund's fees were waived or expenses reimbursed; otherwise, returns would have been lower.

## PORTFOLIO ALLOCATION:

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| **Concentrated Long Biased Equity Strategies vs. Broad Market Indices (Short) - Allocation: 33%**<br>Boston Company Asset Mngmt, Long/Short Equity and Credit<br>Kovitz Investment Group, Long/Short Equity<br>St. James Investment Company, Opportunistic Equity<br>Yacktman Asset Management, Opportunistic Equity<br>Absolute Investment Advisers, Macro Positioning | This group combines several strategies that are long biased with different approaches to fundamental value investing. These strategies often utilize a limited number of positions. Aggregate positioning is focused on companies with strong balance sheets and the ability to withstand a variety of different economic environments, particularly margin pressure. Short exposure consists mainly of broad market indices but also certain sector funds or single name securities. Some short exposure is derived by the Sub-Advisers; some short exposure is derived by Absolute. This group has been net short at times. (Percentage reflects allocations to external manager strategies only.) |
| **Global Short Biased Equity Strategy - Allocation: 20%**<br>Longhorn Capital Partners, Global Long/Short Equity | This group consists of one strategy based on shorting a number of individual equity securities and using long broad market equity securities to moderate exposure levels. Positioning has been focused on companies with sensitivity to slowing global growth – financials (US, Europe, Asia), consumer cyclicals, industrials, and most recently aerospace. |
| **Market Neutral / Hedged Credit Strategies - Allocation: 22%**<br>LakeWater Capital, Long/Short Credit<br>Mohican Financial Management, Convertible Arbitrage | The Fund's credit exposure is solely in strategies that either have a natural hedge component (Mohican – convert arb) or currently have a balance of longs and shorts (Lakewater – corporate credit L/S). The idea is to isolate security selection while mitigating sensitivity to the seemingly large risks facing the bond markets. This group does contain certain short positions that may benefit from weakness in the bond market in addition to company specific news/events. *(continued on next page...)* |

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## PORTFOLIO ALLOCATION (Continued)

**Special Situation / Sector Strategies - Allocation 14%**

Harvest Capital Strategies, Long/Short Equity, Agriculture Focus

Sabal Capital Management, Special Situations

This group contains two long-short equity strategies with low to moderate net exposure. Each strategy is highly unique and tends to exhibit little correlation with each other or the broader equity markets. One common trait across the two managers is a focus on changing dynamics - either within a company or across a sector, and how those changes may be misinterpreted by the market.

## SELECT MANAGER HIGHLIGHTS & COMMENTARY

In this piece we often include comments from the Fund's Sub-Advisers. These comments may be helpful in understanding Fund positioning or simply what is happening in different parts of the market. Below are remarks from Lakewater Capital.

***AIA: The bond market currently looks pretty crazy, for lack of a better word. One has to look no further than the more than $10 trillion dollars of bonds globally now trading with negative yields. As an investor, does it ever make sense to buy a bond with a negative yield?***

**Lakewater:** Buying a government bond with a negative yield and holding it to maturity is like paying an insurance premium (a known locked-in loss) in order to get your money back. Our strategy is something very different from that. It is to combine a portfolio of positive yielding instruments with short positions. These shorts, in effect, carry a small negative yield or expense. However, the benefit in our view is the asymmetric positive return they can provide if and when the underlying issuer of the short position is perceived to be more at risk.

***AIA: Is there an implication of these low yields on US corporate bond prices and yields?***

**Lakewater:** Of course. It winds up impacting both the equity and credit markets. Finding instruments with an attractive yield in most bond or stock markets has become extraordinarily difficult, particularly if one is conservative and sensitive to price volatility and credit risk. The discounting mechanism of historically low rates is propping up prices on US stocks to historically high valuations at a time when economic growth and corporate earnings are stagnant. The absence of yield along with expensive financial assets make traditional asset allocation schemes mixing stocks with bonds potentially very risky.

***AIA: Does a risk conscious investor have to give up on yield altogether then?***

**Lakewater:** We don't think so. It does require sacrificing some yield, however. We just try to secure yield sensibly, with limited duration risk and with short exposure married to our longs. A relatively short maturity profile on our longs allows for us to have a steady stream of cash from incoming maturities and to limit credit risk, which we believe is growing. Having a balance of long and short exposure allows us to protect capital and take advantage of inevitable bursts in volatility. This year has seen market volatility in both directions, and the moves have been abrupt. We remain comfortable that true long/short credit investing and maintaining liquidity by truncating the maturities in our portfolios has and will in the foreseeable future be the best way to preserve capital AND generate a healthy return for our investors. Investing in a negative yield environment requires patience and the courage to avoid the temptations from unrewarded yield chasing.

***AIA: What looks attractive on the short side?***

**Lakewater:** Companies in focus for us as potential short opportunities are challenged with little or no top line growth and have resorted to financial engineering to maintain earnings per share, a common metric to gauge stock prices. Cheap borrowing costs have driven a re-leveraging of supposedly high quality company balance sheets to debt levels not seen since the depths of the financial crisis. Companies have of course been using cheap debt to buy back their stock, pay dividends and make acquisitions all to support their equity share prices. We believe this favors our alpha short positions in areas such as retailing, leisure, transportation and basic materials. Not only do we benefit from the sensitivity of these companies to a potential economic slowdown, but we also have return potential as these companies grow their debt load in a futile attempt to keep their stockholders happy.

***AIA: You mentioned growing credit risk and corporate re-leveraging. That seems to get overlooked by the financial media in favor of repeated interest rate discussions. Is there an easy way to understand the concern about credit risk?***

**Lakewater:** In normal times, the peaks in corporate leverage occur during or immediately after a recession, as companies' cash flow declines due to cyclical weakness. Here we are, late in an economic expansion, and leverage has already reached recessionary peaks. This, of course, is due to the cheap borrowing that supposedly high quality companies have undertaken to fund share repurchases and dividends in support of their stock prices. *(continued on next page...)*

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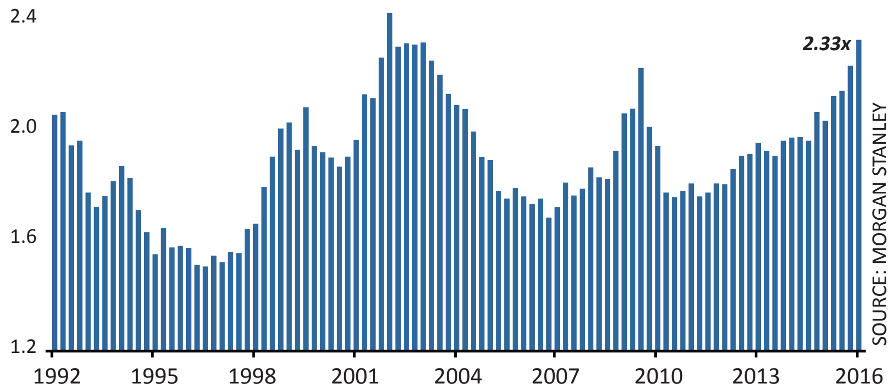
ABSOLUTE
INVESTMENT ADVISERS

**LAKEWATER COMMENTARY (Continued)**

A recent piece by Morgan Stanley quantified the alarming growth in debt leverage at non-financial investment grade issuers. It is depicted in the chart below.

Morgan Stanley goes on to point out two meaningful features of this alarming debt binge that's occurring: 1) it is broad based, with 63% of the issuers they track growing leverage year over year, a level not seen since right after the great recession; and 2) the "tail risk" of looming downgrades of company's debt from investment grade to junk, as the impact from a business cycle downturn is elevated now since over 30% of the investment grade companies in their sample have leverage of over 4.00x (compared to the IG average shown above of 2.33x). These are sobering figures for both debt and equity investors who are concerned about the risks in their portfolios should cheap debt financing eventually dry up, as it has in past recessions and investment cycles.

**GROSS LEVERAGE of INVESTMENT GRADE NON-FINANCIAL ISSUERS**




**Definitions:** *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 multipl Sub-Advisers, 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 in which the Fund may invest. 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 investments 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

Three Canal Plaza, Suite 600, Portland, Maine 04101
(888) 99-ABSOLUTE or (888) 992-2765
**www.absoluteadvisers.com**



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