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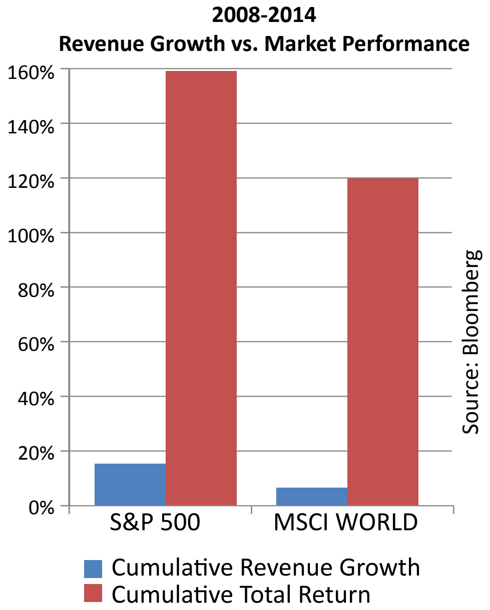
PORTFOLIO COMMENTARY : First Quarter 2015

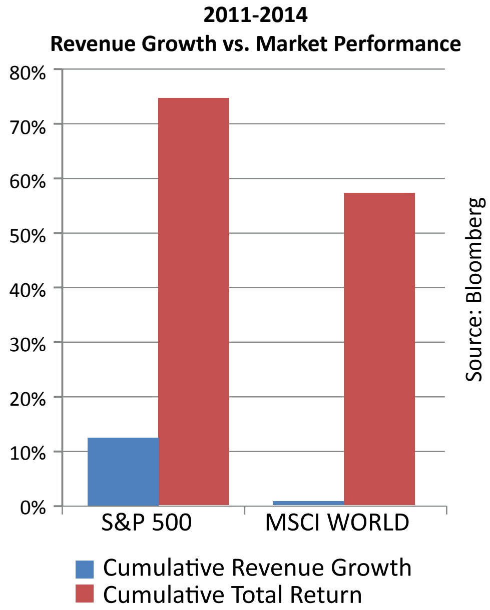
The last few years have been the most difficult and frustrating for our strategy since our Fund's inception almost 10 years ago. Our performance can be fairly assessed by our very conservative positioning over the past 2 years. We've been effectively market neutral, including a slightly negative beta bias over the past 18 months. Why has our positioning been so defensive? Following the initial recovery in asset prices and fundamentals (which we correctly positioned for), we did not believe that lofty expectations for global economic and fundamental growth would be met. We were correct. Global economic and revenue growth has been nowhere near expectations – every single year since 2011. Instead, investors have bid up asset prices (every single year), in hopes that growth would hit some escape velocity. In doing so, we believe asset prices have gone up over the past few years almost solely on the back of multiple expansion (asset inflation) that was fully promoted by the Federal Reserve (Fed) and other central banks.

The cleanest way to put this "bull market" into fundamental context is to simply examine revenue growth vs. total return for the S&P 500 and MSCI World Index since the end of 2008:



For US markets, that's a 159% return for 15% total revenue growth. US Real GDP growth averaged only 1.9% over this time. And, much of the revenue and economic growth came from the energy sector which is now under significant pressure. How many investors are truly aware of this picture?

To be fair, much of the performance gain in equity markets since 2008 came from depressed prices which, we whole heartedly agree, was a great opportunity to be long risky assets. This is why our portfolio was positioned very aggressively (for our strategy) coming out of 2008, after being defensive going into 2008. However by the end of 2011, prices were no longer depressed and the S&P 500 was, at the time, up nearly 100% from the 2009 bottom to Dec. 31, 2011. This is the point at which we believe the European Central Bank (ECB) jaw-boning, Federal Reserve quantitative easing (QE), and corporate financial engineering started to prompt performance and yield chasing by much of the financial community. There was also continuous assurance from Wall Street, the Fed, and the government that the economic recovery was on an escape path for 4%+ GDP growth. Putting all of that into fundamental context looks like this:



In summary, since 2011, (and importantly post the initial 2008 rebound), global equity revenues have hardly grown at all; that's less than 1% total revenue growth in 3 years. US Real GDP growth has only averaged 2.1% from 2011-2014, despite assurances of the "recovery." The S&P 500 is up another 74.5% on the back of 12.3% total revenue growth. This includes any benefit of stock buybacks as the figures are per share.

Apparently math and finance have changed in this new era of QE inspiration. Markets today are not about investing; they are all about central banks. We've been punished for staying disciplined. We did not place a high probability on investor willingness to follow the Fed, chase momentum and drive financial markets into near bubble levels for the 3rd time in 15 years. After two historic episodes of driving unsustainable economic growth via excess liquidity in financial markets, it appears the financial community has decided that central banks are firmly in control. This is the same Fed whose recipe for liquidity-fueled asset inflation ended in complete bust multiple times. We ask ourselves, *"How can we possibly be here, again?"* It doesn't

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matter. Our discipline cost us and we missed much of the last run up. Like every investment, there are times when your strategy is no match for certain short-term market environments. For many traditional strategies, a mis-match would mean significant losses. For us it has simply been significantly frustrating. But now what?

We've had 6 ½ years of continuous "emergency" assistance, including zero percent interest rates, over $24 trillion in global central bank stimulus, plus trillions more in deficit spending. Trillions of dollars in sovereign debt have traded at negative yields with trillions more under 2%. Some of the least credit worthy European sovereign debt is trading as investment grade and appears nearly risk-free simply because it is being "packaged" inside the Euro wrapper. Some very large European institutions also own a great deal of this debt, but supposedly they are not at risk either. Doesn't that sound familiar? As for corporations, according to the Bank of International Settlements, dollar-denominated global corporate debt is up 250% since 2008; much of this may be significantly impacted by a rising US Dollar. US covenant-lite debt, which is generally the worst of the junk market, represents an astounding 2/3 of total debt issuance, up from 25-30% at the 2007 peak. This is just another massive central bank-induced credit expansion that has led to unsustainable asset inflation. If anyone has forgotten, 2007 was the granddaddy of all credit bubbles. What are we supposed to call this?

As for the equity markets, margin debt is at historic highs and margin debt to GDP has now reached 2000 levels. Valuations are now well beyond 2007 peak levels and nearing 2000 levels. Equity market capitalization to GDP is the highest in history outside of a couple of quarters around the 2000 bubble peak; it is over 2 standard deviations above the norm. The median price/revenue of the S&P 500 is the highest in history and above the 2000 bubble; it is also more than 2 standard deviations above the norm. If not for historically high corporate profit margins, the price/earnings ratio for the S&P 500 would be about 30x (using historical average margins). Even using the profit margin from the 1997-2000 bubble peak would give the S&P 500 a P/E of 26. The only way financial pundits can justify meaningful equity exposure is to compare valuations to the 2000 bubble; to require no cyclical adjustment to excessive profit margins; to make no assumptions interest rates will ever rebound; and to use some of the highest valuation multiples in history. They also need to completely ignore the lack of revenue growth.

At some point, both equities and bonds will reach exhaustion. At that point, the impact of liquidity on price and risk could be sudden and painful. To quote one of our managers, Robert Mark of St. James Investment Co.

> *"...liquidity provided by central banks simply perpetuates the illusion of maximum pricing and stability for stocks and bonds while shifting the risk curve to the point where any deviation from "perfection" – or loss of faith in the liquidity of its providers – will ultimately lead to a waterfall in price. When this moment materializes, there is essentially no market because the investor cannot sell."*

There will be no warning for investors before they start losing money. Whatever the eventual "cause," it is likely already working its way through the financial system. This was the case with the delayed reaction of equity prices in 2007-08, and with oil and commodity prices last year; there was also no debate of a bubble in either market before prices dropped 50%. It's not a stretch to say the equity markets are at risk of dropping 40% or more over the next few years. It's also not a stretch to put current upside risk at <10% given the Fed has spent a tremendous amount of goodwill trying to discuss rate tightening and regime change. A quick move back toward QE would seriously damage any remaining credibility.

As for the credit markets, investors who used to worry about duration risk while earning 6-7% are now taking on significant duration risk, credit risk, and liquidity risk to earn income that used to be considered risk-free and FDIC insured. We believe the chances of interest rates going back up from here are much greater than zero. This is not because we believe economic growth is going to rebound strongly, but because interest rates are so low that even the most complacent investor must be considering risk/reward. Trillions of dollars in debt is trading near zero interest rates; how much further does this secular bond bull need to go?

Additionally, we believe the Fed has really boxed themselves into a corner. They've had numerous opportunities to get off the zero bound. But now they are dealing with twin bubbles in bonds and stocks along with an economy that has slowed. However, the real problem may exist with their academic approach and their data dependence. The well-known data here is the unemployment rate and the inflation rate, both of which could easily force the Fed's hand despite low economic growth or a decline in equity prices. The unemployment rate is already in the Fed's target range, and a slight rebound in commodity prices along with modest rent or wage pressures could really cause mass confusion. It's not at all impossible to imagine a rebound in inflation statistics, volatility in interest rates, a low growth economy, and a large drop in equity prices. This is not to say the Fed will or should raise rates. They have simply created bureaucratic targets that are easily identifiable and difficult to steer from. The Fed's credibility could be put to the test sooner than anyone can imagine and it may only take a few months of data. At a minimum, the potential for volatility in bond prices, interest rates, and currencies could be extreme and is completely untested by decades of backward-looking financial models.

The entire risk management environment is completely surreal and quite bizarre. Only 6 years after many investors were nearly wiped out, a disciplined approach focused on managing risk is now outright mocked and punished as Fed-fueled markets reach historic heights. Many of those dismissing risk are the same ones caught naked during the financial crisis and swore they would never let that happen again. The S&P 500

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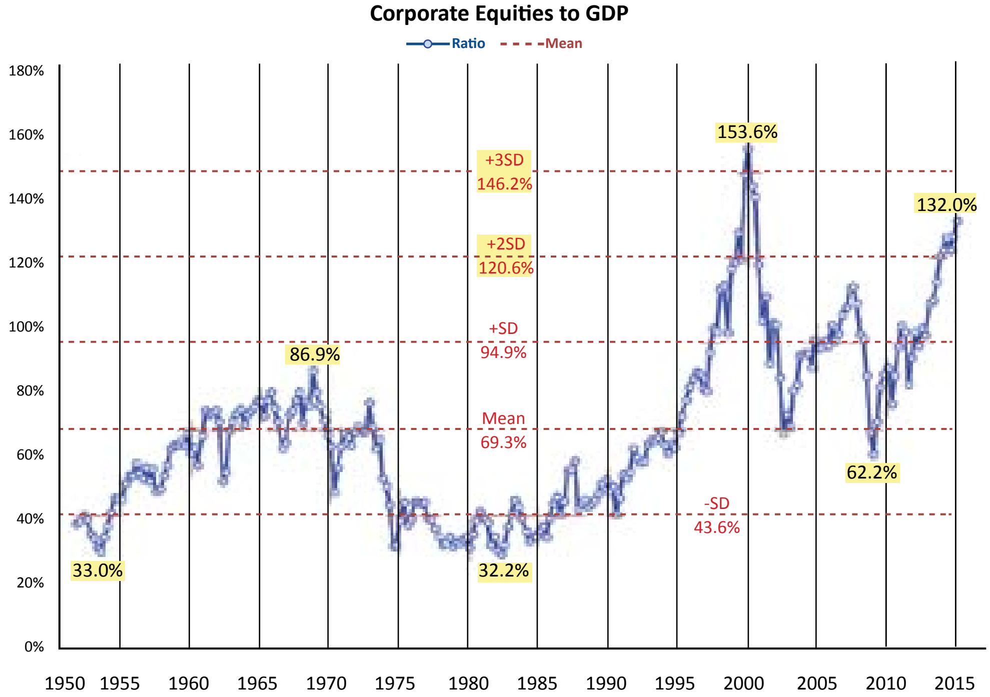
is now considered the risk-free rate and the risk of loss is no longer applicable. Wall Street has once again reached mass delusion. Both fiduciary responsibility and "other people's money" are firmly at risk as savers have been forced into risky assets to maintain basic income.

We have been very fortunate to work with disciplined and honest financial advisors. It certainly has not been easy for many of them to talk about risk when their clients see stock and bond prices hitting constant highs with no volatility. It has probably been the most difficult era ever to maintain true diversification and not be tempted to chase performance. It's hard to blame those who have given in to the circumstances. We understand the pressures and hope many can find a way to talk honestly with their clients without worrying them. However, there also may never be a more important time to consider the probability that markets eventually return to fair value. You cannot try to time an exit. Anyone who has survived the past 15 years knows there are times when you need to focus on defense. There is also a decent probability that a longer, 30-yr cycle driven by a continuous drop in interest rates that has manifested into enormous credit expansion and historical debt levels may be nearing its end. Given that certain global bond markets are nearing 0% yields, longer term investors should be giving this serious consideration. It is hard to imagine, but at some point the secular interest rate trend will reverse. Some asset classes such as REITs, private equity, and junk bonds actually have no experience with a sustained period of rising interest rates.

We do not know how all of this will end. Many statistics that measure risk or suggest highly overvalued markets are at very dangerous levels. These statistics are also highly cyclical and mean-reverting. Even though many of these same statistics have forewarned of frothiness in the past or are strongly correlated to negative future returns, they are again dismissed. That would suggest the markets are pricing in a very favorable outcome and it cannot end badly. We disagree. We think there will likely be a significant re-pricing of risk, tremendous volatility, and unique opportunities to invest both long and short. Although the past few years have been tough, we are incredibility optimistic about the future investing climate for our strategy. As for inflation vs. deflation, we expect both. It just may not be in the form most investors are prepared for; the stock, bond, and commodity trends of the past few years could be nearing a turning point. We also firmly agree with renowned hedge fund investor Stanley Druckenmiller who recently commented on Fed QE and on the current environment:

> *"I don't know when it's going to stop. And on inflation this could end up being inflationary. …but there is nothing more deflationary than creating a phony asset bubble, having a bunch of investors plow into it and then having it pop. That is deflationary."*



Source: dshort.com, May 2015, Q1 Advance Estimate

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 MSCI World Index captures large and mid-cap representation across 23 developed Markets. With 1.631 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. It is not possible to invest directly in an index or average. Alpha is the measure of performance on a risk-adjusted (beta) basis. Alpha takes the volatility (price risk) of a fund and compares its risk-adjusted performance to a benchmark index. The excess return of the fund relative to the return of the benchmark index is a fund's alpha. 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 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

SKU: ASF-COMM-Q115

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