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PORTFOLIO COMMENTARY : Second Quarter 2014

The Fund has performed well in a variety of environments year-to-date with negative correlation to equity and credit markets, as well as to most hedge funds. We are beginning to see several divergences that may be hinting at a return to fundamentals in areas that could benefit the Fund. Smaller cap stocks and high yield credit are beginning to struggle and European banks are starting to reveal some cracks. Additionally, many companies that are tethered to the global growth story are offering forecasts that have not kept up with investor expectations. Other companies have simply run out of ways to create the illusion of growth via stock buybacks and financial engineering. Even a likely rebound in Q2 U.S. GDP growth, may not be enough to mend the big picture. Should these trends continue, the Fund could perform quite well and potentially provide meaningful diversification to investor portfolios.

It has been quite remarkable to see financial markets push to new highs while global economic and earnings trends remain lackluster. We continue to see a heightened disconnect between fundamentals and valuations. Easy money policies by central banks continue to force investors to chase yield and compress risk premiums across risky asset classes. Belief in the Fed "put" has become exceptionally ingrained and easily outweighs any worries of QE tapering or potential rate increases. Asset class correlations, including hedge funds and "alternatives," are very high and complacency toward increased volatility or liquidity problems in the credit markets is simply incredible. We feel as though we have seen this before.

In fact, here is an excerpt from our 2nd quarter 2007 commentary:

> *"Equities returned to their straight-up path for most of the 2nd quarter…historically low and stable interest rates along with record profit margins continue to reinforce a willingness to accept very low risk premiums across many risky asset classes. We've begun to wonder, "Do some investors view the S&P 500 as the new risk-free rate?*
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> *We continue to observe broad asset class correlations and sensitivities (measured by beta), which most recently include the bond market. Combining this with loose credit standards, leverage, and private equity debt dependence could create an interesting environment when profit margins revert to normal, liquidity moderates, or risk premiums and credit spreads widen. Attempts to diversify portfolios using traditional asset classes may prove to be ineffective in volatile markets."*

In our 3rd quarter 2007 commentary we added:

> *"…many hedge fund strategies have relied on easy credit, low volatility and excessive use of leverage. Up until recently this undisciplined approach had created a panacea of incredible returns with low volatility. Unfortunately low volatility does not mean low risk, especially when using illiquid investments that are not marked to market, but marked to a model. When highly levered portfolios are not valued appropriately, a dislocation is inevitable when conditions change."*

While there are certainly differences between 2007 and today, it's remarkable how similar market participants view the low interest rate "excuse" and Fed "put" to ignore excessive valuations. We actually believe financial market risk is much broader today than in 2007. Equity valuations are more excessive, as measures such as price/sales, cyclical P/E ratios, and market capitalization/GDP are well above 2007 levels and nearing 2000 bubble territory. Also, interest rates are much more compressed, junk spreads are tighter, and liquidity in bond markets is likely far worse. Adding to the list of excess, corporate stock buybacks are more egregious with net corporate debt levels at all-time highs, margin debt is at all-time highs, profit margins are further from their long-term average, issuance of covenant lite debt continually hits new records, carry trades are larger, hedge funds are more correlated to equity and credit risk, geopolitical risks are far higher, and groupthink and confidence in central banks is at all-time highs. What happens this time if credit spreads widen? What if volatility increases? What if profit margins revert to the mean? What if debt-fueled buybacks cease? What if China growth continues to slow? What if levered carry trades unwind? What if monetary policy tightens? And, if the current artificial interest rate and money printing environment goes away, what will the true equilibrium reveal?

It is anyone's guess what may or may not happen, but it seems clear that there are many patterns that are unstable and unsustainable. All the while, global growth and earnings remain anemic at best. Given the mystifying level of complacency across markets, we see the potential for investment opportunities in the not too distant future when volatility returns. Our patience, flexibility, liquidity and discipline toward long-term investment fundamentals should be well rewarded.

See Reverse for Definitions & Risks

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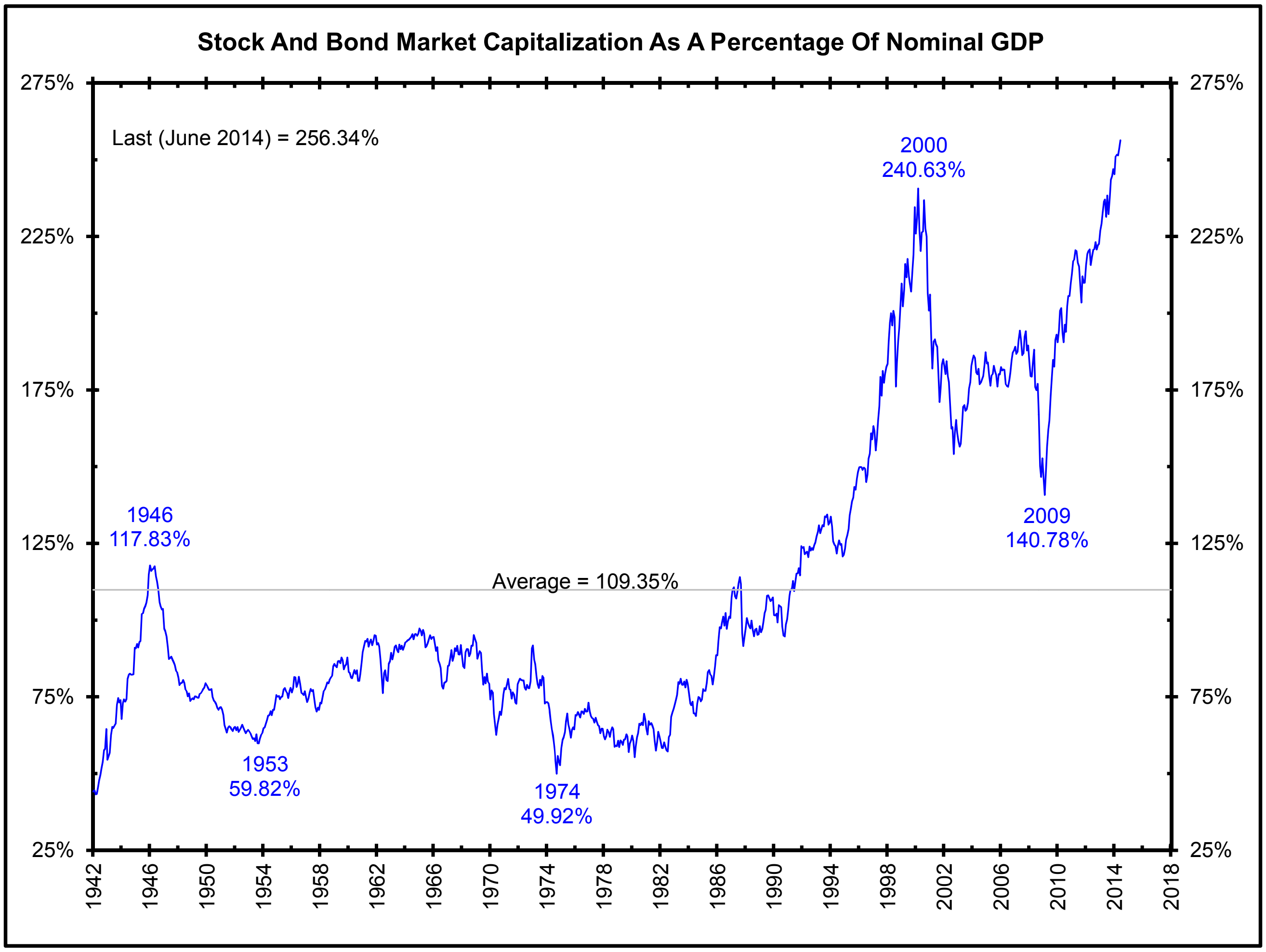
Addendum

To put valuations and financial market excess into full historical perspective, we have included a chart used by one of our sub-advisers, St. James Investment Company. Equity market capitalization alone to Nominal GDP is 4x the level at the 1982 stock market low. When looking at both stocks and bonds relative to GDP, the levels compared to long-term historical ranges are absolutely incredible:



Data Source: Department of Commerce, Ibbotson Associates, Factset Research Systems Inc.

Chart Note: Correctly looking at how companies capitalize their assets with BOTH debt and equity, valuations are above the 2000 peak.

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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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