Jay Compson is the portfolio manager for the Absolute Strategies Fund and Principal and Co-Founder of Absolute Investment Advisers LLC

PORTFOLIO COMMENTARY : Third Quarter 2015

The global market environment is becoming quite volatile and surreal. It can be defined simply as a major battle between central bank status quo and fundamental reality. 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.

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.

As we've discussed at length in prior commentaries, there continues to be a significant unwinding in some very important asset markets and currencies mostly related to China and emerging markets. Equities, bonds, and commodities sensitive to these markets continue to feel the effects of a strong US Dollar and a significant slowdown in global economic growth. As we mentioned in our last commentary, it was only a matter of time until US markets would also be impacted by global weakness and a major break occurred in the 3rd quarter. While US indices have recently rallied strongly, nearly back to the highs, market internals continue to be quite weak. Most of the gains for US indices are due to price movements in only a handful of large cap companies while many more stocks continue to break down following earnings disappointments. Worse, the US Dollar continues to soar which is also a clear negative for US profits.

While investors cheer the market rebound and companies scramble to buy back huge amounts of stock, the fundamental picture has not improved. Repeating our prior comments, China and emerging markets have been the main drivers of global trade and global growth since 2008. These markets have taken on significant amounts of US dollar denominated debt to fund massive projects. Like every credit fueled expansion, it led to large over-investment and a misallocation of capital. The ensuing breakdown is likely to have real implications for the global economy. The seriousness of this process cannot be underestimated because the most vital element and foundation for our entire global leveraged financial system is collateral. Collateral provides the means (the asset-side of a balance sheet) for lending and borrowing. As it relates to emerging markets, the amount of collateral is significant, and it is being hit by both crashing commodity prices and a strong US dollar. Not only is the debt-fueled investment spending binge at an end, it looks to be reversing. Unless China quickly rights itself and reignites global growth, it is likely the US economy is eventually pulled into the mix.

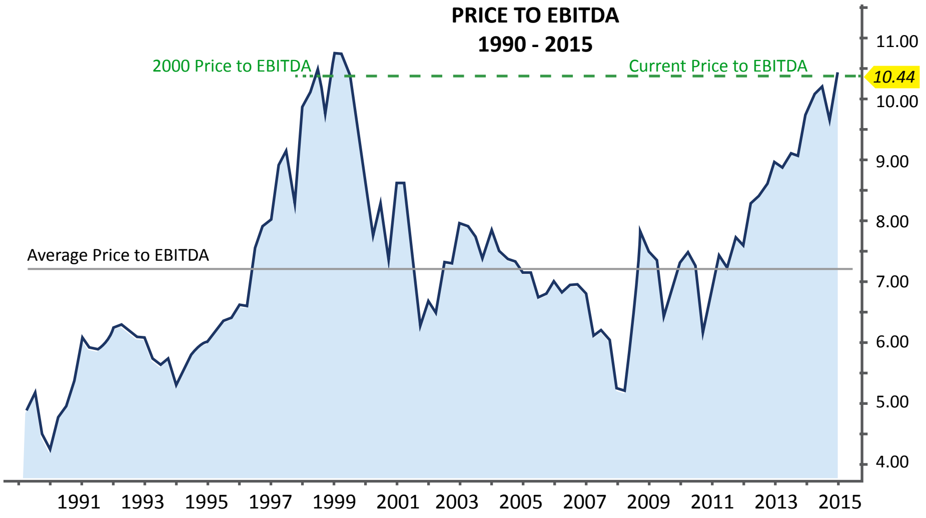
After witnessing violent market swings on no news, a U.S. equity market that is nearing the most over-valued in history (using a variety of metrics) and a bond market that reeks of illiquidity, we struggle to understand how investors are willing to tie so much wealth to today's markets. As seen from 3rd quarter performance reports, there is no way to diversify portfolios through traditional asset classes. We were clearly one of very few strategies that performed well. We also believe markets are reaching extreme overvaluation. The S&P 500 price/sales ratio is 1.85 (vs 1.65 at the 2007 peak), and Price/EBITDA (*Earnings Before Interest, Taxes, Depreciation and Amortization*)* has reached June 2000 bubble levels. We are witnessing a new brand of bubble stocks as companies such as Facebook are now valued at nearly 20x sales, which is higher than Cisco in 2000. Companies such as Valiant and Volkswagen are also typical illustrations of mania behavior, and they have fooled some very smart people. Additionally, overall S&P 500 revenue and earnings growth has been negative for several quarters.

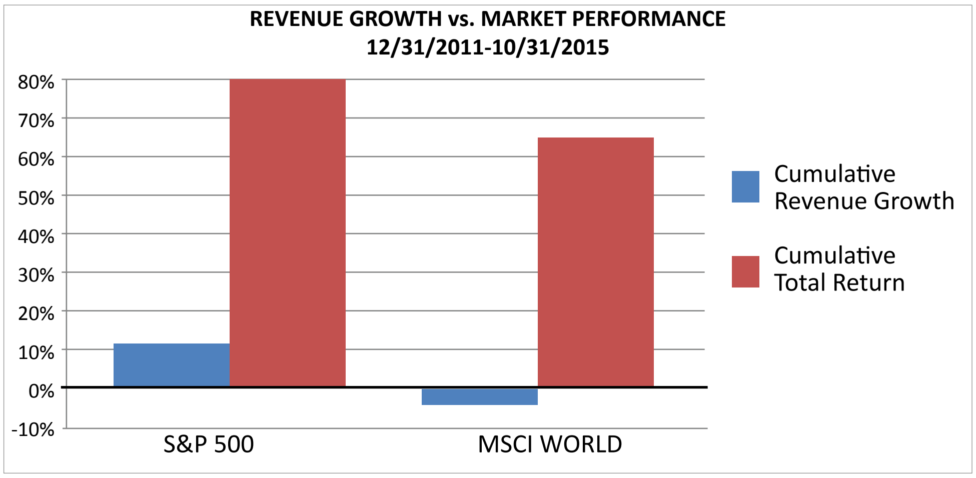
Since markets are near bubble territory, large swings are likely and we have no idea whether the next move is 30% lower or 30% higher. However, we do know that this will eventually end badly and may be made worse by central bank promises and illiquid, highly priced bond markets. There are very few ways 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>. This is an enormous tail risk that nobody is prepared for. Maybe it doesn't occur right away or can be put off a bit further; but we believe it is inevitable and higher interest rates or credit spreads could be the catalyst. Again, much depends on China, not the US, so the path may not be obvious. We are committed to staying disciplined and we continue to be positioned very defensively. For more details, please review our Portfolio Analysis sheet.

[Continued, with charts, on next page]

See Last Page for Definitions & Risks

The charts below are meant to provide simple, logical illustrations of the complete disconnect between market prices and fundamentals. We believe it is important to look at a variety of measures when judging market valuation. An investor should not rely on forward P/E ratios that are influenced by notoriously over-optimistic Wall Street analysts. Nor should an investor rely on trailing twelve month P/E ratios because companies can overstate earnings in the short term. Instead, Nominal GDP, Revenue, and EBITA (cash flow) can be useful statistics because they are difficult to manipulate or "adjust." Each chart below highlights a concept we have talked about numerous times – the market has been rising significantly despite fundamentals remaining weak. In the past, this disconnect has signaled a "bubble." How is it not a bubble this time?





SOURCE: *BLOOMBERG*

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.

ABSOLUTEstrategies FUND

SKU: ASF-COMM-Q315

Three Canal Plaza, Suite 600, Portland, Maine 04101
(888) 99-ABSOLUTE or (888) 992-2765 www.absoluteadvisers.com
Distributor: Foreside Fund Services, LLC