



July 7, 2017

Second Quarter Update and Outlook

The Information Technology sector, at 23% of the S&P 500 in May 2017, topped its past peak weighting in the S&P 500 Index reached during the dotcom peak of 2000. By contrast, the Energy sector's weighting at 6% is a shadow of its former self, peaking in 1980 at 28% of the S&P 500. It is hard to imagine Energy being so popular, as it was back then. Yet, just like Energy was a larger part of the economy back then and its valuations were bid up, the Information Technology sector is benefitting from the same phenomena; it is a larger part of the economy today and its valuations have been bid up. The outperformance of growth stocks evident for most of the past five years (which includes a heavy focus on Information Technology sector) has likely run out of steam in our opinion. The specter of higher interest rates, a mixed economy, and the current large gap in valuations between growth stocks and value stocks will likely be factors in the rotation to value that we expect in the second half of 2017. In addition, our Opportunistic Value Equity Strategy continues to have significant cash reserves (31% at June 30), reflecting our belief that investors are way too comfortable with the overall investment outlook in the near term.

Our investment performance during the second quarter was negatively impacted by our investments in the Healthcare sector, which performed particularly poorly during the quarter. During the quarter, we purchased Alder Biopharmaceuticals, a Seattle area based company that is developing a fast acting drug, Eptinezumab for the prevention of frequent and chronic migraine headaches. Approximately 38 million people suffer from migraines and 3 million suffer from chronic migraines in the U.S. Since our purchase, Alder announced positive phase 3 results for prevention of frequent episodic migraines. Nevertheless, investors are concerned that results may not be enough to set Eptinezumab apart from its competitors in the race to develop an effective treatment for migraines. During the second quarter, we exercised warrants to purchase additional shares of Deutsche Bank, AG. We are optimistic that Deutsche Bank is well on its way to closing the chapter on its past missteps that resulted in large fines paid primarily to the U.S. government for past business practices. The company can now rebuild its business presence, which focuses primarily on areas outside of the United States. We sold our shares in New York Community Bancorp during the quarter. We believe the greater New York City area is in the early stage of a real estate slowdown that will hamper New York Community Bank's goal of building its asset and earnings base.

The U.S. Federal Reserve Board recently changed its monetary stance towards normalizing its policy through a series of interest rate increases and a goal of reducing the amount of government bonds it owns. The Federal Reserve is likely concerned that its opportunity to raise rates will soon be ending after over eight years of U.S. economic expansion. Investors probably haven't noticed that their short term cash investments, including money market funds are actually earning some return now, which hadn't been the case for seven years. If this rising trend continues, it will likely change investors' attitudes towards risk, allowing investors to accept the returns of lower risk investments. If so, it will also mark a change in the general stock market, whereby investors will require better values (higher growth or lower prices) to take on more risk. Hence, our caution on the general stock market outlook.

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