March 31, 2016 Quarterly Report

As always, thanks for your continued support and trust in allowing us to provide you with your investment management solution.

Wild Start to 2016

The Standard & Poor's 500 Index declined over 10 percent in the first six weeks of the year. However, the index still managed to end the quarter slightly positive. This was the biggest quarterly turnaround since 1933. Just as we described in our last letter how more trading was moving towards a limited number of securities, we saw this pattern become uncoupled. The momentum strategies finally came unglued and many traders were on the wrong side of bets on volatility.

Correlated moves among equities reached their lowest levels since 2012 and market breadth, or the number of stock advancing, improved dramatically after trading lower in late January/early February. We were able to take advantage of the increase in volatility by buying additional equities on some of the days with the largest market declines.

High volatility trading is not something that we look for as investors. However, when we see periods of high volatility affect quality assets, we appreciate the opportunity to purchase assets at lower prices.

Investing is never easy. Watching price movements throughout the day makes it even more difficult to formulate objective analysis. We work on this everyday questioning our rationale in all of our investments. We are not as concerned with intraday pricing. We try to focus on the fundamental news for each and every investment.

To provide you with a sense of how we view the day to day price changes within the capital markets, we would like to share with you a comment in a letter written by Howard Marks of Oaktree Capital Management after the Dow had been down over 565 points in January:

> *"Especially during downdrafts, many investors impute intelligence to the market and look to it to tell them what's going on and what to do about it. This is one of the biggest mistakes you can make. As Ben Graham pointed out, the day-to-day market isn't a fundamental analyst; it's a barometer of investor sentiment. You just can't take it too seriously. Market participants have limited insight into what's really happening in terms of fundamentals, and any intelligence that could be behind their buys and sells is obscured by their emotional swings. It would be wrong to interpret the recent worldwide drop as meaning the market "knows" tough times lay ahead."*

We share Mr. Mark's and Mr. Graham's philosophy that the day to day market is not fundamentally driven. It is an emotionally driven market that over time reflects the fundamentals of the companies that are in the market.

While we may accept that we are facing headwinds for corporate earnings and may have entered a recession, we think there remain quite a few factors for maintaining equity exposure at this time. We present some of these reasons below.

The Bullish Case for Equities

1) Since 2008, the Fed has been predicting 3 to 4 hikes each year, and they have yet to accomplish this.

2) From a price-earnings-ratio perspective alone, long-term equity valuations show that U.S. stocks are still delivering real returns in line with historical norms.

3) Strength in the labor market reinforces our view that the economy remains in solid shape.

4) Manufacturing may be finally shifting into a higher gear. The March ISM Manufacturing Index beat expectations by rising from 49.5 in February to 51.8 in March, the highest level since July 2015.

5) Investor Sentiment: The S&P reached its 2016 low on February 11, when bearish sentiment peaked at 48.7%. That was also the day that oil hit bottom at $26 and gold rose $50 in a day to $1240 - the day of maximum pessimism. The proportion of bears in 2016 more than doubled at just the point when they should have been buying.

6) Money Flows: When people withdraw money from equity funds, stocks tend to rise. According to data compiled by Bloomberg and the Investment Company Institute (ICI):

   "in the 12 instances when funds experienced monthly outflows that were at least two standard deviations from the historic mean, the S&P 500 rose an average 7.1% six months later, compared with a normal return of 3.9%."

   This is happening once again in 2016. According to the Investment Company Institute, reporting on February 25, the net new cash flows out of all domestic equity funds declined for 11 months in a row as of January, 2016, for a net outflow of $192.9 billion over the last 12 months.

Bearish Case for Equities

Of course, all of these factors could be mere short term movements in a greater bear market environment. The bearish case for equities is simply the risk we take for investing assets. Risk is present whether or not we decide to invest assets. There are many types of risk, and while they can be mitigated, they cannot be eliminated. But what is risk and what are the biggest risks?

What is Risk?

There are many definitions of risk. One that we recently came across defined risk simply as:

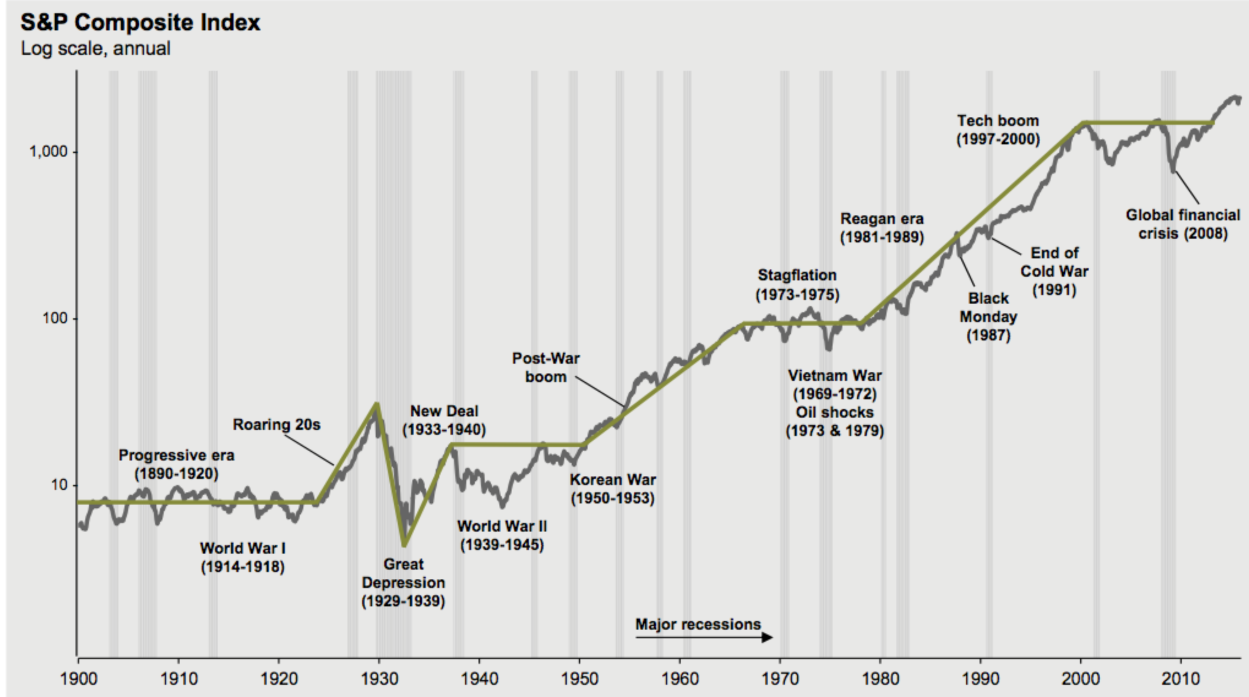
"It's always something."

Ethan Harris, head of global economics for Bank of American, stated this as a way to describe that there is never zero risk that exists when investing. Whether those risks are earnings, China's growth, low oil prices, high oil prices, inflation, deflation, stagflation, low interest rates, high interest rates, default, credit, longevity, war, famine, pestilence, etc…

There will always be risk because for over a hundred years, *it's always something*. We recognize that over the long run, even with a trove of large negative events, equities will grow. As shown in the S&P 500 chart below, the market has weathered global catastrophes, selloffs, wars, etc… and has always found a way to recover.

Stock market since 1900

GTM – U.S. | 15



Source: FactSet, NBER, Robert Shiller, J.P. Morgan Asset Management.
Data shown in log scale to best illustrate long-term index patterns.

Warren Buffett summed the rationale for investing in equities even in the face of a sea of risks in October 2008 when he wrote:

> *"In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497."*

We believe in the long term return that capital markets can provide for your investments. We try not to let the daily sentimental movements affect our judgment and hope that you do not as well. However, we do not blindly accept that we should always be fully invested. There are times that are more opportune than others for increasing exposure to equities.

Financials, Energy and Materials

We continue to believe that over the next few years we will see the Financial, Energy and Material sectors deliver above average returns. These sectors have been laggards over the last 5 years for a myriad of reasons. Most notably, the Fed's Zero Interest Rate Policy and the strength of the US dollar. Both of these factors have worked against these sectors and we believe that this trend is starting to reverse itself. The dollar has been trading off its lows made in November 2015 and we expect interest rates to rise at some point over the next 12 months. While we have been disappointed by the meager returns we have seen since increasing our exposure to these sectors over the last few quarters, we are encouraged by their recent performance as our thesis for investing in companies within these sectors is supported.

Index Returns

Index	Q1 2016	Q4 2015	Q3 2015	Q2 2015	5 Year Annualized
*MSCI ACWI ex-US	1.00%	2.88%	-11.61%	0.42%	-0.33%
S&P 500	1.35%	7.04%	-6.44%	0.28%	11.31%
Russell 2000	-1.52%	3.59%	-11.92%	0.42%	6.60%
Barclay's US Agg	3.03%	-0.57%	-1.23%	-1.68%	3.86%

Data provided by MorningStar Office
*MSCI ACWI ex-USA PR USD is the Price Return of the Morgan Stanley Capital International Index excluding US based companies

Current US Economic Indicators:

- Consumer Confidence up 2.2 pts
- Employment Trends Index down 0.82%
- Help Wanted OnLine down 31,500
- Leading Economic Index up 0.1%
- Measure of CEO Confidence up 2.0 pts

Conclusion

The 1st quarter was not how they draw it up on the chalk board when talking about finance and investment theory. The wild gyrations felt across the global markets remind us that investing is not contained within an efficient model that many people assume. From declining to almost 13% only to finish in positive territory is difficult to accept that markets are efficient. Emotions drive short term price movements and create inefficiencies for us to take advantage. Fundamentals provide the long term performance. We will try to continue this pattern.

Should you have any questions please feel free to call me directly at 314-726-550 or email at bgrunzinger@chrysalisim.com.

Sincerely,

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