CHRYSALIS
INVESTMENT MANAGEMENT LLC

8235 Forsyth Blvd., Suite 200
Clayton, MO 63105
(o) 314.726.5500
(f) 314.881.1868
www.chrysalisim.com

December 31, 2017 Quarterly Report

Happy New Year to you and your families!

Our New Year's resolution is to continue to focus on ideas, services, or structure, whether internal or external, that meet the needs of you and the rest of our clients.

We are always appreciative of your continued support of our relationship and enjoy coming in to the office everyday trying to meet your financial needs. One of the more meaningful aspects of the Financial Industry, and in particular Investment Management, is the dynamic changes that happen each and every day. We got to bed at night reading the news and wake up in the morning reading the news, digesting any and all material to see what might factor in the investments we follow. There has never been a day in our more than 20+ years in the industry that has been the same, and while there are days or periods that have not been as enjoyable as others, we nonetheless continue to have a passion for our industry.

We would like to take the opportunity in this letter to focus on some of the themes that we believe to be major influences on the investment landscape:

- Tax Cuts
- Low Interest Rate Environment
- Return of Inflation
- Energy and Financial Industry
- Cryptocurrency Craze

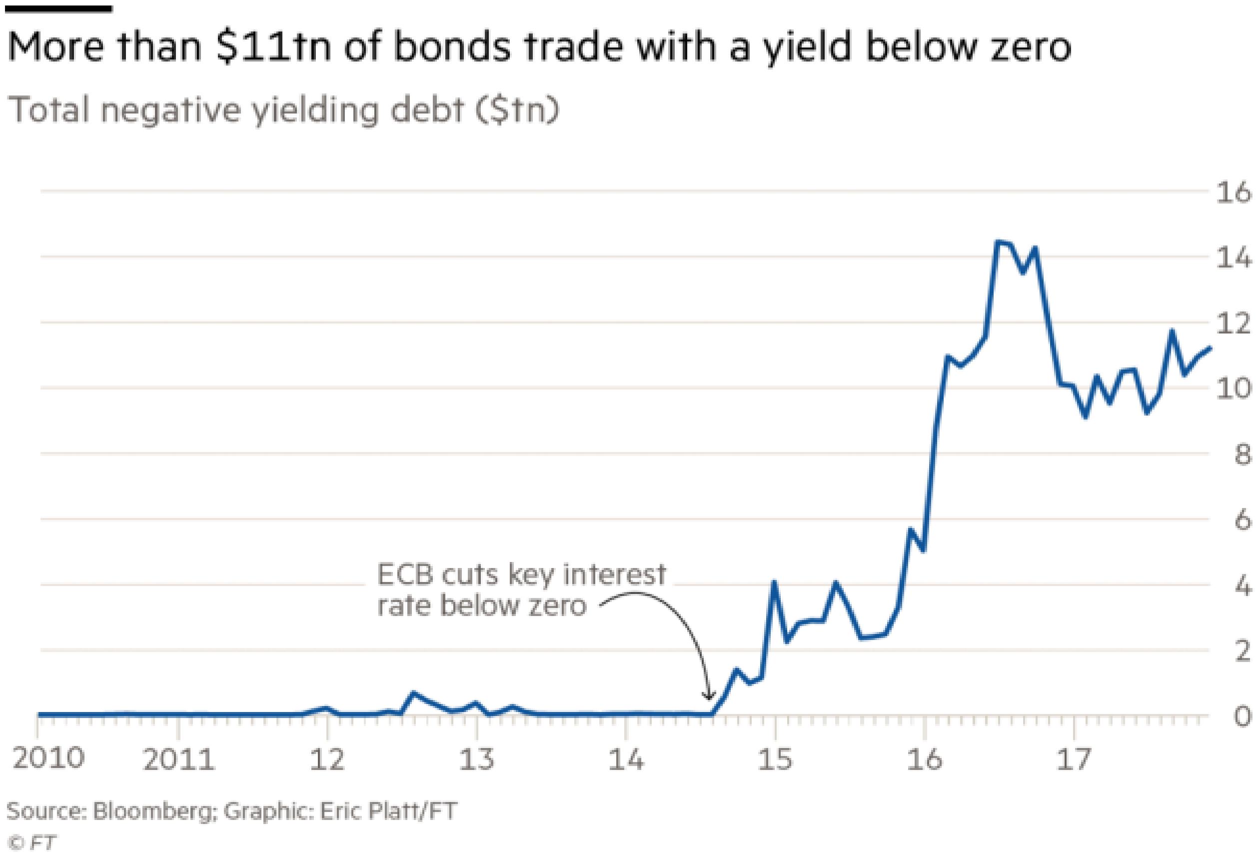
Tax Cut Boost to Equity Returns & Economic Growth Forecasts

With the passing of a $1.5T tax bill that will slash corporate income tax rates to 21% from 35%, we are hopeful that the lower rates will lead to additional returns to shareholders. While we believe most of the euphoria for the short-term tax benefits have been factored in to the current market valuations, particularly given the strong performance of many companies in our universe in December and early January, we are of the opinion that this significant tax reform will benefit the United States based value companies that have been largely overlooked during this market cycle.

Additionally, the tax reform helped push The Fed to raise its growth expectations for 2018, boosting it from 2.1% to 2.5%. Outgoing Fed Chief Janet Yellen stated in her final news conference, "My colleagues and I are in line with the general expectation among most economists that the type of tax changes that are likely to be enacted would tend to provide some modest lift to GDP growth in the coming years." Average estimates predict 2.6% GDP growth in the US and 4% worldwide.

Low Interest Rate Environment

The chart below shows the total dollar values of bonds that trade with a yield below zero worldwide still exceeds $11 Trillion. This means that if invested in these bonds and held to maturity, an investor expects to lose money. While there are many reasons for this, primarily the European Central Bank buying as many bonds as possible, this is certainly not an environment that can exist long term should capitalism remain in force.



Much like the Quantitative Easing (QE) environment perpetuated by the United States Federal Reserve, the European Central Bank, the Bank of England and the Japan Central Bank, have all been maintaining interest rates at historically low levels to support what had been stagnant economic growth. This forces investors to chase more risky investments (e.g. more equities) in order to achieve average historical rates of returns. As David Riley at BlueBay Asset Management said, “This is what QE is supposed to do essentially-to push investors to take on more risk, and part of that risk is taking on ever more interest rate risk, ever more duration. This does raise market risks-if we were to get a significant inflation or a steepening of the yield curve, you’d see some potentially quite volatile and violent market reaction to that.”

While we are currently in an environment where the yield curve (for the United States) is anything but steep, we have been reluctant to invest dollars into longer dated bonds given the risks. It has been difficult to obtain any type of return from historically risk averse investments such as Treasury Bonds when the 10 year yield has been below 3% for the better part of the last 6 years!

<u>Inflation Potential Returning</u>

Purchasing Managers Indexes released recently from China, Germany, France, Italy and the U.K. all pointed to deeper supply constraints. The U.S. reading from IHS Markit rose for the third month in the past four, reaching the highest level since March 2015 amid "increased capacity pressures”. During supply constrained inflationary periods, companies must raise their prices, propelling inflation to squeeze expansion. GAM Investment Chief Economist Larry Hatheway stated, “A key development to watch out for in 2018 is the potential advent of accelerating inflation. It matters most because it’s almost entirely unanticipated by markets, yet seems likely from the perspective of macroeconomic conditions.”

We would expect a rising inflationary environment to continue to affect positively the results we see in our commodity plays, as well as a significant contributor to our holdings of Treasury Inflationary Protections Securities (TIPS) investment.

Reemergence of Energy & Financials

A rising interest rate environment, at least a steepening of the yield curve, should theoretically benefit the Financial Sector, which has underperformed since 2009. Chief Investment Strategist Art Hogan of B. Riley Financial, believes that market leadership will shift over to financials. Also, banks will be the beneficiary of repatriated capital as well as the lower rates from the recently passed Tax Bill. We continue to remain optimistic on our Financial exposure through our holdings of Citigroup (SYM: C) and UBS Group (SYM: UBS).

We also are more optimistic as it relates to the Energy Sector. Even though this sector underperformed throughout the last couple of years, we believe that the late December 2017 surge reflects a rotation to Energy, as it is one of the more economically sensitive sectors. Of particular interest is the continued supply/demand imbalance because of the lack of additional exploration spending during the oil price downturn. Finally, the Middle East tensions, lower US production growth, OPEC supply cuts extended, as well as increased demand have started to push energy prices higher.

Cryptocurrency Craze

The new investing fad that has reshaped some of the world's wealthiest lists (at least for a short period of time where the founder of the Ripple cryptocurrency is worth more than the founders of Google) is the activity surrounding "cryptocurrencies". The amount of euphoria and attention rivals patterns seen from other investment bubbles that we have studied (e.g. Tulip Mania, French Mississippi Bubble, South Sea Bubble, etc.)

Cryptocurrencies are, presumably, a peer-to-peer electronic cash system that was proposed by the pseudonymously named Bitcoin inventor, Satoshi Nakamoto, back in 2008. Coinmarketcap.com claims roughly 1,384 types of investible cryptocurrencies are in circulation now. Bitcoin price has soared more than 1600% in 2017 as of December. Ethereum risen more than 6100% and LiteCoin more than 9000%.

An example of cryptocurrency mania is Bioptix. When announcing just a name change from Bioptix to Riot Blockchain (RIOT), its stock went from $4 to $40 in a matter of months. Previously the company focused on diagnostic machinery for the biotech industry, but now is focusing on buying cryptocurrency and blockchain businesses. As for volatility, we note that Bitcoin rose 88% from December 1st to December 19th, and then fell by 23% by December 30th.

As for the usefulness of crypto currency, that remains to be accepted. As of December 2017, it costs $1 to move $10 worth of Bitcoin, making small transactions useless. SEC Chairman Jay Clayton stated in December 2017 "Investors should understand that to date no initial coin offerings have been registered with the SEC. The SEC also has not date approved for listing and trading any exchange-traded products (such as ETFs) holding cryptocurrencies or other assets related to cryptocurrencies. If any person today tells you otherwise, be especially wary. Please recognize that these markets span national borders and that significant trading may occur on systems and platforms outside of the US. Your invested funds may quickly travel overseas without your knowledge. As a result, risks can be amplified, including the risk that market regulators, such as the SEC, may not be able to effectively pursue bad actors or recover funds."

Index Returns

Index	Q4 2017	Q3 2017	Q2 2017	Q1 2017	5 Year Annualized
*MSCI ACWI ex-US	2.23%	5.51%	4.80%	7.21%	4.24%
S&P 500	6.64%	4.48%	3.09%	6.07%	15.74%
Russell 2000 Value	2.05%	5.11%	0.67%	-0.13%	12.48%
Barclay's US Agg	0.39%	0.85%	1.45%	0.82%	2.12%

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

Summary

With the recently passed tax reform, the potential of rising interest rates, the inflation outlook accelerating and potential tax reform, we have become increasingly more optimistic about our small cap value investments and value philosophy overall. Technology stock valuations and the apparent bubble in cryptocurrencies has us concerned about the associated diminishing prospects for future growth equity returns. We continue to analyze and scour all available investment choices.

Should you have any questions, please feel free to call me directly at 314-726-5500 or email at bgrunzinger@chrysalisim.com.

Sincerely,

Robert J. Grunzinger, CFA CPA (inactive)
President Chrysalis Investment Management, LLC