ENTASIS ASSET MANAGEMENT

QUARTERLY NEWSLETTER

4Q2016

The business of investing requires a humble approach. Our experience has taught us that overconfidence is a long-term recipe for failure. Therefore, we read the commentary of many investors. We believe in the value of work and the benefits that come from constant learning. During this quarter we shared with clients and followers a link to a story written in 2015 that highlights the 50 best things Warren Buffett told investors over the past 50 years. I have included that link here. It is worth a read for everyone. One of our favorites was written in his 1986 shareholder letter.

"We have no idea – and never have had – whether the market is going to go up, down, or sideways in the near or intermediate-term future. What we do know, however, is that occasional outbreaks of those two super-contagious diseases, fear and greed, will forever occur in the investment community. The timing of these epidemics will be unpredictable. And the market aberrations produced by them will be equally unpredictable, both as to duration and degree. Therefore, we never try to anticipate the arrival or departure of either disease. Our goal is more modest: we simply attempt to be fearful when others are greedy and to be greedy only when others are fearful."

This sentiment captures one of our investing maxims we highlight in our Research Focus. It is important because lately we have been getting asked a lot "Can the market go higher?" and "Should I wait to invest?" We think answering directly would be overstating our capabilities. We encourage you to be cautious of those that think they can.

We hope you find a portion of this newsletter useful. Thank you for taking the time read it. If you have any feedback, it is always appreciated.

Bob   Charles   Mark

50 Years of Buffett Wisdom

Market Performance | Market Notes | Equity Portfolio Comments

Fixed Income Portfolio Comments | Research Focus | Client Focus

Click on any button to skip to a new section.

Market Performance

Annualized Returns (As of 12/31/16)

Source: Morningstar Direct

Index Name	Index Category	1 year	3 year	5 year	10 year
S&P 500 Index	Large Cap Stocks	11.96	8.87	14.66	6.95
Russell 1000 Index	Mid/Large Cap Stocks	12.05	8.59	14.69	7.08
Russell 1000 Growth Index	Growth Stocks	7.08	8.55	14.50	8.33
Russell 1000 Value Index	Value Stocks	17.34	8.59	14.80	5.72
Russell 2000 Index	Small Cap Stocks	21.31	6.74	14.46	7.07
MSCI EAFE Index	Non-U.S. Developed Market Stocks	1.00	-1.60	6.53	0.75
MSCI Emerging Markets Index	Emerging Markets Stocks	11.19	-2.55	1.28	1.84
MSCI ACWI Ex USA Small Cap Index	Non-U.S. Small Cap Stocks	3.91	0.76	7.74	2.90
BofAML Preferred Stock Fixed Rate Index	Preferred Stocks	2.32	8.31	6.82	2.74
Barclays Municipal Bond Index	U.S. Municipal Bonds	0.25	4.14	3.28	4.25
Barclays Aggregate Bond Index	U.S. Bonds	2.65	3.03	2.23	4.34
Barclays Intermediate U.S. Gov/Credit Index	Government/Corporate Bonds	2.08	2.09	1.85	3.84
BofAML U.S. Treasury Master Index	Treasury Bonds	1.14	2.64	1.32	4.03
BofAML U.S. Mortgage Backed Securities Index	Mortgage Backed Bonds	1.67	3.04	2.05	4.28
BofAML U.S. Corporate Master Index	Corporate Bonds	5.96	4.22	4.25	5.41
BofAML U.S. High Yield Master II Index	High Yield Bonds	17.49	4.73	7.35	7.45
BofAML Convertible Bonds Index	Convertible Bonds	11.94	6.76	11.85	7.61
BofAML Euro Broad Market Index	European Bonds	0.37	-3.89	1.40	2.53
BofAML Local Debt Market Plus Index	Emerging Markets Bonds	6.53	-3.62	-0.80	2.87

Calendar Year Returns (QTD as of 12/31/16)

Source: Morningstar Direct

	QTD	2016	2015	2014	2013	2012	2011
S&P 500 Index	3.82	11.96	1.38	13.69	32.39	16.00	2.11
Russell 1000 Index	3.83	12.05	0.92	13.24	33.11	16.42	1.50
Russell 1000 Growth Index	1.01	7.08	5.67	13.05	33.48	15.26	2.64
Russell 1000 Value Index	6.68	17.34	-3.83	13.45	32.53	17.51	0.39
Russell 2000 Index	8.83	21.31	-4.41	4.89	38.82	16.35	-4.18
MSCI EAFE Index	-0.71	1.00	-0.81	-4.90	22.78	17.32	-12.14
MSCI Emerging Markets Index	-4.16	11.19	-14.92	-2.19	-2.60	18.22	-18.42
MSCI ACWI Ex USA Small Cap Index	-3.52	3.91	2.60	-4.03	19.73	18.52	-18.50
BofAML Preferred Stock Fixed Rate Index	-3.81	2.32	7.58	15.44	-3.65	13.59	4.11
Barclays Municipal Bond Index	-3.62	0.25	3.30	9.05	-2.55	6.78	10.70
Barclays Aggregate Bond Index	-2.98	2.65	0.55	5.97	-2.02	4.21	7.84
Barclays Intermediate U.S. Gov/Credit Index	-2.07	2.08	1.07	3.13	-0.86	3.89	5.80
BofAML U.S. Treasury Master Index	-3.96	1.14	0.83	6.02	-3.35	2.16	9.79
BofAML U.S. Mortgage Backed Securities Index	-1.98	1.67	1.46	6.07	-1.39	2.59	6.14
BofAML U.S. Corporate Master Index	-2.88	5.96	-0.63	7.51	-1.46	10.37	7.51
BofAML U.S. High Yield Master II Index	1.88	17.49	-4.61	2.51	7.41	15.55	4.37
BofAML Convertible Bonds Index	3.14	11.94	-1.15	9.97	26.60	13.63	-3.76
BofAML Euro Broad Market Index	-8.40	0.37	-9.30	-2.48	6.89	12.95	-0.06
BofAML Local Debt Market Plus Index	-6.03	6.53	-12.02	-4.50	-5.75	13.87	-0.12

How should you use the information provided in the table?

- The returns are not projections. They are historical. Future returns will vary.
- Annualized returns can generally be used to understand historical return trends.
- Calendar returns provide a general understanding of year-by-year return volatility.

Global Market Drivers

Judging the source of market performance over any short period is largely a fool's errand. The predominance of market commentary can certainly provide some insight, but at the end of the day determining a specific connection is nearly impossible, and can lead to overconfidence. Overconfidence is a key driver of bad decision making. The only thing we can generally surmise is that when markets are up there are more buyers than sellers, and when markets are down, there are more sellers than buyers. As the year came to a close, the trend was definitely in favor of buying over selling in most market sectors. As we noted in our inaugural newsletters, we will take a look at our view of the big news for the economy, interest rates and earnings as a basis for our perspectives.

The Economy (The Election)

During the fourth quarter, the clearly dominant headline was the U.S. presidential election. Regardless of your view of the outcome, this election was unique theater. Kudos to Kate McKinnon and Alec Baldwin of SNL for providing some levity in the harsh battle. By the time this newsletter reaches you, we will be talking about President Trump. His victory contributed to some surprisingly dramatic movements in segments of the equity market as "consensus" thinking seemed to rally around four major themes.

- Theme 1 – The new administration and Congress will be "pro-business" resulting in lower corporate tax rates, a more favorable regulatory environment and the repatriation of cash being held overseas by large multi-national corporations.

    Expectation – New policies will rejuvenate a stagnant corporate earnings environment and extend the current business cycle.

- Theme 2 – There will be a shift from monetary stimulus to fiscal stimulus. Monetary stimulus has been winding down gradually, but the new administration and Congress is expected to stimulate the economy through fiscal stimulus, such as massive investment in infrastructure.

    Expectation – Fiscal stimulus will pull forward "future growth" to the short- to intermediate-term, offsetting the withdrawal of monetary stimulus and avoiding economic stagnation.

- Theme 3 – The U.S. will implement protectionist measures that make it costlier for businesses to invest in overseas operations and will impose tariffs (border tax, surcharge, etc.) on imported goods.

    Expectation – Domestic-oriented businesses may benefit as their goods become more competitive relative to foreign producers, but these policies may also cause inflation to increase at a faster rate than expected, which may hurt overall consumer spending.

- Theme 4 – The U.S. dollar may continue to rise relative to foreign currencies.

    Expectation – Businesses that derive a significant portion of their revenues overseas, but whose expenses are largely in U.S. dollars, may be hurt because of an increasingly unfavorable exchange rate (I.e. Revenues in other currencies will be worth less when exchanged back into U.S. dollars).

The shifts in consensus thinking that resulted from these major themes led to large performance differences among sectors of the U.S. equity market. These moves defined a distinct period of trading for stocks that the popular press quickly dubbed the "Trump Trade." The table on the next page summarizes how this new period compared to others in 2016.

Market Notes

S&P 500 Sector Performance

High Yield Equities		Reversal of Income Focus		"Trump Trade"	
12-31-15 to 7-5-16	Return %	7-5-16 to 11-8-16	Return %	11-8-16 to 12-31-16	Return %
Consumer Staples	**9.46**	**Consumer Staples**	**-3.16**	**Consumer Staples**	**-0.61**
Utilities	**23.06**	**Utilities**	**-5.53**	**Utilities**	**0.56**
Financials	**-9.39**	**Financials**	**11.38**	**Financials**	**16.98**
Industrials	4.89	Industrials	3.42	**Industrials**	**8.19**
Technology	**-2.31**	**Technology**	**12.65**	**Technology**	**1.74**
Energy	14.76	Energy	0.15	Energy	9.23
Health Care	0.26	Health Care	-4.86	Health Care	1.55
Consumer Discretionary	-0.26	Consumer Discretionary	0.71	Consumer Discretionary	4.37
Materials	4.82	Materials	2.63	Materials	6.20
Real Estate	10.53	Real Estate	-8.17	Real Estate	2.57
Telecom	24.42	Telecom	-12.99	Telecom	13.62

Source: Morningstar

- High Yield Equities – 12/31/15 to 07/05/16

  This period was highlighted by strong results from sectors of the market that have historically paid relatively large dividends. During this period, investors were drawn to fixed income alternatives in the equity market as yields on fixed income securities declined and investors sought other sources of income. Sectors of the equity market such as utilities and consumer staples registered large gains while growth-oriented sectors such as technology, health care and consumer discretionary lagged.

- Reversal of Income – 07/05/16 to 11/08/16

  Before the election results, it seemed as though this period would carry the day through the end of the year. In many respects, this time frame was characterized by a reversal of the fixed income alternative trade. Brexit was absorbed into market expectations, the Federal Reserve (Fed) strongly hinted at an increase in interest rates during the second half of the year and economic activity rebounded from depressed levels. As a result, consumer staples and utilities declined (these equities are not as attractive as a fixed income alternative if interest rates are expected to increase), financials rebounded (as interest rates increase, the amount a bank or other financial institution can earn on financial products increases) and technology shot higher because of the potential for an improvement in business activity.

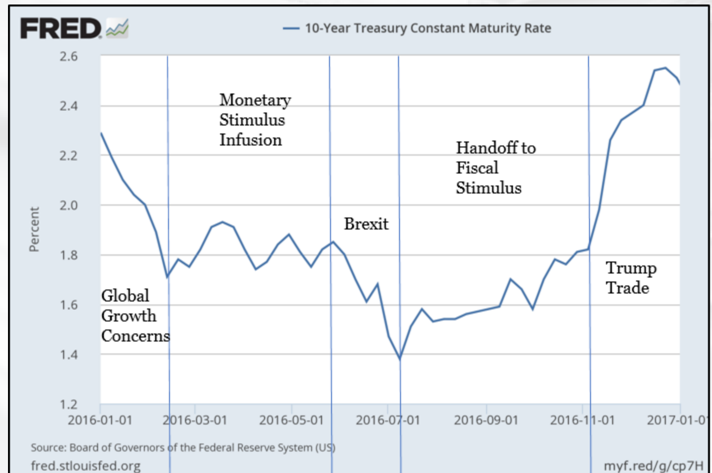
- The Trump Trade – 11/08/16 to 12/31/16

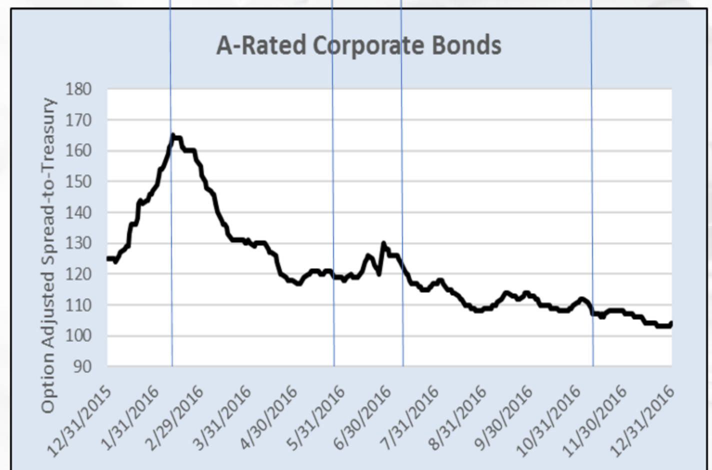
  During this period, the sectors that stood to benefit most from the four market themes we highlighted rallied. Conversely, those expected to come under pressure by the themes struggled, though many still posted gains. The S&P 500® technology sector, which derives the largest share of its revenues from overseas (approximately 58%), was negatively impacted, while domestically-oriented businesses that stand to benefit from infrastructure projects and protectionist measures, performed strongly (I.e. industrials). Financials surged due to a combination of positive expectations for future business conditions and an interest rate increase from the Fed. The Fed also signaled that it would raise rates further in 2017.

Interest Rates

Throughout the year, Treasury and credit markets experienced considerable swings, driven by changing growth expectations, shifting global central bank policies and political surprises in the U.S. and abroad. This led to a significant amount of volatility in fixed income markets.

After starting the year at 2.27% the 10-year Treasury bond ended the year at 2.44%. On the surface this seems uneventful, but if you consider it traded in a 1.23% range throughout the year, it was far from uneventful. Like equity markets, fixed income markets traded through multiple defined environments, which are highlighted in the charts to the right. For the most part, Treasury bonds and the credit sectors followed an inverse path. Quality differences accounted for some of the variances.





- Global Growth Concerns

  Early in 2016 global growth concerns, focused largely on China, fueled a rally in U.S. Treasuries and rattled global credit markets. The 10-year Treasury bond rallied from 2.27% to 1.60% by mid-February while credit markets experienced significant declines.

- Monetary Stimulus Infusion

  By the end of March, volatility subsided as global central banks infused stimulus into the markets. The Fed signaled it would keep rates lower for longer, the European Central Bank announced an expanded quantitative easing program and the Bank of Japan set a 0% target for its 10-year sovereign debt. From that point, interest rates moved moderately higher and credit spreads (the difference in yield between Treasury Bonds and similar maturity corporate bonds) tightened as commodity-related sectors recovered.

- Brexit

  On June 23rd, Britain surprised markets by voting to leave the European Union. The Brexit (Britain plus exit) vote sparked a selloff in global credit-related assets and a rally in U.S. Treasury bonds. During this time frame, the 10-year and 30-year U.S. Treasury yields hit all-time lows. This also marked a bottom in Treasury bond yields for the year.

- Handoff to Fiscal Stimulus

  The market reaction to the Brexit vote proved to be short-lived. Interest rates began to rise and credit markets recovered as investors turned their attention to fiscal stimulus. During this period, evidence of a recovery also became apparent, as many of the popular economic indicators showed significant improvement, and posted better results than most economists predicted.

- The "Trump Trade"

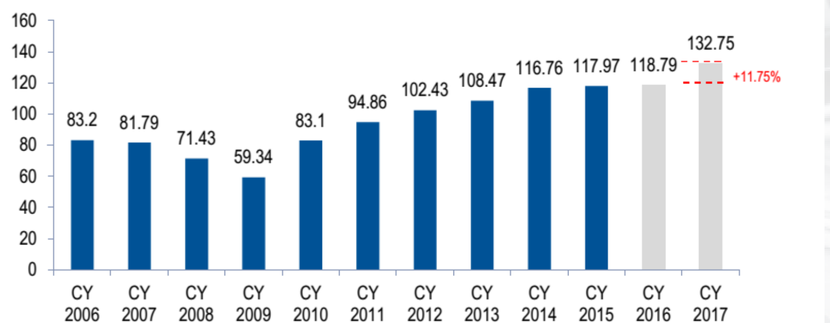
  The last well-defined period of the year took place in the fourth quarter as Donald Trump's victory in the U.S. presidential election had as meaningful an impact on fixed income markets as it did on equity markets. U.S. interest rates moved significantly higher and credit spreads tightened. Trump's victory, along with a Republican-controlled Congress, also contributed to expectations of higher economic growth and inflation as the market priced in the potential for fiscal stimulus, tax cuts, de-regulation and infrastructure spending. During this period the Fed increased the federal funds rate by 25 basis points. It was the first interest rate increase in 2016 and only the second since the 2008 financial crisis.

Earnings

Year-end earnings levels have essentially been flat for the past three years. However, fourth quarter earnings are expected to grow (year-over-year) at a +3.2% rate. If this estimate is accurate, it will be the first time the S&P 500 Index has seen year-over-year earnings growth for two straight quarters since the fourth quarter of 2014 and the first quarter of 2015. While that is certainly a positive, overall earnings growth for 2016 is expected to finish at just +0.2%.

Looking forward the picture looks more attractive. As of year-end, analysts forecasted 2017 earnings growth to be +11.8%. If history is any guide, their estimates will more than likely prove to be too high. Regardless, it will not take much in the way of overall corporate earnings growth to improve on the levels achieved in 2016. The amount of revenue growth and margin improvement companies can achieve relative to 2016 levels will be key to the overall level of earnings growth.

Slide courtesy of Neuberger Berman – Investment Strategy and Asset Allocation December 2016.



Equity Market Results

Despite the relatively large movements among individual sectors of the market we have highlighted, the broad S&P 500 ® Index finished the fourth quarter with a modest gain of +3.82%. For the year, the S&P 500 Index advanced +11.96%.

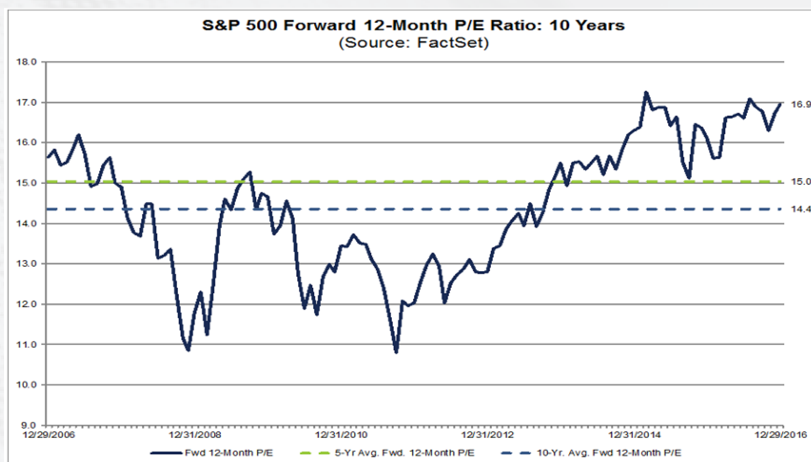
Foreign developed markets and emerging markets finished the fourth quarter in negative territory. Developed foreign equity markets, as represented by the MSCI EAFE® Index, declined -0.71%, while emerging foreign equity markets, as represented by the MSCI Emerging Markets Index, fell -4.16%. After a strong start to 2016, emerging markets faltered during the fourth quarter as investors viewed much of the positive news/developments in U.S. markets to be potentially detrimental to these markets. In particular, investors became increasingly concerned that a rising U.S. dollar and increased protectionist measures would hurt overall economic activity in many markets. Nonetheless, emerging markets ended the year with a gain of +11.19%, which was well ahead of the developed foreign equity market return of +1.00%.

Equity Market Comments

As we move closer to entering the ninth year of a bull market, a period that has seen the S&P 500 Index increase by nearly 3.5 times from March 2009 lows, the obvious question is, “How much longer can this last?” Our blunt assessment is, “We don’t know.” Business activity has increased, confidence among business owners is high and corporate earnings growth has shown signs of life, but valuations have moved higher.

The chart at the right highlights the current market valuation. The S&P 500® Index forward P/E was 16.9x at year-end (blue line), which was nearly unchanged from the third quarter. This compares to a 5-year average of 15.0x (green line) and a 10-year average of 14.4x (blue dashed line).

Slide courtesy of FactSet – Earnings Insight December 30, 2016



At the margin, we agree with consensus that there have been signs of business improvement, but higher valuations have tempered our optimism given the move we have seen in the markets over the short-term. Markets could live up to the hype we have seen in market results so far, but there are numerous risks we see relative to the current consensus opinion.

Risks to Consensus

- Protectionist polices can have negative consequences. Is the market underestimating the potentially negative impacts of protectionism such as trade wars?

- Congress is controlled by Republicans, but that does not ensure quick policy change and consistent party line voting. Has the market priced in an overly optimistic time frame for the implementation of new policies?
- Inflation may increase more quickly than expected. Is the market ready for a more "hawkish" (I.e. Favoring interest rate hikes.) response from the Fed? If the U.S. dollar strengthens too fast, earnings for large multi-national companies domiciled in the U.S. could come under pressure. How much pressure will this put on lofty earnings estimates?
- "Shovel ready" infrastructure projects are largely absent. How does the market respond if infrastructure projects take more than a year to positively impact the economy?

Client Portfolio Impact

We do not aspire to be market prognosticators or economists. We make adjustments to client portfolios when we believe an opportunity presents itself that can have a positive impact on client portfolios over the intermediate- to long-term (roughly 3-5 years or more). Last quarter we highlighted emerging markets equities as one of these opportunities. This quarter we believe we were presented with two attractive opportunities because of the uncharacteristically large movements in certain segments of the equity market.

- The first was an opportunity to increase our allocation to growth-oriented, large-cap equities. After a great year in 2015, growth equities fell behind value-oriented equities in 2016. The Russell 1000® Growth Index underperformed the Russell 1000® Value Index by over 10% in 2016. The combination of growth-oriented underperformance, our overweight to value (dividend-oriented equities) for much of 2016, and our tendency to invest in areas of the market after periods of relative weakness, we reduced portfolio exposure to income-oriented equities and increased portfolio exposure to growth-oriented equities. We expressed this view by redeeming a dividend equity strategy and investing in an actively-managed, large-cap growth-oriented equity strategy.
- The second change in portfolios was to increase the amount invested in actively-managed, large-cap domestic equity, and decrease the amount of our "core" passive equity exposure. In addition to what we view as favorable broad market dynamics, we believe the specific actively-managed equity strategy chosen will improve our odds of success over the intermediate-term. We highlight this trade in greater detail in the "Research Focus" section of the newsletter.

Overall, we have a cautiously optimistic outlook for the equity market. While we do not know where the market will head over the short run, we believe that we have made meaningful adjustments at the margin that will position our clients with a more favorable outcome over the intermediate- to long-term. As always, we encourage our clients and prospects to exercise patience and focus on long-term objectives as opposed to short-term market noise.

Fixed Income Portfolio Comments

Fixed Income Market Results

Fixed income returns were mostly negative during for quarter – high-yield corporate bonds, which returned +1.88%, were an exception. The U.S. Treasury sector declined –3.96%. Negative returns were also experienced in the investment grade corporate, mortgage backed security and municipal bond sectors. Bonds outside of the U.S. were hit hard, due in part to, a strengthening dollar.

Despite a difficult fourth quarter, every major fixed income sector we follow finished 2016 with positive returns. The high-yield corporate bond sector was the biggest winner, as the combination of high coupon income and tightening spreads led to a +17.49% return. On the other hand, after a strong 2014 and 2015, the municipal bond sector generated the worst return of +0.25%, as income earned barely outpaced declines from increasing yields and widening spreads.

Fixed Income Market Comments

U.S. Interest Rates

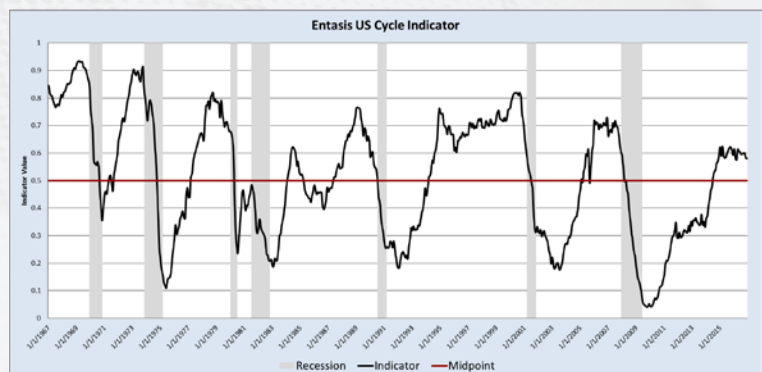
We believe the 10-year Treasury bond, which ended the year at 2.50%, was appropriately priced. Going forward, there is a wide range of potential outcomes for interest rates, which should become clearer as the new administration and Congress move from the planning phase to the implementation phase of their proposals. Until we find out the specific details of the new legislation, we believe it is likely that interest rates hover near current levels, or recover some of their losses.

Yield Curve

The Treasury yield curve is moderately steep (long-term yields are moderately higher than short-term yields) relative to history. Based on our beliefs that the 10-year Treasury bond is fairly valued, and the Fed plans to raise short-term interest rates three times in 2017, we believe a flatter yield curve is likely.

Sector & Quality Management

The U.S. credit cycle and economic cycle are highly correlated. Based on the leading indicators we follow, we believe we have entered the later stages of the cycle. Corporations have increasingly added leverage to their balance sheets to acquire other companies and repurchase their own stock. At the same time, we have seen revenues, profits and free cash flow show little, if any, progress. Credit spreads are below their long-term averages and only slightly above their recent recession lows. It is possible that credit spreads will again approach cycle lows seen in the summer of 2014, but this leaves limited upside relative to the potential downside.



Fixed Income Portfolio Comments

Investment Vehicle Selection

We believe the time for using passive management in risky sectors has passed. Going forward, it is our view that active management is likely to win in most sectors of the market, as a rising tide will no longer lift all boats. In the phase of the credit cycle, issuer selection will be paramount. We believe active managers will be more focused on avoiding blowups than finding winners.

Client Portfolio Impact

Based on the market reaction post-election, it seemed as though significantly higher growth and inflation were a foregone conclusion. We, however, believe there is a wide range of potential outcomes. In our view, upside and downside risks have grown. The successful implementation of pro-growth policies in the U.S., including fiscal stimulus, tax cuts, de-regulation and infrastructure spending, could trigger an upside scenario. However, interest rate and credit markets may be discounting the potential for tougher trade policies and tighter monetary policy. Taken together, we see the risks for 2017 as more balanced than the market, which if realized, could stoke volatility in 2017. Thus, we believe the current environment favors active strategies, prudent risk management and portfolio flexibility.

We have made some key adjustments to fixed income positioning to reflect our views.

- We have taken advantage of narrower credit spreads to selectively reduce exposure to investment grade corporate bonds. We have also reduced our exposure to global bond funds. Together these moves have reduced overall portfolio risk and increased interest rate sensitivity, which lines up with our outlook for increased volatility in 2017.
- Considering the 10-year Treasury moved from 1.30% in June 2016, to in-line with our fair value estimate of 2.50%, we used the opportunity to add interest rate risk to fixed income strategies. Generally, we have re-positioned portfolios to have a similar level of interest rate risk as their respective benchmarks. Prior to this move, fixed income portfolios were positioned to protect against rising rates, which worked out extremely well. We may look to reduced interest rate risk again as the policy picture becomes clearer.
- Given the current scenario, we believe the 2-year to 4-year area of the Treasury yield curve is most vulnerable from a total return perspective. We are positioning portfolios to have less exposure to this area of the yield curve than client benchmarks.
- Despite scaling back our credit position recently in favor of U.S. Treasury bonds and high quality municipal bonds, we are maintaining an overweight to credit related sectors. We believe the income earned from investing in these sectors is key to outperforming over the long-term. We are offsetting some of the risk of being overweight credit sectors by positioning in high quality bonds. We continue to like opportunities outside of corporate credit that we believe offer better late cycle diversification and better risk-adjusted value. We currently favor local currency emerging market bonds, insurance-linked securities, high-yield municipal bonds and preferred stocks.
- We have maintained our significant allocation to non-traditional bond funds because they have the potential to make money whether interest rates are going up or down, if managed properly.

Research Focus

The Anatomy of an Investment Decision

We manage client portfolios through the implementation of our Core/Completion philosophy. We commonly use passive strategies as the "Core" in areas of the market we believe are relatively efficient, while we use active strategies to "Complete" portfolios in areas of the market where we believe active managers have potential to succeed over the long-term. The combination allows us to effectively manage client fees and seek alpha generating opportunities in portfolios.

During the fourth quarter, we reduced the "Core" in portfolios by selling some passive exposure to purchase an active manager, which in turn increased portfolio exposure to "Completion" strategies. The anatomy of that decision can be broken down into five components.

1. We reviewed our list of high conviction managers to identify high quality options that were out of favor. We do this regularly to try to avoid the behavioral pitfall of "recency bias." This refers to a belief that the recent past will continue in the future. Recency bias commonly leads to performance chasing.
2. We then took a detailed look at the root causes for each manager's underperformance and reviewed potential entry points. This is also a normal routine for us. Our goal is not to blindly invest as contrarians, but to refine our investment list to determine if there are attractive areas for investment.
3. Once we narrowed our list, we conducted a thorough qualitative review. During the fourth quarter, our work led us to an active manager that we have followed for years, and have met in person, but whose performance had not provided us with an opportunity to invest until recently. Our review concluded that the manager's performance issues were most likely transitory.
4. Despite the positive aspects identified above, we also wanted to determine if the current market environment was conducive for active manager success. One market metric we utilize is performance dispersion (the spread between top and bottom performing stocks). Generally, higher levels of dispersion have proven to be favorable for active management. After an extended period of low dispersion, dispersion has spiked.
5. Lastly, we analyzed active and passive relative performance trends. Similar to performance cycles for individual managers, active and passive strategies (in aggregate) tend to move in cycles relative to one another. We do not try to time these cycles, but we need to be cognizant of where we are in the cycle, and active managers have been out of favor for an extended time.

The combination of confidence in the active manager, despite near-term weakness, and favorable market dynamics, aligned to provide us with a unique investment opportunity, so we made the investment. We will discuss this example in greater detail in an upcoming version of ViewPoints. Please take the time to check it out.

Charles (CJ) Batchelor, CFA
Chief Investment Officer - Equity

Summary

We utilize passively-managed and actively-managed investment strategies in client portfolios.

We do not try to time market cycles or make "bets" on asset classes. We strategically adjust portfolios at the margin to take advantage of secular trends we have identified through fundamental research.

Out of favor investments are the starting point to our research. An investment decision needs to be substantiated and relative weakness understood.

Entasis Maxims

- Be mindful of cycles
- Don't chase performance
- Be patient
- Focus on the long-term
- Stick to a process
- Know your investments

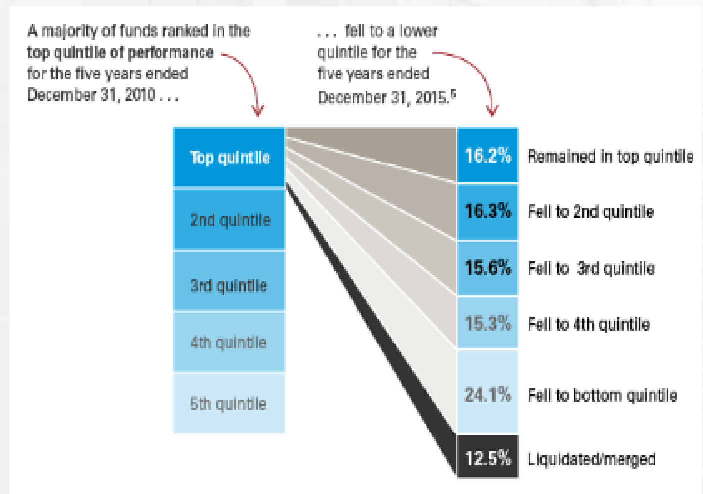
Client Focus

This quarter our Client Focus is on behavioral biases.

Behavioral biases are arguably one of the most harmful detractors to long-term investment compounding that an investor can experience. And unfortunately, they are numerous. We will highlight just a few, of which, all investors should be wary.

***Recency Bias *Herding Bias *Familiarity Bias**

We highlighted Recency Bias in our Research Focus. A belief that the recent past will continue in the future. The chart below illustrates that if an investor simply chose an active manager based on its recent peer group rank (top quintile, or top 20% of managers) for the five-year period ended December 31, 2010, they would most likely be disappointed in the results of that manager at the end of the subsequent five-year period. For instance, only 16% of the managers that finished in the top quintile at the end of 2010, remained in the top 20% of managers at the end of 2015.



Source: Vanguard Infographic "Reframing investor choices: Right mindset, wrong market." September 2016

Solution – Do your homework.

Herding Bias is the tendency to mimic the actions of a larger group. This bias is easily influenced by "water cooler talk," and a fear of missing out. This can lead to buying high and selling low. The results are often damaging. The Morningstar® Investor Return™ calculation captures the impact very nicely. During the 10-year period through December 31, 2015, investors cost themselves between 0.74% and 1.32% per year by mistiming their purchases and sales of equity and bond funds.

Solution – Be patient and invest long-term.

A Familiarity Bias is basically sticking with what you know, and avoiding what you don't. This can be true for something as simple as picking a restaurant, causing a person to miss out on a great meal, but it can also have a detrimental impact on investing portfolios. For example, consider the investor that has all of his/her money tied to a favorite stock, or the stock of the company where he/she works. The Enron scandal is the most dramatic recent example. But a more common, less extreme, example is investing all of a portfolio in U.S. investments when a considerable portion of global investment opportunities are outside of the U.S. A smart allocation in 2016, but a poor one in 2007.

Solution – Establish an investment plan.

Conclusion

Investing can be an emotional endeavor. However, emotion and the biases caused by emotion can be detrimental to long-term compounding. Combating these biases can be simple if you establish a plan, invest long-term and do your homework. That is the basis of what we do at Entasis. We are thankful for the clients that have entrusted us to help them and are here to help others that are making the decision to use an advisor. Please contact us.

Our Team

Bob Batchelor, CFA
CEO
Co-Founder

Bob J. Batchelor, CFA is Co-Founder and Chief Executive Officer of Entasis Asset Management. Bob has 19 years of experience in the investment industry. Prior to founding Entasis, Bob worked at Artisan Partners where he held a variety of roles including Head of Corporate Communications, Managing Director, Head of Marketing and Technology and Head of Marketing and Communications. He also served as a member of Artisan Partners Executive Committee. Before Artisan Partners, Bob worked at Strong Capital Management as Client Account Manager and Director of Investment Research and Communication.

Bob holds an M.B.A. from Marquette University and a B.B.A. from the University of Wisconsin-Madison. He has earned the right to use the CFA designation. Bob is a member of the CFA Institute and CFA Society of Milwaukee.

Bob currently resides in New Berlin, WI with his wife Christine and their three children – Courtney, Sam and Charlie.

C.J. Batchelor, CFA
CIO – Equity
Co-Founder

Charles J. (C.J.) Batchelor, CFA is Co-Founder and Chief Investment Officer – Equity of Entasis Asset Management. C.J. has 14 years of experience in the investment industry. Prior to founding Entasis, C.J. worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Director of Investment Research. He also served as a member of Cleary Gull's Investment Policy Committee, Investment Committee and Equity Strategy Group.

C.J. holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. C.J. is a member of the CFA Institute and CFA Society of Milwaukee, where he currently serves on the Board of Directors.

C.J. currently resides in Muskego, WI with his wife Shelly and their two children – Addison and Ethan.

Mike Peters, CFA
CIO – Fixed Income
Co-Founder

Mike Peters, CFA is Co-Founder and Chief Investment Officer – Fixed Income of Entasis Asset Management. Mike has 14 years of experience in the investment industry. Prior to founding Entasis, Mike worked at Cleary Gull, a multi-billion dollar investment advisory firm, as Fixed Income Portfolio Manager. In his role he served as voting member of Cleary Gull's Fixed Income Strategy Group and Complement (Alternative) Strategy Group. Before Cleary Gull, Mike worked for several years at Madison Investment Advisors, a multi-billion dollar asset management firm, as a Fixed Income Analyst.

Mike holds a B.B.A. in Finance from the University of Wisconsin-Milwaukee. He has earned the right to use the CFA designation. Mike is a member of the CFA Institute and CFA Society of Milwaukee.

Mike currently resides in Oconomowoc, WI with his wife Kristen and their two children – Evan and Eli.

IMPORTANT INFORMATION

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The **S&P 500® Index** is a market capitalization weighted index that measures the performance of 500 leading companies in leading industries of the U.S. economy. The **Russell 1000® Index** measures the performance of roughly 1,000 U.S. large-cap companies. The **Russell 1000® Growth** Index measures the performance of U.S. large-cap companies with higher price/book ratios and forecasted growth values. The **Russell 1000® Value Index** measures the performance of U.S. large-cap companies with lower price/book ratios and forecasted growth values. The **Russell 2000® Index** measures the performance of roughly 2,000 U.S. small-cap companies. The **MSCI EAFE Index** is a market capitalization weighted index that is designed to measure the performance of developed markets, excluding the U.S. and Canada. The **MSCI Emerging Markets Index** is a market capitalization weighted index that is designed to measure equity market performance of emerging markets. **The MSCI ACWI Ex USA Small Cap Index** is a market capitalization weighted index that represents the performance of smaller capitalization companies in developed and emerging markets excluding the U.S.

The **Barclays Aggregate Bond Index** tracks the performance of intermediate-term government bonds, investment grade corporate debt securities and mortgage-backed securities with at least one year to final maturity. The **Barclays Intermediate U.S. Gov/Credit Index** tracks the performance of intermediate U.S. government and corporate bonds. The **Barclays Municipal Bond Index** is considered representative of the broad market for investment grade, tax-exempt bonds with a maturity of at least one year.

The **BoAML Fixed Rate Preferred Securities Index** tracks the performance of fixed rate U.S. dollar denominated preferred securities in the U.S. domestic market. The **BoAML Treasury Master Index** tracks the performance of the direct sovereign debt of the U.S. Government. The **BoAML U.S. Mortgage Back Securities Index** tracks the performance of U.S. dollar denominated fixed rate and hybrid residential mortgage pass-through securities publicly issued by U.S. agencies in the U.S. market. The **BoAML U.S. Corporate Master Index** tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the U.S. domestic market. The **BoAML High Yield Master II Index** is a broad based index consisting of all U.S. dollar-denominated high-yield bonds with a minimum outstanding of $100 million and maturing over one year. The **BoAML All Convertibles All Qualities Index** measures convertible securities' performance of U.S. dollar denominated convertible securities not currently in bankruptcy with a total market value greater than $50 million at issuance. The **BoAML Euro Broad Market Index** gives exposure to euro-denominated investment grade debt publicly issued in the Eurobond or euro member domestic markets including government, quasi-government, corporate, securitized and collateralized securities. The **BoAML Local Debt Markets Plus Index** is a broad composite designed to track the performance of local currency sovereign debt of emerging markets countries.

Past performance is no guarantee of future results. All indices are unmanaged. Investors cannot invest directly in an index. Index returns do not include expenses.

Investment Terms

Valuation levels are typically shown by calculating the price level of an index or a company relative to any number of characteristics of an index or company. For instance, the price-to-earnings valuation metric looks at the price of an index (or stock) divided by the total earnings of an index (or stock). Based on the multiple (in this instance, the multiple is how much investors are willing to pay – the price – for a given amount of earnings), it provides investors with a general sense of how expensive, or cheap, the overall market is at the present time. While there are a significant number of valuation metrics that are used in practice, and many ways to vary/modify the calculation of the price-to-earnings ratio, in this summary we are focused on the price investors are willing to pay (the level of the S&P 500 Index) divided by earnings expectations for the equity market (S&P 500 Index) over the next 12 months. This valuation metric is referred to as the forward P/E.

A yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt.

Morningstar® Investor Return™ calculation measures how the average investor fared in a fund over a period of time. Investor return incorporates the impact of cash inflows and outflows from purchases and sales in the growth in fund assets. A fund's published return reflects a buy and hold strategy. But not all investors buy and hold. Some move money in and out of funds. The investor return calculation methodology can be found at the link below.

Morningstar Investor Return Methodology

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To learn more please visit us at
www.EntasisAM.com

CONTACT US
Entasis Asset Management
300 N Corporate Drive
Suite 220
Brookfield, WI 53045
262-794-5299
Info@EntasisAM.com