ENTASIS ASSET MANAGEMENT

QUARTERLY NEWSLETTER

2Q2017

The second quarter marked our first anniversary as a firm. Like most things it feels like it has gone incredibly fast in hindsight. Creating something from scratch can be challenging, but we have quickly learned that when your beliefs set the foundation for what you are trying to accomplish, it makes it much easier. In that regard, we have only dug in deeper. We are committed to research, keeping our investment process focused on what we know, creating access for clients at various stages of saving and keeping costs transparent and reasonable. There are good firms in our industry, but we don't believe many bring that full combination. And disappointingly, too many prioritize the wrong things, leading to poor outcomes for clients. In that regard, and we won't say this often in relation to many things politically driven, evolving legislation from the Department of Labor, is in our minds, welcome change.

For those unfamiliar with the goal of the legislation, in very brief summary the intention of the legislation is to bring the role of individuals providing financial advice to the level of fiduciary. By definition, a fiduciary is required to act in the best interest of their clients. Many advisors are just held to a standard of suitability. Entasis has always acted as a fiduciary to our clients. We think it is the only way to do business. We are huge proponents of transparency of fees, unbiased investment recommendations and clear, understandable communication. Our Client Focus delves into this topic further. We know the political debate will continue to show up in the headlines. Regardless of the outcome, we are very glad the topic is getting the attention it deserves.

As always, we hope you find a portion of this newsletter useful. In addition to our regular market and portfolio comments, this quarter we are highlighting our "boots on the ground" research in our Research Focus and hitting the Active v. Passive investing debate head on in our Equity Comments.

Thank you for taking the time to read it. If you have any feedback, it is always appreciated.

Bob Charles Mark

Passive and Active Investing

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 6/30/17)

Source: Morningstar Direct

Index Name	Index Category	1 year	3 year	5 year	10 year
S&P 500 Index	Large Cap Stocks	17.90	9.61	14.63	7.18
Russell 1000 Index	Mid/Large Cap Stocks	18.03	9.26	14.67	7.29
Russell 1000 Growth Index	Growth Stocks	20.42	11.11	15.30	8.91
Russell 1000 Value Index	Value Stocks	15.53	7.36	13.94	5.57
Russell 2000 Index	Small Cap Stocks	24.60	7.36	13.70	6.92
MSCI EAFE Index	Non-U.S. Developed Market Stocks	20.27	1.15	8.69	1.03
MSCI Emerging Markets Index	Emerging Markets Stocks	23.75	1.07	3.96	1.91
MSCI ACWI Ex USA Small Cap Index	Non-U.S. Small Cap Stocks	20.32	3.31	10.02	2.91
BofAML Preferred Stock Fixed Rate Index	Preferred Stocks	5.86	7.23	6.72	3.59
Barclays Municipal Bond Index	U.S. Municipal Bonds	-0.49	3.33	3.26	4.60
Barclays Aggregate Bond Index	U.S. Bonds	-0.31	2.48	2.21	4.48
Barclays Intermediate U.S. Gov/Credit Index	Government/Corporate Bonds	-0.21	1.92	1.77	3.87
BofAML U.S. Treasury Master Index	Treasury Bonds	-2.45	2.20	1.37	4.13
BofAML U.S. Mortgage Backed Securities Index	Mortgage Backed Bonds	-0.03	2.15	1.98	4.34
BofAML U.S. Corporate Master Index	Corporate Bonds	2.33	3.54	4.05	5.72
BofAML U.S. High Yield Master II Index	High Yield Bonds	12.74	4.49	6.92	7.63
BofAML Convertible Bonds Index	Convertible Bonds	21.27	6.56	12.27	7.89
BofAML Euro Broad Market Index	European Bonds	0.65	-3.24	2.49	3.16
BofAML Local Debt Market Plus Index	Emerging Markets Bonds	5.34	-2.44	0.22	3.20

Calendar Year % Returns (QTD and YTD as of 6/30/17)

Source: Morningstar Direct

	QTD	YTD	2016	2015	2014	2013
S&P 500 Index	3.09	9.34	11.96	1.38	13.69	32.39
Russell 1000 Index	3.06	9.27	12.05	0.92	13.24	33.11
Russell 1000 Growth Index	4.67	13.99	7.08	5.67	13.05	33.48
Russell 1000 Value Index	1.34	4.66	17.34	-3.83	13.45	32.53
Russell 2000 Index	2.46	4.99	21.31	-4.41	4.89	38.82
MSCI EAFE Index	6.12	13.81	1.00	-0.81	-4.90	22.78
MSCI Emerging Markets Index	6.27	18.43	11.19	-14.92	-2.19	-2.60
MSCI ACWI Ex USA Small Cap Index	6.24	15.56	3.91	2.60	-4.03	19.73
BofAML Preferred Stock Fixed Rate Index	3.35	8.73	2.32	7.58	15.44	-3.65
Barclays Municipal Bond Index	1.96	3.57	0.25	3.30	9.05	-2.55
Barclays Aggregate Bond Index	1.45	2.27	2.65	0.55	5.97	-2.02
Barclays Intermediate U.S. Gov/Credit Index	0.94	1.73	2.08	1.07	3.13	-0.86
BofAML U.S. Treasury Master Index	1.22	1.92	1.14	0.83	6.02	-3.35
BofAML U.S. Mortgage Backed Securities Index	0.90	1.37	1.67	1.46	6.07	-1.39
BofAML U.S. Corporate Master Index	2.42	3.88	5.96	-0.63	7.51	-1.46
BofAML U.S. High Yield Master II Index	2.14	4.90	17.49	-4.61	2.51	7.41
BofAML Convertible Bonds Index	2.82	8.73	11.94	-1.15	9.97	26.60
BofAML Euro Broad Market Index	7.06	7.53	0.37	-9.30	-2.48	6.89
BofAML Local Debt Market Plus Index	3.82	9.95	6.53	-12.02	-4.50	-5.75

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.

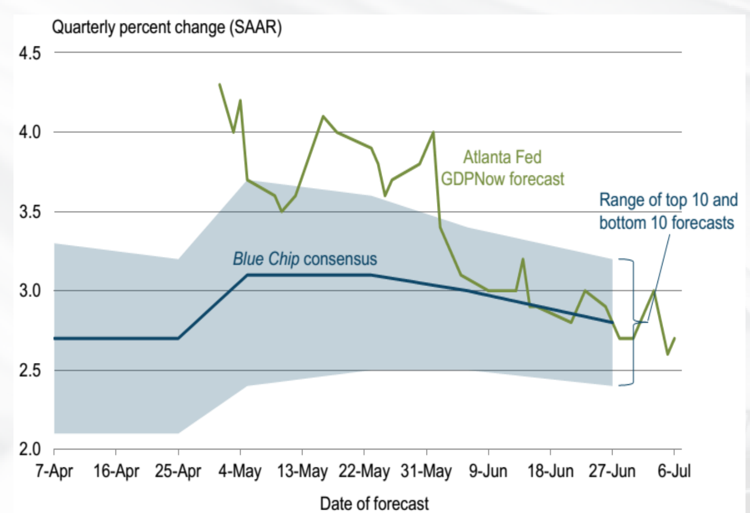
Market Notes

Global Market Drivers

The second quarter of the year was generally solid for equity and fixed income investors. Despite a considerable amount of political items filling the front pages and taking up time on television, market participants continued to weigh economic trends and corporate progress when voting their opinions. Over the long-term we think this is the most prudent course of action. Political events have the potential to be impactful, but are much more difficult to quantify. We are in the group of people that find comfort in hard data and detailed qualitative analysis when it comes to investing for our clients. We incorporate the potential for different political outcomes, but over our careers we have found little value in trying to build or make dramatic shifts in portfolios based on the potential for different scenarios to play out. We will continue to focus on what we feel we can control and quantify. Here is what we saw unfold relative to the key market drivers we follow during the quarter.

The Economy

After months of high expectations, the final reading on first quarter GDP growth was underwhelming. Increased consumer spending and exports did lead to an upward revision, but the final tally was only a +1.4% annualized growth rate. Inflation data was also underwhelming settling at +1.4% after peaking at around +2.0%. On the bright side, employment and housing data were solid throughout the quarter, signaling that second quarter growth should accelerate from the +1.4% pace we experienced in the first quarter. The Atlanta Fed GDPNow forecast is calling for +2.6% growth in the second quarter. (See chart to right.)



Source: Federal Reserve Bank of Atlanta

Outside of the U.S., global growth has broadened and deepened in the most synchronized recovery since 2010. The strength is likely to continue in the short-term, as the widely followed and highly accurate purchasing managers index predicts the broad-based recovery will continue. Also, the International Monetary Fund (IMF) increased its forecast for global expansion to +3.5% for the current year. It pointed to an improved outlook for Europe and Japan, based on continued momentum from global manufacturing and trade that started in the second half of 2016. In emerging markets, moderate growth is expected to return to Brazil and Russia as their deep recessions end. With inflation dropping, both countries' central banks have the capacity to cut rates multiple times. China is expected to grow in the +6.0% to +6.5% range in 2017. However, markets continue to focus on its public-sector credit bubble and private sector capital outflows. The risk factors to keep an eye on that could alter the positive outlook include a drop in commodity prices, weak inflation data and uncertainty stemming from geopolitical tensions.

Interest Rates

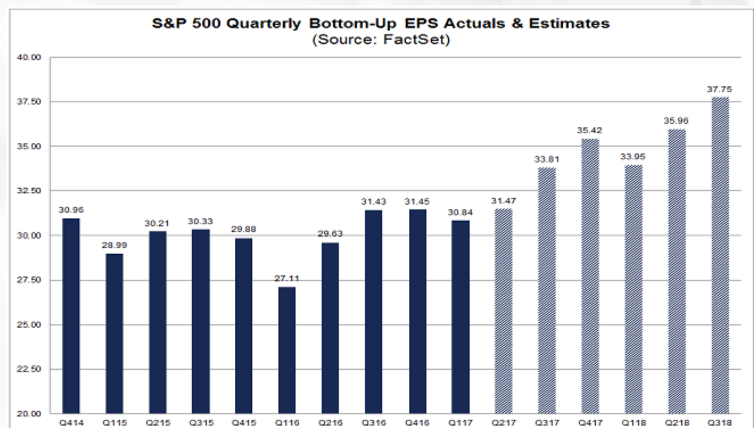
Despite upward pressure on Treasury bond rates at the end of June, intermediate- and long-term Treasury yields ended the quarter lower. The 10-year Treasury bond yield declined to 2.31% and

and the 2-year Treasury rose to 1.38%, resulting in a flatter yield curve (short-term yields rose more compared to long-term yields). On the short-term end of the curve, the U.S. Federal Reserve (Fed) validated market expectations by raising the target federal funds rate another 25 basis points (0.25%) in June. In addition to raising the funds rate, the Fed outlined a plan to reduce the size of its balance sheet, by tapering reinvestment of Treasuries and mortgage-backed securities. If all goes well, the Fed expects to start with a reduction of $6 billion for Treasuries and $4 billion for mortgage-backed securities by the end of 2017. The Fed plans to increase by the same amount every three months until reaching $30 billion and $20 billion, respectively.

Domestically, corporate credit spreads (corporate bond yields compared to Treasury bond yields) continued to tighten (yields between two bonds becoming closer together), as asset volatility declined near historic lows. Generally stable leverage metrics (debt levels compared to equity) and fewer shareholder friendly activities supported the market, as investment grade and high-yield spreads tightened 9 and 15 basis points, respectively. On the other hand, mortgage spreads continued to widen (yields between two bonds becoming further apart) as fears the Fed would begin to reduce the size of its balance sheet became reality. Mortgage spreads widened anywhere between 5 and 10 basis points depending on the bond. Around the globe, a continuation of the global recovery led to the outperformance of non-U.S. credit assets. Specifically, European high-yield corporate credit and securitized credit were the top performers, tightening 69 and 21 basis points, respectively.

Earnings

The outlook for corporate earnings remains solid. In aggregate, earnings for the S&P 500® Index are expected to grow by approximately +6.5% (year-over-year) in the second quarter. However, based on expected earnings surprises that have been reported so far, actual earnings growth may be closer to +9.5% (FactSet estimates) by the time the reporting season concludes. If this earnings growth rate materializes, it would mark the second highest quarterly period of earnings growth for the S&P 500 since 4Q '11 (the highest was last quarter, 1Q '17).



Slide courtesy of FactSet Research Systems – Earnings Insight July 7, 2017.

Despite that fairly rosy picture, increasing wage pressure and a strengthening U.S. dollar are two factors that could adversely affect earnings estimates. The most obvious impact from an increase in wages is that corporate profit margins could erode, especially without a corresponding increase in productivity growth. Wage pressure could also cause inflation to increase, which may lead the Fed to be more aggressive with rate increases than currently anticipated. In regards to currency, a stronger U.S. dollar would negatively impact certain sectors and companies more than others. For instance, the S&P 500 technology sector derives approximately 60% of its revenue from overseas. While all expenses for these companies are not necessarily denominated in U.S. dollars, the impact of a strong U.S. dollar may negatively impact earnings. This is something we will monitor in the coming months.

Equity Portfolio Comments

Equity Market Results

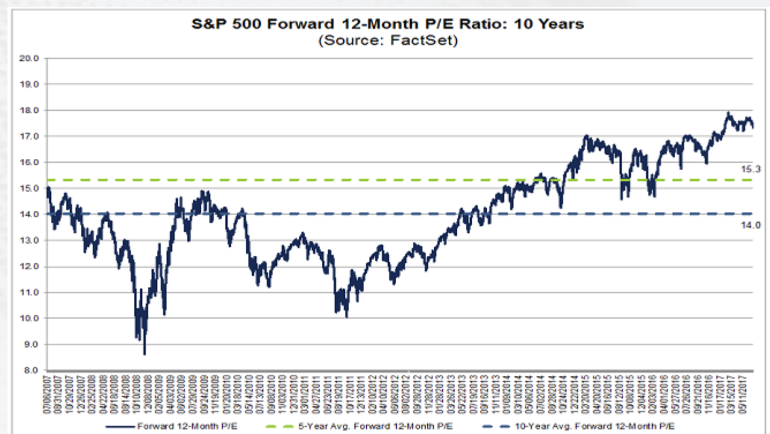
Equity market results were strong once again in the second quarter as investors appeared to focus most of their attention on robust corporate earnings and revenue growth as opposed to negative headwinds facing tax reform. Indications that economic expansion was becoming increasingly synchronized across the globe provided an added tailwind. In fact, based on data from Goldman Sachs Asset Management, economic expansion broadened to include nearly 98% of world economies (based on country and regional purchasing managers index data). Despite the positive data, risks to the global economic expansion remain, including the slower growth and excessive debt burden in China we mentioned earlier. This concern was partially supported by rating agency Moody's decision to downgrade China's credit rating for the first time since 1989. Other risks included the potential for policy missteps from the Fed as it began to wind down its balance sheet, and the ECB (European Central Bank), which ratcheted down its asset purchases.

The U.S. equity market gained +3.09%, as represented by the S&P 500® Index, in the second quarter. However, foreign developed and emerging markets finished with larger gains. Developed foreign equity markets, as represented by the MSCI EAFE® Index, gained +6.12%, while emerging foreign equity markets, as represented by the MSCI Emerging Markets Index, posted a gain of +6.27%. Leadership in the U.S. equity market was similar to the first quarter, with large-capitalization stocks (+3.09%, S&P 500® Index) slightly outperforming small-capitalization stocks (+2.46%, Russell 2000® Index), and growth stocks (+4.67%, Russell 1000® Growth Index) outpacing value stocks (+1.34%, Russell 1000® Value Index).

On a year-to-date basis, all major equity indices have registered positive results; however, there have been a few significant performance differences in certain segments of the market. These include: domestic large-capitalization stocks compared to domestic small-capitalization stocks (+9.34% vs. +4.99%), domestic growth stocks relative to domestic value stocks (+13.99% vs. +4.66%) and emerging market stocks versus U.S. stocks (+18.43% vs. +9.34%).

Equity Market Comments

From a valuation perspective, the S&P 500® Index's forward P/E ratio (price-to-earnings) finished at approximately 17.5x at quarter-end. 17.5x is roughly the amount that investors are willing to pay for $1 of future earnings. This amount is higher than the five-year average of 15.3x, 10-year average of 14.0x, and slightly higher than the 20-year average of 17.2x.



Slide courtesy of FactSet Research Systems – Earnings Insight July 7, 2017.

Based on the data above, equity valuations are elevated relative to history. But, does this mean stocks are destined to decline in the short run? Not necessarily. However, some are certain that current valuations actually do point to an imminent decline. In our mind, this type of simplistic cause (high

valuations) and effect (stock market decline) analysis can be damaging to long-term investment goals, especially when acted upon with a short-term mindset.

To play "devil's advocate," valuations were also relatively high 12 months ago. In the subsequent 12 months, U.S. equities increased roughly +18%. More than likely, individuals that currently believe equities are overvalued and are destined to plummet, also thought that equities were overvalued 12 months ago. This makes us wonder, what if they are wrong again? What if the equity market climbs another +10% from here while they're "sitting on the sidelines" in cash? What if corporate earnings continue to grow at robust levels? What if corporations increase investment in their businesses? What if the U.S. economy, as well as other global economies, continue to improve? What if consumers ramp up spending?

Unfortunately, we don't have definitive answers to any of the questions above. At the same time, we don't think anyone else does either. What we can say definitively is that overconfidence in one's ability to accurately (and consistently) predict the outcome of short-term events and their impact on markets is a very dangerous, and potentially costly, trait.

Client Portfolio Impact

As we stated in our last newsletter, our belief is that valuation by itself does not cause equity prices to go down. There needs to be a catalyst. And we do not pretend to know what the catalyst will be, or when it will surface. We can certainly guess, but investing is not about guessing or hoping for something to happen. And it is certainly not about guessing with our clients' hard-earned capital, and hoping we are correct. It is about patience, discipline and time. With that in mind, we continue to be (as always) fully invested based upon the asset allocation guidelines in each of our clients' investment policy statements. Said another way, we will let others try to be the "heroes." We are more than content staying true to our investment process, and staying true to each investor's long-term investment plan.

On a more granular basis, within a fully invested equity portfolio and with an intermediate- to long-term investment horizon, we continue to favor emerging markets and small- to mid-cap companies among foreign equities and large-cap companies among domestic equities.

Special Topic – Allocating Between Active and Passive Investments

There are certain things that make us uncomfortable when deciding how to allocate capital for clients. One of those things is when market perception regarding a topic moves from "thoughtful debate" to "fact." A two-sided discussion becomes one-sided, and less and less thought gets put into the possibility that the perceived "fact" may be incorrect. Currently, there is one "fact" that we are struggling with – the conclusion that passive investing (or index-based investing) is the only reasonable way to invest. Depending on the context of the statement, it may carry a certain degree of truth, which can be supported by aggregate statistics and other figures. That said, we think the topic is much further from a settled "fact" than what most of the investing public perceives. One of the many things our investment experience has taught us is to be skeptical when so many others are certain.

The portfolio construction portion of our investment process clearly states that we will always have a portion of our Core equity portfolio invested in passive investments. (See our investment process document located HERE). We construct portfolios in this manner because passive management has many great attributes. One of the best attributes is low fees. However, our decision-making process

does not begin and end with fees. That is because, in our opinion, at some point, low-cost passive management becomes expensive. Not in terms of the management fee charged to clients, but in terms of the opportunity cost to investors of blindly investing in all stocks in an index. This is one of the reasons that the percentage we allocate to active and passive investments will vary over time. Currently, the percentage of the equity portfolio allocated to passive investments is at its lowest point since our firm's inception. Clearly, we strongly disagree with the view that active management is dead. If anything is nearing its death in the investment advice industry, we believe it is hard work, research and patience. The herd mentality seems invincible.

The first reason that we are at our lowest allocation to passive is because we believe the active managers that we have selected will be relatively better stewards of client capital over the next three to five years. As we have noted in previous newsletters, the performance of active strategies relative to passive strategies is cyclical. This time is not different. We believe that we have entered a period when differentiation relative to an index is very important. Individual company fundamentals will matter much more than they have in the recent past.

Another reason that we have lowered our allocation to passive investments is because of concern that we may be in a "passive bubble." We are not predicting a sustained market downturn, but what gives us pause is that we are not sure what will happen to the money that has flooded into passive investment products when equity prices do move lower. Many questions come to mind. Are passive/index-based investors smarter or more patient than everyone else? Will they simply hold their positions and be content to ride the wave of stock declines into the reef? What if these investors are saddled with the same behavioral biases as everyone else? Will they (gasp!) sell their passive/index-based equity products and move to cash? Then what? Who will buy the stocks that the passive investment providers are selling? Markets will inevitably "clear," but at what price? Will passive investors become dependent on active investors to pick through the momentum-driven, price-inflated weeds that have grown indiscriminately among good businesses? If active investors do not buy everything in an index (spoiler alert, they will not), then who will?

Are we in a passive bubble? Consider these stats.

- Over the last three years, Vanguard has taken in more money than the rest of the mutual fund industry combined.
- There are 5 times more indices than in 2012.
- Passive inflows in 2016 totaled +$563 billion. Active outflows totaled -$326 billion.

To reiterate, we are not inferring that money leaving passive investments would delve financial markets and passive investors into Armageddon. But, we are also not comfortable saying that everything will be "rainbows and unicorns" either. All we do know for sure is that there has never been this many index-based investment products, or this many assets (approximately $5.5 trillion) ever in passive products.

All in all, based on current market dynamics, underlying company fundamentals, and where we are in the business cycle, we believe we have entered (or are close to entering) an optimal environment to invest alongside disciplined, active investors that purchase solid, fundamentally-sound businesses. This is where our extensive experience in manager research and selection, along with a disciplined investment process replace "guessing" and "hope."

Fixed Income Portfolio Comments

Fixed Income Market Results

In a repeat of the first quarter, all major fixed income sectors posted positive returns in the second quarter. European bonds were the clear winner, as they rose +7.06%. Better economic news out of the continent led to a stronger currency, which accounted for most of the return. Once again, there was a clear line drawn between quality buckets. Below investment grade sectors posted the best results, with local emerging market debt and preferred stocks leading the way at +3.82% and +3.35%, respectively. While still positive, the AAA-rated sectors were the worst performing. Mortgage backed securities and Treasuries were up, but lagged, generating returns of +0.90% and +1.22%, respectively.

Fixed Income Market Comments

Outside of a dramatic external shock, it is likely U.S. economic growth will continue at a moderate pace over the next 6-12 months. The U.S. economic backdrop is supported by a robust labor market and ongoing strength from housing and manufacturing sectors. The closely followed leading economic index suggests growth should exceed +2% over this period. With all the distractions in Washington D.C., any potential fiscal stimulus seems some way off, which makes an acceleration above the current trend less likely over this period.

Over the intermediate-term (12-36 months) we continue to see the risks to growth as balanced. On the positive side, it does not appear there is a significant risk of overheating. Inflation remains in check, inventories are at healthy levels and resource utilization is below potential. Additionally, the possibility of fiscal stimulus is on the horizon, which could extend the cycle further. Conversely, high debt levels, tighter credit conditions and an aging demographic all pose threats. We track several of these factors in our proprietary Entasis U.S. cyclical indicator, which is currently showing signs of late cycle characteristics, but has not yet flashed a peak. Outside of traditional domestic fundamentals, there are always external factors that could push the economy into recession. We are keeping a close eye on developments in Russia, North Korea and the Middle East, challenges with European banks, Chinese debt levels, currency and property markets and the threat of global trade wars.

U.S. Interest Rates

Based on our highest probability scenarios, we believe fair value for the 10-year Treasury bond is 2.35% to 2.80%. The 10-year Treasury bond ended the quarter at 2.30%, which was slightly below the range. The likelihood of accelerating year-over-year real GDP growth and one additional rate hike by the Fed in 2017 are the primary drivers behind our fair value estimate. Other factors that could push interest rates higher are less demand for U.S. Treasuries by foreign buyers and the tapering of reinvestment by the Fed we noted earlier.

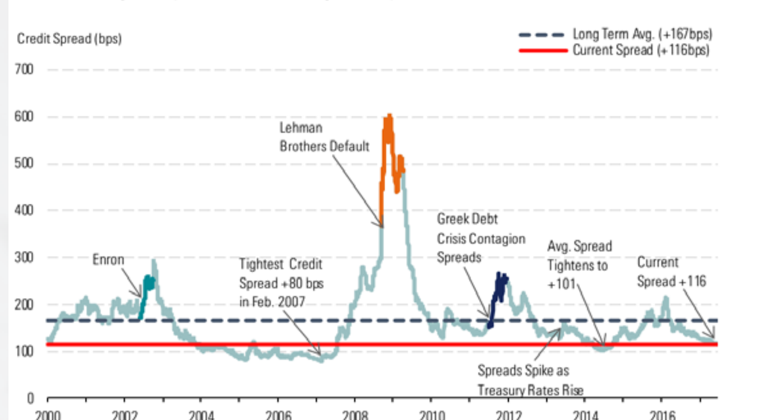
Yield Curve

Coming into the second quarter, we expected the yield curve would continue to flatten as the Fed raised short-term interest rates. The 2-year to 10-year Treasury differential did just that by flattening 0.20%. It is now hovering near long-term averages. Typically, as economic and business cycles age, the yield curve continues to flatten, which is consistent with our long-term view. However, in the short-term, incorporating our view for longer-term rates, we expect the curve could move up in a parallel fashion, or re-steepen a bit, which would make all parts of the curve vulnerable to losses.

Fixed Income Portfolio Comments

Sector & Quality Management

Despite a broadening recovery, we do not think we are being adequately compensated for taking excess risk at this point in the cycle. With a few exceptions, asset valuations across credit markets are historically expensive (see chart below). Corporate debt levels are elevated relative to recent history and interest coverage and cash flow have been deteriorating. Despite relatively high consumer debt levels, in aggregate, personal balance sheets are arguably in better shape than corporations. Plus, many structured products have collateral backing bondholder claims, which means they continue to offer, in our opinion, better risk-adjusted yields. As a result, we continue to like non-agency mortgage-backed securities, commercial mortgage-backed securities and asset-backed securities.



Source: Morningstar.

Investment Vehicle Selection

Our view on investment vehicle selection remains the same. We believe the time for using passive investing in risky sectors has passed and issuer selection will be paramount.

Client Portfolio Impact

Our general positioning of fixed income portfolio assets remains in a somewhat defensive posture as our views have not changed meaningfully. It is our goal to provide downside protection while we wait for better valuations in credit assets that may result from market volatility.

Our fixed income positioning in client portfolios reflects our views.

- We indicated last quarter that we would look to reduce interest rate risk if valuations moved below 2.30% for a considerable period. During the quarter, the 10-year Treasury bond traded in a range from 2.14% to 2.22% for several weeks, which was a perfect opportunity to reposition portfolios from near benchmark levels of interest rate risk to an underweight position.
- From a yield curve standpoint, we decided to reposition the portfolios to have less exposure to longer-term bonds (fewer 7-10 year bonds) since they are more vulnerable to price risk.
- We continued to scale back our corporate credit positions and are now mostly underweight client benchmarks. Where we do have exposure, we continue to favor high quality bonds over below investment grade securities. We like opportunities that we believe offer better late cycle diversification and better risk-adjusted value such as non-agency mortgage-backed securities, commercial mortgage-backed securities, asset-backed securities, local currency emerging market bonds, insurance-linked securities and high-yield municipal bonds.
- To further emphasize this theme, we recently eliminated our use of passive credit ETF's in exchange for a short-term, actively-managed, securitized credit-focused mutual fund. We continue to favor active management in sectors that we believe have attractive opportunities. We have maintained our significant allocation to non-traditional bond funds because, if managed properly, they have the potential to make money whether interest rates move higher or lower.

Bean Town – A Look Inside Our "Boots on the Ground" Research

Do you know how the city of Boston got the nickname "Bean Town?" The conventional wisdom is the city got the moniker for being the birthplace of baked beans. It is true that baked beans gained popularity in Boston, but that is only part of the story. I was recently visiting Boston with my wife and learned the history behind how the dish became synonymous with the city. We were on one of the city's world-famous duck tours, and got the details from our colorful captain "Ray Beez." He told us the early Pilgrims and Puritans of Massachusetts strictly observed the Sabbath, and did not work or even cook hot meals on Sundays. To get around this religious rule, they would bake beans in a pot on Saturdays, and leave them in their hot brick ovens overnight. On Sundays, the baked beans would still be hot when served. Due to the Sabbath, baked beans eventually became a traditional Sunday meal, which lasted until the early 1900s. Interesting, right?

The cool part of the story for me was hearing it while driving through the city's historic North End. It has the distinction of being the city's oldest residential community. People have continuously inhabited it since it was settled in the 1630s. Today, it still has old narrow streets and is tightly packed with red brick buildings, some that date back to the 17th century. The combination of hearing the story while being in eyesight of the original 17th century buildings, made the experience come to life for me. I could almost smell the beans coming from the 17th century homes on a cold autumn Saturday.

North End Boston, MA   Paul Revere House Build 1690 –North End

You may be wondering, how does this relate to research? Prior to touring the city with my wife, I was there on business, meeting with investment managers. To refresh your memory, we spend a significant amount of time on qualitative analysis, which includes in-depth research of an investment team, its firm structure, investment process, risk management and culture among many other factors.

Mike Peters, CFA
Chief Investment Officer – Fixed Income

Summary

We spend a significant amount of time on qualitative analysis which includes in-depth research of an investment team, its firm structure, investment process, risk management and culture.

We recently met on site with the Putnam Tax-Free High-Yield team to review culture, leadership, communication and infrastructure.

On-site visits allows us to connect the dots from our phone conversations, meetings and the materials we have studied to the actual interaction of the team and execution of investment decisions.

Qualitative Factors

- Culture
- Leadership
- Communication
- Infrastructure

Research Focus

In addition to meeting in our office and over the phone, we conduct on-site due diligence meetings with our managers. There are certain things we focus on that can't be picked up over the phone or by reading process materials. Examples are culture, leadership, communication and infrastructure. To give you a better understanding of how valuable this can be, I'll walk you through what I learned on my visit with the Putnam Tax-Free High-Yield team.

While on-site, I met several people in addition to my scheduled meetings with the Fund's lead portfolio manager Paul Drury, portfolio co-manager Garrett Hamilton, investment grade municipal trader Daniel Riordan and high-yield municipal trader Ted Pappafotopoulos. The first hour was spent with Paul Drury in a one-on-one setting where we talked about the strategy. The next hour was spent with the team (Garrett, Dan and Ted) on the trading floor getting an overview of their systems.

Putnam Sign 12 Post Office Square, Boston

- Culture - One of the most important things to get a feel for at an on-site visit is office culture. We believe it is critically important to work in a healthy atmosphere. We want the collective effort of the team to be focused on the task at hand, which is taking good care of our clients' money. We try to get a feel for the team's attitudes and body language.

- My assessment – Generally, the Putnam team works in a very collegial environment. Everyone throughout the office was polite to one another and seemed happy to be working together. I did not notice any closed-off body language or side conversations done with mouths covered and whispering. Specifically, the high-yield municipal team seemed to have fun working together. Nothing I witnessed raised a red flag for me, if anything it gave me comfort that there is likely a below average level of office distractions.

- Leadership – We look at several things when analyzing a lead portfolio manager. Do they have a passion for investing. Do they promote a team atmosphere? Are they confident or overconfident? Can they learn from mistakes?

- My assessment – Paul Drury has a passion for investing, particularly municipal finance. For example, he answered all my questions enthusiastically with a tone of excitement in his voice. He is a team player. He was genuinely excited to give his team credit for the product's success. He was particularly complementary of the team's research analysts. I could tell he sincerely believes their experience is invaluable. I also believe the team generally likes him. I could tell by the way he was received when introducing me to them. They were comfortable and willing to joke with him, they did not seem overwhelmed or intimidated by him. When asked about mistakes you could tell by his body language that he took losses harder than he enjoyed victories and has done his best to learn from them. Overall, I am very impressed with Paul Drury's leadership.

- Communication – When on-site we assess the team's ability to communicate. We evaluate if the environment fosters communication or makes it prohibitive. We want our teams to be able to work together and act quickly.

- My assessment – The team was very well organized. The portfolio managers and traders sat right next to each other on the trading desk, they had open lines of communication and there were no walls or offices dividing them. For example, while getting a demo of their trading software, I overheard bits and pieces of a conversation, about a trade, between Garrett Hamilton and Ted Pappafotopoulos. They did not have to email back and forth or make a call and hope the other was there to pick up. They were able to communicate immediately. Seeing it live gave me confidence they are set up to communicate effectively. The research analysts did not sit on the desk. They had private cubicles, but were in sight and only a few steps away.

- Infrastructure – One of my favorite things to do on a site visit is get a demo of the team's research and trading systems. It is of interest to me because seeing systems live helps me connect several dots about the investment process.

- My assessment – The team has world class systems. Their proprietary trading system XFI is customized to meet the needs of the fixed income team. It has a very well-designed user interface. I felt as if I could use it by the end of the demo. It is also very powerful and makes the team very efficient. For example, they can look across all their portfolios and determine the appropriate trade size by setting a target weight by issuer. I was also given a demo of the team's proprietary research platform MuniLand. It is essentially a database of all of the team's research. It does not integrate with XFI, but has a similar user interface which makes them easy to use together. It is a robust system – it contains every piece of information they have ever written. They can retrieve it quickly and make comparisons across issuers with ease. The team's custom designed systems make it easy to obtain, analyze and process information quickly, which is crucial in the high-yield municipal space.

In summary, there is nothing like experiencing something first hand. Just like learning about "Bean Town" and the North End made it come to life, so does the process of an investment manager during an on-site visit. We are able to connect the dots from our phone conversations, meetings and the materials we have studied to the actual interaction of the team and execution of investment decisions. It is a critical part of a thorough decision-making process and one we prioritize heavily in what we do. We believe it is a true differentiator for us. Anyone can find numbers and run screens because it easy. And most advisors take the easy route. We go the extra mile. Literally.

Client Focus

This quarter our Client Focus is on the role of a Fiduciary.

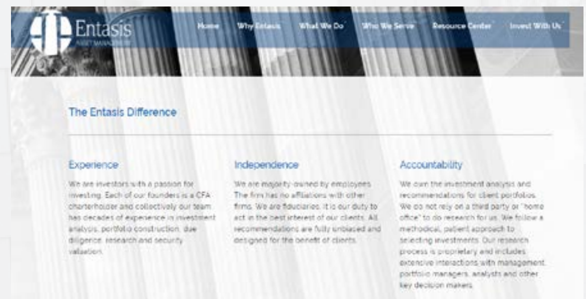
In our industry – generically defined as investment advice – there are two standards of care as it relates to working with clients. Fiduciary and Suitability.

Registered investment advisors such as Entasis are bound by the Fiduciary standard. **A Fiduciary has to place his or her clients' interests ahead of their own.** There should be no conflicts of interest, information should be presented accurately and fairly and analysis should be thorough and accurate.

Brokers or others providing investment advice that adhere to the Suitability standard are only required to make sure investment recommendations are suitable for their clients. It covers topics such as making sure costs are not excessive, but it does not require that clients' interest be first. Some view the distinction as subtle. We believe it is meaningful. The Department of Labor (DOL) agreed and put in place an expansion of the fiduciary standard in June.

There has been a lot of political jockeying on the topic, many wonder if it will last, and we are not sure if the DOL is the best source of regulation (Is the SEC more appropriate?). Regardless, we believe there is huge value in what it shines a light on.

- Too many people are charged too much for the investment advice they receive.
- Too many people lack transparency into what they pay for investment advice.
- Too many people do not even have access to quality investment advice.
- Too many people that provide investment advice are unqualified.
- Too many people that act as brokers do very little investment analysis.
- Too many brokers do not place client interests first and operate with numerous conflicts of interest.



Click on the picture to see the Entasis difference.

Entasis was founded on beliefs and principles to tackle those problems head on.

We have developed a section of our website specifically to help people with the decision-making process that should go into hiring an advisor/broker. http://entasisam.com/choosing-an-advisor/ We have written thought papers on the topic. http://entasisam.com/hiring-advisor-homework/ We have even put together a series of questions to help people interview their existing advisor/broker or a prospective advisor/broker. http://entasisam.com/wp-content/uploads/2016/09/Financial-Advisor-Questionnaire.pdf

People that hire an advisor/broker to help with their investment planning have worked way too hard to build the assets they have to not be thoughtful about understanding the individual and firm they have hired to help sustain and growth that wealth. We want everyone to be thorough in the process they use to hire an advisor/broker. We have created these tools to make sure everyone does just that.

We are fiduciaries at Entasis. We believe we have created a better experience for our clients. We believe we can create a better experience for people that are not yet clients.

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

Statements may be forward looking and are not intended as specific investment advice without further review of individual circumstances. Commentary, opinions, analysis, and recommendations may be subjective, do not guarantee future performance, and could change at any time without notice. Under no circumstances does the information contained within represent a recommendation to buy or sell any security. Charts and graphs provided are for illustrative purposes only.

This information is provided for informational purposes only and does not constitute individualized financial advice or create an advisor-client relationship. This newsletter is published for the exclusive use of our clients and friends and is not intended as investment, legal or tax advice. This newsletter was prepared using information from third-party sources, which we believe to be reliable; however, we have not audited the data from these sources and are not responsible for its accuracy.

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.

A basis point is a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01% (0.0001).

Interest coverage is a measure of a company's ability to meet its interest payments on its debt.

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