ENTASIS ASSET MANAGEMENT

QUARTERLY NEWSLETTER

4Q2017

When we started our business in 2016 one of the key drivers behind the establishment of our firm was the complementary skills of our founders. Bob has had a long career in the investment industry focused on business management, operations, marketing and client relationship management. CJ has considerable experience doing equity research and portfolio management and Mike has similar experience on the fixed income side. We believed we could build a better business and a lasting business by bringing together three distinct sets of experiences for the benefit of our clients.

In our view, we have been successful on many fronts. Our early investment returns are solid compared to the benchmarks we use, and we have met and are working with, a great group of clients that believed in our team approach enough to trust us with their hard earned money. We are grateful.

The mission in front of us now is continuing to grow this business by reaching more clients with goals and interests that align with what we do. We view our business model as highly scalable, but sharing our story takes time, and we do not want to disrupt our focus on value creation for our clients.

Interestingly enough, that mission led to discussions about our goals with, of all people, a client. After several discussions we realized he possessed a set of skills that further complemented ours, and a few short weeks ago we welcomed the newest member of our team – David LaCroix. David has been in our industry for decades and he has a wealth of knowledge in business development and client relationship management. We believe he will make us better at what we do and allow us to find those clients we have not met yet. We are excited to have him on board and pursuing our mission with us.

We hope you find a portion of this newsletter useful.

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

Bob

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 12/31/17)

Source: Morningstar Direct

Index Name	Index Category	1 year	3 year	5 year	10 year
S&P 500 Index	Large Cap Stocks	21.83	11.41	15.79	8.50
Russell 1000 Index	Mid/Large Cap Stocks	21.69	11.23	15.71	8.59
Russell 1000 Growth Index	Growth Stocks	30.21	13.79	17.33	10.00
Russell 1000 Value Index	Value Stocks	13.66	8.65	14.04	7.10
Russell 2000 Index	Small Cap Stocks	14.65	9.96	14.12	8.71
MSCI EAFE Index	Non-U.S. Developed Market Stocks	25.03	7.80	7.90	1.94
MSCI Emerging Markets Index	Emerging Markets Stocks	37.28	9.10	4.35	1.68
MSCI ACWI Ex USA Small Cap Index	Non-U.S. Small Cap Stocks	31.65	11.96	10.03	4.69
BofAML Preferred Stock Fixed Rate Index	Preferred Stocks	10.58	6.77	6.25	5.03
Barclays Municipal Bond Index	U.S. Municipal Bonds	5.45	2.98	3.02	4.46
Barclays Aggregate Bond Index	U.S. Bonds	3.54	2.24	2.10	4.01
Barclays Intermediate U.S. Gov/Credit Index	Government/Corporate Bonds	2.14	1.76	1.50	3.32
BofAML U.S. Treasury Master Index	Treasury Bonds	2.43	1.47	1.37	3.39
BofAML U.S. Mortgage Backed Securities Index	Mortgage Backed Bonds	2.45	1.86	2.02	3.83
BofAML U.S. Corporate Master Index	Corporate Bonds	6.48	3.88	3.50	5.59
BofAML U.S. High Yield Master II Index	High Yield Bonds	7.48	6.40	5.81	7.96
BofAML Convertible Bonds Index	Convertible Bonds	16.03	8.69	12.32	8.80
BofAML Euro Broad Market Index	European Bonds	14.61	1.42	1.69	2.71
BofAML Local Debt Market Plus Index	Emerging Markets Bonds	14.71	2.45	-0.65	2.94

Calendar Year % Returns (QTD as of 12/31/17)

Source: Morningstar Direct

	QTD	2017	2016	2015	2014	2013	2012
S&P 500 Index	6.64	21.83	11.96	1.38	13.69	32.39	16.00
Russell 1000 Index	6.59	21.69	12.05	0.92	13.24	33.11	16.42
Russell 1000 Growth Index	7.86	30.21	7.08	5.67	13.05	33.48	15.26
Russell 1000 Value Index	5.33	13.66	17.34	-3.83	13.45	32.53	17.51
Russell 2000 Index	3.34	14.65	21.31	-4.41	4.89	38.82	16.35
MSCI EAFE Index	4.23	25.03	1.00	-0.81	-4.90	22.78	17.32
MSCI Emerging Markets Index	7.44	37.28	11.19	-14.92	-2.19	-2.60	18.22
MSCI ACWI Ex USA Small Cap Index	6.56	31.65	3.91	2.60	-4.03	19.73	18.52
BofAML Preferred Stock Fixed Rate Index	0.43	10.58	2.32	7.58	15.44	-3.65	13.59
Barclays Municipal Bond Index	0.75	5.45	0.25	3.30	9.05	-2.55	6.78
Barclays Aggregate Bond Index	0.39	3.54	2.65	0.55	5.97	-2.02	4.21
Barclays Intermediate U.S. Gov/Credit Index	-0.20	2.14	2.08	1.07	3.13	-0.86	3.89
BofAML U.S. Treasury Master Index	0.11	2.43	1.14	0.83	6.02	-3.35	2.16
BofAML U.S. Mortgage Backed Securities Index	0.14	2.45	1.67	1.46	6.07	-1.39	2.59
BofAML U.S. Corporate Master Index	1.12	6.48	5.96	-0.63	7.51	-1.46	10.37
BofAML U.S. High Yield Master II Index	0.41	7.48	17.49	-4.61	2.51	7.41	15.55
BofAML Convertible Bonds Index	1.95	16.03	11.94	-1.15	9.97	26.60	13.63
BofAML Euro Broad Market Index	2.12	14.61	0.37	-9.30	-2.48	6.89	12.95
BofAML Local Debt Market Plus Index	0.90	14.71	6.53	-12.02	-4.50	-5.75	13.87

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.

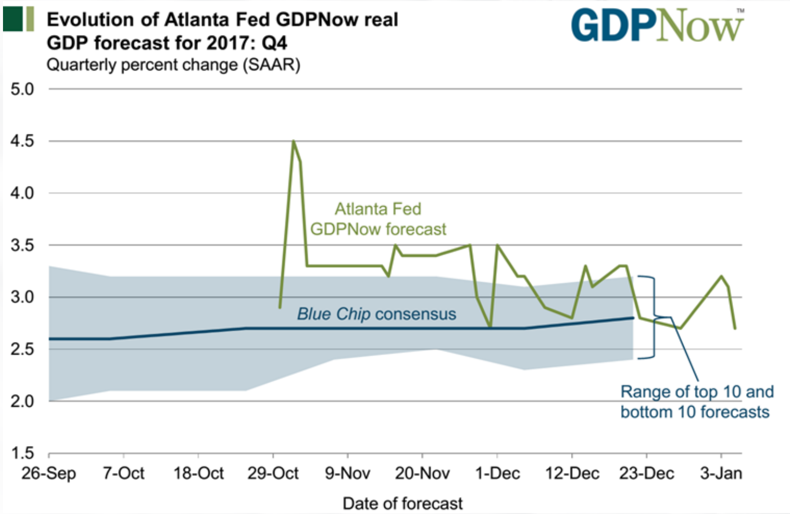
Global Market Drivers

After wondering aloud in our last newsletter if financial market gains could continue at their recent pace, they did just that in the fourth quarter, closing out a broadly solid year. High quality short-term bonds (as measured by the Barclays Intermediate U.S. government / credit index) were the only asset class to take a breather in the fourth quarter and calling it a loss is largely splitting hairs given that it was only -0.20 %. On the other end of the spectrum, non-U.S. and emerging markets equities and bonds surged further closing out stellar years. And a quick review of our global market drivers does not indicate much change on the horizon. Things broadly look positive. We are not, however, conditioned to blissfully ride the wave. We are wired to be cautious – particularly when it seems like all is well. We are drawn to commentary about what could go wrong. We are not pessimists, but we try not to be naïve either. Is this time different? Absolutely. Every cycle is different, but the one thing that always seem to ring true is that markets and economies cycle. That never changes. So, we need to be prepared for that inevitable outcome.

The Economy

During the fourth quarter, economic data continued to paint a positive picture for the U.S. economy. The final read on third quarter GDP growth was 3.2%, which pushed the year-over-year growth rate up to 2.3%, from 1.8% at the end of 2016. For 2017, the economy created an average of 175,000 jobs per month, which equates to over 2 million new jobs, and resulted in the unemployment rate dropping to 4.1%. Despite a booming labor market and accelerating growth, inflation continued to be modest. According to the GDPNow estimate produced by the Federal Reserve Bank of Atlanta (shown below), growth for the fourth quarter is expected to slow moderately to a 2.5% rate.

Data outside of the U.S. continued to be strong as well. Regional economic data in the Eurozone remained positive, growth was supported by solid domestic consumption and export demand. During the fourth quarter, measures for employment and new manufacturing orders reached their highest levels in 17 years. Japanese data was also positive, third quarter GDP figures were revised up to show annualized growth of 2.5%. Exports and corporate investment were the primary drivers of growth while domestic demand lagged.



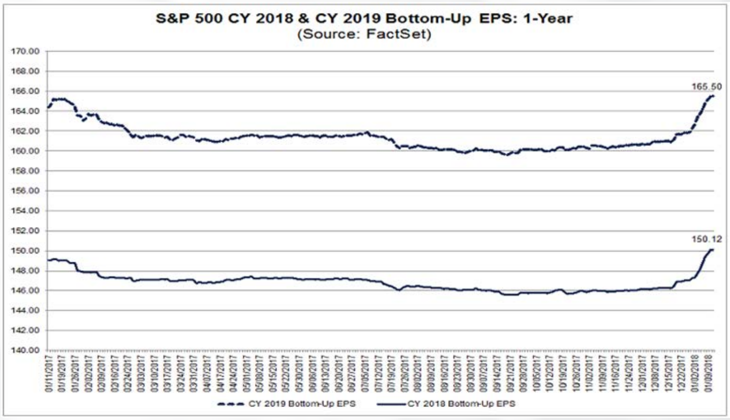
Emerging markets continued to show signs of strength, and seem to be on a self-sustaining path. China generated stronger than expected growth, while Brazil and Russia emerged from recession. India also bounced back from a reform-induced slowdown.

Interest Rates

During the fourth quarter, short-term interest rates continued to climb, as the U.S. Federal Reserve (Fed) reserve raised the federal funds rate 25 basis points (0.25%) in December, marking the third such move in 2017. For the year, the yield curve underwent a major flattening (short- and long-term rates converging), as the yield on the 2-year Treasury increased 69 basis points (0.69%) and the yield on the 10-year Treasury decreased 5 basis points (0.05%). For 2017, Treasury bonds with maturities beyond 20 years saw their yields decrease between 20 and 30 basis points (0.20% and 0.30%), leading to significant outperformance.

Earnings

Corporate earnings growth (year-over-year) is expected to be 10.8% (S&P 500® Index) for the fourth quarter. However, based on estimates from FactSet, earnings growth will more than likely end at roughly 13.8% after all companies have reported (over the past five years, actual earnings have exceeded estimated earnings by 3 percentage points). If this growth rate materializes (13.8%), it will mark the second highest earnings growth rate for the S&P 500 Index since the third quarter of 2011. Earnings estimates also received a noticeable boost at the end of the year due to the passage of the tax reform bill (see chart below). All-in-all, in aggregate, the data *appears* fantastic.



However, as many of our investment management partners will profess, *appearances* may carry weight in the short run, but in the long run, corporate *personality* (i.e. decision-making) rules the day. *Appearances* that cause the most angst for many of our managers typically center on the overall quality of corporate earnings, or lack thereof. Broadly speaking, when looking at the entire U.S. equity market, some are concerned by the large differences between "GAAP" earnings (generally accepted accepted accounting principles) and "non-GAAP" earnings (adjusted earnings that may exclude one-time items, etc.), the use of leverage (debt) to repurchase stock (earnings per share increases as the number of shares outstanding decrease) and the overall lack of prudent capital expenditures (business investments that have the potential to drive earnings improvement in the future).

Does this mean that all corporations suffer from poor earnings quality? Of course not, but a thorough analysis will definitely identify some that do. When the economy and markets are humming along, no one tends to notice, but when economic and market tailwinds turn to headwinds, investors finally take notice. This is one of many reasons that we hire active managers. We want to keep our clients' capital out of poorly managed businesses. We know our managers will not be perfect, but we are confident in their abilities to provide a degree of relative protection when markets inevitably become more challenged, regardless of how positive the current environment *appears*.

Looking ahead to the remainder of 2018 from a corporate earnings perspective, we are most concerned about how markets will react to relatively "less good" year-over-year earnings comparisons as we traverse through the second half of the year. In our view, these disappointments may be one of the drivers of a change in market leadership from a style and sector perspective, and may also be one of the causes that leads to a bumpier equity market in 2018 compared to the largely smooth ride enjoyed by most in 2017.

Equity Portfolio Comments

Equity Market Results

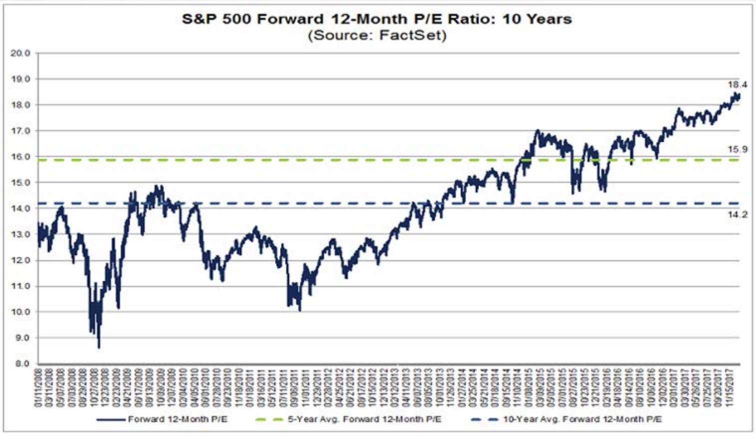
Little stood in the way of the equity market during the fourth quarter. Strong corporate earnings and revenue growth, along with the passage of the tax reform bill, overshadowed the overall hostile political environment in Washington D.C., global indebtedness, fiscal and monetary policy uncertainty and geopolitical turmoil in the Middle East and Asia. While any number of dire predictions or world events could have derailed the equity market, the market largely brushed off the "what-ifs" and instead focused on the "what is."

The U.S. equity market, as represented by the S&P 500® Index, shot higher by +6.64% in the fourth quarter. Developed foreign equity markets, as represented by the MSCI EAFE® Index, returned +4.23%, while emerging equity markets, as represented by the MSCI Emerging Markets Index, led all major equity indices with a gain of +7.44%. From a style perspective, growth-oriented domestic equities (+7.86%, Russell 1000® Growth Index) outpaced value-oriented domestic equities (+5.33%, Russell 1000® Value Index), while among domestic equity market-capitalizations, large-cap equities (+6.64%, S&P 500® Index) registered larger gains than small-cap equities (+3.34%, Russell 2000® Index).

Full year equity results were equally impressive. The broad U.S. equity market gained +21.83% (S&P 500® Index), developed foreign equity markets returned +25.03% (MSCI EAFE® Index) and emerging equity markets gained +37.28% (MSCI Emerging Markets Index). Among U.S. equities, growth-oriented stocks (+30.21%, Russell 1000® Growth Index) finished significantly ahead of value-oriented stocks (+13.66%, Russell 1000® Value Index), and large-cap stocks (+21.83%, S&P 500® Index) ended the year ahead of small-cap stocks (+14.65%, Russell 2000® Index). Differences among sectors of the market were even more pronounced. The technology sector (S&P 500 GICS Technology) posted a gain of +38.83%, while telecom (-1.25%, S&P 500 GICS Telecom), energy (-1.01%, S&P 500 GICS Energy) and utilities (+12.11%, S&P 500 GICS Utilities) lagged the broad market.

Equity Market Comments

The S&P 500® Index's forward P/E ratio (price-to-earnings ratio) expanded to approximately 18.4x at year-end. 18.4x 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 15.9x and 10-year average of 14.2x.



Slide courtesy of FactSet Research Systems – Earnings Insight January 12, 2018.

Based solely on the chart of price-to-earnings data for the S&P 500® Index, it is easy to see that stock prices are currently at an elevated P/E ratio relative to nearer term history. However, as we have stressed in past newsletters, just because stock prices appear to be expensive does not mean that equity markets cannot move higher. Valuation is not a catalyst by itself. Stocks do not simply go down because the broad market P/E ratio hits 18.0x or 20.0x. A higher valuation can certainly result in swifter downward movements in stock prices, but valuation alone does not cause a market to decline. There needs to be a catalyst.

We never know what the catalyst will be. More than likely, it will be a combination of multiple things, and as we said in the opening, we need to be in tune with what they could be. The most frequently cited risks include (in no particular order): 1) uncertainty surrounding Fed decisions; 2) a sharp uptick in inflation; 3) rising interest rates; 4) global indebtedness; 5) an oil shock; 6) trade protectionism; 7) an economic shock emanating from China; 8) conflict with North Korea or in the Middle East; and 9) essentially, we are overdue for a downturn (length of current cycle). Since it makes for good reading, there is never a shortage of worries, or doom and gloom.

At the same time, what if instead of the glass being half empty, it is actually half full? Along these lines, optimists point to catalysts that may help to push the market even higher (or provide the environment for further appreciation) such as: 1) the recently passed tax bill permanently shifts corporate earnings higher; 2) companies repatriate cash held offshore and return it to shareholders in the form of special dividends or share repurchases; 3) companies begin to invest in their businesses at a higher rate; 4) the economy grows at over 3% moving forward instead of 2%; 5) unemployment remains low and wages increase; 6) inflation increases, but remains relatively tame; 7) China continues to walk the proverbial tightrope as its economy shifts from an export-driven market to a services-driven market; 8) the U.S. passes a massive infrastructure bill that softens the impact of modest tightening (increasing interest rates) by the Fed; and 9) geopolitical tensions remain high, but no new conflicts occur.

Unfortunately, the Entasis crystal ball is not giving us a good answer on if, what, or when any of the above positives or negatives will come to fruition. What we do know for sure is that equity markets cannot increase over +20% per year forever, volatility will return, equity prices will decline, but they will also rise again. Markets cycle.

Client Portfolio Impact

In domestic equity markets, we continue to favor growth-oriented stocks over value-oriented stocks, and large-cap companies over small-cap companies. We did begin to reduce our exposure to growth at the beginning of the fourth quarter since we believe the relative attractiveness of growth equities over value equities has diminished since our initial trade (December, 2016). We also continue to assess our stance on small- and mid-cap equities. We have had minimal direct exposure to either since our firm's founding (2016), but we are becoming more constructive on those segments of the market.

In foreign equity markets, we remain convicted about small- and mid-cap equities, as well as emerging markets more broadly. We do not expect the ride to be nearly as smooth in 2018 as it was in 2017, nor do we think it will be as broad-based and synchronized. We believe emerging markets will become more segmented, and that individual country and company performance will be more important to generating relatively attractive results. With this in mind, we made a somewhat unique decision in the fourth quarter to add a new emerging markets equity investment in portfolios. This was unique because we commonly focus our clients in fewer investments. However, considering our outlook, we believed that it was more important to invest in two high conviction managers that think about markets a bit differently. These managers have distinct investment processes and tend to focus their investments in complementary emerging market regions, yet both follow an "all-cap" mindset (will invest in large-, mid- and small-cap equities), which we believe provides the best opportunity to add value over time. In summary, we continue to have a favorable outlook for emerging market equities over the intermediate- to long-term, but fully expect a bumpier ride over the short-term.

Lastly, the lack of volatility in equity markets in 2017 was incredible. In fact, the largest decline for the S&P 500® Index in 2017 was -3%, which is the lowest intra-calendar year decline in over 20 years. We do not believe this type of complacency in markets is sustainable. We believe the odds have increased that markets will turn more volatile. While we believe that corporate earnings and economic data will remain solid, any appearance of it being "less good" may negatively impact markets. We are preparing portfolios in advance of those eventualities.

Fixed Income Portfolio Comments

Fixed Income Market Results

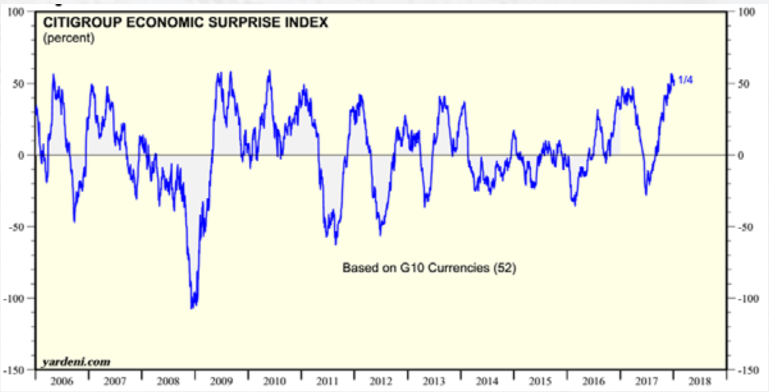
From quarter to quarter, like in the equity markets, the lack of volatility in bond market returns was stunning considering the vast headline noise experienced during the year. Outside of high quality short-term bonds, all major fixed income sectors once again posted positive returns in the fourth quarter. European bonds continued to outperform, as they rose +2.12% for the quarter and +14.61% for the year. Improvement in the monetary unions economic data continued to benefit its currency, which accounted for most of the return. Similarly, emerging market local currency bonds continued to outperform, generating +0.90% for the quarter and +14.71% for the year. Intermediate maturity investment grade bonds were down -0.20% for the quarter and only managed to generate +2.14% for the year. Lower absolute yields and rising short-term rates muted returns. Mortgage-backed securities also had a relatively challenging year, only generating +2.45%, which can mainly be attributed to lower demand from the Fed.

Generally, the municipal bond market continued to perform well in the fourth quarter, but some areas struggled due to rising short-term rates and disruptions from the new tax law, which eliminated advanced refunding. This technique was a popular way for municipalities to save on interest cost. As a result, many of them issued these types of bonds in the last few weeks of 2017, creating a supply and demand imbalance. Despite these hiccups, 2017 was broadly a strong year for municipal bond markets. Generally, longer maturities outperformed intermediate and short maturities by a significant margin. The gap between returns in lower quality and higher quality bonds was also meaningful. High-yield municipals generated returns in the +10% to +12% range while investment grade bond returns were primarily between +4% to +6%.

Fixed Income Market Comments

As economic data continues to get better, it creates a situation where growth rates are difficult to sustain and eventually must fall due to the law of large numbers. One way to look at this phenomenon is to study the Citigroup economic surprise index, which tracks whether economic fundamentals are beating economist expectations or falling short. Over time, this index has proven to be mean reverting because eventually growth rates gravitate toward their long-term potential. The index is currently near a cycle high, which suggests it is more likely to go down than continue to increase. This does not indicate a recession is imminent, but may signal the trajectory of growth has changed.

We also continue to have concerns about intermediate-term (12-36 months) growth prospects. Historically, a tight labor market and rising wages lead to increasing inflationary pressures, but for several reasons such as changing demographics, automation and globalization we have yet to see those forces materialize this cycle. However, we have seen early signs that we may be in transition from a below trend inflationary environment to an above trend one. Wages have started to pick up, commodity prices have

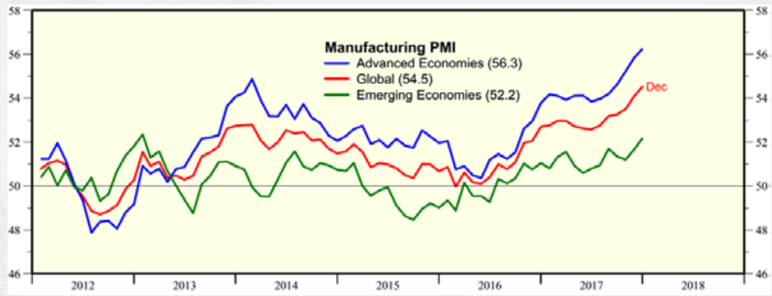


Source: Citigroup, Yardeni

rebounded, and several one-off factors are expected to wash out of inflation readings. The New York Federal Reserve Bank's underlying inflation gauge takes these factors and, many more, into consideration to forecast future inflation. Historically, the gauge has been very accurate predicting inflation 12-16 months out. It is currently suggesting inflation will move moderately above the Fed's 2% target over this period. If inflation continues to rise, the Fed will likely continue to tighten monetary policy, and may have to increase the rate of tightening. These tighter credit conditions could start to negatively impact the economy, especially considering the leverage (high debt levels) in the system.

Outside of the U.S., leading indicators in the Eurozone, Japan, U.K., China, India, Brazil and Russia are all showing continued growth over the short-term. One highly accurate indicator is the manufacturing purchasing managers index, which recently was near cycle highs for these major economies. However, as a result, many of the central banks in these economies have taken the opportunity to tighten monetary policy, or plan on doing so over the short-term, which could have an impact globally over the intermediate-term.

U.S. Interest Rates



Source: HSBC, Markit, Havener Analytics, Yardeni

Based on our highest probability scenarios, we believe fair value for the 10-year Treasury is between 2.50%-3.25%. It ended 2017 at 2.40%, which suggests it is likely to head higher over the short-to-intermediate term. To understand where short-term interest rates are headed, we must look to the Fed, which will undergo several changes in 2018. Most notably, Jay Powell will take over as Fed Chair for Janet Yellen. In addition, there are three open governor positions, including the Vice Chair. Finally, Bill Dudley, president of Federal Reserve Bank of New York, plans to retire in 2018. Despite all of the changes, market participants believe monetary policy will continue to follow a path of very gradual tightening. The current Fed expects to let the balance sheet slowly run off, while raising short-term interest rates three times in 2018. We will have to wait and see if there are any significant changes to this outlook when the new committee members are seated.

Yield Curve

Our last outlook for the yield curve was that longer-term interest rates would rise as fast or faster than short-term interest rates. This suggests rates would move up in a parallel fashion or steepen (long-term interest rates higher than short-term interest rates) a bit, making all areas of the yield curve vulnerable to negative performance. This view did not play out in the fourth quarter, but given our outlook for moderately rising inflation and continued tightening from the Fed, we continue to have this view.

Sector & Quality Management

Despite our relatively constructive view on the economy over the short-term, we continue to believe we are not being adequately compensated for taking excess credit risk. With few exceptions, credit valuations are historically expensive. Most sectors are expensive compared to their long-term averages. Fundamentally, corporate leverage metrics have stabilized recently due to fewer shareholder-friendly activities, but remain near the peak of the last two credit cycles. Despite this, interest and cash flow coverage continue to deteriorate. In addition, we have seen a consistent erosion of underwriting standards, which in the event of a default, would lead to lower recovery values. Taking all these factors into consideration, the risk to reward tradeoff is poor to say the least.

After technical challenges led to a selloff in late 2017, the municipal market became much more attractive. It is expected that there will be relatively light new supply (lack of advanced refundings) and steady demand from individual investors (the top tax bracket changes minimally), which should lead to a recovery. However, one area to watch is demand from corporations, which could decrease as lower tax rates make municipal bonds less attractive. Outside of technical factors, spreads for bonds rated below AAA are only marginally attractive, but are supported by strengthening underlying fundamentals.

Investment Vehicle Selection

Our comments here are virtually identical to our last newsletter. We continue to see idiosyncratic opportunities as the best way to add value. Sectors that we believe offer the most opportunity are non-agency mortgage-backed securities, commercial mortgage-backed securities, asset-backed securities and revenue-backed municipal bonds. To a lesser extent, there are select opportunities in investment grade corporate bonds. These views favor active managers with expertise in our areas of interest.

Client Portfolio Impact

Portfolio positioning continues to broadly reflect a defensive view.

- Considering that fundamental and technical factors are signaling modestly higher rates, we intend to stay moderately short interest rate risk over the short-to-intermediate term.
- We continued to move client portfolios into strategies that could benefit from rising short-term interest rates. We also reduced our exposure to long-term interest rates.
- We remain underweight corporate credit. Where we do have exposure, we continue to favor high quality bonds over below investment grade securities. We continue to like opportunities outside of corporate credit that we believe offer better late cycle diversification and better risk-adjusted value. Broadly, we like emerging market bonds, securitized assets and insurance-linked securities. Due to the recent rise in municipal yields, we increased our allocation to municipal bonds in our tax aware client portfolios. However, tax adjusted rates for municipals are low relative to several taxable sectors. As a result, we continue to hold positions in taxable bonds that look attractive on a relative value basis.
- To exploit our views, we continue to partner with active managers that have expertise in these markets. We are also selectively investing in individual securities in the markets we can analyze and trade efficiently. As a result, we continue to de-emphasize the use of passive index-based mutual funds and exchange-traded funds.

Research Focus

Bubbles.

Two things about bubbles. First, little kids love them. Second, the financial media, casual investors and bloggers love talking about them – the investment version of course. I think it stems from a curiosity about disasters – sort of like slowing down at the scene of a car crash. So, it is not surprising that there is a natural inclination for people to look for bubbles in financial markets. For the financial media, bloggers and the like, it doesn't hurt that it also attracts viewers and readers. Even if a theory sounds like nonsense, the fact that it *could* happen, makes for interesting reading.

A quick definition of an investment "bubble" for those that are not as familiar with the term. *"A bubble is an economic cycle characterized by rapid escalation of asset prices followed by a contraction. It is created by a surge in asset prices unwarranted by the fundamentals of the asset and driven by exuberant market behavior. When no more investors are willing to buy at the elevated price, a massive selloff occurs, causing the bubble to deflate." Source: Investopedia.*

A "bubble" in visual form:

Obviously, as investors, getting caught up in the "mania phase" and the subsequent "blow off phase" can be very painful.

Two often discussed investment bubbles are the housing bubble that led to the global financial crisis in 2008 and the tech/dot com boom bust of the early 2000's. The latter had the largest impact on me because it was the first time I had a front row seat to the mania.

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

Summary

A bubble is an economic cycle characterized by rapid escalation of asset prices followed by a contraction. It is created by a surge in asset prices unwarranted by the fundamentals of the asset and driven by exuberant market behavior. When no more investors are willing to buy at the elevated price, a massive selloff occurs, causing the bubble to deflate.

Investment bubbles occur, and they tend to occur most often when people are blinded by the prospect of easy money, hope and a seemingly impenetrable, fairy tale narrative.

We do not think technology stocks are anywhere near bubble status and not even close to the mania that occurred with tech stocks in the late 1990's.

Bitcoin has all the hallmarks of a full-blown, speculative-induced mania. In my opinion, Bitcoin and cryptocurrencies check every behavioral, bubble box.

Investment bubbles are hard to witness and not want to take part in. However, we have to remain disciplined as investors. We cannot sacrifice our long-held beliefs in the pursuit of a quick buck.

I was a freshman at the University of Wisconsin-Madison in 1999, and there were other students in my dorm that were day-trading tech stocks and supposedly making a lot of money. Not surprisingly, the prospect of making "easy" money caught my attention. I remember my mind being pulled in two directions: 1) join the fun because the "fear of missing out" was really strong; or 2) ignore it because it could not be *that* easy to make money. As it turns out, I never joined the party. I'd like to think that clear thinking prevailed, but I'm sure the fact that I didn't have any extra money also played a part in my decision. Regardless of the reasons, I ended up missing out on the "fun", but I also avoided a massive investment hangover. The event played a large role in shaping the direction of my investment studies, areas of focus and my investment beliefs. Some of the things that crystallized in my mind during those years (most pertinent to this article), and the years that followed were:

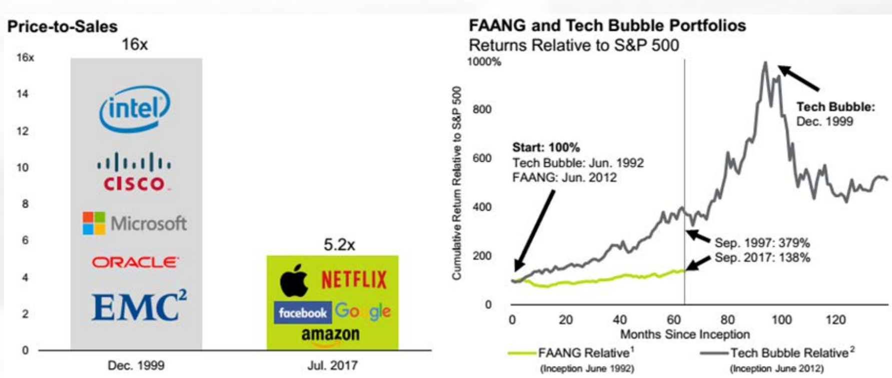
- Hard work beats talent when talent doesn't work hard. The investment industry is filled with a lot of very bright people, but it is also filled with a lot of people looking for shortcuts to make a quick buck or with the wrong motivations. There are no shortcuts. If you take a shortcut without doing the work, it is the same as gambling. Be prepared to lose big.
- Something is only worth what someone else is willing to pay. You may think an investment has the most promise in the world, but unless others also see value, it is not worth as much as you think. My only advice for selling a zero or low demand asset – watch out below.
- Figures lie and liars figure. This was a favorite of one of my mentors. A narrative can always be crafted, through numbers/statistics or otherwise, to make something look good. Nothing is certain. Dig in and find multiple ways to value an investment. Do the work others are not or will not.
- Hope is not an investment process. People are fickle. Develop and utilize a clearly-defined, repeatable investment process. Do not follow the herd and let other's feelings or sentiment replace your process. Find something of value and buy it when it is on sale.

So where am I going with all of this? Investment bubbles occur, and they tend to occur most often when people are blinded by the prospect of easy money, hope and a seemingly impenetrable, fairy tale narrative. However, bubbles do not occur as frequently, or as broad-based as people think they do. The line between "expensive" and "bubble" is blurred far too often. Unfortunately, over use tends to breed complacency when an actual bubble is inflating. Or, the opposite happens. Investors remain on the sidelines and face a large opportunity cost for not being invested as they wait for an imminent disaster that never occurs. In both instances, investors lose.

Let me turn to a couple of recent investment bubble discussions.

Technology Stocks

Technology stocks and the growth-oriented sectors of the market have done extremely well in recent years. However, we do **not** think technology stocks are anywhere near bubble status and not even close to the mania that occurred with tech stocks in the late 1990's.



Source: OFI Global – *Are Stocks Overvalued?*

Research Focus

Based on the charts on the prior page, current tech "darlings" ("FAANG" refers to Facebook, Amazon, Apple, Netflix and Google) are not trading anywhere near the same levels as 1999 tech darlings were during the tech boom on a price-to-sales basis. Furthermore, the outperformance of FAANG stocks relative to the S&P 500® Index in recent times is not nearly as dramatic as it was in 1999. Does this mean that these FAANG stocks do not carry risk today? Of course not. Does this mean that they are good investments or have a lot of room to advance from here? No, not necessarily. We just don't believe they are anywhere close to a full-blown mania-induced bubble. Overpriced? Maybe. Bubble? No.

Cryptocurrencies – Bitcoin

There was a time towards the end of the year on CNBC that it seemed like the anchors and guests talked about Bitcoin and other cryptocurrencies for at least six hours per day, five days per week. Personally, I have never had people ask me about a specific investment, or overhear people talking about an investment, as much as I have with Bitcoin and cryptocurrencies. It has eclipsed the buzz I experienced back in college when tech stocks were the "sure" thing and seemingly everyone had a "piece of the action." There are stories of people taking out home equity lines of credit to invest and using credit cards (to the extent possible) to fund their crypto accounts. In fact, a colleague and I were out to lunch recently and a waiter even asked which cryptocurrencies we had invested in. It is everywhere. It has all the hallmarks of a full-blown, speculative-induced mania. In my opinion, Bitcoin and cryptocurrencies check every behavioral, bubble box. Did you know that there is a "pizzacoin?" I digress. To put the current period into perspective, the chart below compares the growth of $1 invested in Bitcoin versus $1 invested in other specific assets during other historic investment bubbles. The chart below is eye-opening to say the least.

The most common refrain to those that don't believe the cryptocurrency hype? "You just don't understand the technology behind it! People are making a killing! It is going to change the way everyone does business!" And they could be right.

There is no doubt that the technology behind cryptocurrencies is very promising. However, interesting and promising do not necessarily make good investments. Think back to the tech boom bust. Cisco Systems (CSCO) survived the bust, and by many metrics can be considered a very successful company. The only problem? Look at a 20-year price chart. The stock is still trading well below its peak during the tech boom (March, 2000). The lesson? Good companies (or promising technology or assets) do not necessarily make good investments. Price matters.

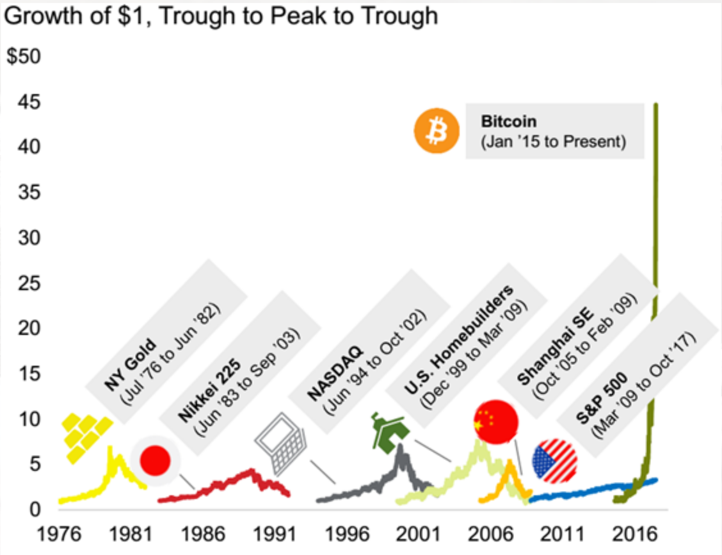


Chart courtesy of Oppenheimer – *Bitcoin – It's bigger than Trump, North Korea and Crossfit combined.*

Investment bubbles are hard to witness and not want to take part in. However, we have to remain disciplined as investors. We cannot sacrifice our long-held beliefs in the pursuit of a quick buck. We certainly will <u>never</u> make an investment on behalf of our clients in any asset or area of the market we believe to be "bubbly." We would rather miss being right, than be horribly wrong. Investment decisions need to have a solid foundation. If your current advisor has recommended any cryptocurrencies as an "investment", we would encourage you to revisit the investment thesis.

Client Focus

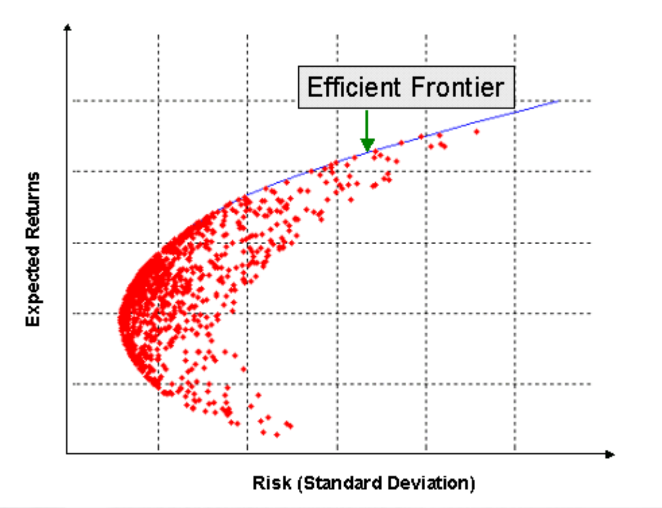
This quarter our Client Focus discusses our belief that Focus Matters.

During the last few months of 2017, news stations, such as CNBC, and our inboxes were inundated with stories about Bitcoin and other cryptocurrencies. The mania surrounding the topic led to a slew of investment discussions by market pundits. We even heard someone suggest it was appropriate to allocate 5% of a portfolio to Bitcoin and other cryptocurrencies. With such a short history and limited information, the discussion is a perfect illustration of why we believe – Focus Matters.

We believe investment planning and investment options have gotten overly complex and excessively engineered.
We believe the complexity created by the number of investment options produces unnecessary distractions that limit return outcomes.
Our portfolios are focused on a well-diversified group of investments that our clients can understand.

There are many ways to express the idea that investment options have gotten overly complex and excessively engineered. A couple simple examples are the number of Morningstar categories (more than 120) and the number of indexes (more than the number of stocks). Both provide a basic indication of all the asset classes available for investment. In our view, the complexity created by the multitude of options already available is distracting and unnecessary. Debating another with no history to analyze and understand, such as Bitcoin and other cryptocurrencies, is even more so.

So, how do we handle the complexity of all of the asset class options and new options when we plan for an optimal portfolio for clients?



A good portion of what we do is based on modern portfolio theory and the efficient frontier, which suggest building a portfolio of investments with the greatest potential returns for a given level of risk. However, we also incorporate practical concepts like redundancy, reasonability, cost and liquidity.

With hundreds of investment options, many are largely redundant to one another given the similarity in risk/return profile. Adding multiple options with similar profiles just increases transaction costs and the research burden of knowing investments well. Reasonability is important because the analysis completed to determine an optimal portfolio is only as accurate as the assumptions used to generate the risk/return inputs of each asset class. To the extent the reasonability of those inputs declines, so does the value of the analysis. Finally, all else equal, if the cost to participate in an asset class is inappropriately high, the transaction costs of owning multiple asset classes is restrictive or access to liquidity is low, we will eliminate those asset classes as options. After all those considerations, what we have found is that the majority of investment options are unnecessary distractions. Therefore, we believe it is most prudent to remain educated about new developments, but focus our attention on a core set of asset classes our clients can understand when building portfolios.

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 20 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.

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 15 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.

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 15 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.

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David LaCroix
Senior Financial
Advisor

David D. LaCroix is a Senior Financial Advisor at Entasis Asset Management. David has more than 45 years of experience in the investment industry. Prior to joining Entasis, David worked at Cleary Gull Advisors, a Johnson Financial Group Company, and Cleary Gull Inc., a prior affiliate of Cleary Gull Advisors, where he most recently served as Vice President, Relationship Manager responsible for high net worth clients. Before Cleary Gull, David worked in a variety of portfolio management and client relationship management positions with A.G. Edwards and M&I Capital Markets Group.

David received his M.B.A. and B.B.A. in Finance from the University of Wisconsin-Madison. He has served as a member of the Archdiocese of Milwaukee Investment Committee, as a Trustee for the Village of Shorewood and as Director/Treasurer of Milwaukee Summerfest.

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.

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The **Dow Jones Industrial Average℠** is a price weighted index that measures the performance of thirty component large-cap U.S. stocks. 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. **Federal funds rate** is the interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight. It is one of the most influential interest rates in the U.S. economy, since it affects monetary and financial conditions, which in turn have a bearing on key aspects of the broad economy including employment, growth and inflation.

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