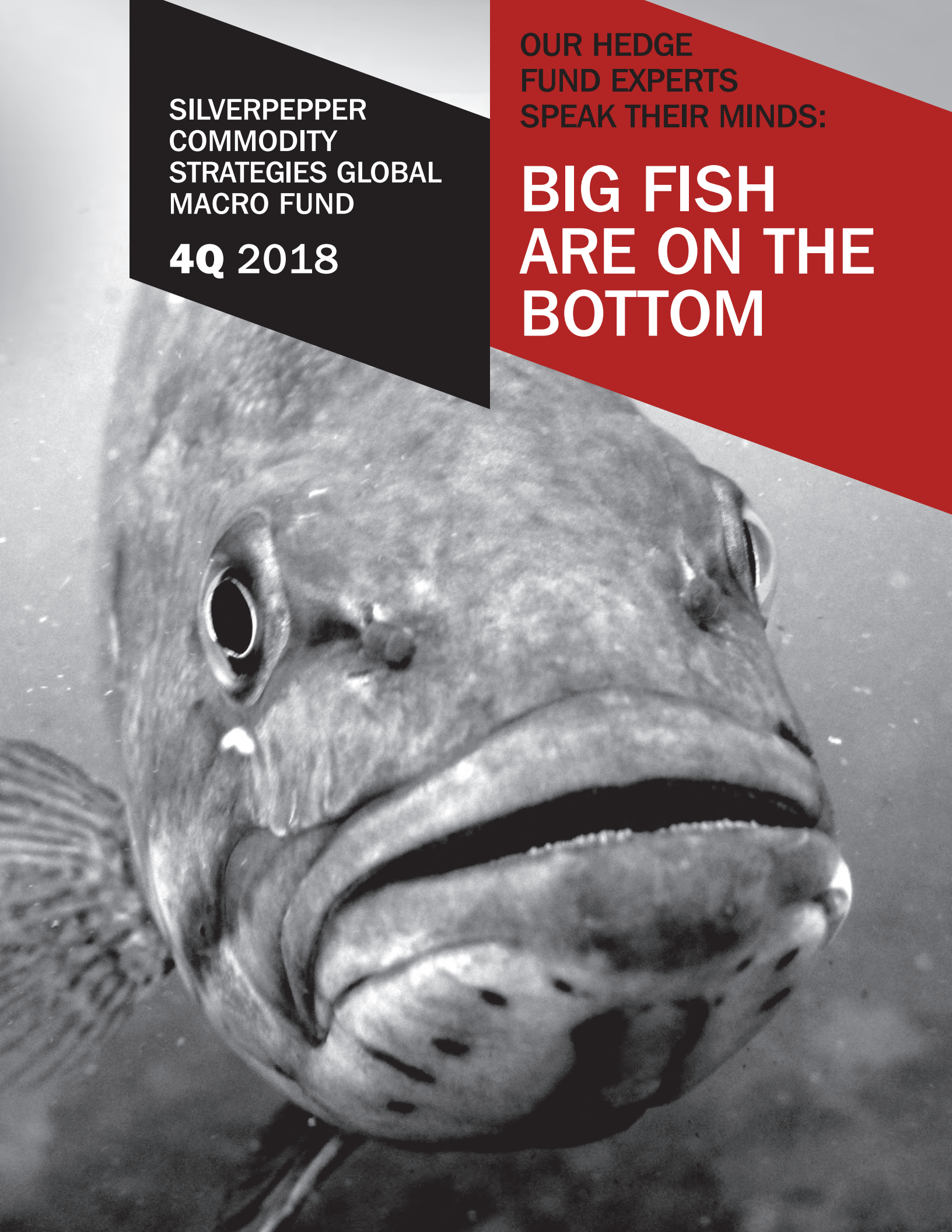
SILVERPEPPER COMMODITY STRATEGIES GLOBAL MACRO FUND

4Q 2018

OUR HEDGE FUND EXPERTS SPEAK THEIR MINDS:

BIG FISH ARE ON THE BOTTOM



The Big Fish Are On The Bottom

Every now and then, when I was a young girl, my father and I would go fishing with Doc Nehring up at Mille Lacs Lake, in my home state of Minnesota. And I remember them speaking quietly, as we fished together from sunrise to sunset. "Renee," they would say: "To catch the big fish, sometimes you just have to bounce the bait along the bottom for a while — but the big fish are on the bottom."

We are in the midst of both a two to three-year bottoming for commodities, but also in the midst of a major turn in the market. And in 2018, we bounced along the bottom. It was disappointing, because based on the fundamentals, I believed the big fish should start biting. However, the fourth quarter of 2018, a period in which we sharply outperformed our benchmark, got me thinking that we were suddenly very close to where the big fish are.

Bounce, snag, release, bounce…

Tariffs. A rising U.S. dollar. A weakening Chinese yuan. Brexit negotiations. And elections in Mexico and Brazil. These were just a few of the political and economic factors that caused the markets — both equity and commodity markets — to sink lower in 2018, especially in the second half of the year. Based on the fundamentals — the supply-and-demand of individual commodities, — we had been expecting a banner year in 2018.

Instead, the Bloomberg Commodity Total Return Index sank 11.24% in the second half of the year, dropping an eye-catching 9.41% in fourth quarter alone. By contrast, the SilverPepper Commodity Strategies Global Macro Fund outperformed the Index by more than 480 basis points in the second half, and 560 basis points in the fourth quarter. Both our risk management, and commodity selection, contributed to our strong outperformance in the latter half of year. And yet we also got hung up on the bottom, posting a negative 8.30%* return for the full-year — which still outdistanced the Index by nearly 300 basis points for the full calendar year of 2018.

****The returns represent past performance. Past performance does not guarantee future results. Investment returns and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Call 855-554-5540 for current to most recent month-end performance.***

SilverPepper

Fundamentals Have Only Gotten Better

Going into 2018, we were bullish on commodities. We had our lines out, and were filled with anticipation, for the rod to bend, and the reel to scream. The factors that promoted our optimism at the outset of 2018 were the big Trump tax cuts, growing global economic growth, and China's massive worldwide infrastructure plan, called "One Belt, One Road." And, with many commodities trading below their costs of production, we thought we were in for a good year.

Instead, what we got were powerful political upheavals and tariffs, the likes of which we haven't seen since the Great Depression, and the enactment of the Smoot Hawley Tariffs in 1930. As a result, our bullish positioning entering 2018 was wrong. Tariffs, Brexit negotiations (and its potential impact on trade), as well as the elections in commodity-driven economies like Mexico and Brazil definitely hurt commodity prices. And yet, they have not markedly changed existing commodity fundamentals. In fact, I would argue that with lower commodity prices, the risk vs. reward for many commodities has only gotten better. And, despite all the concern, we continue to be upbeat about global commodity demand.

SILVERPEPPER COMMODITY STRATEGIES GLOBAL MACRO FUND INSTITUTIONAL MONTHLY RETURNS (%)

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	YEAR
2013											0.10	0.00	0.10
2014	-0.30	0.00	0.50	0.00	0.10	0.70	-0.69	0.00	-1.59	-0.61	-1.43	-3.41	-6.59
2015	-0.43	-1.72	-1.42	1.11	-0.11	0.33	-2.52	-0.67	-1.13	-0.23	-0.57	0.00	-7.17
2016	-0.46	-0.23	1.51	0.69	-1.48	3.00	-0.22	-1.57	1.17	0.45	0.78	1.11	5.30
2017	0.33	-1.31	-1.66	-1.69	-2.06	-0.70	1.99	0.81	0.80	1.25	-0.67	0.86	-2.12
2018	2.35	-3.29	-1.13	1.72	2.25	-3.74	-1.83	-1.28	0.35	-1.65	2.03	-4.11	-8.30
						One-Year Return as of 12/31/2018							-8.30
						Total Annualized Return Since Inception (10/31/2013)							-3.76

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Total, gross annual fund operating expenses are 2.05% for Institutional, and 2.03% for the Advisor class shares. The Advisor has contractually agreed to waive its fees and/or pay for expenses to ensure that total fund operating expenses (excluding, as applicable taxes, leverage interest, brokerage commissions, dividend and interest expenses on short sales, acquired fund fees and expenses (as determined in accordance with Form N-1A), incurred in connection with any merger or reorganization, or any extraordinary expenses such as litigation expenses) do not exceed 1.99% for the Institutional class and 2.24% for the Advisor class. This agreement is in effect until October 31, 2028.

Inception dates for both share classes is October 31, 2013. Performance and risk measures greater than one year are annualized.

For example, investors have been outspoken in their fears that tariffs will hurt China's growth, thereby depressing both global growth and commodity prices. But China today isn't the China of old. Ten years ago, 70% of China's GDP was export driven. Today, it's less than 20%. So, yes, as a headline issue, political uncertainty around trade and tariffs have caused both uncertainty and volatility, but we think China will weather the storm. Certainly, the prospect of global growth is cloudier than it was this time last year. And many are starting to question China's political and economic interests behind One Belt, One Road, and how that could impact existing and future infrastructure projects. Nonetheless, China is committed to One Belt, One Road, and will continue to push domestic stimulus to offset the pressure imposed by the U.S. tariffs.

The factors that caused us to bounce and snag along the bottom have kept our lure down deeper and longer than we had hoped. And, we could still bounce along the bottom. But in the fourth quarter, in which we markedly outperformed our Index, it was clear that supply and demand fundamentals still matter, and what goes down below the cost of production, must eventually go up. At some point, the big fish have to eat.

We Were Right On Natural Gas

Our biggest winner on the year was natural gas. It was our biggest position at the beginning of the year, at about 45% of assets. And gas powered our outperformance in the fourth quarter of 2018. Even though we restructured our position, as we took profits in November, natural gas continues to be the Fund's largest position, at 25% of assets.

Why did we like natural gas? Because prices have been sitting on the bottom for a while, and we had confidence there were big fish to be caught, all of which was visible in natural gas' attractive risk/reward tradeoff. With natural gas hovering around $3 per Bcf (Billion cubic feet) entering the year, our research indicated that natural gas prices had two to five times more upside than downside. We thought prices could fall 30 to 40 cents, but, if our research was correct, they could rise between 60 cents and $2.00. The research was backed up by the long-term changes and innovations taking place in the natural gas market.

Since 2010, natural gas production has grown by about 55%. And production in the U.S. just keeps rising, due to innovations in fracking. In the first ten months of 2018, according to the U.S. Energy Information Association, natural gas production in the United States was 11% higher in 2018, compared with the same period in 2017. Growth has been driven by production increases, coming from the Appalachian Basin in the Northeast, to the Permian Basin in western Texas and New Mexico, and all the way to the Haynesville Shale in Texas and Louisiana.

Even though natural gas production has been going through the roof, we have long believed that demand was going to outstrip supply. That's because coal-fired and nuclear power plants are being supplanted by plants using cleaner-burning natural gas. As a result, compared with the same period in 2017, consumption in 2018 was a full 17% higher.

In addition to domestic consumption growth, we are starting to see exports really pop, for both dry and liquefied natural gas (LNG). Recently, state-of-the-art liquefied natural gas export facilities have begun operations, at the Sabine Pass LNG export facility in Louisiana, and the Cove Point facility in Maryland. This makes for growing exports, particularly to Mexico. Those exports are now exceeding about 6 Bcf per day. These two demand factors, exports and plant conversions, have powered our thesis that natural gas prices needed to rise — especially in the future — to incent producers to keep growing supply to meet this burgeoning demand. Yet, with natural gas production continuing its upward growth, and with prices trading to about $2.80 per Bcf in September, we had to double- and triple-check our research, to maintain our conviction in our position.

The other factor working in our favor was storage. For the past year or more, the market has been incredibly complacent about the level of natural gas in storage. The levels of storage have been low by historical measures. As we finished the storage season in 2018, and entered the cold winter months of the 4th quarter, there were 3.25 Trillion cubic feet (Tcf) in storage. That's 500 Bcf below the previous year, which was in turn more than 360 Bcf below the lowest level seen in the previous five years! Despite this storage deficit, as we entered the winter months, in the beginning of October, current-month futures contracts were still only trading a few ticks above $3 per Bcf.

Then, POW! A shot of cold weather in November frightened the market, precisely because of the underlying tightness of gas supplies in storage. Speculators who had been fixated on the never-ending growth in supply, and actually held "short" positions in natural-gas futures contracts, were caught off guard. They scrambled for the exits, and as we hit the high-end of our value zone (a range of prices where we will either enter or exit a position), we took full profit, selling at prices up to $4.69. Our value zones proved pretty spot on, as we sold near the highs reached for the year. So our timing and trade execution were quite good, especially because prices tumbled back towards $3, as December drew to a close. As a result, about 75% of the Fund's profits were attributable to natural gas for the year.

Having taken those profits, we have since restructured and reduced our position in natural gas, from 45% of the portfolio to about 25%. Nonetheless, it still remains our largest position. Moreover, our position continues to be unique among commodity funds. Unlike index-based commodity funds that only own the current-month futures contract, our current natural gas position is spread out evenly across every contract month of 2019, with additional exposure to 2020. We bought these contracts because they were much cheaper than the front-month contract. They also allow us to more precisely structure our position to capture our well-researched thesis that natural gas prices must rise in the future to incent future production to meet the growing demand from both domestic and export markets.

Dr. Copper's Bitter Medicine

Although natural gas was our biggest and best performing position, it was our positions in industrial metals that rusted a hole in the portfolio. About 75% of the portfolio's losses stemmed from investments in industrial metals, ranging from aluminum to zinc. And copper was the biggest stinker of the bunch. Copper prices are aligned with global growth. In fact, that's why it's often called "Dr. Copper" — it can be used to diagnose and predict turning points in global economic growth. Yet, the attractive supply and demand characteristics of the copper market just couldn't avoid the rain clouds precipitated by the Trump tariffs, which have depressed forecasts for growth, particularly in China.

Copper was the largest metal position in the Fund at year-end, with weighting equal to about 7% of the portfolio's assets. However, we haven't changed our long-term outlook for the metal.

Copper is a versatile metal, with about 19 million tons being mined annually. It has widespread use in the building trades for pipes and roofing and it's used for conducting electricity in appliances, computers and automobiles. But it should also be getting a boost from the electric car market. A car with a combustible engine uses about 55 lbs. of copper. In contrast, an electric car is estimated to use 165 lbs. of copper, or nearly three times as much.

The story for nickel is similar. Its demand, like copper, tends to rise and fall with expectations about growth. That's because about 65% of nickel is used in the production of stainless steel, which has multiple applications for autos and airplanes. And, like copper, nickel should see a boost in demand from the electric car and battery industries, which depend on nickel-containing lithium-ion batteries. In addition, nickel is also used in another form of rechargeable batteries, called NiMH (Nickel-Metal Hydride) batteries. So as the number of electric vehicles grow, nickel demand will also grow. Right now, batteries account for about 3% of total nickel demand, but our market analysis suggests it could jump to 8% within the next four to six years.

Both copper and nickel have been pressured by concerns over global/Chinese growth amid the trade impasse, taking prices below the cost of production, and deep into our value zone. But, if we see the threat of a trade war diminish, the metals, particularly nickel, have all of the storyline elements necessary for a rally, with downside risk of about 10% to 15%, with upside of 30% to 40%.

Everyone Needs A Flu Shot — Even Pigs

Moo Shu Pork. Pork Fried Rice. Twice-Cooked Pork! With all of those delectable dishes, it's no wonder China is both a huge consumer and producer of pork — their primary source of protein. With a population of approximately 700 million pigs, China has about half of the world's swine population. Unfortunately, the African Swine Flu has broken out in Asia.

The African Swine Flu is highly infectious, and almost 100 percent fatal to pigs, killing them in three to five days. What's worse, there is no flu shot to protect against it. The only way to contain the disease is to immediately slaughter the diseased pigs, before they infect others. So, currently, pigs are being slaughtered by the thousands in China.

Fortunately, the disease cannot be spread to humans, even if you eat an infected pig (although I'm not going to test it). As a result of the outbreak, the Chinese have been trying to calm their citizens. An official pronouncement about the disease was placed on the website of the People's Daily, the Communist Party's official paper, touting the safety of pork, and declaring that everyone should be "at ease about eating pork." The Chinese are so used to propaganda, however, they aren't fully buying the proclamation.

As a result, we see the flu causing a substitution effect for protein. Demand will shift from pork to beef. As a result, at the tail-end of 2018, we started to build a position in live cattle, primarily using options. As a low-volatility asset, live cattle options are pretty inexpensive to purchase. Hence, we bought long-dated call options that give us an excellent risk/reward profile. Because of how we have structured the position, as the price of the cattle increases from $1.20 per pound to, let's say $1.28 per pound, our exposure to cattle grows from about 7% of the portfolio to 15%. We think this is a smart way to have structured the trade from a risk and reward perspective.

What About Shorting?

Recently, with commodity markets going lower, I was asked, "Why isn't the Fund making buckets of money on shorts?" It's a good question, since going short on oil and metals would have been prescient in the second half of 2018. But, over the past year, we held very few shorts because, as we said, many commodities have been selling below their costs of production. We don't want to be shorting below the cost of production. Why? Because farmers and miners either stop producing, or go broke selling soybeans or copper for less than what it costs to produce them. Supplies then shrink, until futures prices allow the farmer or miner to make a profit. Moreover, even if we think near-term prices might fall further below the cost of production, the bias is for prices to rise. That means, the odds are, that sooner rather than later, prices will go up. That's why it just gets too risky to short below costs. So, I am happy to short something trading above the cost of production, but not below.

We Have A Line In The Water

We enter 2019 bullish, again. Our eyes are wide open, though, knowing that major market turns can take time. We'll remain nimble, waiting out the prospect of possibly continuing to bounce along the bottom for a bit longer. But we do see a number of catalysts for higher prices.

First, the ratio of commodity prices to the S&P 500 is at its lowest point since the 1970s, suggesting commodities are as cheap as they have been to stocks for four decades. We see that, currently, hard assets are much cheaper than paper assets. Second, the U.S. Federal Reserve seems to be taking a pause (although it may be just that — a pause) in raising short-term rates. This is causing the U.S. dollar to soften, relative to other currencies. Given that commodities are priced in U.S. dollars, when the dollar falls, it makes commodities cheaper for other countries. When commodities are cheaper, we tend to buy more of them. Third, the tariffs have been a buzz kill for markets. An easing of both political and trade tensions would create more economic certainty, supporting better growth expectations and higher commodity prices. Fourth, China seems committed to both economic stimulus and to One Belt, One Road. And finally, if there is one thing that President Trump and the Democrats might — and I say might — agree on in 2019, it's an infrastructure spending bill. Infrastructure's fuel is commodities. All, or any of these factors, could set the hook for rising commodity prices in 2019.

Respectfully yours,

Renee Haugerud

Portfolio Manager

SilverPepper Commodity Strategies Global Macro Fund

Investors should carefully consider the Fund's investment objectives, risks, charges and expenses. Please see the prospectus for a complete discussion of the risks of investing in this Fund. To obtain a prospectus, please call 855-554-5540 or visit silverpepperfunds.com. The prospectus is boring but should be read carefully before investing.

All investing involves risk including the possible loss of principal. There can be no assurance that the Fund will achieve its investment objective. The Fund's specific risks include futures/commodities risk, derivatives risk, Subsidiary risk, high-fee risk, tax risk, foreign investment risk and non-diversification risk. Futures contracts may fluctuate significantly and unpredictably over short time periods and commodities are subject to disruptions and distortions, causing loss of principal. All these risks may increase costs, volatility and lower performance. See the prospectus for a complete discussion of investing in this Fund.

As of December 31, 2018, notional exposure of futures and/or options in Natural Gas were 25%; WTI Crude Oil, 5.5%; Brent Crude Oil, 5.0%; Copper, 7.7%; Nickel, 4.9%, and Cattle, 8.5%, of the SilverPepper Commodity Strategies Global Macro Fund's total net assets. Portfolio holdings are subject to change without notice and are not intended as recommendations. Since Inception time period is 10/31/2013 to 12/31/2018. Past performance is not indicative of future performance.

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