# SILVERPEPPER MERGER ARBITRAGE FUND

**2Q** 2017

## OUR HEDGE FUND EXPERTS SPEAK THEIR MINDS:

# THE HIGHEST STOCK PEAKS – CAN YOU RETURN SAFELY?

"I don't care what you do. Just make sure you're damn good at it, son. Be the best." That expectation was drilled into my head from the time I was barely knee-high. Fast forward, and for more than 20 years, I have been devoted to investing in mergers and acquisitions. It's pretty much all I do. So, it was gratifying to discover in March of this year that the SilverPepper Merger Arbitrage Fund was recognized with a Lipper Fund Award. It's a prestigious award. And you can bet I will brag to my Dad about it!

## WINNING THE LIPPER AWARD FOR "BEST FUND"

Lipper, one of the premier fund-research firms, has been, according to its own admission, recognizing superlative funds for 30 years. In our first year of eligibility, the SilverPepper Merger Arbitrage Fund (SPAIX), based on its strong, risk-adjusted performance, walked away with the Lipper Fund Award for Best Alternative Event-Driven Fund, over the last 3 years ending November 30, 2016, out of all 37 alternative event driven funds. The "Best Fund Award" is based on "consistently strong, risk-adjusted performance, relative to its peers."

Winning this "Best Fund" Award means, according to Lipper, that the SilverPepper Merger Arbitrage Fund has achieved "The Highest Standard Of Excellence, Across The Globe." That's a nice accolade.

There are a lot of funds out there. And few earn such a recognition. In combination with our 5-Star Overall Morningstar Rating, out of 111 funds in the Morningstar "Market Neutral" Category, it suggests the Financial World has taken notice that we have been delivering attractive risk-adjusted performance for our investors.

## No Resting On Our Laurels

Now that you know Lipper thinks we're doing a great job, and gave us a beautiful diamond-shaped trophy to commemorate it, your next question probably is...

### "Did you guys make me a ton of money in the first six months of the year?"

And the honest answer is, no, not a ton. But we did make money, and the Fund is performing as it's designed to — earning persistent and positive monthly returns, which we try to compound over time. Since inception, about 80% of the Fund's monthly returns have been positive. That's why we describe the goal of the strategy as "Dime after Dime, Time after Time."



SilverPepper

The first six months of 2017 is a good example. Despite merger activity having fallen from record-high deal volumes in 2015 and 2016, the Fund earned 1.27% in the first half of 2017. Our returns look a bit light compared to our benchmarks, the S&P 500 Index, which earned a much higher 9.34% during the same period.* The disparity in performance, however, allows us to draw a strong distinction between the SilverPepper Merger Arbitrage Fund and its benchmark, and how the Fund's hedged investment strategy may add true diversification to an investor's portfolio.

## Yes, You Made It To The Top, But At What Risk?

Sir Edmund Hillary was the first to climb Mt. Everest, in 1953. But some speculate that the first person to reach the top of the world's highest peak was George Mallory, in 1924 — since his frozen body was discovered in 1999, about 2,000 feet below the summit, where he appeared to have died after a fall.

When a reporter asked Sir Edmund Hillary about who was first to reach the top, he responded with dry Kiwi New Zealand wit: "I'm rather inclined to think, personally, that maybe *it's quite important, the getting down*. And the complete climb of a mountain is reaching the summit and getting *safely* to the bottom again."

And, that's the point of our strategy. Reaching the highest peak of returns doesn't feel that successful, if the risk of falling to your death actually happens. And over the last three years, the risk of the S&P 500, as measured by standard deviation of return is 9.98, or about 5 times higher than that of the SilverPepper Merger Arbitrage Fund.

The SilverPepper Merger Arbitrage Fund has distinct risks from the broad stock, or for that matter, bond markets. Our risks are tied to the successful completion of each merger we invest in. We aren't, therefore, like an S&P 500 fund, dependent on the broad moves of the market. To take one recent example, in the first 30 trading days of 2016, the S&P 500 plunged more than 10%, while this Fund did what it always does, collect the steady spread on merger arbitrage deals, which amounted to a 0.75% gain for those six weeks. When equity markets were shaken in 2016 on the Brexit vote, dropping nearly 4% in a single day, the SilverPepper Merger Arbitrage Fund posted a profit. Our .22 correlation to the S&P 500 index affirms that we tend to zig when the market zags.

***The returns represent past performance. Past performance does not guarantee future results. Investment will fluctuate so that and investor's shares, when redeemed, may be worth more or less than their original cost. Performance shown is as of date indicated, and current performance may be lower or higher than the performance data quoted. To obtain performance as of the most recent month end, please call 855-554-5540.***

# Could The "Trump Bump" Suddenly Dump?

Ben Graham, one of the wise men of value investing, observed many years ago, "In the short run, the market is a voting machine. But in the long run, it is a weighing machine." Since the November election, investors and business leaders have continued to vote for President Trump, expressing vigorous "animal spirits." But the key question investors must confront is: How long can the market carry the weight of high, but unfulfilled, expectations?

Markets roared their approval for the Trump administration, starting late on November's election night. As represented by the S&P 500, stocks have rallied more than 9% since the beginning of 2017, and are up nearly 18% since the election. Corporate CEOs jumped on the bandwagon as well. The Index of Small Business Optimism surged following the election, and in January, hit its highest level since December 2004. The Business Roundtable, which gauges the spirits of big-company CEOs, is also near its highest level in a decade. Not surprisingly, with a strong stock market, and inspired CEOs, the economy has continued to chug along with steady growth and job creation.

Business owners' excitement is largely attributed to optimism surrounding Trump's promises of "Repeal and Replace," deregulation, infrastructure spending, tax cuts, and repatriation of a couple trillion locked up in foreign bank vaults.

**But at some point the lack of progress by the Congress on Trump's promises could disappoint the stock market,** endangering the 18% gains that S&P 500 investors have pocketed since the election. No one knows when that moment could occur, but the clock is surely ticking.

# What This Means For Mergers

If Trump (and the Congress) make good on policy changes, that would supply robust economic stimulus that leads to more jobs, capital expenditures, and crucially for our investors, a surge in mergers and acquisitions.

More mergers mean more opportunities for us to find the kind of deals we like: well-financed, strategic, and with little regulatory risk. More mergers mean more dimes are scattered on Wall Street, waiting for us to pick up, and pocket for our investors. And the icing on the cake: a stronger economy means higher interest rates, which means richer spreads in the deals we buy — our dimes might soon be worth 12 or 13 cents a piece.

However, the nightly blubberers on cable-news networks fixate on the Trump administration's failure to deliver progress on the issues dear to the markets and CEOs. From Benjamin Graham's perspective, we're right between the short-term and the long-term: the votes have been counted, but the weighty improvements have not materialized. The President has been bogged down feuding with Democrats, media, courts, and intelligence agencies. And there has been little concrete progress in Congress on healthcare, tax and regulatory reform, infrastructure or repatriation.

And so while CEOs are more optimistic, they are still reluctant to pull the trigger on new mergers. As a result, according to MergerMarket, the number of deals announced in the first quarter of 2017 fell by 17.9% relative to 2016.

If Trump does not deliver, S&P 500 investors could find themselves in George Mallory's frozen shoes, fallen 2000 feet below the summit. Yet, for Merger Arbitrage investors, a Trump failure probably will not matter much. Our returns are largely independent of the broad market, and instead tied to the successful completion of a merger.

## Fewer Mergers, But Quality Remains Good.

Despite the lack of progress by Congress on Trump's promises, and the tepid deal flow, deal quality remains good, especially in the type of deals we like. Banks are still consolidating, partly at the guidance of the Fed, and partly because of the desire for owners to cash out at good prices, after years of turmoil in the industry.

As is typical, we have about 35% of our assets in the financial sector. And we continue to find attractive opportunities in smaller-capitalization companies. So, we are pleased that we continue to find solid opportunities among

**SILVERPEPPER MERGER ARBITRAGE FUND INSTITUTIONAL MONTHLY RETURNS (%)**

| | JAN | FEB | MAR | APR | MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC | YEAR |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2013 | | | | | | | | | | | 0.10 | 1.00 | 1.10 |
| 2014 | -0.10 | 0.10 | 0.10 | - 1.48 | 1.40 | 0.69 | 0.79 | 0.68 | -0.77 | -0.10 | 1.37 | -0.23 | 2.44 |
| 2015 | 0.60 | 0.99 | 0.10 | 0.29 | 0.78 | 0.10 | 0.48 | 0.77 | 0.19 | 2.47 | 0.19 | 1.25 | 8.49 |
| 2016 | 1.13 | 0.37 | 0.00 | 0.37 | 0.37 | 0.18 | 0.64 | -0.27 | 0.46 | -0.18 | -0.09 | 1.25 | 4.30 |
| 2017 | -0.18 | 0.00 | 0.36 | 0.36 | 0.18 | 0.54 | | | | | | | 1.27 |
| | | | | | | One-Year Return as of 6/30/2017 | | | | | | | 3.10 |
| | | | | | | Total Annualized Return Since Inception, (10/31/2013) | | | | | | | 4.79 |

***Total annual fund operating expenses for the Institutional class shares are 6.78% gross, 4.17% net; Advisor class Shares 7.03% gross, 4.42% net, after contractual fee waiver and/or expense reimbursement. The Advisor has contractually agreed to waive its fees and/or pay for expenses to ensure, that except for certain excluded expenses as outlined in the prospectus, total fund-operating expenses do not exceed 1.99% for the Institutional share class, and 2.24% for the Advisor share class This agreement is in effect until October 31, 2026, and it may be terminated or amended prior to the end of the term with the approval of the Trust's Board of Trustees.***

***The returns represent past performance. Past performance does not guarantee future results. Investment will fluctuate so that and investor's shares, when redeemed, may be worth more or less than their original cost. Performance shown is as of date indicated, and current performance may be lower or higher than the performance data quoted. To obtain performance as of the most recent month end, please call 855-554-5540.***

community and regional banks. Currently, about 50% of the portfolio is invested in merger targets whose market cap is less than $2 billion. A good example of a merger we like, and have about 3% of the Fund's assets invested in, is the $480 million acquisition of Oklahoma-based Southwest Bancorp. They are being acquired by Simmons First National, of Pine Bluff, Arkansas, which is looking to expand its existing banking footprint in Kansas. But they also want to grow into Oklahoma, Colorado and Texas, where Southwest Bancorp has branches.

**Southwest is emblematic of the deals we zero in on within the smaller-cap banking space.** It's a strategic acquisition for Simmons. It makes strategic sense to consolidate technology systems, compliance and streamline general and administrative expenses. Simmons is well-financed. They have a good balance sheet, and will have no trouble paying for the smaller, community bank. The regulatory risks of the deal are manageable. And the "spread," which is what we are trying to lock-in and earn, in every merger arbitrage deal, is reasonably attractive as well.

If the deal closes as anticipated in the third quarter of 2017, we should capture a spread of about 3% over the holding period, or about 4.5% annualized. In general, we think these types of mergers offer wider spreads, even though deal risk is less compared to larger, more complicated transactions. And because we think deal quality is high in these instances, we can use leverage opportunistically, without incurring much additional risk. As of June 30, our gross exposure to merger investments was 189%.

## Merger Risks Are Real. Stay Picky.

The Fund primarily bears the risk that the carefully-selected deals in our portfolio fail — maybe the financing doesn't come through, maybe regulators object, or maybe the buyer gets cold feet. However, these are exactly the kind of risks we try to carefully screen out, based on our 20 years of deal-picking experience. We're so picky about our deals, that to date, we've never had a deal break in this Fund…

## Knock On Wood.

While we haven't had a deal break, some have certainly been badly bent. One recent example of a tricky situation is the deal by EQT Corporation to buy Rice Energy. On June 19, EQT announced it was buying Rice Energy for cash and stock, which would serve the strategic purpose of making EQT the largest natural-gas producer in the U.S., as well as give it valuable pipeline assets. When the deal was announced, we made Rice Energy about a 6.5% position in the portfolio. Under the deal terms, Rice shareholders would receive .37 shares of EQT, plus $5.30 in cash. To hedge the value of the position, and lock in our spread, we sold short .37 shares of EQT for every share of Rice we purchased.

In early July, JANA Partners — an activist, investment-management firm — announced they had purchased a 5% stake in EQT and began agitating for EQT to give up the Rice Energy merger, and instead split EQT's pipeline and production

assets. This caused the price of Rice Energy stock to fall approximately 4%, over concern the deal would not be consummated. At the same time, EQT shares rose a comparable amount, creating losses on both the long and short sides of our trade. While JANA's opposition to the Rice deal came out of left field, and really couldn't have been anticipated, this quickly became one of those life-or-death-of-the-deal moments...

**When this happens, the only thing to do is work your tail off.** With a lot moving pieces, we started to move quickly. We got on the phone and started talking to analysts, the companies' managements, and other investors. We were looking for affirmation that it was highly unlikely that JANA could scuttle the deal. We got good confirmation across the board, but, problem was, management wasn't talking. They were in the "quiet period," where they were legally forbidden to discuss the transaction. So, they couldn't put the market speculation to bed.

Despite the short-term losses, our 20 years of experience informs how we "listen between the lines" of what is said and not said. No newcomer can hear these dog-whistles like we can. And it tells us to stick to our guns, despite residual uncertainty.

**So far, that decision has paid off,** and we have seen Rice stock rebound — but it is still a fluid situation. The final outcome of this deal is not in. What will happen? Will we maintain our Fund's winning streak, of no broken deals? And while we hate to leave you with a cliffhanger ending to this climber's tale, it illustrates the need to be picky in deal selection.

Because like an experienced mountain climber or test-pilot — we aren't looking for excitement. We are looking for "Dime after Dime, Time after Time."

## What About The Risk Of Bond Funds?

We've had a lot of calls with investment advisors as of late. They are increasingly aware that bonds have their own distinct set of risks, some of which might be coming home to roost.

Existing bonds lose value when interest rates on new bonds goes up. It's simple. If I can get a new bond that pays 4%, I'm not willing to pay as much for an old bond that pays 3%. This basic law of bond pricing may soon become a cruel reality for unsuspecting bond investors, as the Federal Reserve Board has raised interest rates twice this year, and is likely to raise them again, and even more next year. Money is no longer going to be so easy.

For decades — since Paul Volker raised short-term interest rates to 17% — the bond market has been on easy street, benefiting from declining interest rates. As a result, they have developed a reputation as "safe." Yet, the investment advisors we have been speaking to aren't so sure, and are interested in the SilverPepper Merger Arbitrage Fund as a diversification play to help protect investors from rising interest rates.

Our Fund has little correlation to stocks or bonds: .22 and .04 respectively. Why? Our returns are not tied to interest rates, or GDP, or corporate profits, but instead to a singular event — the successful completion of a merger. If interest rates rise, we believe it will actually provide a tailwind to our merger arbitrage investors, as short-term interests rates are a factor in merger spreads. As the 3-month and 1-year T-Bill rates increase, so too should merger spreads.

When investing, as with climbing Mt. Everest, it's always important to ask, "What if I'm wrong? How much risk am I willing to take?" Bond investors can fall from a much lower peak than Mt. Everest and still get badly hurt. Hence, we believe a reallocation from bonds into the SilverPepper Merger Arbitrage Fund may be a sensible avenue for investors to explore in portfolio rebalancing. Our Fund could be the missing piece of your asset-allocation pie chart.

## The SilverPepper Advantage

At the SilverPepper Merger Arbitrage Fund, we continue to invest in a way that we believe is most advantageous to our shareholders. We only invest in announced deals. We prefer smaller-capitalization companies, where spreads may be wider, and regulatory risks are far smaller. We are picky about the types of deals, and the number of deals, we invest in. We try to stay off the icy edge. Instead, we try to find an appropriate level of deal diversity, that doesn't sacrifice deal quality. And, we use leverage opportunistically, in an effort to generate higher returns.

To maintain these advantages, we are committed to limiting the amount of assets in the Fund to approximately $500 million. It's a size that provides enough asset heft to reduce the Fund's expense ratio through economies of scale, but is also maintains a small enough asset base to keep our investment advantages intact — and turn them into enduring advantages for our investors.

Thank you so much for your investment in the SilverPepper Merger Arbitrage Fund.

Warm regards,

Steve Gerbel
Portfolio Manager

***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.*** ***More ➤***

*All investing involves risk including the possible loss of principal. There can be no assurance that the Fund will achieve its investment objective. For the Merger Arbitrage Fund, the primary risk is event risk which revolves around the successful or unsuccessful completion of an announced merger or acquisition. If a merger doesn't close as expected, the fund could lose money. Other risks include smaller companies risk, foreign investment risk, derivatives risk and non-diversification risk.*

*As of June 30, 2017, Rice Energy Inc was 7.54% of the portfolio, EQT Corporation, 6.14%, Southwest Bancorp Inc., 3.02%, and Simmons First National Corp, 2.44%. Portfolio holdings are subject to change without notice and are not intended as recommendations.*

*About the Lipper Fund Awards*

*The Thomson Reuters Lipper Fund Awards, granted annually, highlight funds that have excelled in delivering consistently strong risk-adjusted performance relative to their peers.*

*The Lipper Fund Awards are based on the Lipper Ratings for Consistent Return, which is a risk-adjusted performance measure calculated over 36, 60 and 120 month periods. The highest 20% of funds in each category are named Lipper Leaders for Consistent Return and receive a score of 5, the next 20% receive a score of 4, the middle 20% are scored 3, the next 20% are scored 2 and the lowest 20% are scored 1. The highest Lipper Leader for Consistent Return in each category wins the Lipper Fund Award. Lipper Leader ratings change monthly. For more information, see www.lipperfundawards.com. Although Thomson Reuters Lipper makes reasonable efforts to ensure the accuracy and reliability of the data contained herein, the accuracy is not guaranteed by Lipper.*

*The SilverPepper Merger Arbitrage Fund won the 2017 Lipper Fund Award for Best Alternative Event Driven Fund based on consistent risk-adjusted return. For Lipper Best Individual Funds, the calculation periods extend over 36, 60 and 120 months. The highest Lipper Leader for Consistent Return (Effective Return) value within each eligible classification determines the fund classification winner over 3, 5 or 10 years as of 11/30/16. 37 Event-Driven Funds were eligible for the award for the three-year period ended 11/30/16.*

*About the Morningstar Rating*

*The Morningstar Rating for funds, or "star rating", is calculated for all mutual funds with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a mutual fund is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. The Morningstar Rating is for both the Institutional and Advisor class shares. Past performance is no guarantee of future results.*



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