August 8, 2014

Dear Fellow Investor:

We write mostly to tell you that we have examined all of the recent economic and company specific evidence that we can find and see nothing that changes our views or portfolio themes. Tensions in the Ukraine and the Middle East have obviously elevated the geopolitical risk factors of investment decision making. Nonetheless, we have made no major shifts because of these events as we were already quite cautious.

The most critical point we can make at this juncture is that it seems clear to us that the Fed is set to end QE in October at a point when sustainable growth is no more assured than when it commenced this latest ill-conceived scheme. In addition, Japan's mammoth money printing effort looks to have been a failed policy as well given poor economic data from that nation.

We put forth two more thoughts. First, though we wish it were otherwise, under the adage of "give a man (or woman) a hammer…" we would not be surprised to see more QE in the next year if equity markets correct substantially or economic growth becomes even more disappointing. Second, we would suggest that if the end of QE causes treasury rates to rise meaningfully, which we doubt, then it just might be riskier markets like equities, high yield bonds, and European sovereign debt including that of Italy and Spain which run into major trouble. After all, we do know that those asset classes stand out as the most expensive that they have ever been on the misguided belief that QE has somehow removed company specific and default risks across the board.

With so many stocks already down 15-20% from their highs, we would suggest that investors are beginning to wake up to the fact that the central planners are unable to insure against each and every case of earnings disappointment, though they speak as if they can. In addition, rapidly falling European financials stocks indicate risks are mounting in another region declared "fixed." Italy is now officially back in recession and its equity market has cracked 15%. Furthermore, credit ratios do not look to have turned the corner in a positive way across the EU.

The central bankers have been backed into a corner because they have been left with only one tool and it has failed to produce the authentic recovery they and their text books promised. Having made no moves to tighten policy after so many years since the last official recession in the U.S. and constantly cheering for equities even at these multi-year highs, we wonder what is really left to placate markets let alone alleviate economic dysfunction. The big question is what happens when those still fawning over the Fed realize that earnings have not remotely kept pace with stock prices.

After all, the popular trade has been to buy stocks and short bonds. We have taken the opposite position. With QE ending, many pundits warn about the risks inherent in *all* bonds, but see no risks for *any* stocks. We disagree. While we appreciate the enormous magnitude of the Fed's treasury and mortgage purchases over these last few years and do agree that *short* rates are being held quite low by this extreme intervention, treasury rates further out the curve in 10-year maturities (2.50%) and 30-year (3.30%) appear quite high versus short rates here and versus other high quality alternatives like German bunds near 1%. Spanish and Italian bonds trade near 2.50% and involve enormous credit and currency risks.

We still most strongly favor municipal closed-end funds where we can still own bonds at 10% discounts and 5% tax-free yields. Roughly half of our bond fund capital (about 27% of total capital) is invested in such funds, which seem to be quite compelling even after their big rally this year. We believe we are being quite well compensated over a three-year horizon in spite of angst over changing monetary policy. Besides, long treasuries have had strong performance in 2014 even as the Fed shrinks its purchase activity by a big percentage. Yes, we do find it ironic that rates have fallen with QE's demise and that should help borrowers and the economy. Just another example of how academics at the Fed may not really understand what they are doing.

We certainly appreciate the patience of our fellow investors who have waited with us for the other half of the earnings cycle to play out as we remain rooted in our disciplines. When momentum-chasing trading seems to be the only thing that is working, it is as if all the forces are aligned against the use of a value oriented, absolute-return process. We do understand the temptations faced by those who decide to wander into the dangerous waters of investment strategies which are so risky at this point in history, but seem so alluring at present. Nonetheless, we still have a very high portion of our family's assets invested in our fund and would choose no other strategy. We simply do not have it within our fiber to significantly expose our capital to one of the riskiest equity investment periods we have ever seen. It goes without saying that we are also quite grateful it has been easier this year to be us!

We are 102% long and 37% short with a 55% exposure to closed-end bond funds and 8% of capital invested in precious metals-related positions. Our net equity exposure is minus 11%. Please call with questions and comments.

Sincerely,

Scott E. Brown, CFA