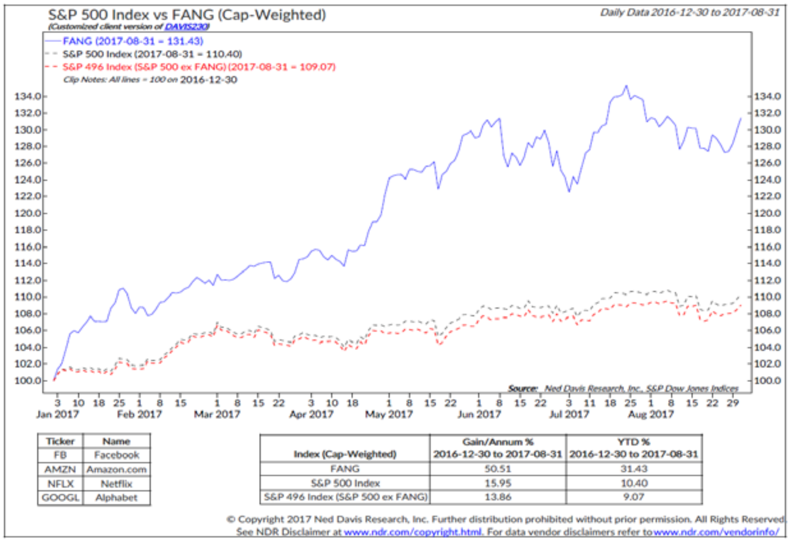
"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."
- Mark Twain



Source: Ned Davis Research

It's college football season again and with it the preseason polls ranking the top 25 teams this year. For the top teams, such as Alabama or Ohio State, it may not matter what poll a fan looks at, but for teams such as Washington State, the poll compiled by the Associated Press versus the Coach's poll means the difference between being in the top 25 and out. How are these polls compiled and calculated?

Investors have begun asking us an important question, "How are you different than an index?" In our business this requires a discussion of the index and how it is compiled and calculated. The premise of an index is that results will derive from a broad exposure to many securities with no single security dramatically impacting results in order to avoid company specific risk. The problem is that many popular indices appear concentrated in a few names with potential valuation risk.

Horizon Kinetics, an investment firm, highlights the challenges with the popular NASDAQ 100 index where over 40% of the index is concentrated in five stocks; Apple, Alphabet, Microsoft, Amazon, and Facebook (or FANG stocks plus Microsoft). In the European community where the index trades as a mutual fund, active managers would not be permitted to create such a portfolio as it would be deemed reckless because it lacks the required diversification, yet in the U.K. the product has over $1 billion in assets.

NASDAQ 100 Top Five Holdings

		Weight
AAPL	Apple Inc.	11.75%
GOOG, GOOGL	Alphabet, Inc. (Google)	8.84%
MSFT	Microsoft Corp.	8.21%
AMZN	Amazon.com Inc.	6.82%
FB	Facebook Inc.	5.42%
Source: PowerShares QQQ		41.04%

Not only is the NASDAQ 100 concentrated, but PowerShares QQQ fact sheet calculates the price-to-earnings ratio using a "weighted harmonic average." Why employ this method? This method eliminates firms with negative earnings and effectively excludes companies with excessively high price-to-earnings ratios. But as someone who places money into the index, the investor owns those non earners and high price-to-earnings stocks! One of the differences in our SMID product versus the index is that our product only owns companies with earnings versus the index where roughly a third of the companies in the index do not report a profit. In this case of the NASDAQ 100 index, calculating the simple average for price-to-earnings ratios of the 91 profitable companies in the index results in a valuation of 43.6x versus 22.2x in the NASDAQ 100 fund fact sheet according to Horizon Kinetics. As the firm noted,

Fund Characteristics as of 06/30/2017

Price/Earnings Ratio[1]	22.19
Price/Book Ratio[1]	5.01
ROE[2]	21.92%
Avg Market Cap[2]	$288,292MM

[1] Weighted Harmonic Average
[2] Weighted Average

Source: Invesco PowerShares

"No active manager would be permitted to manage a concentrated, high P/E portfolio for an institutional client. Only an index enjoys this privilege."

Are there implications for the S&P 500? Similar dynamics can be observed here as well due in large part to a few high price-to-earning stocks impacting returns in what is considered a well-diversified index without company specific exposure. Ned Davis Research notes that the FANG stocks as of August 31, 2017 are up 31.4% year to date versus 10.4% versus the index. The return for the S&P 500 without FANG stocks is 9.1%. The four stocks contributed 15% of the index's return for the first eight months of 2017.

How are we "daring to be different" for the benefit of clients? Valuation is a key investment pillar for our process and the average price-to-earnings multiple for the most recent published stock additions for the five marketed Equity Opportunities portfolios is 14.5x on 2019 forward estimated earnings. This lower valuation level compares with the 15.5x for the S&P 500 and 31x for the vaunted FANG stocks (using equally weighted positions). We hold that below average valuations combined with above average earnings growth, balance sheets, and returns on capital have the ability to put our clients at the top of the rankings earnings.

As always thank you for your interest and trust managing your investments.

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