GRIPMAN FUNDS

THE GOOD, THE BAD & THE UGLY

For the most part, we as humans don't think about the reasons behind the things we do. We simply react. When searching for someone to help manage their investment portfolio, most folks reach out to people they know. When soliciting this type of advice, you don't really know if the information is any good, but most of us have a strong Social-Proof Tendency bias to think and act as others around us think and act. For example, your friend Joanna (your go-to investment expert of choice) could have spent five years and countless hours researching the most effective strategies and firms in the investment industry or she may have listened to a commentator on CNBC refer to a product.

The trend for capital allocation is currently shifting to passive investment management. However, before you jump on this bandwagon, we believe our clients should know the differences between active and passive management and why we choose to actively manage our client's capital. Currently, the debate in the financial media has been whether investors are better served by using an active manager or by using passive investment strategies. The short answer is that it depends.

The biggest consideration that goes into picking whether to use a passive or active strategy is the amount of money that you have to invest. Asset bloat happens when a fund strategy or asset manager gets larger and larger and size makes it more difficult to generate returns above an index. I would estimate that the maximum amount of assets that you would want to have for a pure active strategy is $10 billion.

Now you may be asking yourself, "Why should I consider your opinion over that of my friend, Joanna?" It all comes down to numbers and experience. We have investment experience going back twenty years. Initially, this experience came in the specific asset class of commodities and only as an active speculative investor. At first, our knowledge of the equity and fixed income markets was mostly gained from books and MBA classes. However, over time the practical experience in researching, trading, and investing in equities and fixed income assets has grown our knowledge base through various jobs and new start-up companies. Practical knowledge across asset classes is somewhat unique and is a reason that our multi-asset strategies combining both equities and fixed income assets have been and can continue to be successful.

The following content of this paper explains our reasoning for why an active strategy is the best investment strategy using our wide knowledge and skill base.

THE GOOD – ACTIVE MANAGEMENT

The four structural things you need to be a good active manager:

AUM under $10 billion

A one percent position in a $10 billion strategy results in a $100 million position size. A $100 million position is sizable. However, through a good trading process, an active manager can get in to and out of a position of this size. Fixed Income positions of this size could cause a bit more of a liquidity issue.

A good example is a great bond that we bought for our strategy last week. There is only one bond available for this corporate issuer that has a maturity of less than seven years. The bond issued has only $250mm outstanding. We could buy a full allocation easily, but any asset manager with $10 billion or more in assets would have had significant difficulty if they even considered the investment at all.

Investment markets are relatively efficient. So, the ability to take a full position on an investment idea that is mispriced is a huge advantage to us and other small asset managers. Of course, the asset manager also needs to have a clear and disciplined strategy. However, the small asset manager has an advantage by keeping assets at a manageable level while executing their strategy.

Invest only when you see advantage

Over-diversification happens when the asset manager becomes too large to take full positions in mispriced securities. Asset managers will move from good securities to placeholder securities that they consider safe until the money can be reallocated to better ideas down the road. Over time, portfolios will include more and more of these securities until at some point the manager's returns will look more like a closet index. The result is that if fees are high enough the manager may no longer beat the market.

Limit the Cooks in the Kitchen

Charlie Munger points out 25 psychology-based biases in his writings on the Psychology of Human Misjudgment. Add more people to any investment team and it gets harder to make effective investment decisions. Since everyone looks at the market with their own bias, when you add more investors to the team, there can be many different opinions. Ray Dalio at Bridgewater has talked about this extensively. Since his firm has spent a lot of time focusing and refining staff additions and retention surrounding the investment process, they have been able to maintain generating alpha for $150 billion of AUM. Others, such as Appaloosa Management, handle this by keeping team size and AUM relative low with AUM at $7 billion. The more complex the interactions between team members the more of a chance to miss opportunities and/or miss risks from orphaned positions.

Pick one thing and do it really, really well

Our culture breeds the desire to be better than everyone else. In the markets, this desire to be a hero generally comes out as boastful strategy suggestions (i.e. "I know that the 10yr bond will be at 3% in a year"). Strategists for the larger asset managers and from sell side brokerages release their macro recommendations that they suggest investors should follow for any given time period. There are many things going on in the world at any given time and the ability to prognosticate the future is a low probability practice. How many strategists have suggested cash or not buying equities in the past five years? Too many, and sadly, many of these same folks completely missed the 2008 financial crisis, as well.

We suggest that active managers don't need to necessarily predict the S&P 500 level at the end of the year or UST 10-year yield in two years. They simply need to know the risk return dynamics of each security added or subtracted to the portfolio and how each fits into the investment category in which they invest.

Here is a list of the largest public asset managers in the world that are listed in the United States.

Name	2016	2015	2014	2013	2012
Assets Under Management*					
BlackRock Inc	5,147.9	4,645.4	4,651.9	4,324.1	3,791.6
Vanguard	3,965.0	3,398.8	3,148.5	2,752.9	2,215.2
State Street Corp	2,468.0	2,245.0	2,448.0	2,345.0	2,086.0
Fidelity	2,130.8	2,035.7	1,974.1	2,159.8	1,888.3
JPMorgan Chase & Co	1,771.0	1,723.0	1,744.0	1,598.0	1,426.0
Bank of New York Mellon Corp	1,648.0	1,625.0	1,710.0	1,583.0	1,386.0
Allianz SE	1,435.4	1,386.5	1,588.7	1,876.7	1,897.7
Capital Group Inc/The	1,478.5	1,390.4	1,396.8	1,338.8	1,045.6
Deutsche Bank AG			1,257.2	1,274.1	1,214.1
Goldman Sachs Group Inc	1,379.0	1,252.0	1,178.0	1,042.0	854.0
Amundi (Credit Agricole SA)		1,093.0	1,051.4	1,071.7	959.8
Northern Trust Corp	942.4	875.3	934.1	884.5	758.9
Prudential Financial Inc	1,040.1	963.1	933.5	869.9	827.0
Wellington Management Co LLP*	979.2	926.9	913.7	834.4	757.7
Bank of America Corp	886.1	900.9	902.9	821.4	698.1
Natixis	877.0	870.5	890.0	867.6	780.2
MetLife Inc		779.0	790.7	771.7	721.3
Invesco Ltd	812.9	775.6	792.4	778.7	667.4
Franklin Resources Inc	733.3	770.9	898.0	844.7	749.9
Legal & General Group PLC	1,103.9	1,099.3	777.6	745.5	659.4

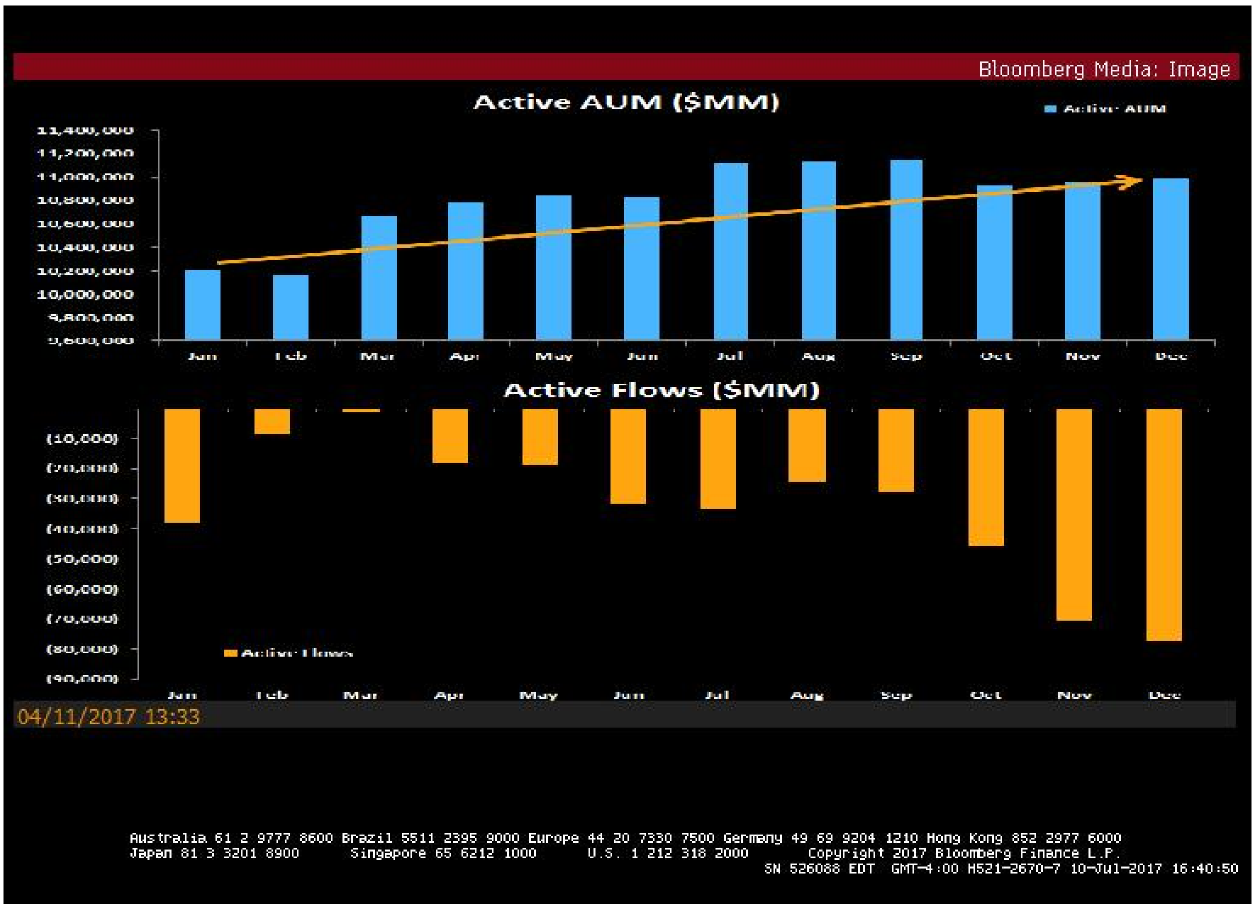
Our suggestion to investors that have less than $100 million is that they be very skeptical of investing with these firms. This could be separate accounts or in a fund type structure. You could be giving away your biggest advantage in generating strong returns and managing the risk of your portfolio.

Each firm on the list and strategy that they manage should be taken on a case by case basis. However, if a consultant/advisor strictly uses one of these firms fund group, that could be a big red flag. Also, don't simply rely on fund assets under management. Asset managers will use a single investment team for funds and separate accounts and then disperse investment ideas across all of the accounts. This can lead to performance issues as assets grow across the entire strategy.

At Gripman, we build portfolios from the bottom up. We understand how macro forces could affect returns on those securities over time; either good or bad. We also understand that the risk of a portfolio comes down to the risk of its individual securities and ultimately not just the correlations between those investments. While our capital allocation strategy limits the volatility of the portfolio, our security selection drives our ability to generate returns above the long-term benchmark.

THE BAD - INDEXING

Indexing has grown rapidly over the past several years. The chart below shows the fall in active management AUM over 2016, with most of this money being shifted into passive management ETFs.



The biggest problem with an index strategy is that you own everything. Yes, when things are going well you may own the Amazon's and the Tesla's. However, these growth investments can be very speculative and your portfolio can see some major damage if the market hits an economic slowdown (as in 2008) or the market stops paying too high a price for expected growth (as in 2000). Since you are more likely to own speculative positions and have companies that will eventually go bankrupt, it is very hard to manage your risk when indexing.

The ability to use fundamental analysis to isolate and avoid potential forced selling due to liquidity issues is key. Also, avoiding investments that are clearly overvalued and don't leave a clear margin of error is just as important. We periodically pull components from our market indexes every month to test for this overvaluation. This month we pulled ten new equity securities and found that one security appeared attractive, four appeared about fair and five looked to be rich. If your index was made up of these ten securities then your potential investment return looks grim.

Indexing makes sense for larger clients like pension funds, large endowments, and insurance companies as they can save a good amount of money in fees. However, these clients are realizing that paying 2% and 20% to hedge funds is a bad idea. The big shift over the past several years is that the large asset managers have embraced this change. The top five have taken an active step in promoting indexing in order to grow their AUM (shown in chart below). In effect, this has assured their strategic advantage as more assets allows them to lower fees further compared to industry peers.

Bloomberg Media: Image

	1985*	1990*	1995*	2000	2005	2010	2014	2015	2016	Share Change 2016 - 1985
Top 5	37%	34%	34%	32%	36%	42%	43%	45%	47%	10%
Top 10	54	53	48	44	47	55	55	56	58	4
Top 25	78	75	71	69	70	74	74	75	76	-2

*Note: Data prior to 2000 reflects mutual funds only

Source: Bloomberg Intelligence, Investment Company Institute

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Since there has been more advertising around these strategies, more consultants/advisors are recommending using indexing. However, for clients below $100-500 million in assets, this just does not make sense. Your total cost is not just the price you pay for investment services, but also your opportunity costs, as well.

The chart below uses 2016 as an example of comparing an indexing strategy to the Gripman Absolute Balanced Multi Asset Strategy. The index components are built from three funds: BIV, BSV and IWD with 70% of the portfolio in bonds and 30% in value based stocks. The fees and returns are totaled in the Total Indexing column. Lastly, the fees and performance of the indexing strategy is compared to the Gripman active strategy.

2016 Returns		Indexing						Gripman
		Vanguard	Vanguard	Ishares				Absolute
		BIV	BSV	IWD				Balanced
		Intermediate	Short-term	Russell 1000 Value		Total		Multi Asset
		Bond	Bond	Stock		Indexing		
Fees		0.07%	0.07%	0.20%		0.11%		0.74%
	Portfolio Mix	35%	35%	30%				
Return								
Gross		3.05%	1.40%	17.46%		6.80%		10.39%
Net		2.98%	1.33%	17.26%		6.69%		9.65%
							Fee Difference	-0.63%
							Opportunity Cost Difference	3.59%
							Total Cost Difference	**2.96%**
							$10 million Portfolio Savings	**$296,350**

For 2016, you would have paid an extra 63bp in fees to get an extra 359bp of performance. It is true that 2016 was a great year for active management as we started the year with plenty of cheap securities and volatility. However, if your manager is able to add value like this over time, the compounding effects far outweigh the extra management fee. In order to achieve this, you need to choose the right active managers.

Since Gripman focuses on cash flow yield, this allows us to compare and allocate capital between the equity and fixed income sleeves of the portfolio and gives a more accurate measure of longer term expected return of the portfolio. We can spend more of our time analyzing companies and looking for attractive longer-term investments than trying to capture the price momentum or more speculative names in the equity space.

Indexing has a place to be used for investment management, especially for a larger portfolio. However, an investor needs to understand that asset management firms are currently pushing these products not for value that they can provide for smaller investors, but for the ability it provides them to continue to grow their own AUM. To quote Warren Buffett, "Price is what you pay, value is what you get." If Warren indexed from 1964 until 2016, he would have returned 12,717%. Instead, he was an excellent active investor with a return of 1,972,595%.

THE UGLY – SAFETY OF INVESTMENT CAPITAL

Madoff - the word has almost become synonymous with the word Ponzi in today's culture. Mr. Bernard L Madoff defrauded his clients by taking advantage of the custodian banks who held the client's money. Westport National Bank was one of the banks that took in Madoff's clients' funds and accepted client assets. They had a one-man custodial department that did not confirm account assets and accepted pricing from Madoff's firm.

The first question an investor should ask is who the investment manager uses to custody investment assets. It is important to know if your money is safe from fraud. It is a big red flag if you hire a firm that self-custodies assets. We, at Gripman, use Pershing as a custodian for client assets. Pershing is the largest and safest place to keep your assets as the public owner of Pershing is BNY Mellon. BNY Mellon is required to keep extra capital under the Systemically Important Bank regulations.

Another question an investor should ask is who prices securities for a client's account. Pershing also prices our client securities on a daily basis. We cannot affect performance due to marking the value of your assets to values we choose.

When you invest with Gripman, your investment capital is safely held and valued by Pershing. You get the benefits of active management with a smaller asset management company. In addition, you maintain the safety of keeping your account custodian as Pershing.

SUMMARY

At Gripman, we are committed to providing our clients with investment strategies that focus on value, stability and growth. These strategies can be particularly useful during volatile and uncertain times. We work with clients, such as advisors, that want to outsource a portion of their investment management duties to us. We also work with private individuals that may have lower risk tolerances for assorted reasons, such as an approaching retirement or due to taking on more risk as an entrepreneur. We also work with institutional investors that want help investing a portion of their insurance assets or a pension mandate. We want to be the firm you turn to that will be focused on providing a great performing, lower risk actively managed multi-asset strategy.