LS Opportunity Fund - LSOFX

LONG SHORT | ADVISORS

4th Quarter 2018 Investment Review

LS Opportunity Fund

Long Short Advisors, LLC launched the LS Opportunity Fund (LSOFX, the "Fund") to offer its clients access to hedge fund strategies without the drawbacks of a typical limited partnership structure. Prospector Partners, LLC, the Fund's "Sub-Advisor," has been operating a traditional hedge fund with a similar investment objective since 1997.

Current Market Environment

Dear Shareholders of the LS Opportunity Fund:

What a difference a year can make . . .

A year ago the stock market outlook was rather sanguine, which is not surprising after the S&P 500 posted a strong 21.8% gain for 2017. The consensus was for the record-setting bull market to continue notching gains on the heels of healthy economic growth, strong corporate earnings, a prolongation of the low interest rate environment relative to history, and the continuation of near-pristine credit quality. Looking back, these were cheery consensus conditions. The dramatic price appreciation of Bitcoin and related cryptocurrencies at the end of 2017 accurately reflected the market sentiment at the time.

Fast forward twelve months and conditions are different. The stock market bulls are quiet and a tone of elevated caution has taken hold of the market (not to mention that the Bitcoin bubble has 'popped' and sold off 80%). You might recall that in our Q1 2018 investor letter, we outlined our case for a flattening yield curve going forward and the possibility of an inversion in the not so distant future. In Q4, we did see a brief inversion in certain portions of the curve and the 10-year / 2-year treasury rate spread ended the year at a meager 21bps (the spread started the year at 54bps). In our view the bond market has historically been a more reliable predictor of the future than the stock market. As such, concern about a recession appearing sometime in the next 18 months has increased markedly.

It's easy to arrive at a more guarded outlook on the market when one considers these factors: the negative impact from tariffs, deteriorating trade relations with China, a possible slowdown in global economic growth, concerns over peak margins, worries over future credit quality, a weakening Chinese economy, the uncertainty surrounding Brexit, a Fed perceived as not dovish enough, and concerns over the health of the housing sector. Yikes! In December 2018, we did briefly breach the 20% sell off threshold in the S&P 500 which most often technically defines a bear market. Revered ex-Fed Chairman Alan Greenspan declared the bull market over and that investors should prepare for the worst (though to our benefit his track record on these predictions is rather poor).

All this said, we are not sounding the recession horn just yet, nor are we necessarily expecting bear market conditions to persist for the full year 2019. Actually, we remain cautiously optimistic on the year ahead (the reasons why are reflected in the 'Outlook' section of this letter). However, we strive to position your portfolio in a way to capture upside potential in the market, yet heavily protect the downside should a bear market scenario come to pass. In fact, should we be entering a period of market turmoil, this is a time where we believe the Prospector Partners approach to investing will especially shine.

The fund in 4Q18 suffered a loss, albeit less than our benchmarks. While we found these results disappointing overall, our bigger surprise was the magnitude of the underperformance of the banking sector during the quarter and the opportunity it now presents.

Fund Overview

As of 12/31/2018

Inception:	09-29-2010
Sub Advisor:	Prospector Partners
Managed by Prospector Since:	05-31-2015

Key Statistics – 3-Year

As of 12/31/2018

Beta:	0.56
Standard Deviation:	6.95%
Sharpe Ratio:	0.71
Upside Capture:	54.10%
Downside Capture:	44.77%

Portfolio Overview

As of 12/31/2018

Exposure:	
Gross:	117%
Net:	56%
Long:	87%
Short:	-30%
Diversification:	
Long Equities:	68
Short Equities:	39
Concentration:	
Top 20 Longs:	46%
Top 20 Shorts:	23%

Management

John D. Gillespie
M.B.A, Stanford - B.A, Bates

Kevin R. O'Brien, CFA
B.A. Central Connecticut State

Jason A. Kish, CPA, CFA
B.S. B.A Providence College

Portfolio Targets

Exposure:	
Gross:	80% - 140%
Net	50% - 80%
Long:	80% - 100%
Short:	20% - 40%
Average Beta:	0.30 - 0.70
Diversification:	
Long Equities:	50 - 70
Short Equities:	20 - 40
Position Limits:*	
Largest Long:	10% of Cost
Largest Short:	5% of Cost
Concentration:	
Top 20 Longs:	30% - 60%
Top 20 Shorts:	10% - 30%

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2018 Returns

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
LS Opportunity Fund	3.63%	-2.59%	-0.79%	0.80%	0.36%	-1.15%	3.70%	0.98%	-0.35%	-3.96%	1.74%	-5.54%
HFRX Equity Hedge	3.41%	-1.49%	-0.69%	-0.55%	0.30%	-0.67%	0.72%	-0.23%	-1.63%	-3.95%	-0.63%	-4.23%
S&P 500	5.73%	-3.69%	-2.54%	0.38%	2.41%	0.62%	3.72%	3.26%	0.57%	-6.84%	2.04%	-9.03%

Returns

	As of 12-31-2018					*As of 12-31-2018*				
	YTD	1-YR	3-YR	5-YR	Inception †	YTD	1-YR	3-YR	5-YR	Inception †
LS Opportunity Fund	-3.55%	-3.55%	5.99%	2.62%	5.54%	-3.55%	-3.55%	5.99%	2.62%	5.54%
HFRX Equity Hedge	-9.43%	-9.43%	-0.09%	-0.25%	-0.05%	-9.43%	-9.43%	-0.09%	-0.25%	-0.05%
S&P 500 TR	-4.38%	-4.38%	9.26%	8.49%	12.33%	-4.38%	-4.38%	9.26%	8.49%	12.33%

(Annualized)

The performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling 1.877.338.8783. The Gross Expense Ratio is 3.33%. The Net Expense Ratio is 2.97%. † Annualized returns since inception date of the Fund, 09/29/2010.

Bank Sector Opportunity

In 2018, the market had disdain for financial services stocks in general. Within the sector, bank stocks were the weakest sub group by far. S&P 500 banks finished the year down 16% while the S&P financials index finished down 13%. There were a few key reasons for this and all of which are perceived as potential headwinds for the sector going into 2019.

First off, while rate hikes are traditionally a good thing for banks (and we saw four in 2018), they were certainly not viewed as such last year. Typically, a rate hike allows banks to reprice loans in the short term and lag on deposit rates over the long term, thus capturing a higher net interest margin spread between what it receives on interest from loans versus what it pays out as interest to deposit holders. However, this year, banks experienced a meaningful ramp in deposit costs as both corporate and retail customers demanded higher deposit rates and refused to sit idle and accept a low rate relative to Fed Funds. As a result, banks have 'given up' a greater portion of the benefit from higher rates in the form of paying higher deposit rates to customers which has constrained earnings growth. These deposit pricing pressures remain a constant topic of focus with investors.

Additional rate hikes have also put pressure on the yield curve which flattened over the course of the year. In short, this puts more pressure on the net interest margin of banks which is another headwind to earnings. Recall that banks typically borrow on the short end of the curve and loan out at the long end, making a steeper curve preferable. Also, with an inversion realized in parts of the curve during the fourth quarter, some investors viewed this as a canary in a coal mine, i.e. a warning sign that a recession is just around the corner. For banks, a recession squeezes profits as credit quality deteriorates and loans turn sour. If this all seems bad enough, loan growth disappointed investors' expectations in 2018. Despite some encouraging data that loan growth is rebounding, investors are still concerned that deteriorating U.S.-China trade relations, global political uncertainty, recession fears, and slowing economic growth will temper loan growth expectations.

While the consensus outlook for the bank sector seems dire, we believe these fears are heavily discounted in current bank stock valuations. First off, while deposit costs have accelerated, there is still room for net interest margins to expand further albeit at a more modest pace. Second, even though a few portions of the yield curve have inverted, this data point alone is not nearly enough evidence to support the argument that a recession is imminent and that credit quality will soon turn adversely. Despite all the talk about a recession, credit quality in the U.S. remains strong and bank management teams enter this period of uncertainty with much more fortified balance sheets than prior to the last downturn a decade ago. Finally, banks still have multiple tailwinds in place in the form of an improved regulatory environment, a strong domestic economic backdrop, the potential for higher capital return, and an improving loan growth outlook per recent Fed data. In our view, the market has essentially priced in much of the downside risk and is largely ignoring the positive tailwinds. As a result, we still see plenty of high-quality opportunities in the sector that also exhibit 'defensive' attributes should credit turn and / or deposit costs rip higher.

One such name, which is a new Q4 addition to your portfolio, is Comerica Incorporated (CMA). Comerica is one of the nation's most revered commercial banks with $71 billion in assets and with operations in California, Michigan, Texas, Arizona, and Florida. One of the primary reasons why we are attracted to Comerica is due to its high quality deposit base. Fully 52% of Comerica's deposit base is in the form of noninterest bearing transaction / checking accounts, while only 4% of their deposit base is in the form of high-cost CDs. As a result, Comerica has less deposit pricing pressures than many of its peers as the bank effectively pays nothing on the majority of its deposit base. Another reason why we are drawn to the stock is due to its large tangible common equity capital buffer of 10.1% which is materially above peers. This provides a greater capital cushion against credit losses should we enter a recessionary environment. Should a recession not occur, Comerica can use the excess capital to grow organically and return the capital to shareholders via share repurchases and dividends. Either way, both avenues will help improve upon the bank's already impressive 16.3% ROE. Finally, we view Comerica as an attractive acquisition candidate given its strong deposit franchise and excess capital base. The best part is that the stock trades at a discount valuation at 1.6x tangible book value, 9x 2019E EPS and at an 8% core deposit premium post the selloff in the bank sector.

Another high quality name in your portfolio is the Atlanta, Georgia based SunTrust Banks, Inc. (STI). The primary reason why we are attracted to this name is due to the fact that it is the preeminent bank in the southeast. We are especially bullish on this region of the country due to its above average economic growth potential, which is supported by robust net population growth. Thanks to tax reform, the revised tax treatment of state and local taxes (SALT) enhances the attractiveness of living and working in the southeast. As a result, loan growth from SunTrust has been above average compared to peers in different areas of the country, and we see no reason why this trend should discontinue. Additionally, similar to Comerica, SunTrust has a strong core deposit base. In the case of SunTrust, 91% of the deposit base is in the form of core deposit accounts with nearly one third of those accounts being noninterest bearing in nature. Like Comerica, SunTrust also has an excess capital base which provides a greater capital cushion should we enter a recession and can also be used to return excess capital to shareholders (in fact, the capital return ratio is approaching 100%). SunTrust also comes at an attractive valuation, trading at 1.5x tangible book value and 9x 2019E EPS.

While the consensus outlook for the bank sector remains bearish going into 2019, we remain confident in our outlook for your bank portfolio given our stock selection process. We will continue to be holders of high-quality names like Comerica and SunTrust while maintaining short positions in banks that exhibit the opposite qualities.

New Position – Leidos

Leidos Holdings, Inc. (LDOS) was a large purchase during the fourth quarter. Established in 1969, Leidos is the largest pure-play defense-services company with more than $10 billion in revenue. It has strong capability in cyber, cloud migration, IT services for defense and intelligence, healthcare, and logistics. We view the defense services sector as attractive due it its strong cash flow characteristics, and steady, recession-resistant business model. The sector has recovered from several years of decline following the drawdowns in Iraq and Afghanistan. Leidos became the largest peer after acquiring a major asset from Lockheed Martin in 2016.

We find Leidos particularly appealing. First, Leidos has a solid balance sheet with 3.3x net debt / free cash flow, which is similar to its defense services peers. Second, it has the strongest free cash flow yield in the group at 7.1%. Third, as the largest player with the broadest set of skills, Leidos is less likely to conduct risky acquisitions going forward which is important since the industry is likely to further consolidate. Fourth, management proved their operational abilities over the past few years by successfully achieving cash generation per dollar of sales to a peer-leading 10%. Finally, with their leading cost structure, they are in good stead to compete for future business.

The fourth quarter was bumpy for defense, as it was for many sectors. Surprises from Washington were mostly to blame. In October, the President spoke about cutting the defense budget 2% in FY20, only to reverse course in December and sign onto plans for growth in FY20. Later in December came the partial government shutdown. Fortunately, the Department of Defense and some other agencies were fully funded already. Analysts are estimating about 10% of the defense services sector sales are impacted. Nonetheless, the sector has seen shutdowns before and can navigate. This will pass, and lost sales are often recoverable. Ultimately, we believe defense spending is dictated by the threat environment. The threat levels are growing, not shrinking. Despite occasional noise from individual politicians, we believe there is broad bipartisan support for defense. Furthermore, as IT and other needs become more complex, we believe there remains a trend towards more outsourcing by government, which should benefit Leidos.

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Top Holdings by Sector*

As of 10/31/2018

Top Longs:		Top Shorts:	
Berkshire Hathaway. B - Financials	4.4%	Willis Tower Watson - Financials	-1.9%
PNC Bank - Financials	4.1%	Ameriprise - Financials	-1.7%
Microsoft - Technology	3.8%	Sysco Corp - Consumer Staples	-1.1%
FLIR Systems - Technology	1.1%	Procter & Gamble - Consumer Staples	-1.1%
Nestle – Consumer Staples	2.4%	Lockheed Martin - Industrials	-0.9%
Mondelez – Consumer Staples	2.0%	Union Pacific - Industrials	-0.7%

*This refers to individual company long and shorts only, excluding ETFs, if any.

Outlook

After a ten-year post-financial crisis period of consistent underlying conditions for equity investing, fundamentals are shifting. Tightening monetary conditions and slowing economic growth overseas have given U.S. investors pause and led to a rerating of risk assets, e.g. a compression of stock market multiples and spread widening for all types of borrowers. Regardless, the U.S. economy remains fundamentally healthy and continues to be a global leader.

Interest and mortgage rates continue near historically low levels, having retraced by 50 basis points from the November highs as inflation remains benign and economic growth moderated slightly. Although we are clearly late in the economic cycle, the odds of a 2019 recession without a full-blown trade war seem modest.

Investment-grade corporations have solid balance sheets and are currently producing acceptable free cash flows. We are carefully monitoring aggregate corporate debt levels (especially the BBB- debt which is a single notch above junk status), which now sit above pre-2008 crisis levels. The 2018 corporate tax cuts and the ability to repatriate foreign cash holdings should continue to drive higher employment, M&A activity, and capital returns including buybacks and dividends. Profit margins remain near all-time high levels, currently 11%, and look to be at some risk from higher wages, interest expense, and input costs.

In our estimation, equity valuations have moderated from extremely elevated levels. We have moved to the seventh decile from the tenth decile over the past year on trailing operating earnings. As a result, equities look most reasonable when comparing earnings yields to Treasury or even corporate bond yields. In any case, the values inherent in your portfolio should attract acquirers and other investors over time. Meanwhile, we believe equities are a superior asset allocation alternative to bonds over the longer term.

Steadfast, we remain committed to our goal of making you money while protecting your wealth.

- Your Investment Team at Prospector Partners

Portfolio Attribution

Name	Ticker	09/30/18 Weight	12/31/18 Weight	Period Return(2)
Top Contributors				
Ameriprise Financial	AMP	-1.9%	-1.4%	-28.8%
Lockheed Martin	LMT	-1.1%	-0.9%	-23.8%
Prudential Financial	PRU	-0.9%	-1.2%	-18.7%
Canadian Imperial Bank	CM.CN	-1.0%	-0.9%	-14.9%
Affiliated Managers Group	AMG	-0.7%	-0.5%	-28.5%

Name	Ticker	09/30/18 Weight	12/31/18 Weight	Period Return(2)
Top Detractors				
PNC Financial Services	PNC	3.9%	3.9%	-13.5%
KeyCorp	KEY	2.1%	1.1%	-25.0%
Suncor Energy	SU	1.7%	1.3%	-27.1%
Microsoft	MSFT	3.9%	3.7%	-10.8%
FLIR Systems	FLIR	1.5%	1.1%	-28.9%

Disclosure

Risk Statistic Definitions: **Standard Deviation** measures the volatility of the Fund's returns. **Beta** measures the Fund's sensitivity to market movements. **Sharpe Ratio** uses the Fund's standard deviation and average excess return over the risk-free rate to determine reward per unit of risk. **R-squared** represents the percentage of the portfolio's movements that can be explained by general market movements. **Upside/Downside Capture Ratio** measures a manager's ability to generate an excess return above the benchmark return in up markets and retain more of the excess return in down markets. Risk statistics are relative to the HFRX. **Batting Average** is a statistical measure used to evaluate an investment manager's ability to meet or beat their index. **Traynor Ratio** measures excess returns per each unit of market risk, as measured by beta. **Sortino Ratio** is a variation of the Sharpe ratio that only factors in downside risk. **Max Drawdown** is the peak-to-trough decline during a specific recorded period of an investment. **Gross Exposure** is the sum of the absolute values of the fund's long and short exposures. **Net Exposure** is the fund's total long exposure less the fund's total short exposure. The Gross Expense Ratio is 3.33%. The Net Expense Ratio is 2.97%.The Expense Cap is 1.95%. The Adviser has contractually agreed to waive or limit its fees to 1.95%

Prospector Partners, LLC assumed investment management duties on 05-28-2015 and was formally approved by shareholders on 09-17-2015.

The Expense Cap is 1.95%. The Adviser has contractually agreed to waive or limit its fees to 1.95% and to assume other expenses of the Fund until September 30, 2019, so that the ratio of total annual operating expenses (not including interest, taxes, brokerage commissions, other expenditures which are capitalized in accordance with generally accepted accounting principles, other extraordinary expenses not incurred in the ordinary course of business, dividend expenses on short sales, expenses incurred under a Rule 12b-1 plan, acquired fund fees and expenses and expenses that the Fund incurred but did not actually pay because of an expense offset arrangement) does not exceed 1.95%.

Investment in shares of a long/short equity fund has the potential for significant risk and volatility. A short equity strategy can diminish returns in a rising market as well as having the potential for unlimited losses. These types of funds typically have a high portfolio turnover that could increase transaction costs and cause short-term capital gains to be realized.

As of 12/31/2018, Comerica Incorporated (CMA) comprised 0.99% of the fund portfolio, SunTrust Banks, Inc (STI) comprised 2.01% of the portfolio, and Leidos Holdings, Inc. (LDOS) comprised 1.33% of the fund portfolio.

You should carefully consider the investment objectives, potential risks, management fees, and charges and expenses of the Fund before investing. The Fund's prospectus contains this and other information about the Fund, and should be read carefully before investing. You may obtain a current copy of the Fund's prospectus by calling 1.877.336.6763. The Fund is distributed by Unified Financial Securities, LLC. (Member FINRA).