Total Asset Partners Year End Review

December 2015

On balance, 2015 was a year for Investors to forget. U.S equity and bond prices ended the year essentially flat, equity gains in Europe were mostly wiped out by the fall of the Euro for US dollar investors, while commodity and oil prices collapsed, creating considerable disruption in those sectors of the equity and high yield markets. China sparked a brief panic with clumsy interventions to stop a stock market collapse and further roiled markets with an unexpected currency devaluation, although the Shanghai Index ended the year up roughly 5%. The only unambiguous good news came from Japan, where strong corporate profits and a stable yen sent the TOPIX up 9% in dollar terms.

In recent letters we have expressed a skeptical view (prematurely with hindsight) that Fed policy will effectively suppress market volatility indefinitely. Last year validated this view, with heightened volatility across multiple markets. Stocks in the S&P 500 (SPX) are weighted by the size of their market capitalization. While the index posted modestly positive returns in 2015, the gains came from a small group of large cap stocks. An SPX where the stocks are equally weighted posted negative returns in 2015, finishing the year down 2.6%. The broad equity markets crossed from gain to loss and back 21 times. The market's fixation on the Fed's exit from its unprecedented monetary experiment heightened volatility in the Treasury markets, while the historic 30% move in the Swiss Franc roiled currencies.

As we look to 2016 and beyond, we do so through the lens that growth, valuation, and liquidity drive financial market returns. We believe growth in the US economy this year will fall in the range of 2% to 2.5%, supported by positive job creation, an uptick in wages from mandated increases in minimum wages, tightening labor markets, and the pass-through of lower energy prices. The commercial construction sector, which is relatively insulated from the impact of a strong dollar, should also support growth, especially multi-family housing. We expect that the strong dollar will continue to be a drag on the manufacturing sector and cutbacks in capital spending and employment across the energy patch will further impede growth. In November 2015, the U.S Industrial Production Index fell 1.17% year-over-year, the first negative reading since 2009.

It is important to recognize, however, that growth is slowing, both domestically and globally. U.S. real GDP growth fell by almost half, from 3.9% in 2Q 2015 to 2.0% in 3Q2015. The Atlanta Fed's GDP model recently lowered its forecast for 4Q2015 from 1.3% to 1.0%. The IMF reduced its estimate of Gross World Product by $3.8 Trillion (4.9%) in 2015, a magnitude of deceleration that we have only seen once since 1980, and that was during the Great Recession of 2007-2009. Economic momentum in China, the world's second largest economy, has faded, reflecting excess investment, a growing problem of bad loans, and a secular shift from production to consumption as the primary driver of growth. Witness the turmoil in the RMB and equity markets there. Commodity exporters across the globe are reeling from the declines in industrial commodities exports, and we are increasingly concerned that the U.S economy may fall into recession without a meaningful drop in the dollar.

As we look beyond 2016 there are a number of secular forces that we believe will impact global growth and investor returns over our 3-5 year secular horizon. First, we believe trend growth in the United States, the world's largest and most stable economy, has shifted permanently lower from the 3.25% rate that was considered normal between the end of World War II and the 2008 financial crisis, to something closer to 2.25%. This downward shift in structural growth reflects long term demographic shifts including an aging workforce, historically low workforce participation rates, growing entitlement spending, and levels of government debt that limit the effectiveness of fiscal policy as a tool to support growth.

Second, growth in the developed economies of the US and Europe is driven more by intangible services and less by physical production. This trend has been in place for much of the post-industrialization period but gains momentum through demographics: as people get older, they buy fewer manufactured goods, but require more in the way of services such as entertainment and healthcare. This is reflected in merchandise trade volumes which, after several decades of growth greater than global GDP, are now growing at roughly the same pace. It should also be noted that many of the fastest growing technology companies today are not significant employers. They generate substantial revenues on a relatively small employee base.

Finally, growth in China is slowing. Given the opacity of Chinese economic data and politics, the scale and nature of this shift is probably underestimated. Based on official statistics, real growth in the local currency averaged 10% from 1978 to 2013. Over the next decade growth will come in much lower. After 15 years of production-driven expansion, the Chinese economy out of necessity will shift towards a greater reliance on the consumer and services. We expect that poor long-term demographics in China together with the shift in the source of growth from production and credit expansion to consumption and services will lead to lower growth in global GDP.

Across most sectors that form our investment opportunity set, little has changed with respect to valuations from a broad-based, top-down perspective. Real interest rates remain negative in short and intermediate-term US debt, and extend further out across the yield curve in much of the Euro Zone. Equity valuations remain stretched. Most aggregate measures of equity valuation continue at elevated levels and are in the 10^{th} decile of available historic data. A return to mean historic valuations would imply a roughly 20% downside for the equity markets, which is consistent with what would be viewed as a normal correction.

While the liquidity environment has not turned decidedly negative, there are a number of clouds on the horizon. We have undergone six years of an extraordinary monetary expansion, where the Federal Reserve balance sheet has grown to unprecedented levels relative to GDP. While we are skeptical that domestic economic results will support the 4 interest rate increases currently envisioned by the Fed, it seems likely that we have lost the tailwind of overt monetary ease. Somewhat disconcertingly, growth in the monetary base has turned negative.

Other factors contributing to our cautious view of the liquidity environment include the following.

- A deceleration in loan growth. A growing number of the banks we follow are reporting loan growth in the area of 2%, which is down from prior years.
- Credit spreads have widened in the bank loan, investment grade corporate bond, and the high yield markets. A rise in the cost of capital is seldom a good sign and widening credit spreads are often precursors to economic weakness. It poses a higher hurdle rate for capital spending, which has disappointed during this expansion, but also constrains the ability to borrow money for stock buybacks and acquisitions, which many companies have relied on to boost earnings per share.
- It looks increasingly likely that the big boost of Japanese monetary stimulus may no longer serve as a tailwind as the Bank of Japan seems increasingly inclined to sit on its hands.
- It appears that the ability of the European Central Bank to engineer economic expansion through a lower Euro may be fading. With real interest rates across the whole German yield curve close to negative, the

question remains as to whether the ECB will be able to deliver an upside surprise in monetary easing in the face of doubtful results and growing political resistance to more extreme quantitative easing.

- The Dodd-Frank regulatory framework that was enacted after the great recession has resulted in a flight of capital from the traditional market making role of the financial sector. The loss of this support on top of the continuing growth of algorithmic trading, highly levered hedge funds (often through derivative markets), and a large number of mutual funds and ETF's that promise daily liquidity despite being invested in illiquid underlying assets will likely exacerbate volatility and market swings.

Portfolio Structure

We entered 2016 with a defensive portfolio structure, reflecting our concerns over increasingly conflicting economic crosscurrents, stretched valuations across broad market sectors, a deteriorating liquidity environment, and heightened geopolitical uncertainty. Our portfolio structure and strategy emphasize wealth preservation while seeking to maintain a growing income stream as opposed to aggressive risk taking in pursuit of maximum returns. The portfolio allocations at year end and performance attribution for 2015 are shown below.

Seaport Total Asset Partners
as of 31-Dec-15
Exposure and Contribution to Gross Portfolio Returns[1] by Asset Class

asset class	exposure	beta	duration	yield	rating	returns ytd	ytd contrib
Equity	26.1%	0.86	-	3.24%		0.4%	0.11%
MLP/REIT	6.6%	0.72	-	5.53%		(9.1%)	(0.64%)
Options	0.9%	0.90	-	-		15.5%	0.22%
Credit	24.1%	0.17	0.63	4.34%	BBB3	1.2%	0.21%
Mortgage	13.9%	0.02	2.58	3.52%	BB3	3.7%	0.65%
Muni	4.9%	0.24	1.57	5.89%	A3	8.0%	0.35%
Commodity	1.0%	0.20	-	-		(10.9%)	(0.20%)
Cash	22.4%	-	-	-	AAA	-	-
Grand Total	100.0%	0.34	0.59	3.04%	A3	0.71%	0.71%

1. Unaudited gross returns before fees and expenses. Numbers may not add due to rounding.

Equities

Our 2.7% exposure to the energy sector in equities and MLP's was the largest detractor from 2015 performance. The sharp drop in oil prices has resulted in equally sharp declines in the prices of stocks and high yield bonds across the entire energy complex including many companies that have limited direct exposure to oil prices, such as Enterprise Product Partners and Amerigas Partners. Enterprise Product Partners owns pipelines, storage facilities, and processing facilities that are critical to the domestic energy infrastructure. They function essentially like utilities in serving their customers and generate relatively stable cash flows. Amerigas Partners is a propane distributor, generates substantial free cash flow, and is impacted more by weather than energy prices. It should be noted that both of these companies have recently raised their dividends despite the difficult industry environment. We believe that our energy holdings are undervalued, that the dividends are safe, and that these holdings offer prospects of attractive returns in time.

Given current oversupply conditions in energy markets, we would not be surprised to see oil prices test new lows over the short term. We believe that the sharp cutbacks in industrywide capital spending will result in reduced production. This reduced production, combined with the fact that the industry is not replacing current production with new reserves, will ultimately lead to lower production and higher prices in the future.

Our equity investments emphasize companies that generate stable and growing cash flows, offer attractive dividend yields and growth, and currently trade at discounts to our assessment of fair value. Below we list our top 10 equity positions at year end along with our assessment of their prospective dividend growth and fair value.

Seaport Total Asset Partners
as of 31-Dec-15
Top 10 Equity Holdings

company	sector	price	% portfolio	yield	12mo dividend growth	estimated dividend growth	estimated price to fair value
Microsoft	Technology	50.00	1.00%	2.9%	12.2%	11.0%	91%
CVS Caremark	Consumer Staples	93.00	0.92%	1.8%	25.3%	16.0%	89%
Macquarie Infrastructure	Industrials	59.00	0.86%	7.6%	14.6%	11.0%	91%
Johnson & Johnson	Healthcare	95.00	0.85%	3.2%	6.9%	6.0%	90%
Xylem	Industrials	32.00	0.83%	1.8%	10.0%	8.0%	84%
Republic Services	Industrials	42.00	0.79%	2.8%	7.0%	5.0%	93%
ITC Holdings Corp	Utilities	37.00	0.77%	2.0%	14.8%	12.0%	88%
Unilever	Consumer Staples	40.00	0.76%	3.2%	6.0%	4.0%	89%
Procter & Gamble	Consumer Staples	75.00	0.76%	3.5%	4.7%	4.0%	83%
AmerisourceBergen	Healthcare	90.00	0.75%	1.5%	21.6%	13.0%	86%
Raytheon	Industrials	116.00	0.73%	2.3%	10.7%	7.0%	93%

Another important theme in our portfolio can be found in our holdings of real estate investment trusts (REITs). The recent market volatility has offered opportunity to add to our holdings in Ventas and Welltower (formerly Healthcare REIT), which operate senior housing and healthcare real estate including hospitals, skilled nursing facilities, and inpatient and outpatient facilities. We believe that these companies will benefit from the demographic tailwinds of an aging population and that they are relatively insulated from economic cyclicality, and are well managed. They have solid balance sheets, and at current prices offer yields in excess of 5.5%, dividend growth of 3-5%, and trade at discounts to our assessment of fair value. We expect them to generate attractive total returns over time.

We recently added to our REIT holdings a position in Crown Castle international, which is a leading owner and operator of cell towers in the US. This is a stable business that serves a critical function and should benefit from the growing volumes of wireless communication. The stock currently yields 4.5% and we expect dividend growth of 6-8% range over the next 3-5 years.

Increased market volatility translates into increased prices for options, which provides us with more opportunities to execute conservative covered option strategies. Our positions are structured to take us out of equities at premiums to our assessment of fair value or to buy equities at prices we believe to be cheap. This strategy offers a meaningful enhancement to portfolio income and has been one of the best performing strategies in our portfolio.

Fixed Income & Commodities

Credit	We have been cautious on high yield credit for the past several years in the belief that high prices reflected investors' search for yield and that we were not getting paid for the risk. The idea that one pays \$1.00 and earns 5.5% if everything goes well but loses \$0.70 if it doesn't has never made sense to us. Our current positions have an average quality of investment grade and with an average duration of 0.6 face little exposure to rising interest rates. We believe that the recent disruption in the high yield sector will present attractive opportunities going forward and have increased our attention to this sector. In the meantime, we maintain a short position in investment grade credit as a hedge against rising interest rates and a deteriorating fundamental credit quality.
Mortgages	We have found attractive relative value in the non-agency mortgage sector for the past several years. We are finding far fewer opportunities now. We continue to focus on individual securities that benefit from substantial collateral support, sound structures, and modest exposure to rising interest rates.
Municipals	The municipal yield curve is unusually steep and after adjusting for the tax-exempt nature of the interest paid, taxable equivalent yields are quite attractive. We are predominately invested through closed end funds that are investment grade in quality and trade at discounts to the underlying net asset value.
Commodities	Gold is our sole direct commodity exposure, which we hold as Armageddon insurance. While this position has detracted from performance for the past several years, we point out that recent prices are still 50+% above our cost and believe that this small position serves as a worthwhile hedge.

We are appreciative of our Seaport clients who share our view of long-term, fundamental, value-driven investing, independent of short-term market moves. Thank you for your continued trust and support.

Sincerely,

Ben Trosky
January 21, 2016

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