Seaport Investment Management
Registered Investment Advisor

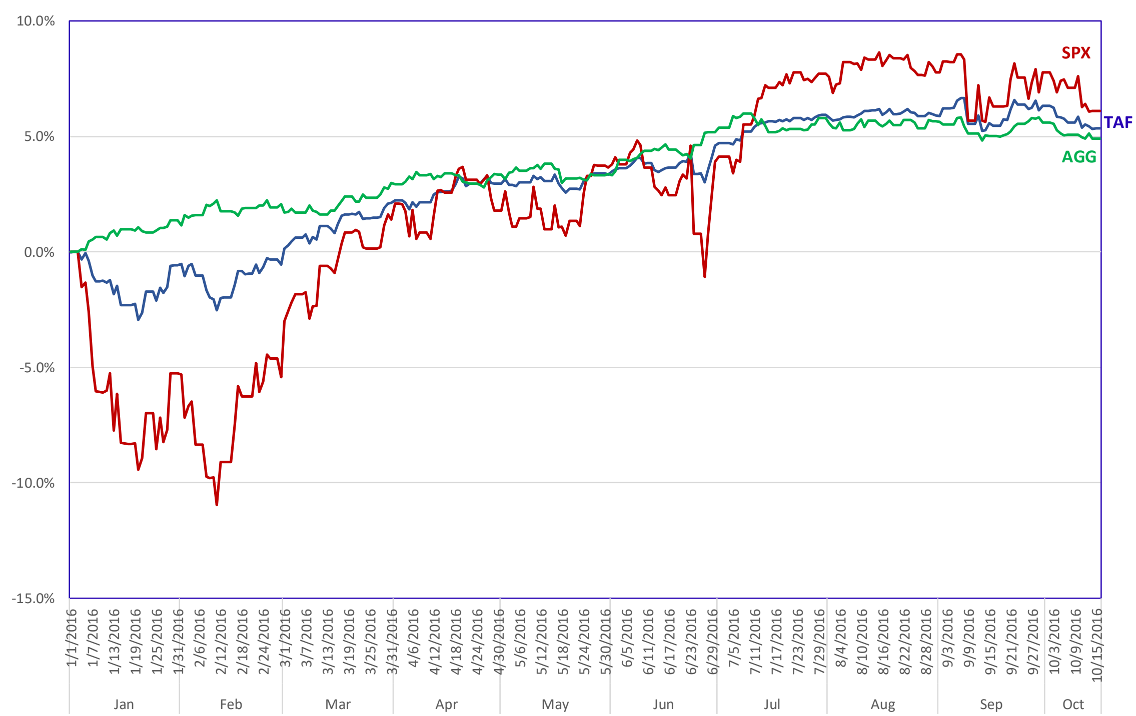
Total Asset Partners Third Quarter Review

October 2016

We entered the third quarter 2016 with a defensive portfolio, reflecting our sense that expectations for both economic and corporate profit growth were too high, that valuations across fixed income and equity markets are stretched, and that the liquidity was declining in the markets. We believe the data continues to support this point of view.

For the third quarter ended September 30 Total Asset Partners returned 1.54% net. Year-to-date through September 30 our portfolio returned 6.27% net. We remain focused on providing an attractive level of income with a positive real total return after inflation, taxes, and expenses. We rarely expect to outperform the S&P in rising markets, but as you can see in the chart below our returns year-to-date have surpassed fixed income, have been competitive at a small discount to equities, and posted a real return of 5.07% over year-to-date CPI of 1.2% through September. We have achieved these results with limited volatility month to month.

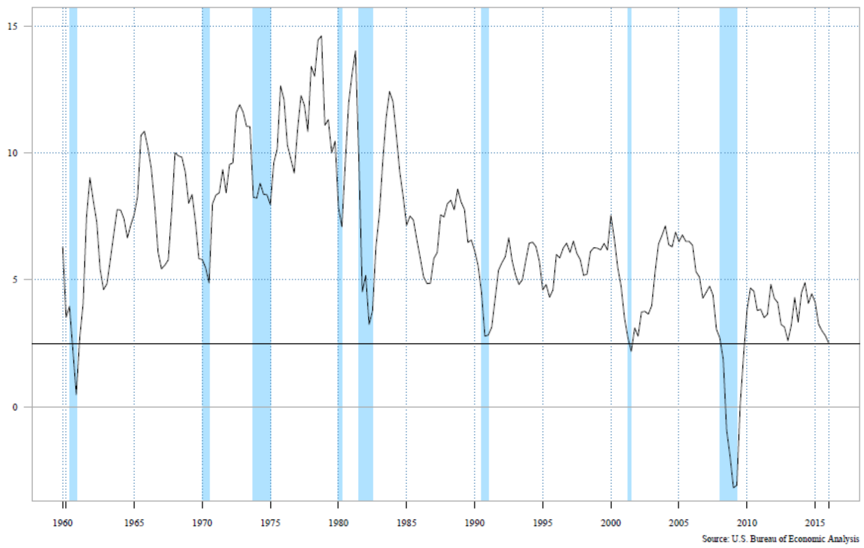
Seaport Total Asset Partners
as of September 30, 2016
Comparative Year-to-Date Returns for Total Asset Partners,
S&P 500, and Barclay's Aggregate Total Return



Economic Outlook

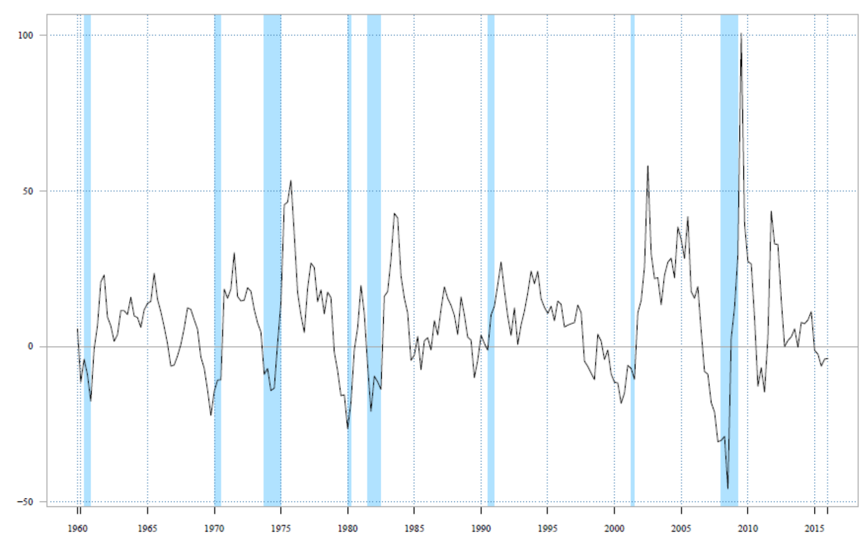
Consensus forecasts for domestic and global economic growth have drifted lower since the beginning of the year with downward revisions accelerating after the Brexit vote. Second quarter real GDP growth came in at an anemic 1.4%. Through this economic cycle, GDP growth has averaged just 2%, the weakest expansion since World War II. In the chart below, trends in nominal GDP remain disconcertingly low with only three instances at these levels since 1960, and all three were during recessions.

U.S. Nominal GDP, Quarterly
Percent Change over One Year



In the face of deflationary headwinds, corporations have struggled to grow revenues and staunch a year-over-year decline in profits that has continued for the past 5 quarters, as you can see in the chart below. While some attribute the downturn in profits to the sharp drop in oil prices, this weakness extends well beyond the energy sector. The 4-quarter average of U.S corporate profits excluding oil & gas declined an estimated 4.3% during the second quarter to levels consistent with recession.

U.S. Domestic Corporate Profits ex Petroleum, Quarterly
Percent Change over One Year, IVA and CCA Adjusted



As a leading indicator, this trend raises the prospect of weaker economic growth in the future. With a strong US dollar, competition from imports limits pricing power for corporations domestically at the same time that domestic and global economic growth remain weak. Profit margins have probably peaked, will likely remain under pressure due to rising labor costs and a recovery in energy and raw material prices, and can be expected to have a negative impact on business confidence. The recent sharp drop in job openings from NFIB Small Business

Optimism Survey may be a harbinger of things to come. The gradual tightening in credit conditions will also constrain growth.

Consumer spending, which accounts for roughly 70% of GDP, has been the primary engine of economic growth in the U.S. since the beginning of 2015. Real wages and salaries grew 2.9% year-over-year in July, down from a 5.1% annual rate the prior year, while real growth in consumer spending has been decelerating for several quarters to its current level of 2.8%. While we expect consumer spending is to remain a positive contributor to growth, we are increasingly concerned that the American consumer has become vulnerable to economic shock: a recent Fed survey found that 47% of those surveyed could not raise $400 for an emergency except by borrowing or selling assets.

For much of the quarter, most pundits, market observers, and investors focused on monetary policy and the September meetings of the Federal Reserve and Bank of Japan. The Fed announced that it would leave rates unchanged, but now peg the long term growth rate for the U.S. at 1.8%, down from 2% in June and 2.5% in 2011. At the same time the Bank of Japan announced it would peg the yield for the 10-year government bond at 0% and raised its inflation target to over 2%. In the immediate aftermath of the announcement the Yen strengthened and long term interest rates rose!

In the past we have consistently expressed our belief that the experiment in extraordinary quantitative easing in monetary policy by Central Banks will not generate sustainable growth in real economic activity. In our opinion, these policies have encouraged a misallocation of capital, exerted enormous pressure on insurance companies, and jeopardized the funding status of defined benefit pension plans. Today, Central Banks are beginning to recognize that there is little they can do to stimulate economic growth and the onus is now rests almost entirely on fiscal policy.

Unfortunately, options for expansionary fiscal measures are limited by a massive overhang of global debt and there appears to be little evidence of the political will required implement pro-growth economic policies. The current dysfunctional political climate poses substantial risk to economic growth, and this risk does not appear to be fully understood by the majority of voters.

World Bank estimates suggest that for the 20 largest economies trade accounts for slightly over 26% of global economic growth. Yet both candidates in the U.S. election have taken hostile positions to trade. They are ignoring history. As the Great Depression was taking hold, the United States passed the Smoot-Hawley Tariff in 1930, which enacted tariffs on 20,000 imported goods in an attempt to protect American jobs (sound familiar?). Our trading partners were quick to respond with their own tariffs on American imports into their countries and within three years world trade plummeted 64%. Protectionism made the depression worse. Today, any move towards protectionism could have a more profound impact on today's global economy than in the 1930's.

Corporate tax rates offer another area where the implementation of substantial policy reform could have a positive impact on growth. The U.S. has the third highest corporate tax rate, at 35%, of the 188 countries surveyed by the Tax Foundation. Corporate tax reform that reduces tax rates, broadens the tax base, and simplifies the tax code will promote higher wages and economic growth. One would think that there would be serious, bi-partisan support for corporate tax reform, but this is not the case.

Markets

In the context of our cautious economic outlook, valuations appear expensive to us across both fixed income and equity markets. We believe investors are not being adequately compensated for the risk of a downturn, and values in some parts of the market are beginning to look like a bubble. In fixed income, negative yields prevail across $13 trillion debt in much of Europe and Japan. Traders have been buying government securities at negative yields, and often with significant leverage, in hopes of front running ECB purchases and selling to the ECB at even lower negative yields. We believe that this game will end badly.

In the U.S., Treasury yields fell to all-time low levels following the Brexit vote. Over time, Treasury yields track nominal GDP growth. In an environment of 1.5 % real growth and 2% inflation, 10-year Treasury bonds should trade at yields between 2.75% and 3.5% in markets free of Central Bank manipulation. A move in interest rates from today's yield of 1.73% for the 10-year to 2.75% would result in a 9% loss in price. In our portfolio we continue to maintain a defensive position with duration of just under a year at 0.85, which reflects our significant cash position.

The beneficiary of low yields in government and investment grade corporate bonds has been the high yield market, which has been the only real source of yield globally. With a return year-to-date through September of 14.8%, high yield today offers limited value. Fundamentals are deteriorating, leverage is increasing, and the default rate is quietly picking up. We believe defaults, and overall dislocations in the high yield market, will rise over the next 12-24 months. We will be looking for individual credit opportunities that offer the prospect of attractive total returns when they become available.

For a long time, we have felt valuations in equity markets have been expensive and took a defensive position, which in hindsight appears premature. Valuation measures are poor guides to timing the markets because it is their fundamental nature to swing between extremes valuation. Today, however, equity markets are rich by historical standards no matter what measure you choose.

The chart on the next page plots enterprise value to net capital and 12-month rolling forward returns for the S&P 500 from 1990 through September 2016. We've chosen enterprise value to net capital as our valuation benchmark because it is based on physical assets and liabilities that can be measured precisely, unlike net income, which includes estimates and other arbitrary assumptions. It is a more stable valuation measure since it can be negative only under extremely rare circumstances. Finally, companies do not trade below their net capital for long periods unless there are significant assets of questionable and hard-to-determine value on their balance sheets. Consider this a simpler version of Tobin's Q Ratio, which measures market capitalization of stocks to their replacement value, but requires a vastly greater number of estimates than enterprise value to net capital.

The other element of the chart plots the 12-month forward returns for the S&P 500. In other words, for each point on the chart we've calculated the rolling return for the next 12 months. A comparison of the two series demonstrates the common sense point that lower future returns naturally follow higher valuations.

At the end of September, the S&P 500 closed trading at an enterprise/net capital valuation of 1.49x. As you can see in the chart, this comes close to the top of the range, leaving aside the crazy valuations that accompanied the telecom internet boom of the late 1990's. We don't consider this to be a tool for market timing, but it is hard to avoid the conclusion that equities are trading at historically high levels. There isn't much room left for valuations in aggregate to expand without significant growth in the global economy.

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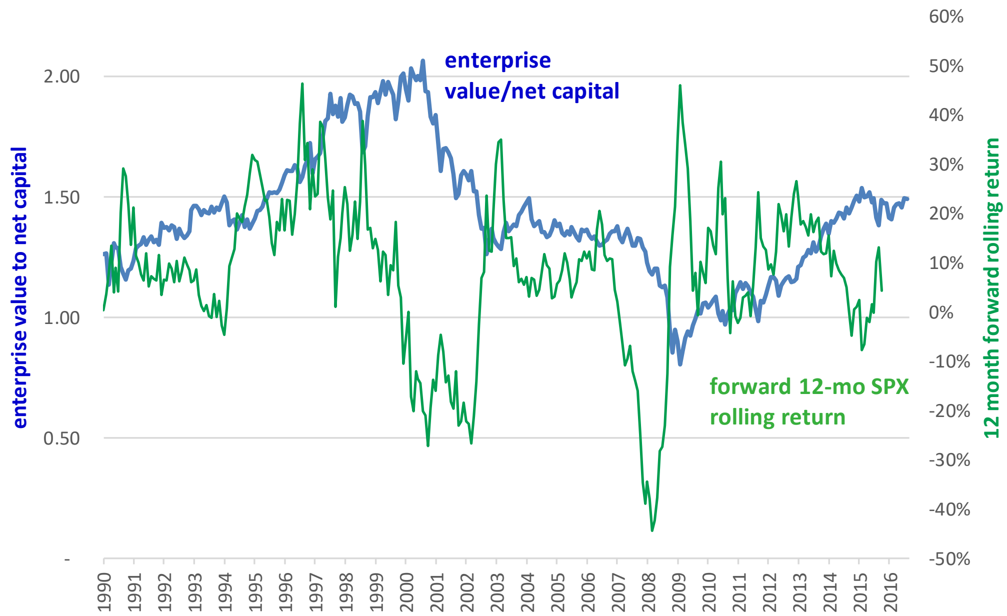
S&P 500 Enterprise Value to Net Capital versus SPX Forward 12-month Returns, 1990-2016



Portfolio Strategy and Structure

Little has changed in our portfolio over the third quarter as we have maintained the defensive posture we've held since the beginning of the year. Cash balances and our equity exposure are slightly higher than in June, while fixed income is lower as mortgage positions paid down and several corporate bonds matured in August. Please see a more detail analysis in the portfolio statistical summary included with this letter, but a briefer summary follows in the table below.

Seaport Total Asset Partners

as of September 30, 2016

Exposure and Contribution to Portfolio Returns[1] by Asset Class

						returns	
asset class	exposure	beta	duration	yield	rating	ytd	ytd contrib
Equity	27.0%	0.89	-	2.4%		10.70%	2.74%
MLP	3.7%	0.87	-	5.9%		25.19%	0.72%
REIT	3.6%	0.72	-	3.7%		16.49%	0.56%
Options	0.3%	0.19	-	-		9.52%	0.12%
Credit	29.6%	0.13	1.08	3.2%	BBB3	3.36%	1.02%
Mortgage	10.1%	0.02	2.62	3.6%	B1	2.97%	0.35%
Muni	5.3%	0.20	5.09	4.7%	BBB2	11.56%	0.55%
Commodity	1.0%	0.14	-	-		18.17%	0.25%
Cash	19.4%	-	-	-	AAA	-	-
Grand Total	100.0%	0.35	0.85	2.6%	BBB1	6.27%	6.27%

Equities *(35%)*

Equity exposure, which includes equities, MLP's, REITs, and options, rose from 32% to 35% over the quarter, but retains a conservative beta of 0.87, a measure of volatility relative to the market, versus 1.0 for the S&P 500 (the beta for the entire portfolio is 0.35).

Over the quarter, we took a position in Agrium, a producer and distributor of potash and other agricultural products, which has agreed to a merger with Potash Corporation to form a dominant, low cost, integrated company. We believe the transaction enhances the company's strategic position and positions it for attractive returns in the future.

Another new position taken in the quarter is Star Gas Partners, a distributor of home heating oil and propane to customers in the Northeast and Mid-Atlantic and consolidator in these industries. The units offer a 4.3% yield and trade at approximately 4.0x free cash flow. We also added a position in EQT GP Holdings, which operates a network of pipelines and storage facilities in the Appalachian Mountains. EQT GP also owns 100% of the Incentive Distribution Rights which we believe are quite valuable and will propel distribution growth well in excess of 20% annually for at least 3 years.

After exceptionally strong year-to-date performance in the sector, we trimmed our holdings in REITs, recognizing that the sharp upward move in share prices was primarily driven by the move in long term interest rates to historic lows. Returns in the sector propelled share prices to parity or slight premiums to our assessment of net asset value. We have also been reducing our exposure to companies in the Consumer Staples sector that have become expensive relative to the prospects and cash flows of the underlying businesses.

Fixed Income & Commodities *(46%)*

We reduced exposure in our fixed income portfolio from 49% to 45% in the third quarter as our mortgage portfolio continued to pay down at the rate of 8% per month while new positions corporate bonds were essentially replacements for bonds that matured. Overall duration of the fixed income portfolio remained steady at 1.89 versus 1.82 in June, while credit quality remained the same at crossover high yield/investment grade levels of BB+. Including our cash balances, the overall credit quality of our fixed income portfolio remains solidly investment grade at BBB+.

We continue to manage our fixed income risk actively with a short position in the iShares Investment Grade ETF (LQD), increasing the position by over 20% during the quarter to -2.5% of the portfolio. LQD enables us to reduce the duration of our fixed income holdings and limit our exposure to rising interest rates and widening credit spreads.

The biggest contributors to returns this quarter in our fixed income portfolio were corporate bonds and closed end funds, which have returned 3.4% since June. Year-to-date, however, municipal bonds remain the biggest contributor at 11.6% through September.

Our allocations to commodities, specifically gold, held flat for the quarter after a 17.7% return in the first half. Year-to-date returns came in at 18.2%.

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
October 19, 2016

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