LOSS AVERSE EQUITY INCOME STRATEGY

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Income Tranche
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We have seen a little negative volatility recently in our portfolio, and we wanted to explain why. It is from two factors, the first is the fact the market, or the S&P 500, has been hitting new highs recently, while the average stock in the S&P 500 is down over 7% from its recent high. This is a rather unusual event, and generally speaking it's associated with the later part of a bull market, or in other words, the beginning of a bear market. As we hedge our portfolio primarily with inverse S&P 500 ETFs, this has caused some underperformance, as the market has been stronger than the average stock. More significantly, our income tranche has had some negative volatility. We wanted to give our investors more detail as to why the income tranche has been weak of late. We are down a little less than 2% from our recent high, which is not much relative to the volatility of both the stock and bond market, but it is high for us.

In terms of background, we focus on equities to get income, rather than fixed income securities, as fixed income yields are extremely low, and therefore risky. We expect over time, that bond yields will rise, not necessarily due to strong economic growth, but the removal of the Federal Reserve's QE policy. By using equities to garner yield, it should dampen the downside relative to fixed income securities, as yields on income oriented equities are much higher than fixed income securities.

The sectors that we focus on to get yield, and in order of weighting in the portfolio, are business development companies (BDC's) with a 19.2% weighting, equity REITs at 7.5%, mortgage REITs at 5.7% and finally Master Limited Partnerships (MLPs) we have 1.5%, (we own through an ETF to avoid issuing a K1 to investors) which brings the total to 33.9% of the portfolio. The other sectors we focus on for income are electric utilities, and global telecom companies, which we have no current exposure.

Last year we moved money out of the mortgage REIT space and into BDC's and high yielding equity REITs because they are less interest rate sensitive. Additionally, we have a double inverse ETF in the portfolio on the 20 year treasury to take out volatility associated with rising interest rates. The BDC's are not very sensitive fundamentally to rising interest rates. What many of the BDC's do is maintain conservative balance sheets, and they borrow additional funds at fixed rates. BDC's usually lend to borrows, or their customers, at a floating rate, therefore, when rates rise they collect more income and can pay out higher dividends. As a result, some BDC's benefit from rising interest rates.

We will focus on the BDC space as it is the largest sector and frankly all of our income oriented stocks seem to be trading the same way. Around the third week of August our income stocks started to act poorly, and around the last week of August/first week of September the long end of the bond market started acting poorly. One of our favorite BDCs is MCC, but the charts all look the same, a little before the bond market fell about 6% from high to low, MCC started falling, and ultimately declined about 10% from high to low. This short term volatility in the BDC's has caused the short term volatility in our portfolio.

The Chart below is the 20 year treasury (TLT) and Medley Capital (MCC) over 3 months

The income tranche is providing very attractive income, and we are taking out as much of the volatility as possible relative to the bond market, but the issue we have is we cannot take all of the volatility out, it just is not possible. Our strategy really does not have a lot of negative volatility, but it does have some wiggle.

Over a longer period there is some volatility to the BDCs, but you can see from the chart below they tend to be pretty stable. The sector is trading toward the bottom of its range and off over 9% from its recent high.

The chart below is two years of the BDC ETF

We are using equities to get income and protecting with inverse ETFs to dampen the volatility, and even when we are very defensive and conservatively positioned we can still have some volatility. You can see by the chart below there is a great deal of volatility in the bond market which is not present in our income tranche.

The chart below is the 20 year treasury ETF over two years.

The chart below is the Franklin Income fund which is down about 2.7% from its recent high.

Generally speaking, our income stocks have very positive fundamentals, are attractively valued, and are oversold relative to the bond market and stock market.

We have explained the recent volatility in our portfolio, and if you should have additional questions we are happy to discuss further.

See reverse side for disclosures

*Performance results are presented in U.S. dollars and are net-of-actual-management fees and trading expenses of the composite and reflect the reinvestment of dividends and capital gains. Actual fees may vary based on, among other factors, account size and custodial relationship. *Annual returns are compounded over the specified period. The current dividend yield is calculated gross of fees as of quarter end date. No current or prospective client should assume future performance of any specific investment strategy will be profitable or equal to past performance levels. All investment strategies have the potential for profit or loss. Changes in investment strategies, contributions or withdrawals may cause the performance results of your portfolio to differ materially from the reported composite performance. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will either be suitable or profitable for a client's investment portfolio. Historical performance results for market indices generally do not reflect the deduction of transaction and/or custodial charges or the deduction of an investment-management fee, the incurrence of which would have the effect of decreasing historical performance results. Economic factors, market conditions, and investment strategies will affect the performance of any portfolio and there are no assurances that it will match or outperform any particular benchmark. Portfolios in the composite utilize levered index products. Leveraged ETFs are considered risky. The use of leverage strategies by a fund increases the risk to the fund and magnifies gains or losses on the investment. You could incur significant losses even if the long-term performance of the underlying index showed a gain. Most leveraged ETFs "reset" daily. Due to the effect of compounding, their performance over longer periods of time can differ significantly from the performance of their underlying index or benchmark during the same period of time. Exchange traded funds (ETFs) are offered by prospectus only. Investors should consider a fund's investment objective, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other important information, is available from your Financial Advisor and should be read carefully before investing. The investment return and principal value of an investment will fluctuate, so that an investor's shares, when redeemed, may be worth more or less than their original cost. ETFs trade like stocks and may trade for less than their net asset value. The S&P500 Total Return Index is the total return version of the S&P 500 Index which includes the effects of reinvested dividends. The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS. The U.S. Aggregate rolls up into other Barclay's flagship indices, such as the multi-currency Global Aggregate Index and the U.S. Universal Index, which includes high yield and emerging markets debt. The U.S. Aggregate Index was created in 1986, with index history backfilled to January 1, 1976.The investment strategy and types of securities held by the comparison indices may be substantially different from the investment strategy and the types of securities held by the PVG Equity Income strategy. PVG Asset Management ("PVG") is a registered investment advisor with the United States Securities Exchange Commission (the "SEC"). SEC registration does not constitute an endorsement of the firm by the Commission nor does it indicate that the advisor has attained a particular level of skill or ability. Inception for the Equity Income strategy is 10/1/2010; prior performance represents the Income portion of the Balanced Strategy Composite, which PVG believes was managed with the same investment goals. Composite performance represents the results of the PVG management team, which has changed over time due to retirements and new staff. Additional information is available upon request.*