REGAL

Total Return

Market Summary

The equity markets continued to chug higher in the second quarter. This advance occured despite some mixed economic data while the Federal Reserve (Fed) looked through disappointing inflation readings and further tightened monetary policy. At the June meeting of the Federal Open Market Committee the US central bank raised base rates by 25 basis points and set out detailed plans to reduce its balance sheet. Many forward-looking activity indicators failed to build on the highs they achieved in Q1 2017, including those tracking the health of the manufacturing and consumer sectors. However, official consumer spending data remained resilient, adding to hopes the US economy would bounce back in the second quarter following **GDP** growth of 1.4% in Q1.

Political uncertainty remained an important feature in the market as President Trump dismissed FBI director James Comey. This raised doubts over the ability of the administration to push its fiscally expansive policies, and weighed on the dollar. The dollar was further negatively impacted amid rising expectations that central banks in other major developed economies are also preparing to tighten monetary policy.

Large cap equities outperformed small and mid-caps over the period, with the **Russell 2500** and **Russell 2000** recording respective total returns of 2.1% and 2.5% vs. a return of 3.1% for the **S&P 500**. Healthcare, industrials and financials were among the top-performing sectors, while consumer staples, energy and telecommunication services underperformed.

Our fund posted another positive quarter. Our diversification did dampen some of the upside, but we believe that this is a price we are willing to pay to attempt to mitigate potential volatility.

Thoughts on Active Management

One of the main arguments of the passive investor is to say that the expense ratio of an actively managed mutual fund, *on average*, is too high to beat an index or smart beta fund after fees and expenses. Within the closed loop world of academia where all investments return the same amount, this is clearly true. However, in the real world, managers that produce **alpha** through a disciplined, principled, systematic process, are more than worth the expense. Rarely do academics explore the true cost of index investing, which can be considerable.

Evidence Against Passive Investing

The research relied upon by the passive investment community does not control for specific variables of active managers and instead, views active managers in the aggregate, attempting to form an average from which conclusions can be drawn about active investing. This fails to provide investors with actionable information to build a portfolio with, and instead constitutes nothing more than marketing propaganda for the passive investment followers. Not all active investment managers are the same and passive investors should not imply that they are.

For example, researchers at Vanguard put out a paper entitled " The Case for Index Investing" it is routinely referenced by passive investors as "proof" of the superiority of passive investing over active management. On page 4, in the section entitled "Record of Actively Managed Funds," the authors make the argument that the vast majority of actively managed mutual funds have underperformed the market. While I would take issue with the methodology used to reach this conclusion, the authors contention is true when we are analyzing the large number of "active" managers that are merely closet indexers posing as active management. To the extent that an active manager is closet indexing at a higher fee, it is obvious that they will underperform. In this sense the authors are correct in asserting that an investor would in fact be better off with an index fund, when the alternative is a closet index, high fee fund. However, when compared against active managers generating alpha through sound processes and potential risk mitigation, there is a clear opportunity for outperformance.

More times than not, when a passive index is compared to a disciplined investment manager, employing a systematic process of security selection, and aiming to control risk, the data has shown that the active manager had attractive returns. When the active manager does well, the investors who entrust them with their hard-earned capital perform well.

The Case for Active Management Explored

A recent paper by the storied investment firm, Dodge & Cox, sought to demonstrate the advantages of active management. In their research paper Understanding the Case for Active Management the team at Dodge & Cox found that:

"While many active equity managers do not outperform the market in any given year, there are a number of skilled active investment managers who have outperformed over long investment horizons. However, in order to benefit from this kind of long-term outperformance, investors must be prepared to take a long-term view and have the discipline to withstand inevitable periods of underperformance. Those who stay the course are more likely to achieve meaningful incremental results that accumulate over time. Academic and industry research has identified six attributes of active managers who have the highest probability of generating above-benchmark long-term results. This research has also confirmed that investors are well advised to take a long-term view, not only because few investors can accurately time the stock market, but also because few can effectively time their decisions to hire and fire investment managers."

They continue:

"An index fund is not risk-managed: It contains all of the issues-and all of the risks-associated with an index, such as the S&P 500. While the index fund manager is obliged to invest in companies presenting a wide range of risks, an actively managed portfolio can seek to avoid the securities that embody the greatest risks. This creates the opportunity to reduce risk that is not provided by a passive investment in an index."

An index funds lack of price sensitivity when purchasing equities, means investors are buying more and more of a company's stock as the market cap increases. This makes no sense, when investors should understand Warren Buffets mantra of investing, price is what you pay, value is what you get. Index investors are thus paying high prices, limiting their potential future return, and maximizing their risk. Therefore, an investment in an index fund, is nothing more than an average return for maximum risks. I don't think that is what investors, particularly retirement investors want in their investment strategy.

Please note: The views in this material are intended to assist readers in understanding certain investment methodology and do not constitute investment. Please consult your advisor. The views in this material were those of the author as of the date of publication and may not reflect their view on the date this material is first published or any time thereafter.

DEFINITIONS:

Gross Domestic Product (GDP): is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

S&P 500 Index: is an unmanaged index fo 500 common stocks primarily traded on the New York Stock Exchange, weighted by market capitalization. Index performance includes the reinvestment of dividends and capital gains.

Russell 2000: is an index measuring the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks.

Russell 2500: is a broad index featuring 2,500 stocks that cover the small and mid-cap market capitalizations. The Russell 2500 is a market cap weighted index that includes the smallest 2,500 compaines covered in the Russell 3000 universe of United States-based listed equities. You cannot invest directly into any index.

Alpha: takes the volatility (price risk) of a mutual fund and compares its risk-adjusted performance to a benchmark index. The excess return of the fund relative to the return of the benchmark index is a fund's alpha.

RISKS:

There can be no guarantee that any strategy (risk management or otherwise) will be successful. All investing involves risk, including potential loss of principal.

Emerging Markets securities tend to be more volatile and less liquid than securities in developed countries. Foreign Securities involve risks related to adverse political and economic developments unique to a country or region, currency fluctuations or controls. The Fund invests in exchange traded funds (ETFs) which are securities of other investment companies. An ETF seeks to track the performance of an index by holding all, or a sampling, of the securities of that index, and may not be able to exactly replicate the performance it seeks to track. Shareholders of the Fund bear their proportionate share of the other investment company fees and expenses as well as their share of the Fund fees and expenses. **Small-cap and Mid-cap** company stocks are considered riskier than large-cap stocks due to greater potential volatility and less liquidity.

An investor should consider the Fund's investment objectives, risks, charges, and expenses carefully before investing. This and other important information about the investment company can be found in the Fund's prospectus. To obtain a prospectus, please contact your financial advisor or please call 844.66.REGAL(73425). Please read the prospectus carefully before investing.

IMST Distributors, LLC, Distributor of the Regal Total Return Fund