That Giant Sucking Sound

Equity values for the US market, international markets, and ACR holdings were essentially flat in 2015.

2015 Total Return

EQR Net 1.25%[1]	-0.4%	**S&P 500**	1.4%
ACR Multi-Strategy Quality Return (MQR) Fund[2]	-1.9%	**MSCI ACWI**[3]	-1.8%

[1]EQR (Net 1.25%) is the total return (dividends and capital appreciation) of the Equity Quality Return Advised SMA Composite calculated net of a 1.25% hypothetical annual fee. The EQR (Net 1.25%) return calculation is supplementary information based on the average recommended fee schedule across our client/partner base. Please refer to our full composite performance presentation with disclosures published under the performance section of our web site at www.acr-invest.com. Actual fees may be higher or lower than 1.25%.

[2]MQR Fund returns are net of fees and include the reinvestment of all income and accrual of dividends as of the ex-dividend date for the I share class fund (MQRIX).

[3]MSCI ACWI (All Country World Index) returns are reported gross of withholding tax.

ACR's portfolio companies paid dividends, and the ACR investment team estimates that the overall intrinsic value of the portfolio grew, even though the value creation failed to register in this year's market return. A far longer period than a year is necessary to be sure that market prices and intrinsic values have had sufficient time to converge.

Full Cycle Total Return

	EQR Net 1.25%[4]	**S&P 500**
Since Inception (4/3/2000 – 12/31/2015)	10.8%	4.0%
Most Recent Full Cycle (1/1/2008 – 12/31/2015)	9.2%	6.5%

[4]EQR (Net 1.25%) is the annualized total return (dividends and capital appreciation) of the Equity Quality Return Advised SMA Composite calculated net of a 1.25% hypothetical annual fee. The EQR (Net 1.25%) return calculation is supplementary information based on the average recommended fee schedule across our client/partner base. Please refer to our full composite performance presentation with disclosures published under the performance section of our web site at www.acr-invest.com. Actual fees may be higher or lower than 1.25%.

While a year is too short to draw conclusions about market and intrinsic returns, we still find it useful to track intrinsic value changes yearly. Intrinsic results are more stable and ultimately determine market returns. ACR estimates that the EQR portfolio intrinsic value increased 6.5%[5] last year. Adding a dividend yield of 2.2%, the total increase in value was 8.7%[5]. Given an inflation rate of 0.7%, 2015 was a satisfactory year for EQR's companies, if not their stocks.

[5]The EQR portfolio intrinsic value is based on ACR's weighted average estimate of the intrinsic value of each portfolio company. Appraised intrinsic values and returns are estimates. Actual returns may vary widely from those estimated. Past returns are not indicative of future results.

Even though 2015 was a flat year for market returns and a pedestrian year for intrinsic values, much was going on underneath the surface. The giant sucking sound of declining demand coming out of China

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drove a collapse in major commodities and a recession in emerging market (EM) economies. In the US and EU, the security prices of companies with exposure to commodities and EM economies declined precipitously.

What was going on underneath the surface in 2015 has bubbled up in 2016, or should we say down. Broader financial markets in the US, EU and Japan have declined significantly and have become more volatile. The contagion appears to be psychological, as all indications so far this year indicate that the broader US economy has not entered a recession. Yet the direct and indirect effects of a hard landing in China could conspire to produce a global recession.

The ACR investment team is observing these effects at the company level. As demand for natural resources plummets, so does the demand for train carloads of freight, valves and pumps for processing liquids, new loan demand of impacted companies and so on down the supply (and demand) chain. At the same time, stretched US and EU consumers have not yet responded to lower commodity prices with expected increases in consumption.

The specific circumstances are always different, but the general storyline remains the same. Economic turmoil has reared its head multiple times in every generation since markets have existed. As the economic historian Charles Kindleberger remarked, financial crisis is a “hardy perennial.” The ACR investment team finds it helpful to consider several concepts when contemplating the inevitable financial crisis or the more mundane recession: acknowledged unpredictability, advance preparedness, patience, opportunity and prosperity.

Economic events seem predictable with hindsight. For example, the US housing bubble was no secret. Pundits and real economists warned us many times over (including our very own macroeconomic advisor Steve Fazzari). Same with the China bubble. The problem is that a bubble cannot be truly confirmed until it pops. Even those who properly spot the bubble in advance do not know the precise timing nor the magnitude of the economic tsunami to follow. Timing and transmission are unpredictable: we simply have not figured out the economics, and human behavior is itself unpredictable. Investors would do better to be clear about what they do not know and waste neither time nor money speculating about unpredictable events.

Rather than speculating, we are more like Noah preparing for the flood which will someday come. ACR’s investment Ark is built of two materials: quality and price. The enterprise or government cash flows to which we have attached our financial claims must be durable, and the price we pay for the stocks and bonds which have a claim on those cash flows must secure a satisfactory absolute return. When such returns cannot be secured, we sit on cash. ACR may adjust the quality of our holdings depending upon the values we find, yet we never compromise a base level of quality capable of withstanding a 100 year economic flood.

Price is our ultimate weapon, value our compass. Seeking securities with the lowest prices relative to values is the best way to navigate economic turbulence. Patience is the key. For example, our purchases in 2008 declined still further in early 2009 when we bought still more. Despite the short term declines, our purchases in early 2008 were profitable by the end of 2010. When a sound return can be secured at a specific price, we do not wait for additional short term price declines. Anticipating short term price movements is in our opinion nearly impossible. “Don’t catch a falling knife” is a catchy phrase, but poor advice. “Strike while the iron is hot” would be more apropos, even if it gets a little hotter.

Recent declines are presenting opportunity. Our primary on deck list of approximately 500 companies has gone from a paltry half dozen or so at the end of 2014 to over 70 today. For the first time since 2012, the ACR investment team is beginning to find more to buy than to sell. The slow process of accumulating our cash pile in EQR by selling 14 stocks and only purchasing 9 since 2012 is reversing. And almost all securities under review are significantly lower in price than they were over the past few years as our cash position grew.

Yet we will not jump at every opportunity. In 2008 when investment banks began to register as statistically cheap, ACR went on record saying we would not bite. In January of that year we wrote: “Alpine will avoid some investments regardless of how attractive they look. Looks can be deceiving. Today, many financial institution balance sheets are like black boxes. A massive casino of esoteric financial instruments has developed in recent years to which all major banks have exposure. The underlying risk and value of these instruments cannot, in many cases, be reliably assessed.” Today the US financial system is on solid ground. It’s not the investment banks that are looking inordinately cheap, and possibly dangerous, this time around.

China’s investment-led demand is today’s culprit. China is not going away, but its modestly over $4 trillion per year of capital investment is unsustainable. The exact level is difficult to quantify. We will not purchase companies whose revenues and profits mostly rely on a source of demand which is unsustainable and difficult to reliably assess. As for oil, gas and other commodity related companies, we are sifting through the rubble. The ripest area for opportunity in our opinion consists of cheap industrial companies with modest exposures to Chinese investment demand and commodity sensitivity. In our opinion completely indiscriminate selling has not yet taken hold. We hope it does, as such an environment generally presents the very best opportunities.

The great irony of investing is that major price declines create opportunity. Short term pain produces long term gain; assuming one has the cash, flexibility and valuation acuity to capitalize upon the malaise. The other pillar of opportunity is the continued rise in standards of living which market based economies have enjoyed for the past few hundred years. ACR is concerned about current economic conditions, yet we believe that nothing has changed in the long term outlook for the US and world economy. The goose which laid the golden egg of human prosperity in the early days of the Industrial Revolution – that is, market economies and the rule of law – is alive and well. Healthy free market economies have always produced market turmoil; our job is to protect and profit from it.

Nick Tompras
January 2016

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- *Investing in the Fund carries certain risks.*
- *The value of the Fund may decrease in response to the activities and financial prospects of an individual security in the Fund's portfolio.*
- *The Fund is non-diversified and may invest a greater percentage of its assets in a particular issue and may own fewer securities than other mutual funds.*
- *The performance of the Fund may be subject to substantial short term changes. Stocks of smaller companies may be subject to additional risks, including the risk that earnings and prospects of these companies are more volatile than larger companies.*
- *When the Fund invests in fixed income securities, the value of your investment in the Fund will fluctuate with changes in interest rates. Typically, a rise in interest rates causes a decline in the value of fixed income securities owned by the Fund. The Fund may invest in high-yield, high-risk securities, commonly called "junk bonds", that are not investment grade and are generally considered speculative because they present a greater risk of loss, including default, than higher quality debt securities. Emerging market countries may have relatively unstable governments, weaker economies, and less-developed legal systems with fewer security holder rights.*
- *The Fund's use of futures involves risks different from, or possibly greater than, the risks associated with investing directly in securities and other traditional investments. These risks include (i) leverage risk (ii) risk of mispricing or improper valuation; and (iii) the risk that changes in the value of the futures contract may not correlate perfectly with the underlying index.*
- *Investments in inverse ETFs will prevent the Fund from participating in market-wide or sector-wide gains and may not prove to be an effective hedge.*
- *There are risks associated with the sale and purchase of call and put options. As the seller (writer) of a covered call option, the Fund assumes the risk of a decline in the market price of the underlying security below the purchase price of the underlying security less the premium received.*
- *If a security sold short increases in price, the Fund may have to cover its short position at a higher price than the short sale price, resulting in a loss.*
- *Leveraged ETFs employ financial derivatives and debt to try to achieve a multiple of the return of a stated benchmark or index over the course of a single day. The more leverage used, the greater the potential magnification of gains or losses on those investments.*
- *These factors may affect the value of your investment.*