Centre Funds Insight – Spring/Summer 2016 Market Review & Outlook – Multi-Asset Fund

Our process in managing the Fund remains flexible and allows us to opportunistically shift emphasis to each of the various asset classes as conditions warrant based upon the ability for each asset class to perform best during particular market environments. For example, during the period we maintained our zero exposure to all industrial, non-precious metal Commodity-Linked securities and tactically added to U.S. equities after their early 2016 correction. In general, incorporating asset classes such as Commodity-Linked ETNs and ETFs, Real Estate Investment Trusts, and ETNs and ETFs with returns linked to REIT Indexes, that are sometimes inversely or less correlated to U.S. stocks and bonds held within more traditional balanced funds, should offer enhanced diversification benefits and the ability to take advantage of the changes in asset class performance that may take place with changes in different inflationary or deflationary environments. The Fund is designed to help reduce the level of risk that comes from concentrating in a single asset class. Additionally, we aim to emphasize asset classes we believe are poised to perform best based on our understanding of how different asset classes respond to the level of inflation or deflation and changes in economic conditions. The result is a broadly diversified portfolio that could be viewed as a core flexible balanced type holding or as a complement to existing equity or fixed income strategies. Also, given that certain historical correlations between asset classes tend to change, particularly during periods of market stress, the Fund is able to take defensive positions in an attempt to respond to adverse market, economic, political, or other conditions when deemed tactically prudent.

We continue to see competing inflationary and deflationary forces in a "tug of war", namely ultra-accommodative monetary policy now in its eighth year on one hand and aging demographics with the baby booming generation just beginning to retire in earnest on the other hand, respectively. We think the longer-term risk of inflation is higher than it has been in quite some time. However we also recognize that shorter and intermediate- term market signals such as an appreciating U.S. dollar, economic weakness globally and slack industrial capacity have given deflationary pressures the upper hand and will continue to do so for the foreseeable future. ***The irony is that we expect inflation to increase only after a sustained period of deflation which may result in a change in central bank and fiscal policies that target nominal growth rather than real growth due to continued underwhelming levels of productivity, with, perhaps, a near abandonment of inflation stability.***

Since the 2008 financial crisis, investors have experienced a prolonged period of abnormally low interest rates. Since 2010, the expectation was that rates would revert back to more normal levels, once the financial and housing crisis had passed. In 2011 and 2012, the conviction was that it was central banking policy that was keeping rates low, and that once banks stopped or slowed down quantitative easing, rates would rise. In 2013 and 2014, it was easy to blame one crisis or the other (e.g., Greece) for depressed rates. In 2015, the talk shifted to commodity price driven deflation and China's excess capacity and slowdown being responsible for rates being low. The end result is that with each passing year, the conviction that rates will rise back to what people perceive as normal recedes and the floor below which investors thought rates would never go has become even lower. In fact, last year we saw short term interest rates in at least two currencies (Danish krone, Swiss franc) become negative and this year, the Japanese yen joined the group, with the euro maybe the next currency to breach zero nominal interest rates. When central banks in these currencies strongly signal their intent to drive interest rates to zero and below, their intent is that lower interest rates lead to higher prices for financial assets and more real investment in the economy, either through the mechanism of lower hurdle rates for investments or a weaker currency making businesses more competitive globally. Unfortunately, ***theory has not yet translated into the applied and it has not worked thus far despite nearly eight years of implementation. That is, as interest rates globally test new lows each year for the last few, we have not seen an explosion in real investment in these countries***. However,

stock prices have risen but this has not transmitted significant benefits to economies in what is sometimes called a "wealth effect.s" Part of the reason for the lack of transmission is that devaluing exchange rate effects from declines in interest rates have been muted by other central banks acting at the same time, i.e., euro versus the yen versus the yuan, etc. From our perspective, negative interest rates are bad news, since they are incompatible with a healthy, growing economy and we're reminded by central bank actions of the old definition of insanity as trying the same thing over and over, expecting a different outcome. After nearly eight years of continually lowering interest rates hoping that it will lead to economic expansion, it is time for central banks to perhaps recognize that this lever is not working. By the same token, the very fact that central banks revert back to the interest rate lever every time there is financial market distress or economic indicators when the evidence suggests that it has not worked, seems to indicate a sign of desperation, an admission by central banks that they have run out of ideas.

The big concern is that of unintended consequences. Namely, as interest rates hit zero and go lower, there have been many investors, in need of fixed income, who look in high risk places for that income. Investors who chased after high yield bonds, master limited partnerships (MLP) and other high dividend paying entities likely experienced pain starting in 2015. We don't see this abating. The inconvenient truth is that the long-term trend of growth is declining globally. The math is simple. Potential labor force growth is likely to average only about ½ percent per year for the foreseeable future, and U.S. labor productivity growth may stay around ½ percent a year, its average for the last five years. These add up to 1 percent potential GDP growth. Actual GDP growth can surpass this level during a cyclical upswing but, more importantly, lower during a cyclical slowdown as we're experiencing currently. This is a challenging problem, with demographics practically set in stone, and a boost to productivity growth uncertain. Consequently, in our view, after years of abnormally low interest rates and Quantitative Easing (QE)1 attempting to pull demand forward from the future, central banks are increasingly powerless when it comes to the economy itself. They can "print" money, but not economic growth.

If U.S. growth keeps slowing this year, recession risk in 2016 should rise, and the Federal Reserve may revisit negative interest rates as we've seen in other areas. Ultimately, only policies that genuinely address the challenges of demographics and productivity have a chance to succeed but we see little likelihood of measures being introduced to address these. The failure of U.S. fiscal policy to stimulate growth has caused dependency on this unprecedented and massive monetary easing and it is unlikely that monetary policy will suddenly transmit growth stimulus to the real economy (as opposed to financial assets) when it has not in the past eight years given the collapse in monetary velocity[2].

On the outright deflationary side, in a number of industrialized countries, including the U.S., on the assumption that fertility remains at or close to present levels, populations will start to decline and, in some cases, do so quite rapidly in the near future. The impact on developed societies will likely be decreasing demand for goods and services but increasing pension liabilities. This can be crushing in terms of taxation on younger workers and a potential source of unrest and political disruption. Japan, the pathfinder of this phenomenon as it embraced Western family planning even before Europe and the U.S. and where adult diapers now outsell those for children, shows the debilitative impact from an aging society and need to resort to new radical inflationary macroeconomic policies to combat its ill effects. No developed world

[1] "Quantitative easing" refers to steps that the U.S. Federal Reserve takes in attempting to boost the country's lagging economy. Historically, the Fed's main tool for spurring growth has been lowering short-term rates. However, QE employs expansionary monetary policy, which involves the purchasing of bonds when the interest rate can no longer be lowered. In September of 2012, the Fed announced its third round of quantitative easing, often abbreviated to "QE3."

[2] The rate at which money is exchanged from one transaction to another, and how much a unit of currency is used in a given period of time. Velocity of money is usually measured as a ratio of GNP to a country's total supply of money.

country is immune from this significant problem which is just starting to be felt in Europe, the U.S., and elsewhere.

Current market conditions and trends have created a myriad of possible outcomes over the next few years that are likely to contribute to a rise in the level and volatility of long-term inflation expectations, but only after a sustained period of deflation and, increasingly, recession. This is due to the ***negative macro circumstances being unlike any in the past and our lack of confidence in the ability of public officials to manage them given the unprecedented fiscal and monetary policy employed thus far and without the expected efficacy as seen in the past***. The Centre Multi-Asset Real Return Fund will attempt to deliver on maintaining investor purchasing power of today's dollar in nominal terms plus attempt to deliver a positive real return on capital by using its tactical flexibility across broad asset classes with the added ability to take defensive positions under volatile market conditions and when the potential for large drawdowns is perceived to be highest.

James A. Abate, MBA, CFA, CPA

Fund Manager – Multi-Asset Real Return Fund

Managing Director & Chief Investment Officer

Centre Asset Management, LLC

<u>Disclosures</u>

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