DENALI

Advisors, LLC

Quarter I, 2017 Performance Review

NV International

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International Markets

The first quarter of 2017 saw strengthening in international economic conditions, in both developed and emerging markets, helped by strong U.S. import growth. Reported growth in Chinese GDP stabilized, and European economies were strong enough for the European Central Bank to contemplate rolling back its economic stimulus. The IMF forecasts the global economic growth rate to rise from its post-financial-crisis low of 3.1% in 2016 to 3.5% in 2017, close to its average since 1980. In response, the international equity market produced strong returns in the quarter, with the MSCI World ex US index gaining 6.95% (6.81% net of withholding taxes) in dollar terms, amplified by the dollar's 3% reversal against other major currencies. Dispersion between sectors was relatively muted in the quarter, but Technology solidly outperformed the overall market, and the cyclical Industrials sector, particularly Capital Goods, also did well. The Energy sector was the only loser in the quarter, pulled lower by a 6% drop in the price of crude oil. These sector dynamics produced outperformance for the Growth style index over Value in the quarter. The Financial sector was an average performer, as long-term interest rates in major markets remained fairly stable (still negative in Switzerland and flat-lined at zero in Japan). Spain was the best-performing developed market in the quarter as the Spanish economy grows faster than the rest of Europe. Hong Kong and Singapore, along with Australia, also outperformed as confidence in Chinese growth solidified. The weight of the oil industry put Norway and Canada at the bottom of the performance ranks for this quarter along with New Zealand, but all countries produced a positive return.

Denali Performance Analysis

Denali's NV International strategy continued to outperform in the first quarter of 2017. Denali's NV International composite returned 7.85% in the quarter before fees (7.80% net), 0.90% ahead of the benchmark MSCI World ex US index return of 6.95% (6.81% net of tax withholding). For the year ending in March, NV International gained 17.03% (16.74% net) vs. 12.52% (11.93%) for the benchmark, an active return of 4.51%. For the sixteen month period since its inception, NV International has returned 12.05% annualized (11.74% after fees), outperforming the benchmark's 6.34% gain by 5.71%.

Our Network Value index reference portfolio returned 7.79% in Q1, essentially accounting for our composite's outperformance. However, with Value underperforming in the period, the cross-sectional performance of the NV Arbitrage forecast was only modestly positive. Our intrinsic value forecast model's performance was basically neutral in the quarter. Our characteristics trend model had somewhat negative predictive performance in this period. The most negative factor impact was from our position favoring lower price relative to book value, consistent with the underperformance of Value in the quarter. Our trend model's continued correct forecast of underperformance for higher accruals/assets stocks again helped us to mitigate our exposure, and this was also the case for our exposure to stocks with lower gross profit margin. Higher sales to price and lower cap ex to sales provided the most positive factor impacts. We were also helped by the model's forecasts favoring the Asia ex-Japan region and disfavoring the Energy sector. Our earnings estimate revision model performance was also somewhat negative on average this quarter. The performance of the combined composite forecast was about neutral for the quarter, consistent with our portfolio performing in line with the Network Value index.

Barra analysis shows that we were surprisingly helped by our positive exposure to their composite Value factor, but hindered by our smaller market cap size. Our exposures to individual country factors were also positive in their framework.

Our active positioning among countries had a slightly negative effect on the quarter's performance, but again outweighed by our successful selection within countries. Our most positive exposures were our overweights to Hong Kong and Singapore (which were the most negative in Q4), while we had negative impacts from overweighting Israel and underweighting Spain and Australia. We benefited significantly from good stock selection results in Japan and Hong Kong, partly offset by negative results in Germany and Austria.

Our portfolio's active sector positioning was approximately neutral to performance in Q1, with the gain from underweighting Energy offset by net losses from positions in other sectors. Our positive active return was mostly accounted for by successful stock selection within sectors. Our stock selection within sectors was particularly advantageous in the Industrial sector and also positive in Technology, Financials and Real Estate, but produced negative results in the Utilities and Telecom sectors.

Outlook

Consensus expectations are for world economic conditions to continue gradual strengthening in coming months. The U.S. Federal Reserve should continue with gradual rate increases, and no further monetary stimulus is likely from central banks in Europe. Thus, long-term interest rates will probably at last begin to move upwards to more normal levels as foreign bond markets compete with higher U.S. debt yields. This will eventually begin to pressure valuation multiples, especially for those stocks which investors have sought for income yield, as well as those whose prices are more heavily based on expectations for future growth. In the equity markets, given the strong upward move of the first four months of this year, we expect some period of consolidation in the short term with more muted gains and relative outperformance for those stocks whose valuations have not yet risen as much. As we saw this past quarter, U.S. oil production elasticity should limit any increases in oil prices, providing stability for consumers but limiting the potential returns of Energy sector equities. In the mid-to-long term we hold to our valuation-based forecast for Value stocks to outperform Growth (see our Research Review "Value has Turned a Corner," June 3, 2016). The higher and more stable average earnings produced by Denali's investment strategies should prove advantageous

Disclosures

Returns are presented gross and net of management fees and include the reinvestment of all income. Past performance is not indicative of future results. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Denali was established in 2001 and manages equity and alternative assets for primarily institutional clients. The U.S. dollar is the currency used to express performance.

NV International: Composite consists of fully discretionary International (large cap) portfolios. Results are compared against the returns of the MSCI World ex-U.S Index and intended to outperform this benchmark while maintaining similar sector, industry and security characteristics. The NV International portfolio construction is based on the analysis of earnings, liquidity and other characteristics of selected large and mid cap companies from developed international stock markets (e.g. the markets represented in the MSCI World ex-U.S Index). The Denali NV International Composite was created November 30, 2015. Portfolio rebalancing is done monthly or more frequently if judged to be advantageous. The fee schedule for this product is 0.75% on the first $50 million, 0.65% on the next $50 million, and 0.50% on the balance. Actual investment advisory fees incurred by clients may vary. There is a marketing minimum of $10 million. Client returns will be reduced by advisory and other expenses the client may incur. Net returns have been calculated by reducing gross returns by actual management fees incurred. Leverage is not used.