DENALI

Advisors, LLC

Quarter I, 2017 Performance Review

NV Large

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Market and Economy

Economic conditions in the U.S. continued to strengthen in the first quarter of 2017. Reported GDP growth for the fourth quarter was slightly higher than expected at 2.0% year-on-year, benefiting from strong increases in private investment and consumer spending, with first quarter growth estimated at 2.2%. With (perhaps surprisingly) strong U.S. import growth, global conditions improved as well, with reported Chinese growth stabilizing, and European economies strong enough for the European Central Bank to contemplate rolling back its monetary stimulus. U.S. unemployment fell to 4.7%, near its estimated structural floor, while S&P 500 company profits grew strongly at 17% over the prior year, with further brisk increases expected in the short term. With headline CPI inflation expected to double to 2.5% in 2017 (though "core" metrics looking more moderate), the Federal Reserve Board lifted the Fed Funds rate by a widely expected 25 bp at its March meeting, and signaled its intention for regular further increments. Long term interest rates actually held quite steady during the quarter, settling from 2.45 to 2.40% after last quarter's 50% rise, having touched 2.6% just before the Fed's meeting. The U.S. dollar retreated about 3% from the 14-year high reached at the end of 2016. The price of oil gave up about half of its rise from Q4 on reports of plentiful supplies in March, ending the quarter below $51.

Russell Index Returns, Q1 2017

	Q1 2017		
Index	All	Growth	Value
Russell 3000	5.74%	8.63%	2.99%
Russell 1000	6.03%	8.91%	3.27%
Russell Midcap	5.15%	6.89%	3.76%
Russell 2000	2.47%	5.35%	-0.13%
Russell Microcap	0.38%	2.63%	-1.02%

With expectations or hopes for higher growth seeming to be confirmed, U.S. stock prices rose briskly in January and February as the new administration took office, reaching new record highs in early March. The rise stalled out in March, however, as the failure of Congress to pass a health care reform bill raised the prospect that business-friendly policy changes (e.g., a lowering of corporate tax rates, increasing net earnings and supporting stock prices) would be at least delayed. For the quarter, the broad Russell 3000 Index did gain a fairly impressive 5.7%. Dispersion in returns remained quite high, and there were quite a few reversals of relative performance within the market from last quarter. For example, the Health Care sector, last quarter's laggard, solidly outperformed with a 9% return, led by technology and equipment companies, while the previous quarter's leader, Financials, underperformed at 2.2% in the absence of further gains in long term rates. This quarter's leading sector was Technology, seen both as able to produce growth and as an odd sort of safe haven, less affected by policy uncertainty. Consumer Discretionary stocks also outperformed, with a 7.9% return for the sector. The Energy sector was the weakest for the quarter, tracking the price of oil with a 6.8% loss. Telecomm stocks also lost ground with a 3.5% decline. The reversals in relative sector performance produced a switch for style indexes as well, with Growth outperforming Value in all size categories, while larger cap stocks solidly outperformed smaller cap stocks, again reversing from Q4.

Denali Performance

	Q1 2017			One Year			Since 9/30/2012		
Strategy	Gross	Net	Bench-mark	Gross	Net	Bench-mark	Gross	Net	Bench-mark
Denali NV Large	4.71%	4.65%	3.27%	17.09%	16.80%	19.22%	16.12%	15.72%	13.66%
Denali NV Mid	3.32%	3.22%	3.76%	21.31%	20.87%	19.82%	17.92%	17.51%	15.15%
							Since 5/31/2013		
Denali NV Small	-3.19%	-3.44%	-0.13%	23.87%	22.69%	29.37%	13.84%	12.74%	10.89%
							Since 12/31/2013		
Denali NV Micro	-2.39%	-2.70%	-1.02%	30.43%	28.90%	33.27%	10.54%	9.19%	7.04%

Returns for Denali's NV Large, Mid, Small and Micro composites are presented gross and net of management fees. Please refer to disclosures at the end of this commentary.

The active performance of Denali's U.S. strategies was mixed during the first quarter, with our NV Large strategy outperforming strongly, but our Small and Micro cap strategies significantly behind their benchmarks. This was partly due to the fact that we were overweight in Technology vs. our Large Value benchmark, but underweight in the small cap portfolios, and partly due to the unusual circumstance that some valuation factors, notably both current and forecast earnings-to-price ratios, produced positive results among large caps but negative within the small cap universe. All Denali strategies are well ahead of benchmark for the period since the inception of the Network Value based forecasts. Denali's NV Large composite returned 4.71% in the quarter before fees, 1.44% ahead of the benchmark Russell 1000 Value Index return. For the trailing year, NV Large returned 17.09%, trailing the very strong 19.22% benchmark return by 2.13%. For the 18 quarter period since its inception, NV Large has returned 16.13% annualized, outperforming the benchmark's 13.66% return by 2.46% annually before fees.

The return of our Network Value reference portfolio was 5.36% for Q1, more than accounting for our strategy's positive active performance in the quarter. However, the cross-sectional performance of the NV Arbitrage forecast model was slightly negative for the period (not surprising given the underperformance of Value). Our Characteristics Trend model also had somewhat negative predictive performance in the first quarter. The most negative impacts on our portfolio were from incorrect forecasts of outperformance for stocks with higher sales-to-price and sales-to-assets ratios and with higher ROE, all three of which had been significant positive contributing factors in the prior quarter, and in the case of sales-to-assets for the seven previous quarters running. We did benefit from a correct prediction of outperformance for stocks with higher forecast earnings-to-price ratios, and the sector trend portion of the model was also successful, particularly in favoring Technology, though disfavoring Health Care was untimely. Our detailed estimate revision forecast produced moderately negative results in Q1, but our intrinsic value model, perhaps surprisingly, was modestly successful. Barra's attribution analysis shows that we benefited from a positive exposure to Growth relative to our benchmark, but sees most of our outperformance as due to industry/sector positioning (see below) and specific asset selection rather than to exposures to their linear systematic risk factors.

A little over 1% of our active return came from our active positions in GICS sectors, with the remainder from stock selection within sectors. We gained from overweighting Technology and underweighting Energy and Telecom, while suffering some modest drag from underweighting Health Care. Within sectors, we had successful stock selection in the Materials, Consumer Discretionary and Financial sectors, partly offset by adverse selection in the Industrials, Technology, and Health Care.

Outlook

As we began to see last quarter, growth in the U.S. economy appears to be solidifying. The probability for a recession in the near term, which six months ago seemed quite tangible, has declined to just 15% in Bloomberg's survey consensus. Our cautiously optimistic outlook remains similar to a quarter ago. Consensus estimates for U.S. GDP growth for 2017 remain at about 2.25%, based on healthy consumer spending and growth in private investment. Corporate earnings are forecast to rise around 20% above the prior year for the next two quarters, while these robust growth expectations appear to be well-reflected in equity prices after two strong quarters of market gains. However, these forecasts are predicated partly on the expectation of tax and regulatory reform in Washington, and the chance that these may be delayed or not materialize may be the principal downside risk to the financial markets. Meanwhile, upside to the economic scenario could be provided by incipient growth in some long-moribund developed economies abroad. Increased inflation expectations imply that higher short-term interest rates are fairly certain in the coming year. If long-term rates follow as expected, this will produce pressure on equity valuation multiples, especially for those stocks which investors have sought for income yield and those whose prices are more heavily based on expectations for future growth. The higher and more stable average earnings produced by Denali's investment strategies should prove advantageous in this environment, and Denali's current sector allocations should also be well positioned to benefit from rising interest rates.

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. Leverage is not used in these products.

NV Mid: Composite consists of fully discretionary mid cap value portfolios, measured against the Russell Mid Cap Value Index, and intends to outperform that benchmark while maintaining similar sector, industry and security characteristics. The NV Mid Composite was created October 1, 2005. As of January 07, 2014 the Denali Mid Cap Russell Composite was renamed the Denali NV Mid Composite., and then on July 17, 2014 renamed the NV Mid Composite. In September 2012, the investment process changed to select stocks using Denali's proprietary Network Value forecast model that ranks stocks by earnings and illiquidity in addition to the other factors that were previously being used to rank stocks. There were no changes to the investment objective. The sector and industry characteristics of the NV Model are still similar to the Russell Mid Cap Value Index. The management fee schedule is as follows: First $25 million 0.75%, next $25 million 0.70%, balance 0.65%. Actual investment advisory fees incurred by clients may vary. There is a marketing minimum of $5 million

NV Large: Composite consists of fully discretionary large cap value portfolios measured against the Russell 1000 Value Index , and intends to outperform that benchmark while maintaining similar sector, industry and security characteristics. The Denali NV Hi Concentrated Composite was created September 30 2012. As of July 17, 2014 the Denali NV Hi Concentrated Composite has been renamed the NV Large Composite. As of 02-18-2016 the secondary benchmark S&P 500 was removed as it is no longer representative of the strategy. The NV Large portfolio construction was based on the analysis of earnings and liquidity of selected companies from the Russell 3000 index combined with a factor forecast applied to stocks in this same universe. Portfolio rebalancing is done once or twice per month using a reference portfolio of the Denali NV Hi Index. The management fee schedule was as follows: First $50 million 0.50%, next $50 million 0.45%, balance 0.40%. There is a marketing minimum of $5 million.

NV Small: Composite consists of fully discretionary small cap portfolios. Results are compared against the Russell 2000 value and intends to outperform that benchmark while maintaining similar sector, industry and security characteristics. The Denali NV Small Composite was created May 31, 2013. As of July 17, 2014 the Denali NV Small Composite has been renamed the NV Small Composite. As of 02-18-2016 the secondary benchmark Russell 2000 was removed as it is no longer representative of the strategy. The NV Small portfolio construction is based on the analysis of earnings, liquidity and other characteristics of selected companies from the Russell 2000 index. Portfolio rebalancing is done monthly. The management fee for this product is 1.00%. The composite is comprised of 100% non-fee paying accounts for all periods presented. Net returns have been calculated by reducing gross returns by a model management fee of 1%. There is a marketing minimum of $100,000.

NV Micro: Composite consists of fully discretionary micro cap portfolios. Results are compared against the returns of the Russell Microcap Value Index and intended to outperform this benchmark while maintaining similar sector, industry and security characteristics. The NV Micro portfolio construction is based on the analysis of earnings, liquidity and other characteristics of selected companies from the Russell Microcap Index. As of February 4, 2014, the benchmark was changed from the Russell Microcap Index to the Russell Microcap Value Index retroactively. This change was made because we believed that the Value style index would provide a more useful performance comparison for clients and prospective clients in this strategy. The Denali NV Micro Composite was created December 31, 2013. As of July 17, 2014 the Denali Network Value Micro has been renamed the NV Micro Composite. Portfolio rebalancing is done monthly, or more frequently if judged to be advantageous. The fee schedule for this product is 125 bps on the first $50 million and 75 bps on the remainder. The composite is comprised of 100% non-fee paying accounts for all periods presented. Net returns have been calculated by reducing gross returns by a model management fee of 1%. There is a marketing minimum of $1,000,000. Client returns will be reduced by advisory and other expenses the client may incur.