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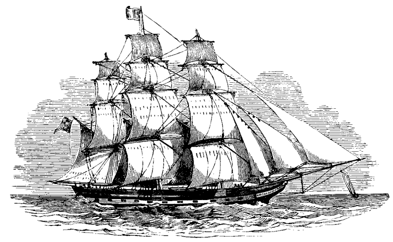

Pilot Capital Management
Quarterly Investment Commentary

Date: April 13, 2016
From: Greg Staub, CFA, Ph.D.; Matthew Staub, CFA
To: Pilot Capital Clients & Friends

Dear Clients and Friends,

Your reports for the first quarter of 2016 are enclosed. This letter gives a review of the quarter and briefly summarizes our current investment views.

First Quarter 2016 Market Review

Market/Index	2015 Close	As of March 31st	Month Change	*Quarter Change*	Year-to-Date Change
DJIA	17425.03	17685.09	7.08%	*1.49%*	1.49%
S&P 500	2043.94	2059.74	6.60%	*0.77%*	0.77%
Russell 2000	1135.89	1114.03	7.75%	*-1.92%*	-1.92%
Global Dow	2336.45	2307.34	6.88%	*-1.25%*	-1.25%
Fed Funds	0.25%-0.50%	0.25%-0.50%	0 bps	*0 bps*	0 bps
10-Yr Treasury	2.26%	1.79%	6 bps	*-47 bps*	-47 bps

The first quarter of 2016 started with a whimper as equities suffered several weeks of losses. However, as March came to a close, several of the indexes listed here recovered enough to finish the quarter in positive territory. The Dow picked up 260 points to close 1.49% ahead of its fourth-quarter closing value. The S&P 500 also finished the first quarter slightly better than it ended the previous quarter. However, the NASDAQ, Russell 2000, and Global Dow each ended the quarter behind their respective December 2015 closing values. March proved to be a good month for equities, as each of the indexes listed here yielded positive returns, led by the Dow and the Russell 2000, each gaining more than 7.0% over February.

The debt side of the ledger also produced a mixed bag of revolving returns as 10-year Treasury yields fell to their lowest end-of-quarter levels since the fourth quarter of 2012.This was primarily the result of a flight to quality in light of global equity volatility. Yields on long-term Treasuries opened the quarter at around 2.25%, but ended it at 1.79% as money moved in, driving prices higher and yields lower.

Key Takeaways

After 2015's volatility carried into January and early February, we have begun to see some stabilization in key drivers of that volatility.

Stabilization in Oil

After starting the quarter around \$37, the price of oil (WTI) dropped to a February 11th low of around \$26.21, only to finish the quarter at \$37.49, an increase of 46.28% from the low (Figure 1). This recovery has been driven in part by weakening in the U.S. Dollar against foreign currencies after dramatic strengthening in the previous year. During Pilot Capital's recent Winter Investment Briefing, we reminded clients that commodity bear markets tend to last 15-18 months, and that the combination of a weakening U.S. Dollar and surprise inflation would be a catalyst to bring stabilization and potentially a reversal. Both of these have been presenting themselves in the market, making this a potential sustainable reversal in commodities.

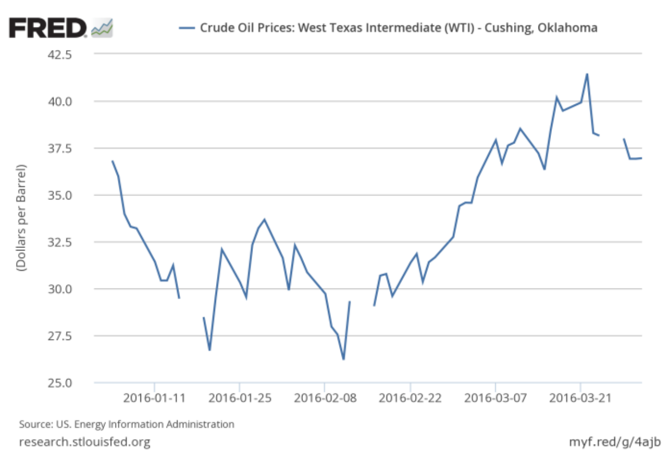

Figure 1

The Federal Reserve

The Federal Reserve backed off its initial (and quite aggressive) federal funds rate increase schedule. At both its January and March meetings (it did not meet in February), the Federal Open Market Committee determined that overall economic conditions were not sufficiently improved to justify a further interest rate hike. The last time the Fed increased rates was December, when the Committee raised the target range for the federal funds rate to 0.25%-0.50%. In support of its decision to maintain interest rates at their present level, the FOMC noted that strong labor market conditions, improvement in the housing sector, and increased household and business spending were offset by slowing economic growth, soft exports, and low inflation, which is continuing to run below the Committee's target rate of 2.0%.

International Markets

International markets were heavily dented in 2015 by the strength of the US Dollar. With global monetary policy looking slightly more aligned after the Fed's implication that rates will be raised more gradually, the US Dollar has weakened, taking some pressure off international markets. After a run-up in the dollar like we saw in 2015, we expect to see, on average, a trend of a weakening dollar going forward, which should act as more of a tailwind to international equity returns for U.S.-based investors.

Portfolio Positioning

We continue to stress the importance of maintaining a broadly diversified, global portfolio. As global growth has slowed, investors have increasingly crowded into a small group of growth "champion" stocks such as the "FANG" stocks in the S&P 500 (Facebook, Amazon, Netflix and Google). In 2015, the top-performing 15 stocks in the S&P 500 gained an average of 36%. The return for the rest of the stocks in the index was -2%. The average P/E of the not-so-profitable FANG stocks is 242! Meaning that if you invest in them today at the current rate of earnings it will take 242 years to pay you back your original investment. This is very narrow market leadership indeed and reminds us very much of the "Nifty Fifty" stocks of the late 60s and early 70s, and the "Dot Com" bubble in the S&P 500 in the late 90s. These levels of valuation rarely lead to superior returns moving forward, and have often been associated with severe corrections. Failing to learn from history, investors continue to blindly pour money into passive index funds that force investment into these potential time bomb stocks. We prefer active managers that avoid paying extreme valuations for dubious earnings growth.

On the fixed income side, we continue to see opportunity in absolute return bond funds like Loomis Sayles Bond (LSBDX) and Osterweis Strategic Income (OSTIX). These funds focus on exploiting opportunities in the fixed income arena and maximizing long-term total return. Recently, these funds have underperformed the U.S. Aggregate Bond Benchmark. Given the absolute-return-oriented strategy of these funds, periodic underperformance is not unexpected and we are willing to tolerate it as the outsized returns eventually realized provide meaningful long term value to our clients. We feel that true value has been created in this area by valid concerns about debt issued by U.S. energy companies spilling over into the rest of the corporate bond market. We feel the effect of energy fears on the rest of the corporate bond market has been overblown, creating a market environment that will allow absolute return bond managers to excel.

International equity is another area where we see exceptional value. International equity, both developed and emerging markets, took it on the chin in 2015. This poor performance was dramatically affected by weakening foreign currencies against the U.S. Dollar. This had the effect of reducing returns for U.S.-based investors relative to the local (foreign) currency returns. It is important to remember that relative performance between domestic and foreign equities runs in cycles. Any period of outperformance by domestic equities will be followed by a period of outperformance by foreign equities (Figure 2). With monetary policy in Europe having become more accommodative, improving corporate profit margins, attractive historical valuations, and currencies now acting as a tailwind rather than a headwind, we continue to maintain a weighting of international equities that reflects the market capitalization of widely followed global equity indexes.

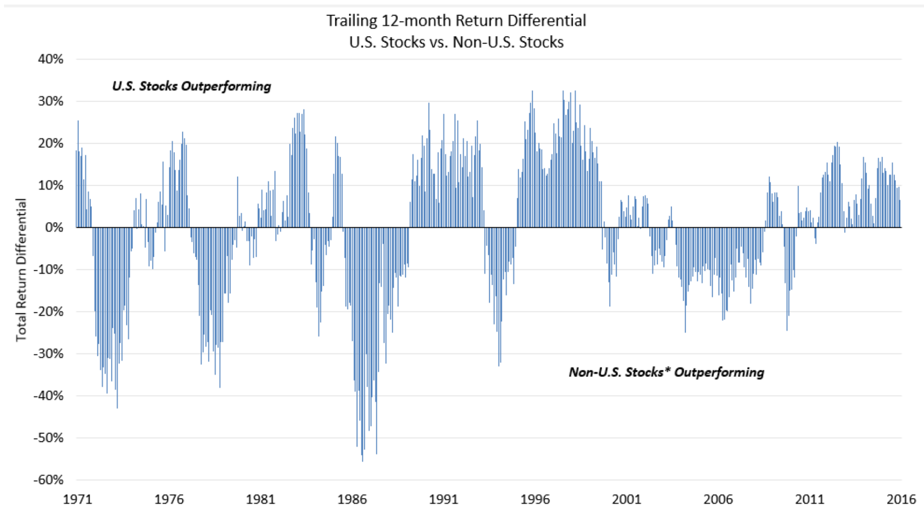

Figure 2

Thank you for your continued trust and confidence in Pilot Capital Management. As always, should there be any questions, please don't hesitate to contact us.

Sincerely,

Greg Staub, CFA, Ph.D.
President

Matthew Staub, CFA
Vice President