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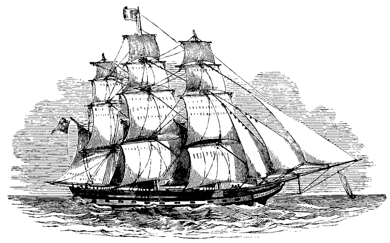


Pilot Capital Management
Quarterly Investment Commentary

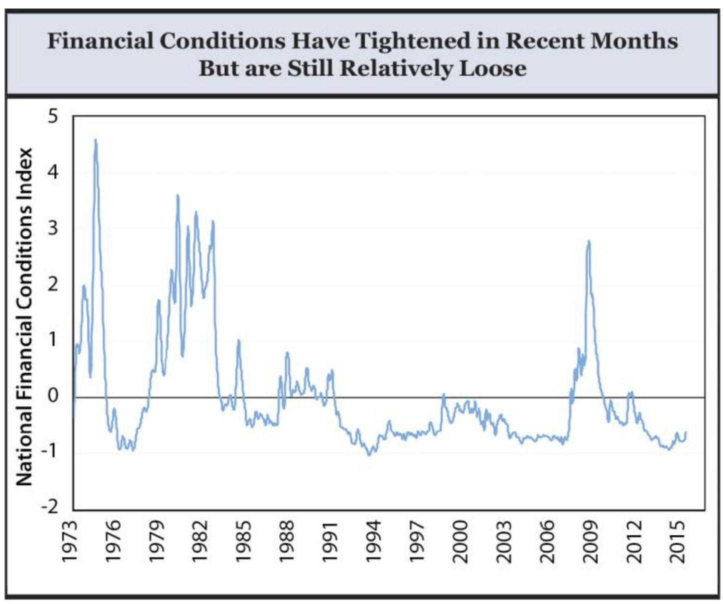
Date:	October 12, 2015
From:	Greg Staub, CFA; Matthew Staub, CFA
To:	Pilot Capital Management Clients & Friends

THIRD QUARTER 2015 INVESTMENT COMMENTARY

Dear Clients and Friends,

Your reports for the third quarter of 2015 are enclosed. This letter gives a review of the quarter and briefly summarizes our current investment views.

Given the market's historical pattern of corrections, we've mentioned the potential for a market decline in each of our last three quarterly investment commentaries. So we weren't surprised by the volatility witnessed in the third quarter. But that's not to say we were predicting it would happen or what the triggers or catalyst might be. Short-term market predictions are a fool's errand, and history doesn't exactly repeat. But, knowledge of market history and cycles is useful for putting the present moment into context and thinking through different potential scenarios, risks, and investment opportunities. We



Source: Federal Reserve Bank of Chicago. Data as of 9/18/2015.

will discuss the impact of the recent market turbulence on our asset class views and portfolio positioning later in this commentary, but first we will spend a bit of time discussing the proverbial elephant in the room: the Federal Reserve.

The big question looming for the markets over the quarter was whether the Federal Reserve was going to raise interest rates for the first time in more than six years. Ultimately, the Fed decided to hold off on a rate hike, citing that "recent global economic and financial developments may restrain economic activity somewhat and are likely to put further downward pressure on inflation in the near term." Fed Chair Janet Yellen pointed specifically to the recent developments in China and emerging markets as factors that gave them pause. She also noted the "tightening of financial conditions" due to stock market declines, a stronger dollar, and wider credit spreads since the FOMC's last meeting. Thirteen out of the 17 Fed policymakers indicated they expect to raise rates at least once this year, with six of the 13 expressing a preference for two rate hikes. The FOMC meets again October 28 when we can go through this all over again!

Impact of Market Volatility on our Asset Class Views and Portfolio Positioning

U.S. Stocks – While the market decline made future returns for U.S. stocks look incrementally better, the price drop was not large enough to lead us to increase our U.S. stock exposure. Our analysis still indicates that over a broad range of scenarios, expected returns for U.S. stocks over the next five years remain unattractive. Valuations are still stretched and earnings are well above normalized levels for a variety of reasons (e.g., due to unsustainably high profit margins). Earnings estimates also continue to decline. So we see a substantial risk of earnings disappointment and valuation multiple contraction, implying subpar returns.

Developed International Stocks – We continue to have a positive view of European stocks. We believe European stock valuations are much more attractive than those of U.S. stocks, while European corporate earnings are well below normal (unlike in the U.S. where earnings are well-above their long-term trend). As such, in our base case and more optimistic scenarios, we see potential for both improved earnings growth as well as some multiple expansion, implying significant outperformance for European stocks compared to the U.S. market over our five-year outlook.

Emerging Markets – After recent declines in emerging-markets stocks, we now view them as more attractive, to varying degrees, than U.S. and European stocks. Specifically, using what we believe are quite conservative earnings growth and valuation assumptions for emerging markets, we now estimate returns are comparable to what we expect from U.S. stocks in our optimistic scenario and from European stocks in our base case scenario. Importantly, we think our assumptions adequately capture the risks stemming from a slowdown of growth in China and other emerging-market countries.

Investment-Grade Bonds – The events of the latter part of the third quarter did not lead to any material changes in our fixed-income asset class views. Our expected returns for core bonds are very low looking out over the next several years in almost any reasonably likely macro scenario. This is why we have invested a large portion of our fixed-income allocation in more flexible bond strategies. Based on our analysis of each fund's strategy and our strong positive assessment of the managers' strengths, we think these funds have the potential to generate returns outpacing the core bond index over the next five years, across a broad range of macro scenarios. Nevertheless, we still maintain exposure to core bonds in our more conservative portfolios because of the risk management role they play—smoothing overall portfolio volatility and mitigating some of the downside risk of owning stocks in the event of a global growth scare, recession, or worse.

Floating-Rate Loans – In our view, the fundamentals for floating-rate loans remain healthy, as interest coverage levels and overall leverage levels are reasonable, while the amount of debt maturing over the next couple of years is extremely benign. At current price levels, which are below par, our view is that floating-rate loans offer attractive return potential over our investment horizon. We continue to own a tactical allocation to the asset class via positions in diversified, high-quality floating-rate loan funds that emphasize liquidity in order to benefit from and protect against rising short-term rates and unexpected inflation.

Concluding Comments

The reality of owning stocks is that occasionally, inevitably, we will experience correction. This underscores the importance of our risk management, in which we seek to reduce our balanced portfolios' vulnerability to stock market downturns through strategies that include owning "insurance" assets such as bonds and lower-risk alternatives. Another key ingredient in managing through bear markets is helping our clients accurately assess their risk tolerances and investment objectives. If you are in an appropriately structured portfolio, there is no benefit to selling in a market downturn. In fact, by doing so you risk selling nearer to the bottom and then missing the subsequent recovery. We are likely to view such downturns as potential buying opportunities rather than exit points. This is based on our tactical asset allocation approach that centers on analyzing long-term fundamentals and valuations, while remaining sensitive to shorter-term portfolio risks.

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,

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President

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