

## Gavekal KL Allocation Fund

### Q3 2015 Update and Commentary

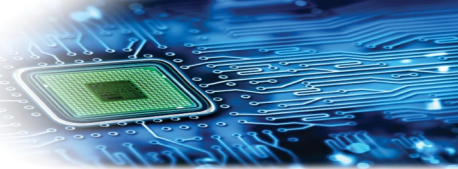
Over the last five years, the Gavekal KL Allocation Fund has returned 8.46% on an annualized basis, which exceeds the performance of both our benchmark and peer group. During this period, the Gavekal KL Allocation Fund has generated a 5.37% annualized alpha with a 6.82% standard deviation and a 6.14% max drawdown. Across all dimensions of risk adjusted-performance, such as Sharpe Ratio and Treynor ratio, we have outperformed our benchmark and peer group. If we compare our results to all the funds in the Morningstar Aggressive Allocation category over the last five years, we exhibit the single lowest beta, volatility, and max drawdown while simultaneously generating among the highest alpha, Sharpe ratio, and upside/downside capture ratio. Our investment objective is capital appreciation with a focus on capital preservation and we believe these results suggest we are achieving this dual mandate.

Fund (as of 9/30/2015)	1Y	5Y	Since Inception
Gavekal KL Allocation Fund (GAVIX)	3.68	8.46	8.46
Gavekal KL Allocation Fund (GAVAX)	3.45	8.16	8.16
<b>Benchmark</b>			
MSCI All Country World Index	-6.66	6.82	6.82
MSCI World Index	-5.09	8.29	8.29
Morningstar Aggressive Allocation Category Average	-3.47	7.84	7.84

Trailing 5 Years - As of 9/30/2015			
Risk Metrics	Gavekal KL Allocation Fund	Morningstar Aggressive Allocation Average	MSCI All Country World Index
Beta	0.4	0.77	1
Alpha	5.37	1.82	0
Standard Deviation	6.82	10.22	13.08
Sharpe Ratio	1.22	0.74	0.57
Treynor Ratio	21.12	9.4	6.77
Max Drawdown	-6.14	-16.64	-20.47

Peer Rankings Compared to Morningstar Aggressive Allocation Funds	
As of 9/30/2015	5 Year
Beta	1%
Volatility	1%
Max Drawdown	1%
Alpha	97%
Sharpe Ratio	96%
Upside/Downside Capture Ratio	98%

***The performance data quoted here represents past performance. Past performance is no guarantee of future results. Investment return and principal value will fluctuate, so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance information quoted. To obtain performance information current to the most recent month-end please call 888.998.9890 or visit our website at [www.gavekalfunds.com](http://www.gavekalfunds.com). A redemption fee of 2.00% will be imposed on redemptions or exchanges of shares you have owned for 90 days or less. Please see the prospectus for more information.***



***The Fund's advisor has contractually agreed to waive its fees and/or pay for operating expenses of the Fund to ensure that total annual fund operating expenses do not exceed 1.50% and 1.25% of the average daily net assets for Advisor Class and Institutional Class shares of the Fund, respectively. This agreement is in effect until March 31, 2016, and it may be terminated before that date only by the Trust's Board of Trustees. The Fund's advisor is permitted to seek reimbursement from the Fund, subject to limitations, of fees waived for payments made to the Fund for a period of three years from the date of the waiver or payment.***

*The total annual operating expenses of the Fund are 1.48% and 1.23% and net expenses are 1.53% and 1.28% for the Advisor and Institutional Classes, respectively. The inception date of the Gavekal KL Allocation Fund is 9/30/2010.*

Digging into the performance data further, if we isolate and look at just beta and total return we can see how much of an outlier the Gavekal KL Allocation Fund is with respect to the level of systematic risk (otherwise known as market risk) taken by the fund. The Gavekal KL Allocation Fund manages to produce the lowest realized 5-year beta among all Aggressive Allocation funds by a wide margin while simultaneously generating a commensurate level of total return. This, by definition, implies a high alpha. We would also note that over the last five years, there has been a slightly negative relationship between beta and total return. (Source: Morningstar, as of 9/30/2015) This means that portfolios taking on more systematic risk have actually resulted in lower levels of total return for this group of funds. This is contrary to what textbook portfolio management theory expects and shows that investment managers are not able to juice nominal returns simply by taken on more risk.

Moving on to standard deviation – a measure of volatility, or risk – and total return, we observe that the Gavekal KL Allocation Fund has had the lowest 5-year standard deviation among its peers (Source: Morningstar, as of 9/30/2015). Surprisingly, we have found that there is a slightly negative relationship between standard deviation and total return among this group of funds over the past five years, suggesting that, in general increased volatility has not been rewarded with a higher level of return.

Currently, our overall asset allocation is quite equity focused with equity holdings accounting for over 70% of our overall asset allocation. Within our equity holdings, the portfolio is concentrated in the health care, consumer staples and information technology sectors. We have large relative overweight positions in those three sectors. Conversely, we have large relative underweights in the financial, energy, telecom, and utilities sectors. In fact, we don't own a single stock in those four sectors. Within the fixed income portion of the portfolio, our duration is quite short and credit quality is quite high. Over 75% of our fixed income allocation has a duration less than three years and 100% of our fixed allocation is in government bonds.

If we decompose our equity holdings by region, we are overweight the developed markets in the Americas (primarily the US) and in Asia (primarily Japan). Within the developed markets, we are underweight Europe. Our largest overweight positions are in developed Asia consumer staples (primarily Japan) with an 8x larger relative weighting than the weighting in the MSCI All Country World Index (MSCI ACWI). We also hold a large overweight position in developed Asia health care and information technology, where we have 5x greater relative weighting than what is in the MSCI ACWI. Finally, we also are overweight developed Americas health care stocks, with a 2.5x relative weighting in information technology stocks, with a 2x relative weighting compared to the MSCI ACWI (Source: Factset, as of 9/30/2015).

If we decompose our portfolio by market cap, we can see that the Gavekal KL Allocation Fund has a significantly smaller skew towards large cap stocks than the MSCI All Country World Index. Less than 20% of our portfolio is in stocks larger than \$50 billion in market cap compared to the MSCI ACWI where 42% of the index is represented by stocks larger than \$50 billion. Where we are overweight on a market cap basis is in the \$10-15 billion market cap segment compared to the MSCI ACWI (Source: Factset, as of 9/30/2015). As we have mentioned in many quarterly recaps, we tend to look at the world on an equal-weighted basis and not a market-cap basis. Consequently, we tend to maintain a fairly equal-weighted portfolio and have continued to do so through last quarter with no major position size disparities among our holdings.



Let's transition away from the current make-up of the portfolio to some economic commentary as this should shed some insight to our investors on our current portfolio composition. As the Federal Reserve continues to push back the eventual increase in interest rates, there has been a growing chorus in the financial community that the US may be on the verge of another recession. Contrary to that belief, we don't see a US recession on the horizon and actually see a US consumer that is stronger than it has been in recent years. From the end of the recession in June 2009 through the beginning of 2014, consumption was trending at a fairly tepid pace of 2% annualized growth. However, about 18 months ago consumption kicked into a higher gear and has been growing at about a 3% annualized pace (source: US Nominal Income Proxy Trend Growth, Gavekal Capital, Factset, as of 9/30/2015). When we look at the US economy, we see an environment where the consumer is leading the economy. We not only do not see this deteriorating next year, we anticipate even firmer consumption growth in 2016 and beyond.

Part of the reason we are optimistic about US consumption is the fact that incomes have been growing at about twice the rate of consumption since the end of the financial crisis (source: US Nominal Income Proxy Trend Growth, Gavekal Capital, Factset, 9/30/2015). Our nominal income proxy, which is a function of: 1) the number of people working, 2) the amount they are earning and 3) the number of hours they work, has been growing at a 4% rate since the recession ended in June 2009. As we noted before, up until about only 18 months ago, consumption had been growing at just a 2% rate. The gap between 4% income growth and 2% consumption growth has led to an increase in the savings rate, which is currently around 4.6% (source: US Savings Rate & Consumer Confidence, Gavekal Capital, Factset, as of 9/30/2015). Our models of the savings rate based on consumer credit, consumer confidence, and wealth suggest the potential for the savings rate to decline from here, potentially strengthening the rate of consumption.

Another potential advantage for the US consumer is the fact that basic financial obligations have never been lower. The Federal Reserve calculates a measure called the Household Financial Obligations Ratio (HFOR) which measures the percent of disposable income devoted to interest payments and other debt service. We then add to the HFOR the percent of consumer disposable income spent on energy expenditures to get a HFOR including energy expenditure ratio. According to this combined ratio, basic financial obligations have never been lower over the past 35 years (source: US Household Financial Obligations Ratio & HFOR Including Energy Expenditures, Gavekal Capital, Factset, 9/30/2015) and we feel this strengthens our projections for solid consumption. We believe the HFOR including energy obligations will most likely continue to fall further given the drop in oil prices over the past year. Our research suggests the maximum impact of a drop in energy prices occurs four quarters after the fall. This implies that we may start to see the benefit of lower energy prices over the next several quarters. Gasoline prices have fallen by roughly 50% in the last year which frees up approximately \$100 billion in disposable income (source: US Retail Gasoline & Spending on Gas and Retail Gasoline & Spending on Gas as a % of GDP, Gavekal Capital, Factset; as of 9/30/2015). We believe the energy savings are likely to boost both consumption and savings by about 1% combined. As we said, the current environment is one in which consumption growth is currently leading economic activity. Over the last six months, consumption growth has ticked up to a 4% rate (US GDP & Consumption Spending, Gavekal Capital, Factset, as of 9/30/2015), pulling real GDP growth along with it. Given the 4% trend growth in aggregate incomes, this new, higher trajectory of consumer spending is still neutral to consumer savings. Should the consumer spend some of his/her energy windfall and/or save a little less on the margin, consumption spending could stay at a 4% trend growth rate.

We are seeing some structural indications that the consumer is on a firmer footing than it has been since the financial crisis. For example, households are being formed at a faster pace than at any point in the last nine years. Similarly, vehicle miles driven have recently shot up to an almost 3% growth rate (source: US Miles Driven & GDP, Gavekal Capital, Factset, as of 9/30/2015), eclipsing the growth of real GDP. These are two important "hard data" indicators of economic growth. As more people have jobs



and new households are created, they need to get around and we see evidence that they are driving more. Vehicle miles driven are highly correlated with auto sales and continued strength in the former should help keep the latter firm. The growth in household formation is particularly important as it is a decent leading indicator for residential construction, which continues to be at depressed levels. Residential investment is still just a little more than 3% of GDP which is about 2% below the historical average in the post-World War 2 era (source: US Residential Investment as a % of GDP, Gavekal Capital, Factset, as of 9/30/2015). Just to get back into the normal historic range of 4-6% of GDP, residential construction will have to continue to grow at a rate greater than GDP. Residential investment and durable purchases have been weak spots in US economic growth and they both appear to be improving.

So why isn't the Federal Reserve raising rates in the face of a firming consumer? We think the reason is the strength in consumption is being masked by a manufacturing recession. Our nominal industrial activity proxy, where we multiply industrial production by the producer price index (PPI), indicates that there has been a nominal contraction in manufacturing this year for the first time since 2009. The manufacturing recession has been brought on by two important variables: 1) an inventory correction in the US and 2) a hard landing in China. We would anticipate that inventories will subtract from growth for a few quarters and we don't see the growth concerns in China abating anytime soon.


Investors are very worried that the Federal Reserve will make a mistake by raising rates too early. This explains why the Skew Index recently recorded the highest reading ever, showing a huge preference for put options versus call options. Investors have first-hand experience over the last year of just how impactful Fed actions can be for certain assets. The Federal Reserve's policy decisions can have a large impact on the relative performance of stocks as well as the relative performance of bonds. Moody's BAA spreads have widened significantly over the last year while the Fed completed the tapering of asset purchases and the relationship between Federal Reserve policy actions and the relative performance of cyclical vs. counter-cyclical stocks is well documented. While the Fed has suggested it will maintain the size of its balance sheet as it begins to raise rates, at some point a significant contraction in the Fed's balance sheet will begin. In the last couple years since the taper began, the relative outperformance of counter-cyclicals has coincided with falling inflation expectations. We see little evidence that inflation expectations have bottomed yet, which suggests a continued, though cautious, overweight stance in counter-cyclicals.

The recent widening in high yield spreads has focused our attention on quality. Historically, high-yield spreads are well correlated to corporate profit margins. Validating this, our model which looks at US government finances offers a note of caution and suggests that margins may be under pressure for the next few years. Our model looking at the relationship between US corporate profit margins and the US Dollar raises a red flag, too. We are particularly focused on high quality companies right now.

In our investment process, we have a multi-dimensional method to measure quality. We have constructed a scoring process that involves 9 unique financial metrics, covering a company's income statement, balance sheet, statement of cash flows and profitability. Each variable in our score is equal weighted and each category in our model is equal weighted as well. We convert all data into a percentile by comparing every company against every other company in the index. The companies with the best financial metrics achieve the highest percentile scores. In general, we believe that intangible rich companies are higher quality companies. We believe higher quality companies have higher profit margins, lower debt, more intangible capital and less tangible fixed capital. We seek out the companies that express these traits.

Focusing on specific metrics of our portfolio companies, our holdings tend to have: 1) a much greater intangible investment intensity, 2) less fixed capital intensity, 3) less debt than the average company in the world. In addition, our holdings also produce





higher value added products than do other companies, represented by gross margin, and are able to translate those higher margins into superior levels of profitability and cash flow. Given that the current environment is filled with both economic and monetary policy uncertainty, we believe it is prudent to maintain a portfolio of high quality companies in order to continue delivering superior risk-adjusted returns to our investors.

## **Disclosures**

**Please consider the Fund's investment objectives, risks, charges and expenses before investing. The prospectus or summary prospectus that contains this and other information about the Fund, is available by calling 888.998.9890 and should be read carefully.**

Equity securities, such as common stocks, are subject to market, economic and business risks that may cause their prices to fluctuate. Currency Risk is the risk that the values of foreign investments may be affected by changes in the currency rates or exchange control regulations. Investments in foreign securities may involve risks such as social and political instability, market illiquidity, exchange-rate fluctuations, a high level of volatility and limited regulation. Investing in emerging markets involves different and greater risks, as these countries are substantially smaller, less liquid and more volatile than securities markets in more developed markets. The securities of mid-cap companies may be subject to more abrupt or erratic market movements and may have lower trading volumes. The Fund's return may not match or achieve a high degree of correlation with the return of the Index.

Effective March 31, 2015, the Advisor changed the Fund's primary benchmark from the MSCI World Index to the MSCI All Country World Index in connection with a change in the Fund's principal strategies. The Advisor believes the MSCI All Country World Index is a better measure of the Fund's performance.

On March 31, 2015, the Fund's name changed from Gavekal Knowledge Leaders Fund, to the Gavekal KL Allocation Fund. The investment objective and principal investment strategies have also changed. Further information regarding these matters is provided in the Fund's revised Summary Prospectus, Prospectus and Statement of Additional Information dated March 31, 2015.

The Gavekal KL Allocation Fund is distributed by IMST Distributors, LLC.

Alpha is a measure of the portfolio's risk adjusted performance. When compared to the portfolio's beta, a positive alpha indicates better-than-expected portfolio performance and a negative alpha worse than-expected portfolio performance.

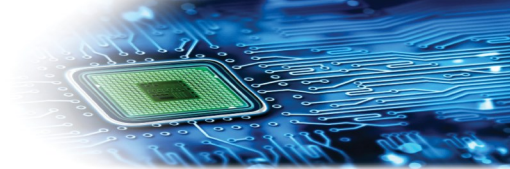
Beta is a measure of the funds sensitivity to market movements. A portfolio with a beta greater than 1 is more volatile than the market and a portfolio with a beta less than 1 is less volatile than the market.

Correlate is a mutual relationship or connection, in which one thing affects or depends on another.

Max Drawdown is the maximum single period loss incurred over the interval being measured.

MSCI All Country Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity performance of developed and emerging markets.

MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets.



Producer Price Index (PPI) is a family of indexes that measures the average change in selling prices received by domestic producers of goods and services over time.

Sharpe Ratio uses a fund's standard deviation and its excess return (the difference between the fund's return and the risk-free return of 90-day Treasury Bills) to determine reward per unit of risk.

Skew Index is an option-based indicator that measures the perceived tail risk of the distribution of S&P 500 log returns at a 30-day horizon.

Standard Deviation is a calculation used to measure variability of a portfolio's performance.

Total Return is the actual rate of return of an investment over a given evaluation period and includes interest, capital gains, dividends and distributions realized over a given period of time.

Treynor Ratio is a risk-adjusted measure of return based on systematic risk. It is similar to the Sharpe ratio, with the difference being that the Treynor ratio uses beta as the measurement of volatility.

Up/Down Capture Ratio shows whether a fund has outperformed a broad market benchmark during periods of market strength and weakness.

Volatility is the rate at which the price of a security increases or decreases for a given set of returns.