Wellesley Asset Management
Convertible Bond Specialists

Wellesley Asset Management Commentary | April 2017

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First Quarter Total Return Comparison (%, through 03/31/2017):

	Q1 2017	1 Year	3 Years*	5 Years*	Since Inception 12/31/2007*	10 Years*	Since 1/1/2000*
Miller Convertible Bond Fund I (MCIFX)	1.67	12.15	3.95	7.25	6.76	NA	NA
TRW	1.91	14.16	5.02	8.40	7.61	7.72	8.52
S&P 500 TR	6.07	17.17	10.37	13.30	7.52	7.51	4.80
Bloomberg Barclays U.S. Aggregate Bond	0.82	0.44	2.68	2.34	4.13	4.27	5.18
V0A0	5.62	21.08	6.32	10.31	7.68	7.31	5.61

The performance data quoted here represents past performance. Current performance may be lower or higher than the performance data quoted above. Past performance is no guarantee of future results. The investment return and principal value of an investment will fluctuate so that investor's shares, when redeemed, may be worth more or less than their original cost.

Please review the Fund's prospectus for more information regarding the Fund's fees and expenses including other share classes. For performance information current to the most recent month-end, please call toll-free 877-441-4434.

Total operating expenses for the Miller Convertible Bond Fund are Class A 1.49%, Class C 1.99% and Class I .99%.
See index descriptions and accompanying footnotes.
**Returns are annualized.*

1st Quarter Update

Stocks continued to march higher in the first quarter of 2017 on optimism that the new administration would enact market friendly policies. Specifically, the market is anticipating lower corporate/individual taxes and less regulation of businesses. The market rallied in a very orderly fashion, resulting in low volatility. The combination of higher stock prices and low volatility created the ideal scenario for convertible issuance which flourished during the quarter.

The S&P Total Return Index returned 6.07% during the first quarter in a fairly unspectacular fashion. Equity markets did not respond to two potentially negative events in the quarter: 1) the Federal Reserve raised interest rates by 25 basis points, and 2) the failure to enact health care reform. With the markets grinding higher, realized volatility approached 20 year lows. In fact, March 21st represented the first time the S&P 500 Index was down more than 1% in 110 trading sessions. This was the longest streak without a 1% decline in 20 years.

The convertible market saw over $14 billion of new issuance in the first quarter. This represents a 300% increase over the same period last year. With Treasury yields and credit spreads fairly steady, the combination of higher equity prices and low volatility led to a healthy first quarter deal calendar. Technology companies accounted for half of the new issuance during the quarter.

Convertible returns were strong despite the supply of new paper in the market. The Bank of America Merrill Lynch V0A0 Index was up 5.62%, the Bloomberg Barclays U.S. Aggregate Bond Index returned .82%, and the TRW was up 1.91% for the quarter. While the TRW substantially lagged the return of the S&P 500, we would like to remind investors that many of the companies we invest in are small-cap companies. In the first quarter, small-cap companies lagged large-cap companies.

There has been much debate about whether investors should employ active or passive investments as a means to achieve their goals. Most experts agree that paying higher fees for active management may not be worth it for equity investing. However, this may not be the case when it comes to fixed income. The article below highlights some recent studies suggesting why paying for active management in fixed income might make sense.

Active vs. Passive Management of Convertible Bonds

The debate over actively-managed funds versus passively-managed or index funds has been a major topic of discussion in financial news over the past two years. Post-financial crisis has been a difficult time for actively-managed equity funds, as many of them have been outperformed by the S&P 500 and other major market indexes. In turn, investors are moving their money away from active managers and instead placing it in low cost index funds and exchange-traded funds (ETFs). Passive managers have benefited greatly from this trend; for example the Vanguard Group recently broke $4 trillion in assets under management for the first time in late January and reportedly has added $322 billion of assets in the past year.[1] Even with such immense growth, Vanguard isn't the largest passive asset manager in the industry as rival BlackRock boasts over $5 trillion in assets.

A recent *Barron's* article, "An Active Voice for Bonds"[2] proposed the argument that while low cost passive ETFs can make sense for equity investors, the same does not hold true for bonds. Bond indexes that are weighted by market capitalization put the most weight towards the largest borrowers, which are not necessarily the borrowers with the greatest ability to repay their debt. As the article lays out, this means passive corporate bond ETFs put the most weighting towards debt issued by big banks and financial firms, which, as we learned in 2008, don't always have the greatest ability to repay their debts.

In the convertible bond universe, there is one popular ETF in existence that tracks the U.S. convertible market called the SPDR Bloomberg Barclays Convertible Securities ETF (CWB). The CWB follows a passive strategy tracking the Bloomberg Barclays U.S. Convertible Bond >$500MM Index, which is comprised of U.S. convertible securities that have outstanding issue sizes greater than $500 million. Over the past 7 years, the CWB has performed similar to our Thomson Reuters Wellesley Absolute Convertible Bond Index (TRW) (designed to track Wellesley Asset Management's actively-managed convertible bond strategy), returning 8.45% on a market basis[3] versus the TRW returning 8.26%.

Despite the similarities in recent performance, there are some large differences between our TRW strategy and the CWB ETF that we hope shows the flaws in investing in passively-managed convertible security funds.

The first difference is similar to the *Barron's* article discussion with corporate bond funds: the index the CWB tracks is market capitalization weighted and is only comprised of convertible securities that have an issue size greater than $500 million. This means the CWB is comprised of the largest convertible bond issues (and largest issuers as well), which are not necessarily the securities that have the best risk/reward profile or those that are issued by companies with the best ability to repay their debt. We believe that some of the best value in convertibles comes from bonds issued by smaller companies with strong balance sheet fundamentals and promising growth potential. Therefore, as of March 31, 2017, the TRW Index had 83% of its portfolio comprised of convertible bonds with issue size less than $500 million.

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[1] http://www.reuters.com/article/us-vanguardgroup-assets-idUSKBN15Q0OD

[2] "An Active Voice for Bonds" by Randall W. Forsyth, *Barron's* February 25, 2017

[3] Unlike mutual funds, ETFs trade in the open market like a stock and therefore the share price often trades at a premium or discount to the fund's underlying NAV. This means the ETF has two performance values, its NAV and its Market performance.

The second difference is evident in the underlying portfolio statistics. The TRW strategy is designed for full market cycle performance and predominantly buys convertibles trading near par with a liquidity date within 7 years. Because it is actively managed, the TRW index sells bonds when their risk/reward profile no longer fits the strategy, such as bonds very deep in the money with large negative yields to maturity, or busted convertibles whose issuers' credit may have declined. This means that the TRW Index generally has an average bond price around 103-105 and an average maturity of 5 years or less. As of March 31, 2017, the average price in the TRW index was 105.51 and the average maturity was about 5 years.

The CWB is constrained by the characteristics of the index it tracks, which means its only buy/sell discipline is if the convertible security has an issue size greater than $500 million. As of March 31, 2017, the CWB had an average bond price of $126.40 and average maturity of over 10 years. This means potentially much larger equity downside exposure (as convertibles appreciate their deltas rise, meaning they more closely follow the movements of their underlying equity) and greater duration risk than the TRW strategy.

The CWB has only been in existence since April 2009, so there's no historical record of its performance during a bear market. However, the index the CWB tracks, the Bloomberg Barclays U.S. Convertible Bond >$500MM Index has been around since 2003.

During the 2008 bear market, the Bloomberg Barclays U.S Convertible Bond >$500MM Index had a maximum drawdown of -43.65% versus the TRW index drawdown of -24.16%. More importantly, the Barclays index did not recover until December 31, 2010 while the TRW recovered by September 30, 2009. In the additional 15 months that it took the passive index to recover, the TRW index grew 20%.

We believe that passive strategy continues to be exposed to more of the downside risk of convertibles than our TRW strategy. Even in a raging bull market in which the CWB has outperformed our TRW index on a total return basis, the risk-adjusted stats show the potential risk of the CWB. Since the CWB's inception, the TRW index has had a lower beta and higher alpha versus the S&P 500, lower downside risk, and higher Sharpe ratio. We expect over a full market cycle that the TRW would perform even better in comparison on a risk-adjusted basis.

Passive convertible strategies such as the CWB ETF fail to capture the risk/reward profile of convertibles that can lead to outperformance of both stocks and bonds over full market cycles. By only being exposed to the largest convertible issues, CWB investors are missing out on large amount of the opportunities in the domestic convertible market. According to Barclays Live, as of March 31, 2017 only 116 out of 482, or 24% of U.S. convertible securities have issue sizes greater than $500 million. The passive style of the ETF also means that the fund will not sell convertibles when their risk/reward profile is no longer favorable or if the issuer's credit deteriorates.

According to the *Barron's* article referenced earlier, "the way to win in bond investing is to avoid defaults", and because the CWB cannot sell out of positions if the credit deteriorates, it potentially is more exposed to default risk than an actively-managed convertible strategy. In addition, as evidenced by the 2008 performance of the Bloomberg Barclays U.S. Convertible Bond >$500MM Index that the CWB tracks, not being able to actively move in and out of convertible positions can lead to severe losses in a bear market. It can take many years to recover from huge drawdowns, which is exactly why our actively-managed TRW convertible strategies are focused on full-market cycle performance. By actively investing in a balanced convertible bond portfolio, we believe we can create an attractive risk-adjusted portfolio that will outperform both stocks and bonds over full market cycles.

Important Disclosures: *Past performance is no guarantee of future results. No content in this article should be construed as specific investment advice, or replacement for investment advice from Wellesley Asset Management, Inc. (Wellesley), or any other investment professional. All investments, including convertible bonds, have a risk of loss. Investors should carefully consider the investment objectives, risks, charges and expenses of the Miller Convertible Bond Fund. This and other important information about the Fund is contained in the prospectus, which can be obtained by calling 781-416-4000. The prospectus should be read carefully before investing. The Miller Convertible Bond Fund is distributed by Northern Lights Distributors, LLC, member FINRA/SIPC. Wellesley Asset Management, Inc. and Northern Lights Distributors, LLC are not affiliated entities.*

Drawdown is the peak-to-trough decline during a specific record period of an investment, fund or commodity. A drawdown is usually quoted as the percentage between the peak and the trough. Beta is a measure of the volatility, or systematic risk of a security or a portfolio in comparison to the market as a whole. Alpha is a risk-adjusted measure of the active return on an investment. It is a measure of the manager's contribution to performance. A positive annual Alpha indicates the portfolio outperformed the market on a risk-adjusted basis, and a negative Alpha indicates the portfolio underperformed in relation to the market. Sharpe Ratio is a risk-adjusted measure of return that is used to evaluate the performance of one portfolio comparable to another by adjusting for risk. The Sharpe ratio is used to characterize how well the return of an asset compensates the investor for the risk taken, the higher the Sharpe ratio number the better.

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Index Descriptions:

Index	Description	Source
Thomson Reuters Wellesley	TRW is the Thomson Reuters Wellesley Absolute Convertible Bond Index ("TRW"). The Index is a joint venture between Thomson Reuters and Wellesley Asset Management (WAM) that was created in January 2013. Index performance for the period from February 2002 to the creation date is calculated based upon a model portfolio maintained by WAM. TRW is intended to represent a strategy with the goals of absolute returns and outperforming both equities and fixed income over complete market cycles deploying convertible bonds. WAM has discretion over the selection of index constituents and their weighting in the index.	Thomson Reuters
Standard & Poor's 500 Total Return	A free-float capitalization-weighted index based on the common stock prices of 500 top publicly traded American companies, as determined by S&P and considered by many to be the best representation of the market.	Bloomberg data / Standard & Poor's
Bloomberg Barclays U.S. Aggregate Bond	A market capitalization-weighted index often used to represent investment grade bonds being traded in United States. The index includes Treasury securities, government agency bonds, mortgage-backed bonds, corporate bonds and a small amount of foreign bonds traded in the U.S.	Bloomberg data / Barclays
Bank of America/Merrill Lynch All Convertibles ex Mandatory (V0A0)	Represents all U.S. convertibles, excluding mandatory convertibles, small issues and bankruptcies.	Bank of America
Bloomberg Barclays U.S. Convertible Bond > $500MM Index	The index is designed to represent the market of U.S. convertible securities, such as convertible bonds, with outstanding issue sizes greater than $500 million.	Bloomberg data / Barclays

Investors cannot directly invest in an index and unmanaged index returns do not reflect any fees, expenses or sales charges.

Investments in convertible securities subject the Fund to the risks associated with both fixed-income securities, including credit risk and interest risk, and common stocks. A portion of the Fund's convertible securities may be rated below investment grade. Exchangeable and synthetic convertible securities may be more volatile and less liquid than traditional convertible securities. In general, stock and other equity security values fluctuate, and sometimes widely fluctuate, in response to activities specific to the company as well as general market, economic and political conditions. Lower rated fixed-income securities are subject to greater risk of loss of income and principal than higher-rated securities. The prices of lower rated bonds are likely to be more sensitive to adverse economic changes or individual corporate developments. All fixed-income securities are subject to two types of risk: credit risk and interest rate risk. When the general level of interest rates goes up, the prices of most fixed-income securities go down. When the general level of interest rates goes down, the prices of most fixed income securities go up.

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