Wellesley Asset Management Commentary | October 2017

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Third Quarter Total Return Comparison (%, through 09/30/2017):

	Q3 2017	YTD	1 Year	3 Years*	5 Years*	Since Inception 12/31/2007*	10 Years*	Since 1/1/2000*
Miller Convertible Bond Fund I (MCIFX)	1.93	5.02	5.84	4.88	8.22	6.76	N/A	N/A
TRW	2.27	5.87	7.15	6.12	9.07	7.62	7.44	8.50
S&P 500 TR	4.48	14.24	18.61	10.81	14.22	8.01	7.44	5.10
Bloomberg Barclays U.S. Aggregate Bond	0.85	3.14	0.07	2.71	2.06	4.07	4.27	5.17

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.*

What Keeps Me Up at Night

By Jim Buckham CFA, Portfolio Manager

As a follower of the markets, I am often asked "What keeps you up at night"? This is another way of asking what concerns me about the current state of the capital markets. I would like to share some of my observations about the stock and bond markets and why I feel that, going forward, investors should proceed with caution.

The Stock Market

We are currently in the second longest stock bull market in history. The price action has been fairly orderly as the market continues to grind higher in a very non-volatile fashion. Investors remain complacent and the market refuses to react to potential issues such as lack of progress with government reforms, international instability, and high equity valuations. In early October, the VIX, a well-known barometer for market volatility, closed at an all-time low of 9.19. We have yet to experience panic buying that can often signify market tops. Remember the fourth quarter of 1999 when the Nasdaq was up over 45%. However, there are some fundamental differences with the composition of today's markets that are cause for concern.

The breadth of the market rally has been fairly widespread. When one market leading sector suffers a setback, another sector takes over to lead the market higher. Despite the breadth of the market rally, fewer stocks are driving market returns higher. In 1975, the largest 109 companies accounted for half of the profits made by U.S. companies. By 2015, the largest 30 firms accounted for half of the profits made by U.S. companies. The market capitalization of the top five stocks in the S&P 500 (Microsoft, Google, Amazon, Apple, and Facebook) is greater than the market capitalization of the bottom 250 stocks. Since the performance of the index is market cap weighted, these five stocks have accounted for almost 25% of the S&P 500 return this year. Stated differently, one percent of the stocks in the S&P 500 have accounted for 25% of the index's performance, possibly raising the danger of concentration risk. It's hard to argue that S&P 500 investors are buying into a diversified index.

Another change in the marketplace has been the proliferation of passively managed funds. It is estimated that nearly 20% of the assets held by investors today are in passively managed funds, which have the goal of replicating the performance of an index. The allure of these funds is that they charge lower fees than actively traded funds and, in recent history, they have outperformed a majority of actively managed funds.

My concern is that the combination of these changes in market structure is creating a positive feedback loop. More investors are seeking lower priced funds that deliver 100% of the market return. This is creating inflows into passively managed funds. As these funds receive inflows, they must invest in the stocks in the underlying index. In the case of the S&P 500, which is the most common proxy for the equity market, a disproportionate amount of these funds is invested in the top five stocks, causing those stocks to go higher. This in turn, drives the return of the index higher and creates more demand for passively managed funds as investors chase performance.

The disconnect is that with passive investing, there is no reality check with respect to stock fundamentals. Many active fund managers with valuation disciplines have stopped buying the top five stocks in the S&P 500 as the prices have soared. Unfortunately, the more these stocks outperform the index, the larger the percentage of the index they become. It's easy to see why active managers continue to underperform the S&P 500 index (and the correspondent ETFs).

Don't get me wrong, I think these five companies are leaders in their industry with amazing potential for future earnings growth. Furthermore, they are in fine financial shape with large cash reserves and solid balance sheets. But what price should investors be willing to pay for the future earnings of these companies? The forward P/E ratio (non-GAAP) of Amazon has risen this year from 38x to 61x. At what point do investors stop paying inflated prices for high growth stocks?

I don't know what will cause this bull market to end or when it will end. Some potential bear market catalysts include the return of inflation, geopolitical risks, and anti-trust action against some of the large technology companies mentioned in this writing. It's not hard to imagine a scenario where the economy slows and stocks sell off. When this happens, investors will realize that getting 100% of the market return isn't so fun after all. They will in turn try to sell stocks as they seek to return to the safety of cash. But the marginal buyer of stocks won't buy until valuations return to normal levels or the economy starts to turn around. In this environment, I can see a scenario where active managers will outperform passive ETFs causing investors to rethink the management fee versus performance equation.

The Bond Market

Perhaps more disturbing are trends in the global fixed income markets. In the United States, bond yields have been declining for 35 years and corporate credit spreads are at some of the lowest levels in history. In response to the 2008 financial crisis, many central banks have resorted to the similar strategies to revive the economies of the world. In an effort to promote growth, central banks have reduced short term interest rates to zero or near zero levels. Sensing that this wasn't having enough impact, many central banks purchased government bonds in an effort to reduce long-term rates. Some central banks even took this a bit farther by purchasing corporate bonds and stocks.

While central bank policy could create challenges for U.S. bond investors going forward, I feel that it has led European bond investors to grossly misprice risk. In 2009, the Bank of America Euro High Yield Index yielded

25% and had a spread over U.S. Treasuries of 22%. Today that index yields 2.3% and the spread is now below the U.S. 10 year yield. The table below shows how quickly bond yields have collapsed in Europe.

% of Eurozone Junk Bonds with Yields below U.S. Treasuries:

2017	72%
2016	16%
2015	8%
2014	5%
2013	3%
2012	0%

I have a hard time believing that 72% of the high yield issuers in Europe are more credit worthy than the U.S. government.

The low interest rate environment is also affecting the rates at which sovereign entities can issue debt. In 2012, Ireland issued a 5 year bond with a 5.5% coupon. In early October, Ireland decided to issue €4 Billion over 5 years. Because there was €10 Billion in demand for the issue, the bond was priced slightly above par with a 0% coupon. Investors who hold the debt to maturity are guaranteed to lose .008% over the five year life of the bond! A recent study by Deutsche Bank estimates that 17% or $8 trillion of global debt outstanding trades at negative interest rates.

Back in the U.S., the economy is showing signs of life as the unemployment rate has returned to the 4-4.5% range. Though inflation is running low at 2%, the Federal Reserve has raised rates four times to the 1-1.25% range as the economy returns to more normal growth. Furthermore, the Federal Reserve intends to shrink its balance sheet over the next several years. As bonds mature that the central bank bought as part its Quantitative Easing program, the Federal Reserve will not replace them. It will be interesting to see what happens to long-term rates as one of the largest buyers of Treasuries over the last several years exits the market.

Low interest rates in the United States have been a boon for both U.S. government and corporations issuing debt. The government has been able to service ever increasing levels of debt with relative ease due to the low interest rate environment. Investors looking for yield have been forced to go further out the risk curve by extending the maturities they invest in or lowering the quality of credit they invest in. Corporations have been the beneficiaries of this as they have been able to issue large amounts of debt at historically low rates.

Unfortunately, all debt eventually matures and must then be refinanced. It is estimated that the market capitalization of the high yield market is between $1.5 trillion and $2 trillion. A recent article by Bloomberg states just over $1 trillion of junk debt will mature by 2021, with the bulk of it occurring after 2019. Given that both short- and long-term rates are trending higher and credit spreads are near all-time lows, it's hard to believe that more than half the U.S. high yield market will be able to refinance at advantageous rates over the next few years.

What keeps me up at night?

I have many concerns about investor complacency, valuations, and potential shocks to U.S. stock and bond markets. When people ask me "what keeps you up at night?" I refer to the points discussed in this piece. Invariably though, I like to talk about what doesn't keep me up at night. At that point the conversation usually turns towards Wellesley Asset Management's strategy for managing convertible bonds. Not only do I invest client's money in our strategy, I also invest a substantial amount of my own money in the strategy. Our strategy centers around one core principle: protection of principal. We have found that by investing in, short duration convertible bonds of high quality companies, we have historically been able to outperform both stocks and bonds over full market cycles. Most importantly, by taking a conservative approach, it has been our experience that during bear markets, our strategy may not go down as much or stay down as long as equities. And that is what allows me to sleep at night.

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.

NOT FDIC INSURED – NOT BANK GUARANTEED – MAY LOSE VALUE

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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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