Limited Risk Investor™

The Ultimate Guide to Building and Preserving Your Wealth with Convertibles

FALL 2016 EDITION

Greg Miller, Publisher
Darlene Murphy, Editor
Wellesley Asset Management, Inc.
20 William Street, Wellesley, MA 02481
781-416-4000 www.WellesleyInvestment.com

IN THIS ISSUE ...

Barron's Ranks Greg Miller One of America's Top 100 Independent Financial Advisors for the Sixth Consecutive Year

For the sixth year in a row, Greg Miller and Wellesley Asset Management have been named one of America's Top 100 Independent Financial Advisors by *Barron's* Magazine. In the August 29, 2016 publication, Greg ranked 9th on the list, marking the second consecutive year that he has ranked in the top ten nationwide.

As we celebrate our 25th anniversary year of helping our clients grow and protect their wealth, we are extremely honored to be recognized once again by *Barron's*. The criteria evaluated by *Barron's* are: the advisor's assets under management, annual revenue generated, and quality of business practices. The advisor must also maintain a clean regulatory record to be considered. In the magazine's Special Report, *Barron's* states, "Independent financial advisors are a fast-growing group. And many of them attribute their success to delivering a 'fiduciary' standard of client care—in which clients' interests are placed first and foremost."

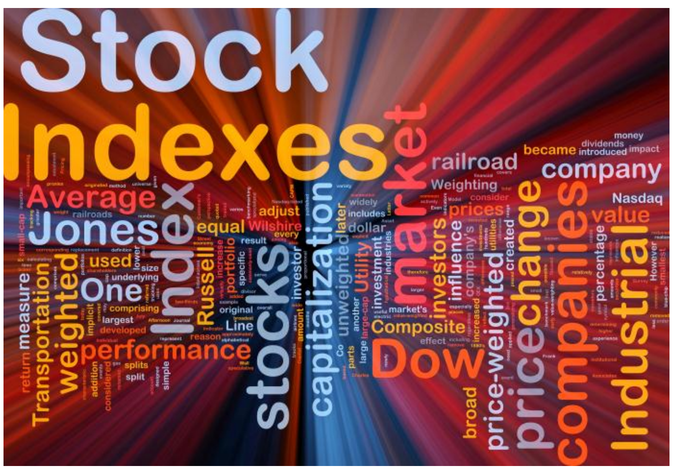
We extend our sincere gratitude to our loyal clients for their trust in our services and to our team of dedicated employees who continually work toward making these types of recognitions possible.

This Market Bears Watching

By Jim Buckham, CFA, Portfolio Manager

Anyone lucky enough to have invested their money in the Dow Jones Industrial Average since its inception would have been rewarded handsomely. The Dow's chart through time moves nicely from the lower left corner to the upper right corner. Since the start of the Dow in 1896, the price of the index has increased over 450 times! However, like most financial instruments, the Dow has experienced downturns along the way. Any time an index trades down (up) 20% from its most recent high (low), market technicians say the index is in a bear (bull) market. Although the Dow has performed extremely well over time, it turns out the index has also experienced a lot of bear markets along the way.

We conducted a study to determine how many bear markets there have been in the Dow Jones Industrial Average throughout time. We chose the Dow because it has the longest history of any index. What we found was that for every decade there were one to three bear markets.* In addition, the average return for each bear market has been a loss of 36%. Not only are bear markets common occurrences throughout history, but when they happen, they result in large losses for investors.



Given this knowledge, what are long-term investors supposed to do? There have been several studies showing that market timing does not work for the vast majority of investors. Investors engaging in timing more often than not buy high and sell low. With that said it is not easy to be a buy and hold investor and watch the value of your stock portfolio decline by a third or more in a bear market. Furthermore, the day to day volatility of a stock portfolio can be hard to take.

Fortunately, there is one instrument that, if properly deployed, may alleviate some of the challenges that investors face – convertible bonds using the Thomson Reuters Wellesley Absolute Convertible Bond Index (TRW) absolute return strategy. Buying a portfolio of short-dated, high quality convertible bonds can take some of the guess work out of market timing and may still provide equity-like returns. Unlike stocks, convertible bonds have a fixed date in the future when the investor, barring a default, can get his principal back. This feature provides protection in the case of a bear market and provides faster recovery times. In the bear market 2008, The TRW Index was back to even within six months, whereas it took equity investors over three years to recover. Furthermore, convertible bond returns are about one third less volatile than the returns of equities.

We feel that the subject of bear markets is timely because the current bull market has been going on since 2009. This makes it the second longest bull market in history. In addition, we are almost in the seventh year of this decade and we have yet to have a bear market. Apparently we are not the only ones concerned about the prospect of a bear market. A recent *Barron's* survey of investment strategists finds the group less optimistic than they were at the time of the last survey in December. Their concerns include U.S. elections, Fed rate increases, weakness in China, and post-Brexit turmoil in Europe.

Market history has shown that holding equities over long periods of time provides investors with solid returns. However, we also know that bear markets are inevitable. When they do occur, bear markets can lead to large losses and long recovery times. Convertible bonds offer investors the potential to achieve equity-like returns without some of the negative consequences of equity investing. Convertible bonds are about two thirds as volatile as equities and recover much quicker from market downturns than equities. While we would like to see the markets continually trade higher, we know there will be market corrections and bear markets. An investment in convertible bonds can help mitigate the risks involved in equity investing.

*The Dow Jones Industrial Average was down 19% once during the 1950s. However, since the S&P 500 did have a 22% decline in 1957, many investment professionals consider the decade to have had a (single) bear market.

Risk-Adjusted Performance and the Sharpe Ratio

By Sean Edelman
Associate Portfolio Analyst

Last time you researched a new investment strategy or mutual fund to add to your portfolio, what was the ultimate deciding factor on what you picked? Most investors' response would be a resounding "performance!" The most prominent figures in the investment world like Carl Icahn and Bill Ackman are famous because of how strong their raw performance has been for their investors. But the truth of the matter is that with large returns often comes a large amount of risk, and most investors do not have nearly as strong of a risk appetite as they might think they do. When investments start experiencing large amounts of volatility, many get skittish seeing their portfolios losing money and sell out of a mutual fund at a loss, most likely missing out on the recovery when asset prices rise again. Jumping from strategy to strategy when things get rocky is an easy way to achieve long-term underperformance.

Therefore, we believe a superior way to help determine which mutual fund strategy fits your portfolio would encompass both the performance of the fund *and* how much risk, or volatility, the fund takes on to achieve that performance. This is known as risk-adjusted performance and fortunately there is a simple and useful measure to calculate it called a fund's **Sharpe ratio**.

Sharpe ratio is a measure that takes the performance of an investment and factors in the volatility of that investment over the same time period. All things equal, a higher Sharpe ratio for a fund may be better, just like when comparing raw performance. In technical terms, the Sharpe ratio is defined as "a measure that indicates the average return minus the risk-free return divided by the standard deviation of return on an investment." While that may seem very technical, it's actually rather simple: average return is the performance of the investment, risk-free return is the return one would get by investing in an essentially risk-free investment like a 3 month U.S. Treasury Bond, and standard deviation is a measure of the volatility, or risk, of the investment. This is what it looks like in equation form:

$$\boldsymbol{Sharpe\ Ratio = \frac{Return - Risk_{Free}}{Standard\ Dev}}$$

Let's use a hypothetical example to illustrate how it works: an investor is trying to decide whether or not to invest in the ABC Mutual Fund or the XYZ Mutual Fund. Over the past year, ABC has had a total return of 10% and a standard deviation of 5%, XYZ returned 15% and had a standard deviation of 10%, and the risk-free rate was 1%. On a quick glance at performance, one would think that XYZ is the preferable investment as it outperformed ABC by 5%, but let's plug those figures into our Sharpe ratio equation and see if it tells a different story:

$$ABC\ Sharpe = \frac{10\% - 1\%}{5\%} = \frac{9\%}{5\%} = 1.8$$

$$XYZ\ Sharpe = \frac{15\% - 1\%}{10\%} = \frac{14\%}{10\%} = 1.4$$

Even though the XYZ Mutual Fund had a higher return than the ABC Mutual Fund, ABC had a higher Sharpe ratio, meaning it outperformed XYZ on a risk-adjusted basis. A savvy risk-adverse investor would therefore then choose ABC over XYZ as the Sharpe ratio shows that ABC is gaining more return per each unit of risk than XYZ Mutual Fund.

At Wellesley we have always been risk-adverse investors, hence our LRI strategy of building portfolios of balanced short-duration convertible bonds with the goal to outperform over full market cycles, and which can lead to outperformance on a risk-adjusted basis. We believe that investors don't like

For illustrative purposes only. This does not represent any Wellesley Asset Management products.

enduring risk in their portfolios and our balanced convertible strategy aims to provide strong performance with low volatility. Here's how our flagship mutual fund, the Miller Convertible Bond Fund (MCIFX), has compared to its competitors* on Sharpe over the past 1 year, 3 years, 5 years, and since inception of 12/31/2007:

those time periods. Going back to the Miller Fund's month-end inception of 12/31/07, its Sharpe ratio beats out the other convertible funds. This is because that time period encompasses the down market of 2008, and therefore our full-market cycle focus shows its benefit.

Annualized Returns as of September 30, 2016

Convertible Fund Name	1 Year Return	1 Year Sharpe	3 Year Return	3 Year Sharpe	5 Year Return	5 Year Sharpe	Return since MCIFX Inception	Sharpe since MCIFX Inception
Miller Convertible Bond (MCIFX)	**11.43%**	**1.18**	**6.46%**	**0.88**	**9.62%**	**1.27**	**6.87%**	**0.63**
Invesco Convertible Securities (CNSDX)	6.28%	0.70	3.81%	0.50	9.24%	1.14	6.43%	0.49
Franklin Convertible Securities (FCSZX)	13.02%	1.31	6.68%	0.79	11.51%	1.24	6.94%	0.46
MainStay Convertible (MCNVX)	11.87%	1.00	6.50%	0.70	11.56%	1.17	6.10%	0.41
Vanguard Convertible Securities (VCVSX)	6.20%	0.72	3.47%	0.48	8.93%	1.12	5.55%	0.41
Putnam Convertible Securities (PCGYX)	8.52%	0.77	5.08%	0.56	9.89%	1.08	5.65%	0.37
Lord Abbett Convertible (LCFYX)	9.87%	0.87	4.58%	0.47	9.53%	0.99	4.68%	0.35
Calamos Convertible (CCVIX)	7.33%	0.68	3.91%	0.43	7.10%	0.77	4.34%	0.34
Fidelity Convertible Securities (FICVX)	6.87%	0.52	3.60%	0.35	9.84%	0.90	4.34%	0.22

Analysis created by Zephyr StyleADVISOR. Manager returns supplied by Morningstar Inc.

For illustrative purposes only. This does not represent any Wellesley Asset Management products. The above funds may contain securities other than convertible debt such as convertible preferred shares, mandatory convertibles, preferred securities and equities. 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.

Factors that may affect performance:

As of June 30, 2016 the percentage of holdings in convertible bonds were: MCIFX approximately 92%, CICVX 62.6%, PCGYX 66.2%, FCSZX 95.57%, CNSDX 65.54%, VCVSX 89.4%, FCVSX 46.8% as of 7/31/16, LCFYX 65.4% as of 8/31/16, and VCVSX 89.4% as of 5/31/16.

As of June 30, 2016 the gross expense ratio for each fund was as follows: MCIFX 0.94%, CICVX 0.88%, PCGYX 0.81%, FCSZX 0.61%, CNSDX 0.63%, FCVSX 0.56%, MCNVX 0.74%, LCFYX 0.86%, and VCVSX 0.38%.

While the Franklin and MainStay Funds outperformed the Miller Fund over the past 3 and 5 years, we feel they've had to do so by taking more risk and therefore achieved a lower Sharpe ratio over

With equity prices at all-time highs and global uncertainty reaching a boiling point with the Brexit, refugee crisis, and a contested U.S. election, it's possible that the next down market is just around the corner. When it does eventually arrive, investors don't want to suddenly realize they've taken on much more risk in their portfolio than they previously thought. Focusing on risk-adjusted metrics like the Sharpe ratio when making decisions on mutual fund strategies may be a great way to make sure you are taking on an appropriate risk level in your portfolio and investing in strategies that suit your investment needs.

*Major convertible mutual funds whose inception date precedes that of the Miller Convertible Bond Fund (12/31/07).

Please see important disclosures relating to this article on page 8. 7803-NLD-10/3/2016

What to Consider When Choosing a Financial Advisor

By Joseph Buscaino, Executive Vice President, Wellesley Investment Advisors

Selecting an advisor to work with is a difficult task. What are the most important questions to ask the advisor and how many advisors should you meet with before selecting one? The process may seem as overwhelming as investing on your own, but good instinct, sound judgment, and a few simple questions can provide you with the direction you need.

- Are you a "Fee-Only" Advisor?
- Do you have other business interests; specifically do you provide other services for a fee?
- What is your track-record and does it include both a bull and bear market (also referred to as a complete market cycle)?

These are a few of the most important questions to ask, and based on the answers you will know whether or not you have an advisor you can TRUST.

Are you a "Fee-Only" Advisor?

A "Fee-Only" Advisor, is an advisor who charges a fixed fee which is typically a percentage of the assets that you entrust them with. The alternative, a Commissioned Advisor, is an advisor who typically receives a fee from the investor plus receives additional compensation from the securities they choose for you.

A "Fee-Only" Advisor is working for you. They select investments best suited for your investment profile without the bias created by having greater or lesser pay from the securities they select. Because they are charging a fixed percentage, as your portfolio grows that percentage remains the same but the dollar amount grows, meaning that the better you do the better they do. A Win Win!

Commissioned Advisors may receive additional payments from the securities they select and those fees are not all the same. Examples of additional fees collected include 12(b)-1 fees and loads from mutual funds. These fees are typically paid upfront so the incentive to continue to provide superior service is lessened. Some of their investment options may pay more than others, creating a conflict of interest. The difficult decision for these advisors is when they find two similar investments that both meet the client's risk tolerance but one pays them more. Will they find reasons to select the fund that puts more money in their pockets?

Understanding whether your advisor is a Fee-Only or a Commissioned Advisor is important. A recent study conducted by the Paladin Registry found that less than 14% of advisors polled claim to be clear on all the fees they collect, for fear that the client or prospect will find their fees to be too high.

Do you have other business interests; specifically do you provide other services for a fee?

Your advisor should serve as your financial quarterback; they must know everything that is happening with your finances and be able to provide advice in several areas. Being well-rounded and knowledgeable in all aspects of your financial picture is paramount, but if they are providing additional services for a fee it leaves one to wonder if they really needed any or all of the additional services they purchased.

Understanding financial planning is important but not all investors need a complete financial plan. They may only need a cash flow analysis. If your advisor is providing financial planning for a fee, they may be inclined to promote a more thorough financial plan. Insurance planning is an important part of financial planning; so if your advisor is also selling insurance, they will be paid handsomely up-front for those services sold and therefore may recommend a greater amount of insurance than one needs. Trusts are a powerful tool to help families protect their funds and assure that their assets pass on to the persons or organizations that they select. However, for most investors there are less expensive options such as designating beneficiaries on their IRAs, setting up a transfer on death account, and/or a simple will may be sufficient and much more cost effective.

The solution is to work with an advisor who has a thorough understanding of all aspects of financial planning and one who has a strong network of independent financial planners, estate planners, insurance agents, and accountants that they have vetted and feel comfortable introducing to their clients. Additionally, it is best if the advisor is not receiving financial compensation for the referral.

What is your track-record and does it include both a bull and bear market (also referred to as a complete market cycle)?

The bottom line in working with a successful financial advisor is finding one that helps you make money during the good times and shelters you during the bad times. Although past performance is no indication of future results, past performance can help you best understand how their strategy worked during bull and bear markets and can set a benchmark for you to measure them going forward.

If an advisor is not willing to provide you with their performance, you must wonder what they are hiding. Although they may customize each client's account, they could easily provide performance on how the entire group did as a whole. Additionally, hiring a reputable firm to review this performance is equally important.

If they have multiple strategies, they may have multiple performance reports. Request that they provide you with the performance on each so you can best understand why they are promoting the program they are presenting to you. Is it presented because it has the best short-term performance or because it meets your investment needs and objectives?

Be sure that the performance that they are stating is not back-tested, meaning that it was achieved with real invested dollars and not a new strategy that they came up with recently but are now looking back and stating if they had invested in this manner, they would have made X%.

Asking the right questions in the beginning helps ensure that there will be fewer surprises later. Having an advisor who is transparent, forthcoming, and puts your interests first allows you a greater ability to trust them to help you reach your financial goals.

Mutual Fund or Separately Managed Account?

By Jim Buckham, CFA, Portfolio Manager

When investors first come to Wellesley Asset Management, they often ask, "Should I invest in a separately managed account (SMA), or the mutual funds?" Our answer to that question depends upon market conditions and individual investor needs. We thought it would be topical to point out the benefits and drawbacks of each of these investments in an effort to better educate our investors.

A mutual fund pools investors' money and buys securities on behalf of its shareholders. Shares of the mutual fund can be bought and sold at the end of each day based on the closing net asset value (NAV). An SMA, on the other hand, is a portfolio of 20-35 holdings which are owned exclusively by the holder of the account. By definition, mutual funds are generally more liquid than SMAs. If an investor wants to gain exposure to convertible bonds through mutual funds, an investor can buy shares at today's closing price. For an investor wanting to start an SMA, the process of buying 20-35 individual convertible bond holdings can take weeks. Similarly, an investor wanting to raise cash from a mutual fund can sell shares at today's closing price. For the SMA holder, this process may take longer as individual holdings will have to be sold.

A convertible bond can be issued in one of two forms: registered convertible bonds or Rule 144A convertible securities ("144A bonds"). Anyone can buy a registered convertible bond. However, only qualified institutional buyers (QIBs) can buy 144A bonds. A QIB must have $100 million in investable assets and cannot be an individual. Because the mutual funds are QIBs, they can buy both registered and 144A bonds. For this reason, we typically have 70-80 positions in our mutual funds as opposed to the 20-35 bonds in SMAs. Most 144A bonds become registered after a one year "seasoning" period. However, there is no guarantee that the bonds will be trading within our buying parameters after a year.

Investors in the mutual funds are buying into more mature investments, with higher average prices and more price dispersion. At Wellesley Asset Management, we seek to purchase bonds at no or small loss to worst. What this means is that we buy bonds at a price that, barring a default, should return investors their principal. When we are building a new SMA, this means that our purchase price is at or around par. However, as time passes, the prices of the bonds will fluctuate. Some will go up while others may decline, leading to increased price dispersion. If the underlying equity market trades higher, as it has for the last seven years, the average price of the bonds will rise.

Taxes are another factor that differentiates the funds and SMAs. In an SMA, the owner is only accountable for the gains and losses that have occurred in the account for the period he has invested in. A drawback to the mutual fund structure is that investors could end up paying for gains that happened prior to their initial investment. At Wellesley Asset Management we may use tax equalization in the mutual funds to try to mitigate this drawback.

Until recently, one could have argued that the SMA was better at meeting the needs of investors with different risk tolerances. However, two years ago, Wellesley Asset Management introduced two new funds to help align investment offerings with various investor risk tolerances. One of our mutual funds employs leverage and offers an aggressive option to invest in convertible bonds, while the other is more conservative, investing in a combination of convertible bonds, traditional bonds and Treasuries.

Given the current market conditions, we think the benefits of investing in our mutual funds outweigh the benefits of investing in an SMA. This year almost 60% of the new convertible bond offerings have been issued with the 144A restriction. For this reason, our funds have participated in more new deals than the SMAs. Also, the funds, since they are QIBs, can have more holdings than most SMAs and are more diversified. Now that Wellesley Asset Management offers three mutual funds, we can construct a portfolio of mutual funds to meet the needs of our investors with varying risk tolerances. As always, your individual investor needs will determine which investment vehicle is right for you. For this reason, we recommend that you discuss your situation with your advisor at Wellesley Asset Management.

Important Disclosures Pertaining to Article: Risk-Adjusted Performance and the Sharpe Ratio

Past performance is no guarantee of future results. This material is solely for informational purposes. The information presented herein has been developed internally and/or obtained from sources believed to be reliable; however, Wellesley Asset Management does not guarantee the accuracy, adequacy, or completeness of such information.

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.

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.

7803-NLD-10/3/2016

Other Important Disclosures: *Past performance is no guarantee of future results. No content in this newsletter should be construed as specific investment advice, or replacement for investment advice from Wellesley Asset Management, Inc. (Wellesley), or any other investment professional. This is not an offer to purchase securities. Certain securities are presented solely to illustrate Wellesley's investment process and its analysis and views of the securities presented as of the date indicated. The securities presented are not representative of all the securities purchased, sold or held for advisory clients, and it should not be assumed that the investment in the securities identified were or will be profitable. Wellesley's views of, recommendations with respect to, and investment decisions regarding, the recommendations are subject to change continually and without notice and may no longer be true after the date indicated. Although information has been obtained from and is based on sources Wellesley believes to be reliable, Wellesley does not guarantee the accuracy of the information, and it may be incomplete or condensed. All investments, including convertible bonds, have a risk of loss. Ratings and rankings by third parties are not a guaranty of future performance.*

 DM101416-1-54