NEPSIS CAPITAL MANAGEMENT

3RD QUARTER 2016 UPDATE

"INDIVIDUALS WHO CANNOT MASTER THEIR EMOTIONS ARE ILL-SUITED TO PROFIT FROM THE INVESTMENT PROCESS"

– Ben Graham

Oops… Well, I'm guessing that many investors were probably a bit surprised by the continued rebound in markets in the third quarter. You may be asking yourself, why would that be the case? It's simple – the numbers don't lie!

Investors continue to feel nervous about investing for several reasons. Of course, more than likely, the biggest reason is this election. Unfortunately, for those investors who think it's better to sit in cash or not stick to their investment plan until the election is over, may find that once again, trying to "time the market" could end up being a futile exercise.

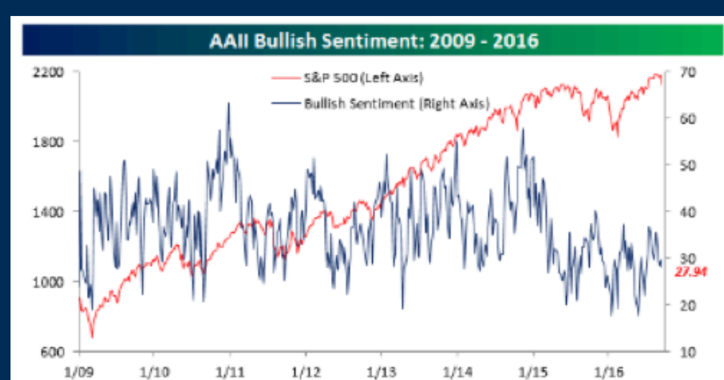
As evidenced by the chart below, there is "No Bull" to be found! According to the AAII reading, bullish sentiment continues to be at historical lows. In fact, as of today there is approximately 20% more sitting in cash than there was in 2010, right after the Financial Crisis.

AAII Sentiment: A One Way Street

Sep 15, 2016

Investor sentiment these days is a bit of a puzzle. When the markets go down, bullish sentiment retreats while bearish sentiment spikes. However, when the market rises, bullish sentiment stays flat. This week's survey from AAII is a perfect example. In the latest week, which includes the declines that began last Friday, bullish sentiment declined from 19.75% down to 27.94%. This represents the 46th straight week and the 80th time in the last 81 weeks that bullish sentiment has been below 40%.

Source: AAII



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"NO BULL" *Continued*

Each quarter, for the last 2+ years, I have been warning investors to expect exactly what has been going on – increased volatility and very small to no growth in the over-all markets, portfolios and economy. Therefore, when investors decide to try and time their investment decisions, they could end up missing a significant amount of portfolio performance by sitting in cash.

Need a reminder? After what we saw in the first quarter of 2016 and the associated volatility, there is no better example of what we consistently tell clients about investing, –"The key to successful investing is time in the markets (or more importantly time owning the businesses we own) and NOT timing the markets."

As evidenced by numbers published by various organizations, many investors continue to hold cash in hopes of a better time to invest. Unfortunately, if we are going to continue with a slow growth environment, the low index and portfolio returns we have seen the last few years could continue.

Bottom line: Stick to your plan!

I want to continue to remind you that you should always be prepared for a sizable correction or stock market crash. As always, corrections and crashes come and go. What is important to remember about crashes and corrections is that they create opportunities to take advantage of increasing the quality of your portfolio and positioning the portfolio for the next stage of growth.

Folks, do not be surprised if we see a major rally into the end of the year after the election. With the amount of money in cash and historically low interest rates making bonds unattractive, at some point, investors will be looking for the best place to invest. I continue to believe, one of the keys to successful investing is investing in great businesses over time!

Are we going to see the elusive 20% market correction?

I am sure that many of our clients have seen the chart below, as we add this chart every quarter to our updates. I believe this chart is a great reminder to our clients of the historical frequency of stock market corrections. Of course, as we have reminded our clients over and over again, we have yet to see a 20% correction since the financial crisis almost 8 years ago.

Magnitude of Market Decline	Frequency of Occurrence
>5%	Every Year
>10%	Every 2 Years
>20%	Every 5 Years
>30%	Every 10 Years
>40%	Every 25 Years
>50%	Every 50 Years

Source: Morningstar

When will we see a correction of the 20% magnitude? Who knows? But, I believe it is important for us to remember corrections happen and will continue to happen in the future.

If the volatility associated with your portfolio bothers you, please consult with your advisor on what may be the appropriate allocation for your particular situation and portfolio.

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The Investment Process vs the Investment Product

As if investors don't have enough to worry about regarding their investments, they now have to contend with changes happening within the investment industry. Recently, the Department of Labor (DoL) announced sweeping changes that will significantly affect the financial services industry. Without going into all of the details regarding these changes, I can say that we at Nepsis Capital have been waiting for these changes to take place for years. **Therefore, we believe these changes will only enhance the value Nepsis provides to its clients. Clarity is the bottom line!**

As many suggest, it can be argued whether or not the DoL changes will severely impact the financial services industry. One thing I believe certainly will happen, is that these changes will impact how investors make decisions on how they want to have their investments managed.

For example, there's a growing trend in the investment world called, "Robo-Investing" or "Robo-Advisor". A "Robo-Advisor" is an online wealth management service that provides automated, algorithm-based portfolio management advice without the use of human financial planners. A major selling point of the "Robo-Advisor" is the "cost" for the asset management is cheaper than many conventional investment options. In light of the growth in the Robo marketplace, I believe the mandated DoL changes will create an environment where investors will be misguided in their decision-making process as to how and who should manage their portfolio.

Along with the push for "cheaper" money management, the media and the companies selling index mutual funds and/or exchange traded funds are pushing the idea of only investing in indexes. They claim they are cheaper and the performance is better than active management. This isn't necessarily true - comparing "active management" vs "passive management" (i.e., investing in indexes), is NOT an apples to apples comparison.

Although there may be advantages and disadvantages to both, the one issue the DoL rules changes and growth of Robo-Investing have not addressed is the behavioral aspect of the average investor. ***This of course is one of the key areas in which Clarity becomes a critical component to successful investing!***

Bottom Line:

Although the investment media and biased investment companies may suggest that the "cheapest" is the best, a time will come when investors will realize that they have yet again been misled and tempted by an "easy" fix for their investment portfolios. Unfortunately at that point in time, it will be too late for investors and the only winners will once again be Wall Street.

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The Headline vs The Bottom Line

Recently, I came across the headline, "Active Management Could Rise from the Dead", published on October 19, 2016 in Forbes. As the article starts, it says, "In August 1979, BusinessWeek famously proclaimed 'The Death of Equities' - right before one of the longest and largest bull markets of all time began.

As I discussed earlier, there continues to be a prevailing thought on Wall Street that investors are better suited owning index funds as opposed to having their portfolio actively management. Their argument is based on primarily two premises. First, the majority of active fund managers underperform their stated benchmarks and the second, they are less expensive than active management, thus leading to a no brainer.

I could not agree more with these premises. First there are inherent flaws in stock market indexes that Wall Street doesn't want to talk about. This includes the potential liquidity issues regarding index funds as well as the structural issues of an index fund. Never mind the fact that in most instances the comparison of an active fund to a passive fund is a flawed process. But, why would you care about that? After all, don't investors spend most of their time chasing historical performances?

Many of you reading this update may remember the "glory days "of 1996 through 1999. Remember those days when the S&P and other indexes continued to hit all time highs? At that time, all the glitter talk was the same: invest in the S&P 500 index because most managers underperform.

What did that lead to? It lead to a stock market bubble that eventually burst in March of 2000.

The reality is, like everything, there are cycles in investing. There are periods when indexes appear to do better and then there are periods when active management appears to do better.

Bottom Line:

At the end of the day, what Wall Street and the media are not talking about is that investors have different investment needs, objectives, and goals. Although many try to fit all investors into a box or into categories, the reality is that no one client is the same. Invest and plan like a business owner – build, monitor and adjust your plan based on your goals and needs. When it comes to your investments, Invest with Clarity!

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SYNOPSIS OF PORTFOLIO PERFORMANCE FOR THE THIRD QUARTER OF 2016

The third quarter continued to show market strength. Of course, it was not without a level of volatility, especially for the healthcare, energy and to the surprise of some investors, dividend stocks.

As I have written in recent updates, investors must be somewhat cautious as it pertains to valuations in dividend producing stocks. Companies that our clients own, such as JNJ, GIS & KHC, are all great companies with nice dividends. However, they also became quite expense. Investors should NOT be surprised that over short periods of time, when the value of a stock has the kinds of moves we have seen in dividend stocks, a pullback will more than likely happen in the future. This quarter was no different.

Of course, we don't manage portfolios for the short-term. When we see the potential headwinds in companies or sectors which we are invested in, it is prudent to monitor the situation and make adjustments if and when it is needed and appropriate.

This was no different in the third quarter as we took some profits in some of the dividend companies in portfolios.

Lastly, and maybe most importantly, our Investment Philosophy & Strategy calls for portfolio diversification, NOT, over-diversification (arguably, an inefficient form of investing). However, as fiduciaries of our client's assets, we must adhere to appropriate portfolio diversification. Therefore, our portfolios continue to be invested in both the U.S. as well as international and emerging market companies.

> **"Portfolio theory mandates appropriate diversification which means allocating assets in international businesses and emerging market businesses along with owning U.S. businesses."**

Bottom Line:

We continue to be extremely proud of our long-term performance of client portfolios. Portfolio theory mandates appropriate diversification which means allocating assets in international businesses and emerging market businesses along with owning U.S. businesses. Government policy continues to limit economic growth. Portfolio returns will continue to come in the form of inconsistent short-term performance. Long-term view will continue to be the best approach to successful investing.

STATE OF THE "MARKETS"

Although I addressed the current status regarding the markets earlier, below are additional points you should consider regarding the current investment climate. As we have moved through the third quarter of 2016, investment "themes" continue to be difficult to gauge.

Other notable themes in the last quarter include the following:

1. Investors continue to pay for "growth". However, the bio-tech and healthcare sectors have continued to be very weak and will probably continue this way until we have greater clarity on who will be the next President of the U.S.

2. Energy continues to bounce around between $40-$50 a barrel. It is my belief it will continue to trade in a range until we see some noticeable pickup in the overall economy.

3. For many years now, investors have paid very expensive prices for investing in "growth" stocks. Stocks whose valuations, many would argue are that of the pre-bubble in 1999. I believe this is pretty typical when you have an environment of very low interest rates. Investors look for new and different ways to generate returns and do so by paying up for "growth". Emerging markets and international markets continued to perform well and certainly better than they have in the past. Both widely followed emerging markets ETF's, the VWO and EEM were both up nicely, far outperforming U.S. and European indexes.

4. We do believe that the U.S. economy will continue to plug along while Europe and the EM will begin to improve. This should provide for continued growth in the values of the businesses we own over the next several years.

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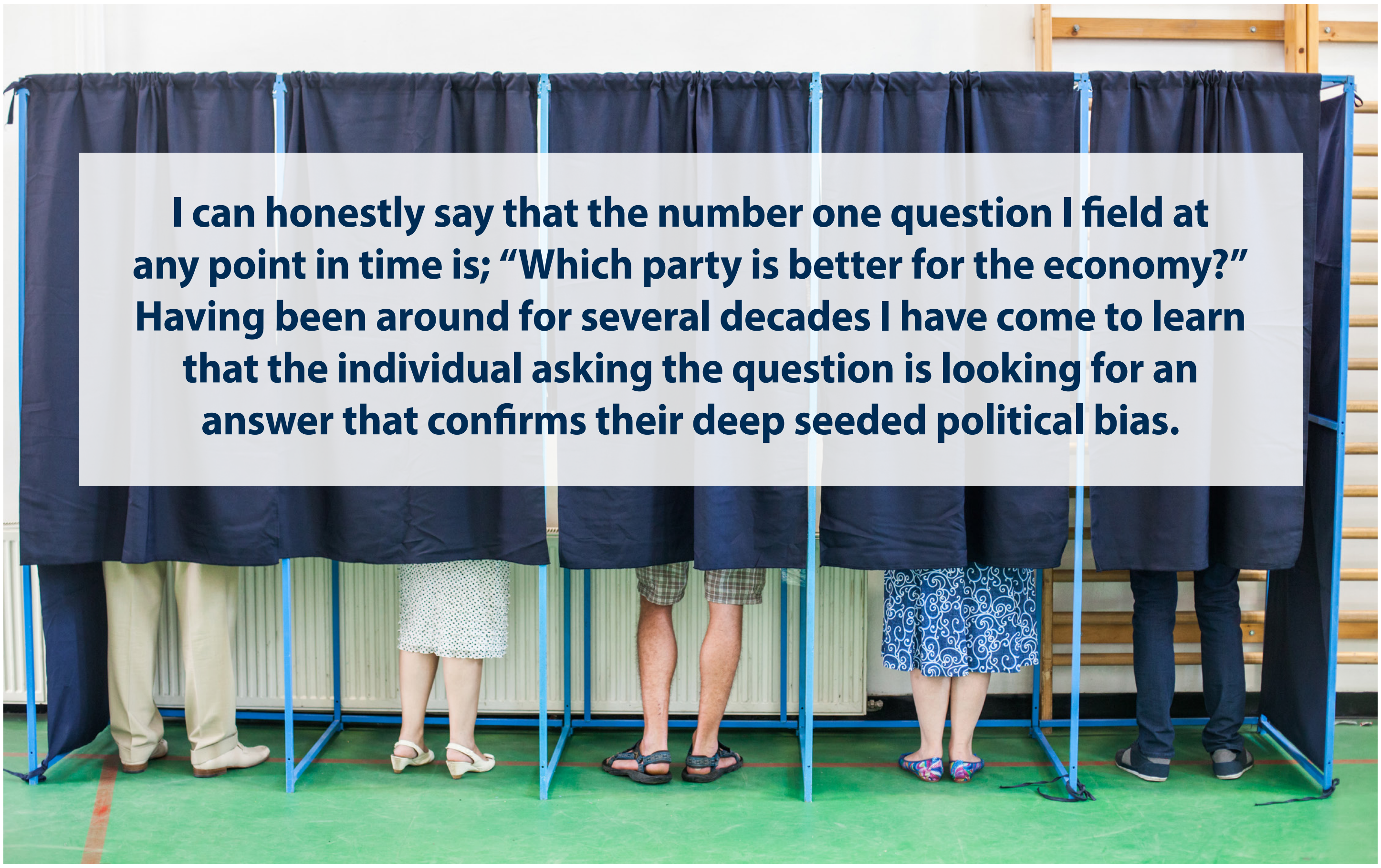
INVESTING WITH CLARITY™

REFLECTION ON ELECTION

- From the Desk of the Vice President of Global Research



In the study of English grammar, we would refer to this as a rhetorical question, which we would define as a figure of speech in the form of a question that is asked to make a point rather than to elicit an answer. Though a rhetorical question does not require a direct answer, in many cases it may be intended to start a discussion or at least draw an acknowledgement that the listener understands the intended message.

Unfortunately, in this article we will not seek to answer the question posed above, but instead look at historical patterns of the stock market in US presidential election years and try to determine if any patterns exist or not. The reason we seek to do this is because the country is so deeply polarized as it pertains to the traditional right and left, individuals equate the winning or losing of their candidate of choice as a primer for investing. In all actuality, I will go out on a limb and suggest that no matter your side of the aisle, my guess is that everyone wishes that November 8th comes and goes like a flash of lightening so we will not have to listen to anymore of the bombast and accusatory rhetoric. That is one thing we can all agree on.

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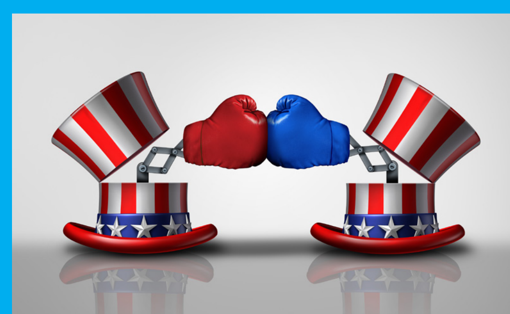
Although we cannot give advice as it pertains for whom to vote, what we can recommend is not to let Washington dictate your investment portfolio. Historically, stocks have done similarly no matter which party operates the White House or Congress. It's true that policies that emanate from executive directives or congressional law favor certain industries or sectors. This is where a prudent money manager must assess what environment is optimal for certain businesses versus others.

A candidate who decides to favor greater military spending or a hike in the minimum wage would, in broad terms, place buy ratings on defense stocks and sell ratings on restaurants for obvious reasons. There is always a time and a season to find good businesses on sale and top portfolio managers look for these opportunities. This certainly is a proper mindset to take but unfortunately most investors allow the political winds in Washington, D.C. to dictate their investment strategy that is all or nothing. Truth be told, the years following a presidential election (1993, 1997, 2005, 2009, 2013) outside of 2001 (the 9/11 attacks) over the last 25 years going back to 1992 have been on average significantly higher earning 15.5% per annum. An even more compelling reason to stay invested comes from research developed by our friends at Bespoke. Per Bespoke, going back to 1928 in each presidential election year the median return in the fourth quarter was 7.5%, which is significantly higher than the average in all years of fourth quarters of 2.4%. The other glaring reason to stay invested is that going back to 1928 in presidential election years, the percentage of fourth quarters had a positive return totaling 77%. I'd say those are pretty good odds, wouldn't you?

Despite the historical probabilities of earning a substantive return in the presidential election, the sad reality is that many investors are also voters. When their candidate does not win or they appear likely not to win, they sell and miss out on the following relief rally that takes place when the ambiguity of the winner of the race has been decided.



Do you remember all the Democrats who were going to move to Canada if George W. Bush was reelected in 2004 and all those Republicans who were going to take up residency in tax-haven states if Barack Obama was reelected in 2012? It is this type of philosophy that prevents investors from getting the most from their investment plan. In closing, how does one clear through the mess of the election? As we reflect on the election we think the answer is quite simple. Vote for your candidate of choice when it comes to politics and vote for Clarity when it comes to investing. This is the recipe for Investing with Success!

- From the Desk of the Vice President of Global Research

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PORTFOLIO STRUCTURE AND OUTLOOK

Listed below are changes that took place in a general manner in portfolios during the third quarter and reasons for these changes.

1. We continue to be very happy with the companies we own in client portfolios. However, during periods of volatility, there are usually opportunities to potentially improve portfolios by selling weaker companies in favor of stronger companies. This last quarter was no different.

2. We continued to take profits in companies we want to continue to own as we balance the percentage owned in the businesses while raising cash for new opportunities or income needs.

3. Because we are quite pleased with the companies in the portfolio, it has been very difficult to raise cash for new opportunities during this correction because we really haven't wanted to sell any of the companies. Therefore, the majority of cash that was raised was by lowering the percentage owned of other positions in the portfolio (AA, GIS, JNJ, SAM, etc.), to raise cash for the new opportunities.

   Some companies added to portfolios included: TWLO, NVDA, MU, NTNX. We increased our exposure in technology this quarter as we believe technology companies will continue to perform well as companies look to add productivity to their bottom line.

4. In light of the overall valuations of publically traded companies, we continue to be very selective and patient with opportunities we see in the marketplace. Because many companies currently sell for higher valuations than they have in the past, we are happy to be patient and picky.

5. On a relative and absolute basis, the valuations of client portfolios as a whole, do trade at a discount to the overall markets and I believe are well positioned for future growth as we continue to move further away from the financial crisis in 2009.

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Strategy for Buying & Selling Holdings

As many of our clients know, we actively manage client portfolios. This active management includes the continual buying and selling of a small amount of shares in one's portfolio – we call this Strategic Cost Averaging™.

Our process of SCA is something we believe is very unique and important to our portfolio management strategy. It allows complete flexibility in the management of your portfolio. We believe this flexibility is extremely important for the long-term as it allows us to continually invest in great businesses over time while at the same time providing flexibility to sell a portion of a business following our "Four Sell Disciplines". In fact, we have written a blog piece called; "A Penny For Your Thoughts" to give investors a deeper look at the strategy behind this process. If you are interested in reading this piece, it can be found on our website or contact your advisor for a copy.

That said, there were several factors in the last quarter that accentuated this process. These factors included the extreme volatility, the amount of new companies we wanted to add to portfolios and not wanting to sell out of current holdings and the fact that the portfolios are structured using models to provide the percentages we want owned in any given position.

Because of these factors, we did a lot more adjusting of the target percentages for each position in portfolios. With the addition of six new positions, which is quite more than we usually see in a quarter, it had us adjusting percentages quite often.

It is extremely important to remember two things; first, our clients pay no trading costs. This of course provides us with complete flexibility in managing the portfolios. Second, as we often remind clients, there is no one position in the portfolio that should make or break the long term performance of one's portfolio. The portfolio's overall allocation is far more important.

Although there was a lot of adjusting during the last quarter, the bottom line is, this had very little if no impact on the overall performance of the portfolios, yet, it allowed us to add quite a few new positions we wanted our clients to own.

Please remember, we have four sell disciplines we adhere to in our investment process. Those four disciplines include:

1. **Selling a company when the long-term fundamentals are in jeopardy or have changed.**
2. **Selling a part of a position to lock in profits to raise cash for other opportunities or cash needs.**
3. **Selling a weaker company in favor of a stronger, less expensive company. This happens most often during corrections of the market or the sector the company belongs to.**
4. **Selling positions to take a loss to offset future gains (Tax-Loss Harvesting).**

As we continually say, a portfolio has a lot of moving parts. Due to the way our portfolios are structured there is not any one position that will make or break a portfolio and its long-term performance.

Every position is owned for a specific reason. As we continue to watch the markets and valuations, we continue to look at our current companies and new opportunities available.

THE STATUS OF FIXED INCOME

Investing in fixed income investments will not provide the types of returns they have historically. In light of the Federal Reserve finally making a move to normalize interest rates, more than likely we are in the beginning stages of a long-term trend to higher interest rates.

Of course, like any type of investment, higher interest rates will not happen overnight. It will take time. However, like any good investment, we like to look at what we call, "Risk Adjusted Return".

What is risk adjusted return? It is level of risk taken for the associated investment return on the investment. Bonds do not warrant the associated risk for the potential associated return. . However, we continue to believe that the only way to own bonds is to have shorter duration bonds (1-5 years at most), and they should be viewed as investments to help reduce portfolio volatility not providing much assistance in overall portfolio return.

As for our target allocations, particularly in the more "conservative" portfolios, we continue to be extremely selective and patient on what bonds we want to own for our clients. Therefore, we continue to favor solid dividend producing companies with long standing businesses to continue to provide income opportunities for our clients and continue to hold cash as we look for opportunities that have appropriate risk vs. the potential reward.

Some exciting news at Nepsis Capital Management

As you may be aware, approximately 6 months ago, Nepsis Capital launched the radio show, "Investing For Success". The show can be heard in Minneapolis locally on the AM dial, 1440 KYCR. For those who would like to listen outside of the Minneapolis area, you can tune into the show on iHeart Radio by searching out 1440 KYCR Investing For Success.

There are many reasons why I finally decided to start the show. They include having a platform where our clients can hear thoughts, ideas and other information from their Portfolio Manager in an easy format. Additionally, I continue to be extremely passionate about the ideal of "Investing With Clarity" and the fact that many investors end up NOT Investing For Success because of the lack of Clarity in their portfolios and investment strategy.

My goal is to have not just our clients, but investors as a whole, "Invest For Success"! The show airs 4-5pm Monday-Friday. Please be assured, markets are closed during this time and the live show does not inhibit in ANY way our ability to manage our client's portfolios!

Show information including podcasts are at www.investmentsuccessforyou.com. Please feel free to listen in and invite friends and family as well!

As Nepsis Capital Continues to grow, we appreciate your continued confidence and support. We believe successful investing requires "Investing With Clarity" in your portfolio. We look forward to continually providing you with the Clarity needed to be a successful investor long-term.

Respectfully,

Mark Pearson
President, Founder & CIO
Nepsis Capital Management, Inc.

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