NEPSIS™
INVEST WITH CLARITY™

4TH QUARTER 2017 UPDATE

"KNOW WHAT YOU OWN AND WHY YOU OWN IT."

"WHAT WE LEARN FROM HISTORY IS THAT PEOPLE DON'T LEARN FROM HISTORY."
- WARREN BUFFETT

AS WE MOVE INTO 2018, THERE ARE MANY EXCITING CHANGES TAKING PLACE AT NEPSIS.

First, based on advice from our marketing and brand studies, it was recommended we change our name from Nepsis Capital Management, Inc., to Nepsis, Inc. The primary strategy behind the name change is to share with the marketplace that "Nepsis" is more than just a portfolio management company. Nepsis is committed to providing our clients with clear content which in turn will enable them to find Clarity in their investments, Clarity in their planning, and ultimately Clarity in life.

We are extremely excited about this change and look forward to walking alongside our clients on their personal journey to find Clarity.

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Secondly, as recently announced, we are EXTREMELY excited about our new partnership with Trust Company of America (TCA). Although we have worked with TD Ameritrade for more than 10 years, we feel that a new custodian relationship is needed to support our clients. We feel Trust Company of America is a much better fit.

If you have not heard, recently, Trust Company of America announced it was being purchased by E*TRADE. This was a strong consideration in our decision to move to TCA along with their technology, service and client experience platform. Although some of the services and processes at TCA are different from those at TDA, we like that TCA is an actual Trust Company with the access to services at E*TRADE . Furthermore, learning about TCA's commitment to the financial advisory industry helped lead us to the decision to move our accounts to TCA. Please look for more information to come along with the necessary paperwork to move your portfolio to TCA.

Additional Important News - New Name… New Website… New Communication Tools!

Last but not least, we have updated our website to better reflect what "Nepsis" is truly all about and what it means to invest with "Clarity". We are very proud of our new site which includes new content for our clients to enjoy while enhancing their investment journey. We have changed the URL for the site to better reflect our core message – ***www.InvestWithClarity.com.*** We encourage clients to visit our new website and view our content as it is designed to assist them along their investment and planning journey.

Continuing on towards our goal to provide clients with greater Clarity, for the past couple of years, we have hosted a radio show here in Minneapolis called, **"Investing for Success";** (you can also listen in on iHeart Radio). About seven weeks ago, we began simulcasting the show on Facebook Live! We are thrilled about this addition and believe it is another great resource that enables investors to not only hear from the Chief Investment Officer and guests, but also watch first hand.

Additionally, we have officially launched our Podcast series, "Invest With Clarity™". Investors can follow the podcast series through the links on our website ***(www.InvestWithClarity.com)*** as well as on SoundCloud and iTunes.

The purpose of doing the radio show and podcast series is to make available an avenue for investors and clients to listen to topics pertaining to current market events. The radio show and podcast series also provides an avenue in which the investment team aims to educate clients on pertinent information related to investing with Clarity.

We are very excited about these advancements and hope you will find these avenues beneficial!

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2017 PORTFOLIO & PERFORMANCE UPDATE

While our investment team has been saying for quite a few years, this could be one of the greatest bull markets in history (and we still believe that to be the case), it does not mean there will not be hiccups along the way, both in the markets and more importantly, the businesses we own.

While we have maintained an extremely bullish stance on equities since the bottom of the crash in 2009, we continue to believe the economy is going to continue to improve and in general, stock prices are going to continue to move quite a bit higher in the future. That said, it does not mean we will not see 5%-20% corrections along the way, however, we still believe the thesis for investing in equities and more importantly, specific businesses, remains strong for the foreseeable future while owning many types of bonds will continue to be poor performing assets.

Because a lot of our work is with Financial Advisors, many of the investors we work with may not have a long history in working with Nepsis or know much about our company. As the Founder & Chief Investment Officer here at Nepsis, I have been managing portfolios for over 20 years with great long-term success. Unfortunately, while our Income and Income & Growth portfolios did quite well in 2017, our Growth, Growth & Income and Balanced portfolios underperformed our expectations substantially, and frankly this was our worst year in history on a relative basis.

Of course, as an investor, no one likes to hear that their portfolio did not do well on a ***Relative*** basis (***Relative*** meaning our internal expectations for performance and compared to markets in general) in any given year. While on an Absolute basis portfolios did move higher, 2017 was the biggest disappointment I have experienced in portfolio management in 20 years.

> "... we still believe the thesis for investing in equities and more importantly, specific businesses, remains strong for the foreseeable future ..."

You may be asking yourself, why would I discuss poor performance? After all, have you ever heard a portfolio manager say that they were not happy with their **SHORT-TERM** performance and that it was unacceptable? As the leader of Nepsis and the Fiduciary to our client's money, inherently, my belief is to be forthright and not ever make excuses for subpar performance in short periods of time. That said, at the same time, investors should know, that even the best managers over time do have bad years, in fact, studies show almost 50% of the time they have years of underperformance. Fortunately, I believe we have had much better results than 50%. However, it does not preclude me from being up front.

Still, investing is a long-term process in great businesses.

While we are not happy with 2017, I do believe this discussion is warranted. Why the relative poor performance and second, what is the remedy for this situation which will help investors feel confident in the long-term investment Philosophy and Strategy Nepsis, Inc. adheres to.

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Nepsis means "Ultimate Clarity". In investing, we believe it means, "knowing what you own and why you own it". Our largest position in our Growth, Growth & Income and Balanced portfolios is ZEST (Zest Technologies, formally Ecoark Holdings). The performance of ZEST was and has been horrible. It has been THE primary contributor to the lackluster performance in 2017.

I have been an advocate for this company for over 6 years. I have been involved with them since they were private and went public about 2 years ago. Frankly, there are several reasons for why the stock and company has not performed well. The bottom line is, they are at a point where they need to begin to show improvement in their operations and execution of their business plan, or decisions will need to be made regarding the best avenue to provide shareholder value to our clients and portfolios. If you would like to know more about the company, I would encourage you to check out the company at ***www.ecoarkusa.com.***

Although the position had a dramatic negative impact on the portfolios in 2017, many of our other portfolio positions did extremely well! As we move into 2018, although no guarantees, I am expecting portfolios including Zest, to have greater success because even though in any given year a portfolio may have a weak position, successful investing is a process of all positions working together to accomplish long-term goals OVER TIME.

As for how much Zest could negatively impact portfolios in the future? If the position continues to underperform, it will not have the same negative impact in accounts since the percent owned in portfolios is at a much lower percent of overall portfolios. Of course, we are firm believers in continually investing in great businesses over time. However, at this juncture, we believe Zest is at a "prove it" point. In other words, before we add more, we need to see improvement in the execution of their plan. Once we see that happen, we will then consider the continuation of Strategic Cost Averaging™ into Zest again.

It should be noted that on January 9th, I returned from an analyst conference in Orlando Florida where Zest did an analyst presentation that I felt was the best they have done to date. Additionally, in talking to other portfolio managers and analysts at the conference, I was a little surprised by the excitement around Zest and the opportunities before them.

After spending two days with Zest, my confidence in their future is higher than it has been ever. Remember, our investment process is a function of executing our buy discipline and sell discipline. It is my belief at this point that the long-term fundamentals at Zest are better than they have ever been. Nepsis will continue to monitor their progress and assess the position in portfolios as one position in the overall allocation.

While 2017 was not our best year and there are no guarantees in the future, it appears that our portfolios have had the best start to a year since I started managing portfolios. Another testament to the power of "know what you own and why you own it" and "time in a stock, not timing a stock".

BOTTOM LINE:

We continue to be extremely proud of our long-term performance of client portfolios. Portfolio theory mandates appropriate diversification AND Asset Allocation which means allocating assets in International businesses and Emerging Markets businesses along with owning U.S. businesses. It also means continually assessing the long-term fundamentals of companies owned and although we will have years where some companies disappoint, it does not mean we lose focus of the long-term buy and sell disciplines we have in place that have provided us great success in the past.

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DIVERSIFICATION & ASSET ALLOCATION

Investors are bombarded with prognostications, postulations and speculations regarding how their investment portfolio should perform (over short periods of time) by many so-called "experts". However, as I mentioned in the "Bottom Line", the fact of the matter is, investment success is a process over time by following a proven investment Philosophy & Strategy.

Many investors believe they are diversified. More than likely, they probably are. In fact, most portfolios we assess are actually OVER-diversified. It's been my experience that many investors confuse or don't understand the difference between diversification and asset allocation.

What's the difference? In its simplest form...

- Diversification is a function of owning multiple investments in the SAME asset class.
- Asset Allocation includes diversification of similar assets in one asset class, but, asset allocation takes it a step further by owning investments in different asset classes as well (i.e. bonds, stocks, cash, international stocks, emerging market stocks, gold, real estate, etc.).

In today's investment climate, investors are bombarded with the idea of investing in low cost index funds. While that has proven in the short-term to be a good strategy (as in the past), it does NOT mean you should adhere to owning 100% of your investments in U.S. stocks and indexes. The only "index" investors should use is the long-term investment and planning goals.

As discussed, our portfolios for clients are structured in a SMA format. There are two types of SMA portfolios:

- The "Single Style" portfolio (a distinct equity, fixed income or balanced investment style), which of course should give you diversification.
- The second is the "Multiple-Style" SMA. This strategy uses several different investment styles in a single portfolio. The Multiple-Style portfolio is how Nepsis manages our client's portfolios.

Nepsis uses the "Multiple Style" process because it not only provides the diversification, but it also provides the asset allocation (portfolios do not own all of the same types of assets in the portfolio, whether it's stocks, bonds or others).

This is why we DO NOT subscribe to using indexes as our portfolios don't have an adequate comparable index due to the fact we are using an asset allocation strategy as well as a diversification strategy.

We believe this process provides greater flexibility in helping investors accomplish their LONG-TERM investment goals as opposed to short-term goals.

BOTTOM LINE:

Nepsis utilizes a "Multiple Style" SMA approach for managing client portfolios. This process creates a greater asset allocation format so that investors have greater flexibility in taking advantage of opportunities to accomplish their long-term investment goals.

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Are We Going to See the elusive 20% Market Correction?

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

When will we see a correction of the 20% magnitude? Who knows? But, I believe it is important for us to remember they happen and will continue to happen in the future. **Always be prepared for a big correction!**

That said, one of the reasons we require our Advisors to go through a thorough process of understanding our investors risk tolerance AND tolerance for volatility utilizing our Investment Policy And Objective Setting Questionnaire (IPOSQ) is to put our clients portfolio ALLOCATION in a format that enables them to worry less about short-term corrections and volatility and focus more on your long-term goals.

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.

The Headline vs The Bottom Line

Each day, investors are bombarded with financial news and predictions. It is human nature for many to be caught up in the prognostications, postulations and speculations the financial services industry is keen on providing.

However, at the end of the day, what matters most is the Road Map you have plotted out to help you accomplish your long-term goals and investment objectives. **Don't let the news of the day, the speculations or propensity to appeal to your emotions and take you off track. "Stick to the knitting".**

BOTTOM LINE:

What folks are not talking about on Wall Street and in the media, is that at the end of the day investors have different investment needs, objectives and goals. Although many try to fit all investors into a box or into categories, the reality is 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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MAJORING IN THE MINORS

Most Americans are certainly familiar with this famous quote suggesting that we as human beings have a tendency to keenly focus on areas in life that have little relevance to the task at hand. Despite believing that our hard work is making a difference, we funnel resources and energy at things that have little to do with the final outcome of the task we were pursuing.

Although this famous quote has been applied to many disciplines in life, it is no more applicable than in the investment industry. Most specifically, investors and advisors alike major in the minors in the area of performance measurement by using metrics that have very little predictive relevancy such as the way they link past results to future returns. Investors in essence violate the rule that was aided to assist them in that they assign great accuracy to past performance as a strong indicator of future performance.

Despite reading the ubiquitous disclaimer born out of the Securities Act of 1933 known as Rule 156 on every performance graph and chart, we as a society default to choosing money managers solely on what they did in the past because we are ignorant of any other manner in which to evaluate fund manager success. In our estimation, the broadest manner in which we use past performance as an indicator of future performance is via the prolific investment database software known as Morningstar. This application has many appropriate resources no doubt and they are the best in the business at what they do in providing pertinent information to investors.

However, as chronicled in a recent Wall Street Journal (WSJ) dated October 25, 2017 titled, "The Morningstar Mirage" the hallmark of Morningstar's review process, known as their Star Rating system has led to serious unintended consequences that even executives at the company have deemed to be detrimental to investors. Specifically, the article cites the following:

- Morningstar assigns funds a rating of 1-5 Stars with 5 being "the best".
- Due to this many investors and advisors treat the star rating system as a guide to future performance.
- For funds that had an overall five-star rating at any point, the WSJ found that their average Morningstar rating for the following five years was 3-stars—in other words, halfway between the top and the bottom.
- When funds picked up a fifth star for the first time during the period included in the WSJ analysis, half of them held on to it for just three months before their performance and rating weakened.
- For all of the measured periods—three, five and 10 years—five-star domestic equity funds were more likely to turn in a one-star performance than a top one.
- That means a 5-star rating for the equity funds was no more an omen of success than it was one of failure."

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In summary the article stated that Funds Rated 5, 4 and 3-stars saw their relative performance erode. However, on the other hand, Funds rated as 1 and 2-Stars actually moved up the ratings food chain with 1-Star rated funds on average becoming a 3-Star only after three years. If that is not a scathing indictment on the manner in which we assign relevancy to something that is not worthy of it, then I do not know what is. This is a very large exercise in majoring in the minors most certainly.

Although, the WSJ article does a great job in critiquing the manner in which the investing public incorrectly interprets Morningstar's data, the article does not explain what portfolio management metrics have been shown to portend investor success. That is where we seek to add a bit of clarity to the picture.

So, what are those metrics? At Nepsis, we simply refer to them as CC which represents the characteristics of Conviction and Consistency. Furthermore, we suggest that if investors seek money managers who own a select group of businesses for a stated period of time (conviction) while those businesses possessing similar common traits (consistency), that investors have a better chance in meeting their goals vs. not. Although the scope of this paper will note allow us to go into great detail, the extensive study can be read in its entirety at; ***"The Case for High-Conviction Investing" by RS Investments, (RS White Paper Series Updated Winter 2011),*** www.rsfunds.com."

The data leads to several key conclusions; In the last decade from 2000-2010, high conviction managers (those characterized by a more concentrated, low-turnover investment approach) improve investment performance as they were deemed better able to develop a thorough understanding of companies and factors that influence their long-term business values. In addition, over the same ten-year period, risk-adjusted return as measured by the Information Ratio which determines whether the manager outperformed based on skill or luck was greater for high-conviction managers as well. Not only do managers with strong conviction outperform on a return basis but on as important risk-adjusted basis as well.

Conviction of strategy is definitely a trait that leads investment success, but consistency is just as important. Unfortunately, when asked to define their investment strategy, most managers fail to mention a dogged pursuit of what is known as "own strategy stocks." Own strategy stocks are unique to each portfolio manager and can be defined as stocks that have a common definable set of actionable return factors. In essence, what factors or properties does the manager seek to find when contemplating purchasing a company for their portfolio.

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In a landmark study developed by AthenaInvest and C. Thomas Howard, PhD. https://www.athenainvest.com/images/stories/files/research/Importance%20of%20Strategy.pdf and obtained from research done by Cohen, Polk and Silli in 2009 show that it is a manager's top picks that drive Alpha or outperformance and every stock that is added from that point begins to slightly dilute the portfolio' performance. Quite simply, those stocks that held to 100% of a given portfolio manager's strategy traits created much higher annual contributions to return than stocks that held only 10% of the stated strategy traits showing the importance behind strategy consistency. In summary the research can be viewed in the following manner:

- A low number of holdings (20-35) in a given portfolio is important, however what is even more important is how consistent each of the holdings is to the overarching strategy of the given portfolio manager.
- Conviction of holdings suggests a deep-seeded desire to own a small number of companies, but Consistency allows only for that company to be included if it has similar traits to my other businesses.
- For example, I may have a strong conviction to own a certain business, but if I desire to own businesses with strong Free Cash Flow, wide Economic Moat and constant Dividend Growth and the business in question has none of those, I may want to reconsider.

In combination, the WSJ Article and the AthenaInvest Study do a superb job in conveying the fallacy of past performance indeed. However, what they don't do is speak to the rest of the story. In essence, what happens to those money managers who underperform for a given period, do they stay down and out or if they stick to their knitting do they rebound accordingly? A very important study was conducted by Baird, which can be read in its entirety at the following link below discussing this topic. The Study is supported with very strong research on why investors should not only expect – but accept – periods of poor relative performance.

http://www.glassmanwealth.com/wp-content/uploads/2014/07/Truth-About-Top-Performing-Money-Managers.pdf

The extent of the Study will not permit us to go into length about specific details, so we have decided to condense them accordingly to the following seven quotes:

1. "At some point in their careers, virtually all top-performing money managers underperform their benchmark, particularly over time periods of three years or less. The results are compelling as to not only the percentage of top rated managers that underperform but ultimately too how they recover."

2. "Despite their impressive long-term performance, almost all of the top-performing managers in the Study underperformed at some point as 85% of them had at least one three-year period in which they underperformed by 1.00% or more. In fact, on average, these managers underperformed during six separate rolling three-year periods (out of 29), with 51% of them lagging their benchmarks by at least 3% and 25% of them fell 5% below the benchmark for at least one three-year period."

3. "Additionally, when compared with their peers, 81% of them fell to below-average in at least one three-year period – and they remained below par for an average of almost four quarters. It appears that when managers fall below their peer group median, they tend to remain there for some time."

4. "We also looked at shorter holding periods of 12 months because, in our experience, many investors make decisions based on very short-term performance. The results were even more telling. All of the top managers dropped below their peer group average at least once."

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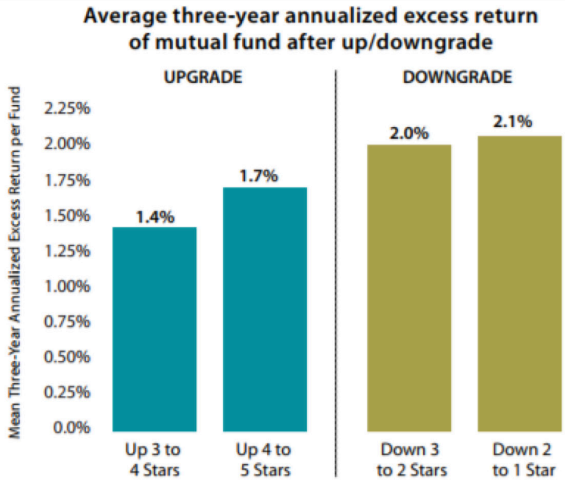
5. "By these measures, it looks as though all great money managers will go through periods of underperformance. What should investors do when they find themselves in the midst of one of these tough periods?"

6. As the adjacent chart highlights, "This research reveals that most high performing managers can and do make up lost ground and add excess return following periods of weakness, particularly over an intermediate-term time period. By abandoning these managers and failing to exercise patience, investors can leave significant wealth on the table. Rather than leaving and abandoning a top-performing manager during one of these periods, investors should anticipate and, quite often, accept this performance cycle."

High-Performing Managers Tend to Outperform After a Difficult Period



Source: Morningstar; Baird analysis

Over the 10 years ended December 31, 2010, top-performing funds that were upgraded produced less excess return over the subsequent three years than those that were downgraded. Investors who abandoned these managers would have left significant wealth on the table.

7. In summary, the Study concludes by saying the following; "It's probably smart to stick with top managers who are underperforming, if they are investing consistently within their style and process, even if it happens to be out of favor. Likewise, it is understandable if managers fall short because they are underweighted in one or two stocks or sectors compared with their benchmark. Evaluating managers over a full market cycle can offer deeper insight into the story behind the numbers. Unless the weak results are sustained and widespread, or supported by material changes in the management team or process at the firm, patience is likely to pay by sticking with a top manager through trying times as informed investors are likely to reap greater rewards than those who chase the latest winner."

In closing, unfortunately, as a society that focuses on maximizing productivity, we tend to deeply focus on what appears at the time to be the quickest and easiest manner in which to finish a given task embodying the "just get it done" mentality. In our estimation, investors and advisors who slap investment portfolios together by relying on past performance via peer group rankings and star ratings are relying on information that is not only irrelevant but detrimental to reaching their investment goals. By majoring in the minors, many advisors are focusing on faulty assumptions driven by such a portfolio construction methodology and thus doing a disservice to themselves and their clients. Instead of building an investment thesis on past performance as an indicator of future success, evidence supports an investment strategy rather centered on a consistent high-conviction approach, characterized by managers who limit their focus to their own selection factors has historically led to stronger risk-adjusted performance outcomes and ultimately allowing investors to reach their goals and a personal level of satisfaction and clarity.

– From the desk of Chuck Etzweiler our Vice President of Research

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STRATEGY FOR BUYING & SELLING OF HOLDINGS

As many of our clients know, we are very active in the management of 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™" (SCA).

Our process of SCA is something we believe is 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 in the long-term success of investing as it allows for the ability to be continually investing in great businesses over time while at the same time providing flexibility in selling a portion of a business under our "Sell Discipline (listed below). In fact, we have written a blog piece called; **"A Penny for Your Thoughts"** to give investors a deeper look at the strategy in this process. Visit our blog at ***www.InvestingWithClarity.com*** to read this article.

There are several factors that contribute to decisions made in our client portfolios. However, it is important to understand that you should NOT view any one position in the portfolio individually. It is the portfolio working as a whole that accomplishes the intended outcome. All positions working together for a specific reason lends to the power of "Asset Allocation".

Think of your portfolio like a machine. There are lots of moving parts working together for the machine to work. They all must work together for the intended outcome. As a "Multi-Style" SMA portfolio, it is our objective to have every position in client portfolios there for a specific reason – to have the machine work as efficiently and effectively as possible.

Factors that contribute to the machine working effectively and efficiently include volatility, which creates opportunity in portfolios to take advantage of continually fine-tuning the portfolio like you do a machine. This is a function of "Strategic Cost Averaging™" and our Sell Disciplines.

Remember, there should be 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.

We have "Four Sell Disciplines" which we adhere to in our investment process.

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).

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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 the 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 and not provide much of any assistance in overall portfolio return. Remember, although bonds may provide some level of return, it is the "risk adjusted return" investors should focus on, in other words, the risk taken to achieve a particular rate of 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.

As Nepsis, Inc. continues to grow, we appreciate your continued confidence and support. We believe successful investing requires "Investing with Clarity". 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, Inc.

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