May 7, 2015

> *"See, there were these two guys in a lunatic asylum... and one night... one night they decide they don't like living in an asylum any more. They decide they're going to escape! So like they get up on to the roof, and there, just across the narrow gap, they see the rooftops of the town, stretching away in moon light... stretching away to freedom. Now the first guy he jumps right across with no problem. But his friend, his friend daren't make the leap. Y'see he's afraid of falling... So then the first guy has an idea. He says "Hey! I have my flashlight with me. I will shine it across the gap between the buildings. You can walk across the beam and join me." But the second guy just shakes his head. He says... he says "What do you think I am, crazy? You would turn it off when I was half way across."*
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> \- The Joker, from Alan Moore's *The Killing Joke*

Dear Client,

Grey Owl's strategies all performed well in the first quarter. The good performance came despite US GDP growth of just 0.2%, continually lowered earnings expectations, and volatile equity and bond markets. Below we discuss the current environment including the now absolute fixation by investors on every Fed comment, our continued focus on an all-weather approach, and our best and worst performing securities during the quarter. First, here is the performance table for the Grey Owl Opportunity Strategy as of March 31, 2015[1]:

	Q1	TTM	Cumulative Since 11/06 Inception
Grey Owl Opportunity Strategy (net fees)	**3.94%**	**7.14%**	**72.86%**
Spider Trust S&P 500 (SPY)	0.88%	12.54%	78.73%
iShares MSCI World (ACWI and MXWD)	2.60%	5.56%	47.32%

[1] For more information regarding performance, please refer to the performance disclosure at the end of this letter.

What's in a name?

"What's in a name? That which we call a rose
By any other name would smell as sweet."

- Juliet in William Shakespeare's *Romeo and Juliet*

News coverage and capital market trading both preceding and following the March 18th Federal Reserve statement release and press conference best resembled a circus. Why? The Fed removed the word "patient" from its communication template. That is, investors should no longer believe that the Fed will be "patient" before beginning to raise interest rates.

"Fed Puts Interest-Rate Hikes in Play" was the title of the Jon Hilsenrath Wall Street Journal story the evening of March 18th. The article followed the release of the Fed's statement and subsequent press conference by Chairwoman Yellen. The first sentence of Hilsenrath's story read, "The Federal Reserve opened a door to raising short-term interest rates by midyear, but signaled it's in no hurry to walk through it." What is the difference between "patient" and "in no hurry?"

Prior to the Fed's statement release, the S&P 500 index was down 13 points (~0.6%) to 2061 from the previous day's close of 2074. Investors were anticipating the removal of "patient" from the release and were selling equities on the concern they could no longer rely on the Fed's easy money policy to boost markets.[2] Then, after Ms. Yellen's dovish presser, investor thinking reversed and the S&P 500 rallied 44 points (over 2%) to 2105 before closing at 2099. In large measure, this manic activity was over a single word, which by all indications has no meaning to the Fed anyway.[3]

Way back in the 1500s, Juliet recognized that a name is merely a simplifying convention and holds no truth in and of itself. The insight was profound beyond her teenage years, and seemingly genius when compared to the collective investment community today.

Juliet, Juliet, where art thou…

News, speculation, and innuendo regarding the Federal Reserve, as well as the European Central Bank and the Bank of Japan, have replaced corporate developments as the primary drivers of capital market trading activity. Like the first inmate from the insane asylum, the Fed has been shining a flashlight across the gap between buildings. Like the second inmate,

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[2] Why were investors anticipating this action from the central bank? The mandarins at the Fed leak their plans to reporters such as Hilsenrath in an attempt to "test" and "cushion" investor reaction. Another suspect policy.
[3] Data from Thomson Reuters.

investors have been walking across. Now, as a group, investors are worried Janet Yellen might turn off the light beam before we make it across.

How it ends, nobody knows, not even Stan Druckenmiller

Six years from the March 2009 equity market trough, the Fed's continued "emergency" largess is putting capital markets, as well as the underlying real economy, at increasing risk. On January 18, 2015, renowned investor Stanley Druckenmiller gave a talk at the Lost Tree Club. A transcript of his comments has been circulating amongst investment professionals via the internet.

The first part of the talk centers on Mr. Druckenmiller's career. Towards the back third of the discussion, he switches from history to comments on the current environment. On the impact of QE & ZIRP he says, "I don't know when it's going to stop. And on inflation this could end up being inflationary. It could also end up being deflationary because if you print money and save banks, the yield curve goes negative and they can't earn any money or let's say the price of oil goes to $30, you could get a deflationary event. … So, the fed keeps talking about deflation, but there is nothing more deflationary than creating a phony asset bubble, having a bunch of investors plow into it and then having it pop. That is deflationary."

Since founding Grey Owl Capital Management in May of 2009, we have argued that binary positioning was dangerous (i.e. aggressively positioning for inflation or deflation). A review of our quarterly letters since that time emphasizes this point. Based on a wide range of tested indicators, we believe the need to maintain this all-weather approach to investing is as critical today as it has been at any point since the late 1990s.

In the long-run; in the short-run.

Despite the Fed's best efforts (or perhaps partially because of them), real gross domestic product (GDP) growth from 2010 through 2014 has averaged just 2.2%. Worse, real GDP growth in the first quarter of 2015 compared to the fourth quarter of 2014 was just 0.2% on an annual basis. This compares to average real GDP growth of 3.1% during the past fifty years (which includes multiple recessions, not just expansions). All told, nominal GDP is up just 8.7% from the prior peak seven years ago and the number of employed has grown only 2%. Further, the 2% employment growth includes significant gains in the energy sector that have now begun to reverse.[4]

[4] Data from the Bloomberg.

In the long-run, corporate growth follows broad economic growth. Thus, as one might expect, S&P 500 sales are up just 7.7% from their prior peak in 2008. Yet, earnings have grown at a much faster rate due to significant cost cutting in 2009-10 and significant net share buybacks by corporations. Share buybacks decrease the number of outstanding shares and therefore distribute corporate earnings over few shares. Earnings per share go up! Which is fine if companies are buying back stock below intrinsic value. Some are, but we are suspicious that this is the case in general. Tepid corporate sales growth may finally be having an impact on earnings growth. As of April 30, with just over 75% of S&P 500 companies having reported first quarter earnings, "as-reported" or GAAP earnings are tracking toward $25.14 and operating earnings (i.e. with "adjustments") are tracking towards $26.96. This compares to first quarter 2014 earnings of "as-reported" earnings of $24.87 and operating earnings of $27.32. Earnings are now either growing at 1.1% or declining at 1.3% depending on how you look at it. Either way, it is far from stellar performance. Current estimates for full-year 2015 operating earnings are $117 compared to $113 in 2014 or a mere 3.5% growth rate.[5]

In the long-run, a security's (or an index of securities') intrinsic value is nothing more and nothing less than all future cash flows discounted back to the present. Due to the cyclical nature of corporate profit margins and the vagaries of accounting earnings, both can overstate or understate the long-term cash generation power of a business. There are logical arguments that current earnings are cyclically elevated, as are earnings multiples. If this turns out to be true and the most recent quarter's change in growth trajectory persists, caution will be warranted. Yet, in the short-run the Fed's interest rate machinations, corporate share buybacks, and other ephemeral factors have a real impact. As with inflation and deflation, a balanced, all-weather structure is the right approach for the current environment.

Largest Portfolio Contributors and Detractors

The first quarter of 2015 saw good performance on both an absolute and relative basis for the Grey Owl Opportunity Strategy. We outperformed most equity indices during the quarter despite holding 30% of our portfolio in cash. In fixed income accounts, balanced versions of the Grey Owl Opportunity Strategy, and Grey Owl Partners, LP (our co-mingled partnership vehicle) we also own long-term US Treasury bonds, which were up over 4% during the period.[6] In addition, we avoided much of the intra-month volatility; the S&P 500 was down 3% in January, up 5.75% in February, and down another 1.58% in March. Most importantly, our best-performing securities significantly overwhelmed our worst performers while also providing stronger returns than the indices.

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[5] Data from Standard & Poors.

[6] TLT, the 20+ Year Treasury Bond ETF was up 4.21% during the first quarter of 2015.

Valeant Pharmaceuticals (VRX) contributed the most to portfolio performance during the quarter. A significant portion of the gain occurred on February 23rd when VRX announced the $14.5 billion acquisition of Salix Pharmaceuticals. This deal expands VRX's business into the gastrointestinal market. It is the first large acquisition by VRX since its hostile bid for Allergan failed. The main benefit of losing the Allergan bid was that VRX showed "clean" financials (i.e. absent deal-driven growth and one-time charges) for the majority of 2014, demonstrating to investors that there is organic growth and that one-time charges were in fact one-time. Now, with the Salix deal they have demonstrated once-again the ability to be opportunistic with large, accretive acquisitions.

Markel was the second biggest positive contributor to quarterly performance. There was no significant corporate news appearing to drive the stock performance – just continued solid execution. As the Markel leadership team wrote in the 2014 annual shareholder letter, book value grew 14% in 2014, and has grown at that same 15% compound rate over the past 5 years. They just keep chugging along.

Laboratory Corporation of America (LH) was the third biggest positive contributor. After first reacting negatively to LH's acquisition of contract researcher Covance, investors seem to have come around. The firm is already demonstrating how it can use its patient database to improve Covance's clinical trials. In addition, LH's core business continues to demonstrate a strengthening trend.

Not all was positive during the quarter. Chief among the detractors was National Oilwell Varco (NOV). Despite oil finding a bottom and trading sideways from the late January low through the end of March (oil is now up about 20% from the recent bottom over the five weeks following the end of the first quarter), NOV continued to sell off and was down another 7% during February and March. Recall from earlier letters that we sold the NOV spinoff, NOW Incorporated (DNOW), shortly after it popped post-spin. We also meaningfully trimmed our NOV position in the fourth quarter. In retrospect, we would have been better off selling the position in its entirety. However, near-term dynamics aside, oil is becoming more and more difficult and expensive to extract and NOV's products and servicing will continue to be necessary.

Wheeler Real Estate Investment Trust (WHLR) was the second biggest detractor. During the quarter, Wheeler recapitalized the firm by issuing $90mm in preferred stock.[7] While this put pressure on WHLR during the quarter, we believe it provides the firm a much stronger platform on which to grow the business.

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[7] Due to the 144 nature of the preferred security, we were able to participate in the offering through Grey Owl Partners, LP, but not in our separately managed accounts.

Believe it or not, Berkshire Hathaway was our third largest detractor. No significant news seems to have caused the modest decline in share price. Following quarter end, the stock bounced nicely on positive earnings and reaction to comments from the annual "Woodstock for Capitalists" in Omaha last weekend.

Portfolio Adjustments

We made very few portfolio adjustments during the first quarter. We added to our gold position, a core element of an all-weather approach. In addition, whereas both stocks and bonds are at the upper end of their trading and valuation ranges, gold is significantly off its price highs and looks reasonably priced compared to other "currencies."

We also added a small position in Herbalife (HLF) near $35.50. As we were finishing this letter, we sold the position near $46.50 following an earnings beat that was coupled with raised guidance. HLF was always an opportunistic trade and after a ~30% return in just over 3 months it seemed prudent to take money off the table. HLF is a controversial company and stock. If you are curious to hear our take on the legal and regulatory implications, feel free to give us a call.

Finally, we sold Blue Rock Residential REIT (BRG) with a nice gain. We think the BRG platform and management are solid; however the REIT sector in general, and apartment REITs in particular, have been on fire. In addition, we expect BRG will need to come to the market soon to raise additional growth capital. We decided to concentrate our micro-cap REIT exposure on WHLR for now.

Conclusion

To repeat once again a line that has now appeared in multiple letters, we continue to structure the Grey Owl Opportunity Strategy as well as our tactical fixed income portfolios and Grey Owl Partners, LP in a balanced manner. Our goal in the Grey Owl Opportunity Strategy and Grey Owl Partners, LP remains to earn equity-like returns over the full cycle with significantly less risk. To do that in the current environment requires an all-weather approach.

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In today's environment, investors face a significant challenge. Across the board, asset prices are elevated. Global debt to gross domestic product is higher today than it was prior to the 2008 financial crisis, creating significant deflationary pressure. Throughout the developed world, coordinated central bank intervention is at unprecedented levels, leading to imbalances and inflationary potential. There is no obvious place for an investor to hide. A traditional indexing approach will likely lead to very low long-term returns with plenty of volatility in the meantime.

If you know of an investor who cannot afford to sit in cash, but recognizes the systemic risk in the current global financial system, please ask him or her to give us a call. We believe our approach has the potential to allow investors to earn reasonable and consistent absolute returns while protecting against the time when the "stable disequilibrium" will eventually destabilize. The other option may wind up being a prescription to one of the Salix drugs VRX just acquired.

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As always, if you have any thoughts regarding the above ideas or your specific portfolio that you would like to discuss, please feel free to call us at 1-888-GREY-OWL.

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Sincerely,

Grey Owl Capital Management

Grey Owl Capital Management, LLC

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The securities discussed above were holdings during the last quarter. The stocks we elect to highlight each quarter will not always be the highest performing stocks in the portfolio, but rather will have had some reported news or event of significance or are either new purchases or significant holdings (relative to position size) for which we choose to discuss our investment tactics. In this particular letter, we discussed every single transaction and the top three largest performance contributors and detractors in our Grey Owl Opportunity separate account strategy during the January 1, 2015 through March 31, 2015 period. They do not necessarily represent all of the securities purchased, sold or recommended by the adviser, and the reader should not assume that investments in the securities identified and discussed were or will be profitable. A complete list of recommendations by Grey Owl Capital Management, LLC may be obtained by contacting the adviser at 1-888-473-9695.

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The performance information for the Grey Owl Opportunity Strategy presented in the table above is reflective of one account invested in our model and is not representative of all clients. While clients were invested in the same securities, this chart does not reflect a composite return. The returns presented are net of all adviser fees and include the reinvestment of dividends and income. Clients may also incur other transactions costs such as brokerage commissions, custodial costs, and other expenses. The net compounded impact of the deduction of such fees over time will be affected by the amount of the fees, the time period, and the investment performance. Grey Owl Capital Management registered as an investment adviser in May 2009. The performance results shown prior to May 2009 represent performance results of the account as managed by current Grey Owl investment adviser representatives during their employment with a prior firm. THE DATA SHOWN REPRESENTS PAST PERFORMANCE AND IS NO GUARANTEE OF FUTURE RESULTS. NO CURRENT OR PROSPECTIVE CLIENT SHOULD ASSUME THAT FUTURE PERFORMANCE RESULTS WILL BE PROFITABLE OR EQUAL THE PERFORMANCE PRESENTED HEREIN. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable. For additional performance data, please visit our website at www.greyowlcapital.com.

The indices used are for comparing performance of the Grey Owl Opportunity Strategy ("Strategy") on a relative basis. Reference to the indices is provided for your information only. There are significant differences between the indices and the Strategy, which does not invest in all or necessarily any of the securities that comprise the indices. In addition, the Strategy may have different and higher levels of risk. Reference to the indices does not imply that the Strategy will achieve returns or other results similar to the indices. The performance shown for the iShares MSCI World Index Fund ("Fund") includes performance of the MSCI World Index prior to March 26, 2008, inception date of the Fund.