April 20, 2016

Dear Shareholders,

"I'm convinced that everything
that's important in investing is counterintuitive,
and everything that's obvious is wrong."

– Howard Marks, Co-Founder of Oaktree Capital Management

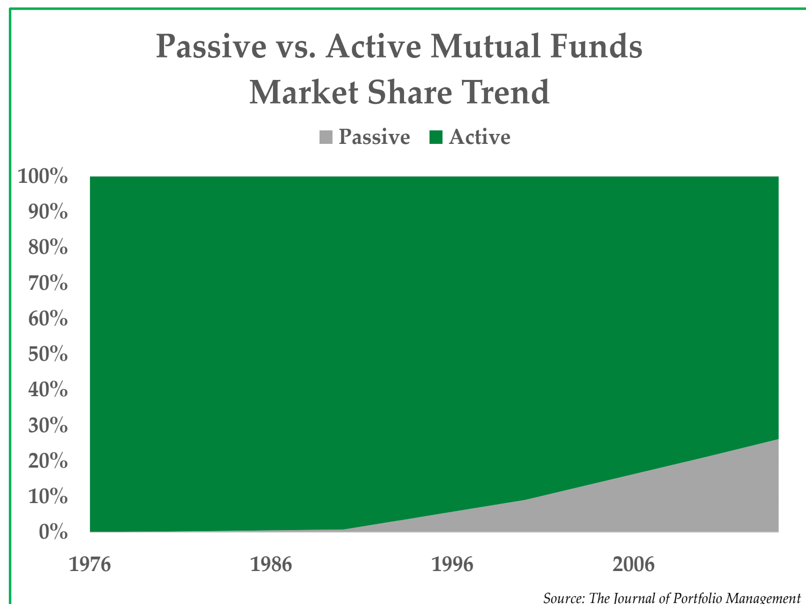
Don't let the conservative dress habits of the financial services industry fool you; the financial world is far from immune to fashion trends, at least when it comes to financial products. Financial fashionistas pioneered the Nifty Fifty in the 1970s, the Dot-Com Bubble in the 1990s, and Collateralized Debt Obligations (CDOs) in the 2000s, to the great benefit of the investment banking industry and to the detriment of their clients.[1]

Today, passive investments, also known as index mutual funds and index exchange traded funds (ETFs), are all the rage in the financial services industry, with the primary benefits of passive investing being low fees and high levels of diversification. The question at hand is, does passive investing deserve the hype it receives? According to the financial press, playing its usual role as the promotional engine of the latest financial fashion, the answer is an obvious and resounding yes. Our own answer is that, like all financial product fashions, today's excessive interest in passive investments has generated a rush through the passive investing doors that creates significant risks; in our opinion, most long-term investors are better off relying on the capable hands of trusted and active investment managers.

To disclose our obvious bias on this question, we are dyed-in-the-wool *active* investors, through and through. We pursue a very active investing approach towards our management of the Appleseed Fund.

A Brief History of Passive Investing

The first index fund, now known as the Vanguard 500 Index Fund, was launched in the mid-1970s by John Bogle, founder of the Vanguard Group. Vanguard has grown since then in tandem with the popularity of index funds; currently, the company manages over $3 trillion in assets and has become the largest mutual fund manager in the United States. As Vanguard has grown, so too, have other companies that offer index funds and ETFs whose prices track various market indexes.

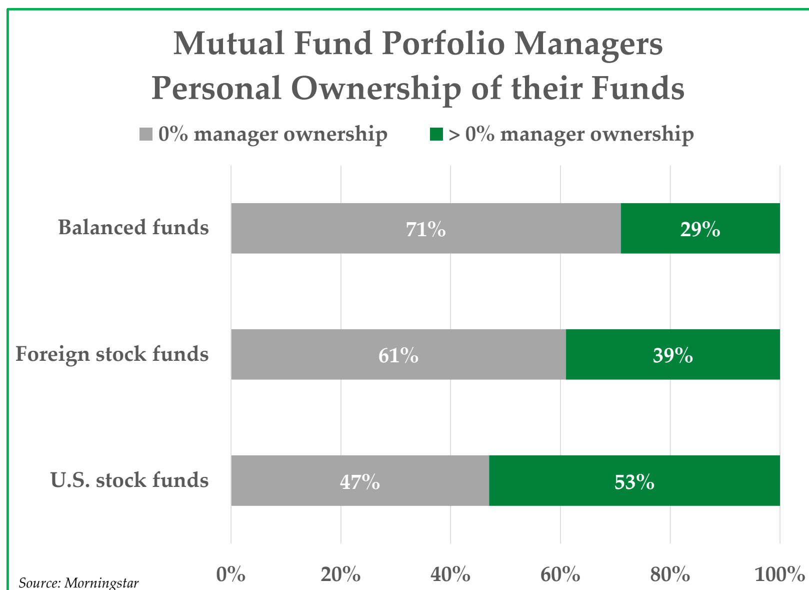


As seen in the chart to the right, more than $1 out of every $5 invested in the markets is invested through some

[1] The *Nifty Fifty* refers to fifty popular large-capitalization growth stocks on the NYSE that propelled the bull market during the early 1970s, but the Nifty Fifty significantly underperformed the broader equity markets later in the decade.

form of a passive mutual fund or passive ETF.

To be fair, passive index proponents have a valid point in their critique of actively managed mutual funds. Many actively managed mutual fund products can be bad for a person's financial health, in our view. In a majority of cases, the portfolio managers themselves do not own the products they manage for others (see chart to the left), and they are quick to jump ship to another mutual fund company as soon as a more attractive opportunity presents itself. Worst of all, the investment strategy, more often than not, is an index hugging investment strategy, which means that the investment portfolio looks rather similar to a market index, but with far higher fees. We have been critical of the broader mutual fund industry for many years, and in 2006 we launched Appleseed Fund in order to offer a product that, in our view, solved many of these problems. We tried to make the fees reasonable (and over time have reduced the fees on several occasions), and we manage Appleseed Fund with little regard to benchmark indexes; importantly, as portfolio managers, all of us have meaningful positions as shareholders in Appleseed Fund.



While conceding that passive investment products provide certain important advantages over many actively managed funds, not the least of which is lower investment fees, passive index products create their own problems that are worth understanding and which go largely underreported in the financial press.

The Market-Weighted Index Problem

Most broad stock market indexes, such as the S&P 500 Index and the MSCI World Index, are constructed to be weighted by market capitalization, which means that large-cap stocks receive a far larger weight than small-cap stocks. As a result, broad stock market indexes, and the financial products that track such indexes, hold an overweight position in large-cap stocks and especially in the most expensive large-cap stocks.

The implication of weighting indexes by market capitalization is that, during liquidity fueled markets where unbridled investor optimism can cause excessive investment in certain sectors, passive investments can become hazardous to an investor's financial health. Rob Arnott of Research Affiliates gets to the heart of the issue when he said:

> *"The Achilles' heel of indexing is that when you have a bubble and a stock is trading way higher than it should, you have your peak exposure at its peak price."*[2]

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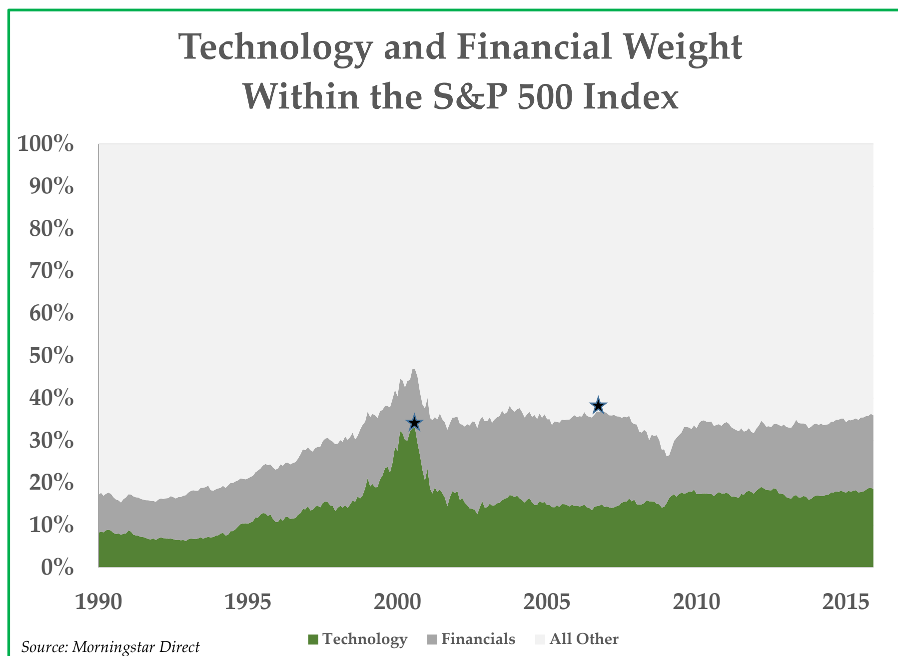
[2] Source: Loic Lemener, "The Great Debate", Jan 22, 2016.

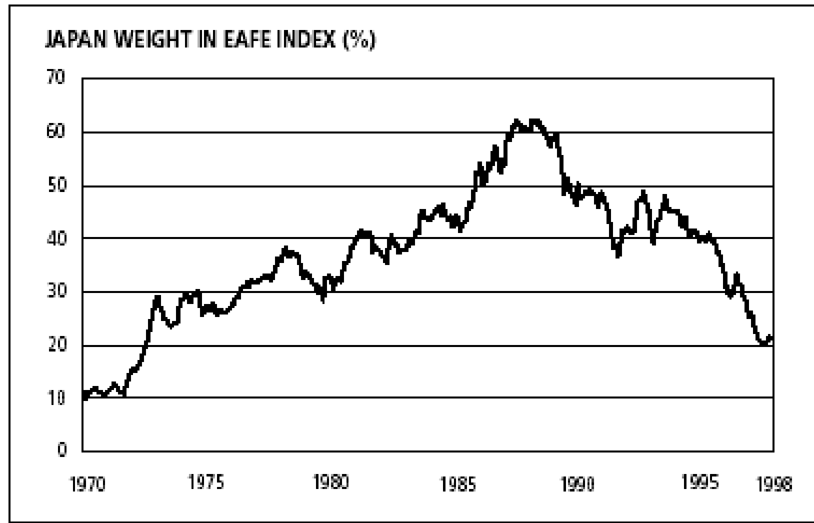
As financial assets inflate during strong, momentum-driven bull markets, such as we have experienced the last few years, passive strategies tend to outperform active strategies. Over the last several years, large capitalization, expensive stocks like Facebook, Amazon, Netflix, and Google (the so-called "FANG" stocks) have outperformed considerably, and, due to their outsized weight in various market indexes, products that track broad market indexes have outperformed many active managers with tremendous long-term track records.

However, the very same phenomenon that causes passive strategies to outperform during momentum markets usually leads to material underperformance once liquidity inevitably reverses and overvalued momentum stocks experience price deflation. This phenomenon can be seen graphically in the S&P 500 sector weighting chart below. Just prior to the bear market of 2000-2002, the largest industry sector in the S&P 500 Index by far was the technology sector due to excessive market valuations among technology stocks. Similarly, in the run up to the Financial Crisis in 2008, the largest industry sector in the S&P 500 Index in 2006 was the financial industry sector due to the housing credit bubble.



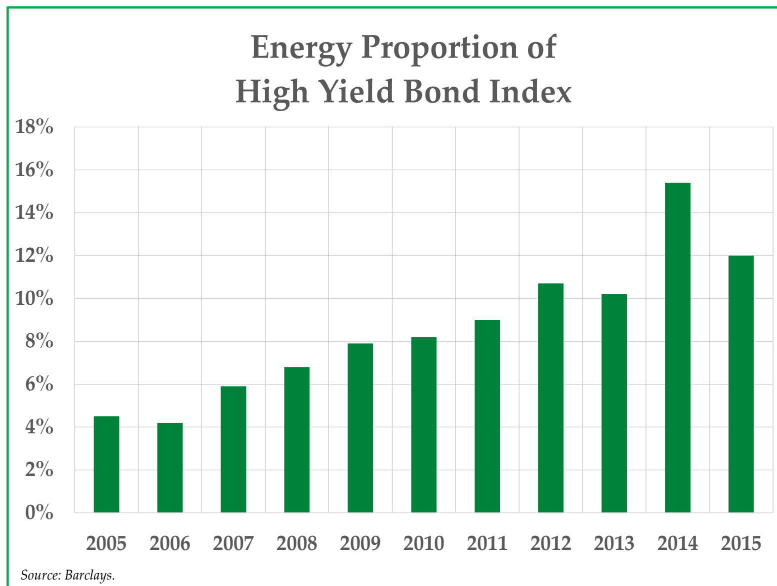
Precisely because market indexes are market cap-weighted, passive investors are overweight the riskiest, most expensive sectors at what has historically been the riskiest time in the market cycle. On the other hand, an active manager can choose to take appropriate actions in an attempt to mitigate these risks. Active investors who avoided excessively priced technology stocks during 2000-2002 outperformed by protecting capital and limiting downside risk, just as active investors who were underweight leveraged financials with credit risk between 2006 and 2008 outperformed. Passive investors in market capitalization weighted index products, by definition, must hold overweight positions in the most expensive, riskiest sectors. Today, the markets are seven years removed from the Financial Crisis, and the risk of owning the S&P 500 Index might appear to be a far-fetched one to the passively inclined investor. We respectfully disagree.

Over the long-term, it is not large-cap growth stocks that have historically outperformed broader market indexes. Research suggests it is value stocks and small-cap stocks that have outperformed. Unfortunately, undervalued stocks are under-represented in market cap-weighted indexes, because they are inexpensive, while small-cap stocks are under-represented in market cap-weighted indexes because they have small capitalizations.



Source: ETF.com

Furthermore, the market weighted index problem is not limited to the United States, and it is not limited to stocks. The largest country weighting in the MSCI EAFE World Index in 1989, by far, was Japan.[3] As seen in the chart to the right, Japan's weighting in the MSCI EAFE World Index at the peak was more than 60%. For more than 20 years leading up to 1989, Japanese stocks generated tremendous investment returns. In 1989, however, investors who wanted to passively invest in overseas stocks by purchasing the MSCI EAFE index were mostly just investing in Japanese stocks at the height of one of the largest stock market bubbles in history. Over the subsequent *25 years*, the Japanese stock market generated a compound return of –2.7% per year.[4] Today, at a time when Japanese stocks represent a far more attractive risk-reward profile to investors, Japanese stocks represent just 22.5% of the MSCI EAFE World Index.[5]



Source: Barclays.

Similarly, bond indexes are weighted (down) by the countries and companies that issue the most debt. As a result, bond index funds and bond index ETFs tend to own overweight positions in the debt of the most indebted countries and companies. Unfortunately, with more indebtedness comes heightened volatility and the risk of permanent capital impairment. For example, as seen on the chart on the left, the high-yield debt issues of the energy sector grew in size to make up more than 15% of the Barclays U.S. Corporate High-Yield Bond Index in 2014, representing the largest industry sector, *because it was the industry which experienced the most excess* in terms of high-yield bond issuance for several years prior to 2014. Passive investors who owned the high-yield bond index at that time

[3] The MSCI EAFE Index is a stock market index used to measure the performance of stock markets around the world in industrialized countries outside of the United States and Canada.

[4] Source: MSCI data from 1/1/90 to 12/31/15.

[5] Source: MSCI as of 3/31/16.

were, in effect, choosing to own an overweight position in the high-yield debt issues of the overleveraged energy sector. Unsurprisingly, recent investment returns of the high yield bond market have been lackluster. In 2015, the total return of the iShares high yield bond ETF (NYSE: HYG) was -5.0%, and, in 2016, the energy sector is currently leading the largest wave of corporate defaults in seven years.[6]

When to Invest Actively, When to Invest Passively

While investing differently than market indexes can be a long-term advantage for active investors, it also can be a challenging endeavor because it requires an investor to be ready and willing to be not only different from the market, but also *wrong*, for an extended period of time. Disciplined active investors know this phenomenon from personal experience, but the challenges have historically resulted in long-term rewards. Active investors who are willing to invest differently from market indexes have an inherent advantage that allows them to side-step the market-weighted index problem. Avoiding significant pockets of investor excess (e.g., the Dot Com Bubble) can better position the active investor to outperform when excessively priced financial assets deflate.

It has now been seven years since investors have experienced a bear market of any lasting duration in the U.S. equity markets, which makes it difficult to remember why making active investment decisions can be helpful over the long-term. Investors have a psychological tendency to chase performance, and investors who are moving into passive index products are not immune from this age-old tendency. Therefore it is not a surprise that assets are flowing out of active strategies and into passive strategies en masse at the present moment, but, for the reasons we have been discussing, we think it is a mistake.

Today, the valuation of the stock market in the United States remains high. A high valuation makes it easy for us to say that the medium term risk/reward profile of the S&P 500 Index is not attractive. Moreover, the poor risk/reward profile of the S&P 500 Index is hardly mitigated by owning an index fund with lower-than-average investment expenses. We would rather own a basket of stocks with an average 10x P/E ratio and pay 3% per annum in fees, for example, than own a basket of stocks with an average 25x P/E ratio and pay 0% per annum in fees.

In our view, in today's environment, the superior way to invest to generate attractive long-term returns is to own investments that *look different* from the S&P 500 market index, particularly at the end of an extended bull market cycle. The prudent and intelligent approach, given the excessive valuation of the S&P 500 Index, is to own a combination of selective stocks with reasonable valuations, including small-cap equities and international equities, high grade fixed income, and capital set aside in the form of gold and cash to purchase stocks at a later date at lower prices.

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Appleseed Performance and Portfolio Changes

During the first three months of 2016, Appleseed Fund Investor shares generated a 7.51% total return, exceeding the -0.35% return of the MSCI World Index. Appleseed Fund Investor shares have generated a 5.93% annual return since inception in 2006, exceeding the return of the MSCI World Index by 2.54% per annum. During the quarter, many stocks worked; we generated 20%+ Internal Rate of Return with United Natural Foods (UNFI), Scansource (SCSC), Female Health Company (FHCO), McDermott (MDR), and Titan International (TWI). From a dollar return standpoint, the most significant contributors to performance were United Natural Foods and the Fund's gold holdings, while the most significant detractors were LPL Financial (LPLA) and Toyo Tanso (5310-JP).

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[6] Source: Barclays.

During 2015, we shared our belief that Appleseed Fund's portfolio is positioned to excel when the dollar weakens, which helped to explain why many of the Fund's holdings declined in price while the dollar was strengthening. With the dollar finally beginning to show weakness in the first quarter, we were glad to see many of the Fund's holdings appreciate in price. We do not have a short-term view of the dollar, but we believe that the long-term fundamentals are likely to lead to a weaker dollar over the next decade, and Appleseed Fund is positioned accordingly.

During the quarter, we sold our Western Union (WU) shares for a gain, as the stock reached our estimate of intrinsic value. Western Union generates enormous cash flows today, but it faces long-term fundamental headwinds specifically related to technology risk. Appleseed Fund generated an attractive return on its shares over the past several years, but we decided that it was time to deploy the Fund's capital elsewhere. We also unwound our Yahoo! stub position after it became apparent that Yahoo! was unlikely to realize our expected base case scenario with regards to its Alibaba spinoff.

Our decision to buy LPL shares for Appleseed Fund was an unforced error on our part, and we sold the Fund's LPL shares for a loss during the quarter. LPL's board made the decision to lever up the balance sheet during the fourth quarter, which was a challenging quarter for the company from an operational and regulatory perspective, in order to repurchase shares from insiders before the bad news became known to the public. Along with a fair amount of value, management also destroyed our confidence in their ability to responsibly allocate capital.

We purchased a new position in China Mobile (CHL) during the quarter. China Mobile is the largest mobile telecom provider on the planet, with 823 million reported customers (almost four times the size of Verizon or AT&T). Along with everyone else, we are concerned about the health of China's economy and particularly its overvalued real estate sector, but we think increased penetration of wireless data will increase over the next five to ten years regardless of the strength of China's economy. In addition, China Mobile's balance sheet is pristine, with 30% of the current market cap consisting of cash and cash equivalents, and its shares were trading at an EV/EBITDA ratio of just 4.0x when we made our initial investment.

Our net allocation to equities at the end of Q2 is 54.5%, and we continue to hold a large position in bonds, cash, and gold. We have recently approved a number of equities for our shopping list, but, with the exception of China Mobile, their share prices have not yet reached our buy limits.

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We appreciate your trust in our ability to manage a portion of your liquid capital by making active investment decisions with Appleseed Fund -- especially so when our active strategy underperforms. We appreciate your patience during periods when our investments might be not only different than the market, but also wrong, during periods of liquidity-fueled optimism. We take a long-term view on investing, and we remain exceedingly grateful to have shareholders who share a similar perspective.

Sincerely,

Joshua Strauss, CFA
William Pekin, CFA
Adam Strauss, CFA

AVERAGE ANNUAL TOTAL RETURNS				
	1yr	3yr	5 yr	Since Inception
Investor Class (APPLX)	-4.76%	1.07%	3.79%	5.93%
Institutional Class (APPIX)	-4.44%	1.32%	*4.04%*	*6.08 %*
MSCI World Index	-3.44%	6.82%	6.51%	3.38%

Table above as of 03/31/2016. Source: Morningstar

Fund's past performance does not guarantee future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. Italics indicates extended performance, as APPIX did not exist until 2011. APPIX extended performance is an estimate based on the performance of APPLX, adjusted for the difference in fees. Performance data current to the most recent month end may be obtained by calling 1-800-470-1029.

At the end of the Fund's reporting period on March 31, 2016: FB – 0.00%, AMZN – 0.00%, NFLX – 0.00%, GOOG – 0.00%, HYG – 0.00%, UNFI – 6.68%, SCSC – 1.99%, FHCO – 0.04%, MDR – 1.56%, TWI – 2.37%, LPLA – 0.00%, 5310-JP – 2.57%, WU – 0.00%, CHL – 1.13%, PHYS – 14.74%., BABA – (1.60%), YHOO – 0.00%, VZ – 3.22%, T – 0.00%

Appleseed Fund has contractually agreed to limit the net expense rate to 1.14% of net assets of Investor shares and 0.95% of net assets of Institutional shares, through January 31, 2017. The gross expense ratio of the Fund's investor class is 1.41%, and the net expense ratio after contractual fee waivers is 1.24%. The Fund's ninety day redemption fee is 2.00%.

The MSCI World Index is a widely followed, unmanaged group of stocks from 23 international markets and is not available for purchase. These indices provide total returns in U.S. dollars with net dividends reinvested. These index returns do not reflect the deduction of expenses, which have been deducted from the Fund's returns. These index returns assume reinvestment of all distributions and do not reflect the deduction of taxes and fees. Individuals cannot invest directly in these indices, however, an individual can invest in exchange traded funds or other investment vehicles that attempt to track the performance of a benchmark index.

Diversification does not ensure a profit or guarantee against loss.

Investing involves risk, including loss of principal. There is no guarantee that this, or any investment strategy will succeed. Small and mid cap investing involve greater risk no associated with investing in more established companies, such as greater price volatility, business risk, less liquidity and increased competitive threat. Investment in international markets present special risks including currency fluctuation, the potential for diplomatic and political instability, regulator and liquidity risks, foreign taxation and difference in auditing and other financial standards. Fixed income investments are affected by overall market movements, changes in interest rates, and other factors such as weather, disease, embargoes and international economic and political developments.

Investments in commodities such as gold may be affected by overall market movements, changes in interest rates, and other factors such as embargoes and international economic and political developments. Commodities are assets that have tangible properties, such as oil, metals, and agricultural products. These instruments may subject the Fund to greater volatility than investments in traditional securities.

The views and opinions expressed in this material are those of the authors. While we believe we have a reasonable basis for our appraisals and we have confidence in our opinions, actual results may differ materially from those we anticipate. These opinions

are current as of the date of this letter but are subject to change. There is no guarantee that any forecasts or opinions in this material will be realized. Information should not be construed as investment advice nor be considered a recommendation to buy, sell or hold any particular security.

P/E (price/earnings) is computed by taking the price of the stock dividend by the current earnings-per-share. Companies with high P/E ratios are more likely to be considered "risky" investments.

You should carefully consider the investment objectives, potential risks, management fees, and charges and expenses of the Fund before investing. The Fund's prospectus contains this and other information about the Fund, and should be read carefully before investing. You may obtain a current copy of the Fund's prospectus by calling 1-800-470-1029.

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