2017 Midyear Observations

1. **U.S. Equity Markets are Expensive** (based on our 26 year valuation history)

*Valuations are high:*
- The S&P 500 is in 17th percentile toward expensive and the Russell 1000 is in 16th percentile towards expensive
  - When markets have been at these levels in the past, one-year forward returns have averaged 3%-5% and two-year forward returns have averaged 8%-10%, which is well below normal returns historically
- The Russell 2000 is in 8th percentile toward expensive
  - When markets have been this expensive in the past, one-year forward returns have been slightly negative

*Markets are speculative:*
- The S&P 500 has returned over 9% for the year-to-date period through June 30th. Large cap stocks are on pace for a 20% annualized return for the year, which is roughly double the normal returns for the 25-26 year history that we examine
- Volatility has remained low:
  - The VIX (Market Volatility) index has returned -20% year-to-date
- Year-to-date through June 30th, we have seen continued outperformance of growth and momentum driven indices over value:
  - The MSCI USA Momentum Index outperformed the MSCI USA Value Index by 12.7% (18.1% v. 5.5%)

Based on history, this kind of environment is one where our style of value investing is not at its strongest. We are generally short “hope stocks,” many of which burn cash and/or trade at 50 to 100 times free cash flow. When people are attracted to those kind of stocks, our shorts don’t perform well. On the long side, we buy stocks that are, by definition, out of favor – and so far this year, they have remained that way.

Fortunately, we believe the current environment has created a very strong opportunity set going forward. Based on our research, our **SPREADS** typically perform best following periods of speculation and high valuations, as markets revert to more normal levels.

2. **There is a Huge Disparity Between Growth and Value**

When growth significantly outperforms value, as it has done this year, it often creates a large future opportunity:
- Year-to-date, the Russell 1000 Growth Index surpassed the Russell 1000 Value Index by 9.3% (14.0% v. 4.7%) and the Russell 2000 Growth Index outperformed the Russell 2000 Value by 9.4% (10.0% v. 0.5%)

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1 Spread is defined as how much our long portfolio outperformed our short portfolio adjusted for leverage (i.e. 100% exposure to the long portfolio, less 100% exposure to the short portfolio)
From 1980 to 2006, value outperformed growth by an average of 2% (as measured by the Russell 1000 Value versus Russell 1000 Growth Index) to 5% (as measured by the Russell 2000 Value versus Russell 2000 Growth Index) per year. Since the global financial crisis in 2007, value-oriented strategies have underperformed growth strategies by an average of 3% per year. Over this period, the only year where value substantially outperformed growth was 2016.

In the trailing 10-year period in which growth has beaten value in an unsurpassed manner, there have been only three calendar years with a greater disparity than the 2017 year-to-date period: 2007 (disparity of 12.0%), 2009 (disparity of 17.5%) and 2015 (disparity of 9.5%).

We do not think this trend can persist; stocks represent ownership shares in a business and we believe that markets will revert back to reflect underlying company fundamentals.

3. The Opportunity Set is Significant

Expensive valuation levels and the speculative nature of the market both point to very attractive expected spreads for us going forward:

- We are very optimistic over the next few years that our long side will perform well relative to the market and that our spreads will contribute positively to returns.
- Even though the market is expensive based on history, we do expect positive returns. Our long portfolios are much cheaper than the market, and we therefore expect them to outperform meaningfully.
- Our shorts are very expensive and can produce significant returns when markets revert to more normal levels.

Predictive indicators of our strategy forward returns (based on our research):

- Our spreads perform best following periods where markets are expensive.
- Our spreads perform best following periods (albeit rare), where the most expensive stocks beat the cheapest stocks (based on our metrics):
  - Although valuations are less extreme than they were in 1999, we do see some similarities in that expensive stocks are outperforming cheap stocks.
  - According to our research, the years following 1999 produced meaningful outperformance for our investment style.

The valuation gap between value and growth has become very stretched. Although we can’t predict exactly when, we believe it will inevitably snap back in a big way; meanwhile we stick to our systematic valuation process. In the periods following 1999 and 2007 valuations normalized leading to long periods of significant outperformance for our investment style. We believe our opportunity set is significant and our long/short returns over the next few years will rhyme quite well with similar periods in the past.

Please feel free to contact us at any time by phone (877-974-6852) or email (gothamfunds@gotham.com).

Sincerely,
Joel Greenblatt and Robert Goldstein
Managing Principals and Co-CIOs
Important Information

This document contains forward-looking statements regarding future events, forecasts and expectations regarding equity markets and certain of Gotham's strategies. Forward-looking statements may be identified by terminology such as "may," "expect," "will," "hope," "believe" and/or comparable terminology. No assurance, representation, or warranty is made that any of Gotham's expectations, views and/or objectives will be achieved and actual results may be significantly different than reflected herein.

Index, portfolio and stock valuations are based on Gotham's valuation methodology.

Broad-based securities indices mentioned herein are unmanaged and are not subject to fees and expenses typically associated with investment funds. Investments cannot be made directly in an index. The performance and volatility of Gotham's strategies will be different than those of the indices.

The S&P 500 Total Return Index and Russell 1000 Index are commonly followed equity indices and are generally considered barometers of the U.S. equity market. The Russell 2000 Index is a commonly followed equity index and is generally considered a barometer of the U.S. small to mid-capitalization markets. Returns for the indices are calculated on a total return basis with dividends reinvested, unless otherwise noted.

Mutual fund investing involves risks, including possible loss of principal. Short sales by a fund theoretically involve unlimited loss potential since the market price of securities sold short may continuously increase. It is anticipated the funds will frequently adjust the size of their long and short positions and thus may experience high portfolio turnover which tends to increase brokerage costs. The funds will use leverage to make additional investments which could result in greater losses than if the funds were not leveraged.

The prospectus contains this and other information about the funds. A copy of the prospectus is available in PDF format by clicking here or by calling 877-974-6852. The prospectus should be read carefully before investing.

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