

Relativity

Capital Advisors

Hawk Alpha Discovery Annual Letter

January 15th, 2018

Update 2/12/2018*

Dear Investors:

In 2017, Relativity Capital's first full year in existence, the *Hawk Alpha Discovery Portfolio* performed well generating net returns of 32.5%*. After missing some of the sharp moves higher in Q1, many names pulled in and provided optimal entries that better fit our strategies, allowing us to increase performance in Q2, Q3, and Q4. In 2017 we closed 527 trades with a 71.92% win rate. Other metrics include a Sharp ratio of 2.39 and Sortino ratio of 3.15. We saw consistent returns with both stock and option positions, each contributing approximately half of the total returns. Healthcare, Tech and Industrial positions led our performance. A few of the larger positive contributors were **Vertex Pharma (VRTX)** call options, **Deere & Co (DE)**, **Regeneron Pharma (REGN)** call options, **Humana (HUM)** call options, **Trip Advisor (TRIP)** stock, **Cree (CREE)** stock, **Biogen (BIIB)** call options and **Palo Alto Networks (PANW)** call options. Hedging event-risk via put options into earnings did result in some performance drag throughout the year, though it is a necessary part of managing risk. Negative contributors in 2017 included **IDEXX Labs (IDXX)** call options, **Alexion Pharma (ALXN)** call options, **Vulcan Materials (VMC)** call options, **Autodesk (ADSK)** call options, **Snap-On (SNA)** put options, **Simon Property (SPG)** put options, **Veeva (VEEV)** stock and **Pepsi (PEP)** call options. Our momentum continues early into 2018 with 54 of 60 closed trades since December 1st, 2017 profitable, while 22 of 29 current stock holdings are profitable as of the 1/12/18 close.

In a year that saw record low volatility and strong returns, our active strategies that have tended to fare better in choppy markets, still outperformed the indices, a testament to our equity research and risk management. Another factor in 2017 was that the returns were lacking the "homeruns" due to a softer M&A environment, as compared to prior years. Sector rotational moves in 2017 were fast and violent, and getting in front of these moves can be extremely lucrative, which we often utilize flows in the options market as a leading indicator to identify which sectors are coming into and out of favor. We will continue to target "best of breed" names in growth industries that have strong profitability, a wide moat, strong management and fit into one of the seven classes of great investments. These main classes, and there are more, include pure revenue growth stories in growing markets, sustainable MOAT, market share takers and disruptors in large TAMs, product mix shift and margin expansion stories, accelerating growth causing multiple re-ratings, new product and replacement/upgrade cycles, and consolidator stories with synergies and growth.

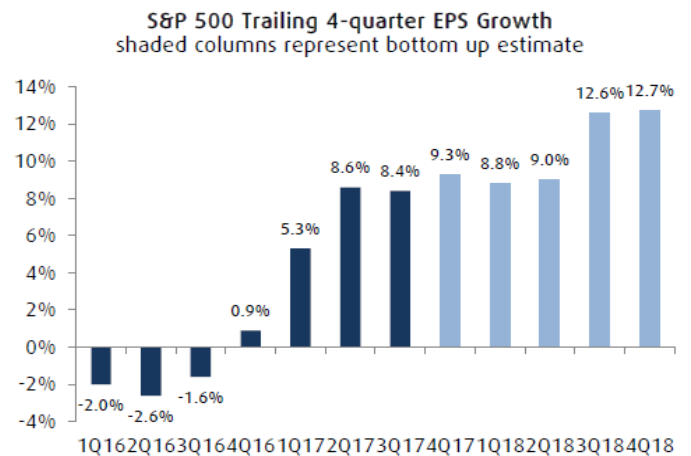
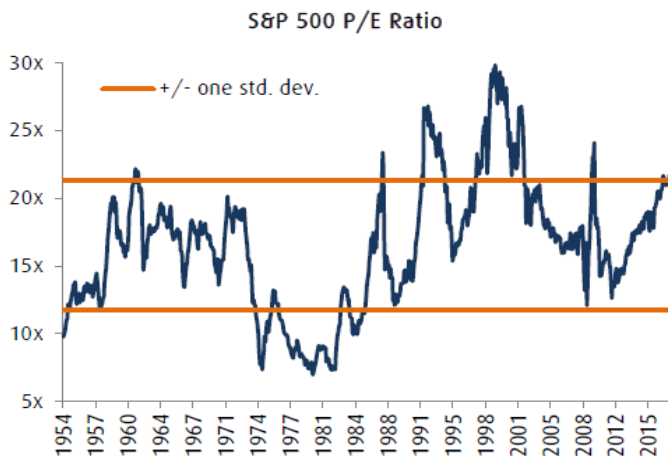
2017 Review

Markets closed the year near highs with the NASDAQ leading performance higher by 29%, the Dow Jones up 28%, the S&P 500 gaining 22%, and the Russell 2000 trailing returns higher by 15%. Sector returns are detailed below via the S&P SPDR website:

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017**
Consumer Staples -14.97	Technology 50.94	Industrials 27.82	Utilities 19.51	Financials 28.51	Consumer Discretionary 42.72	Utilities 28.59	Consumer Discretionary 9.94	Energy 28.01	Technology 34.28
Health Care -23.15	Materials 48.48	Consumer Discretionary 27.46	Consumer Staples 14.00	Consumer Discretionary 23.58	Health Care 41.24	Health Care 25.18	Health Care 6.86	Financials 22.69	Materials 23.94
Utilities -29.08	Consumer Discretionary 41.16	Energy 21.78	Health Care 12.42	Health Care 17.53	Industrials 40.44	Technology 17.75	Consumer Staples 6.83	Industrials 19.95	Industrials 23.84
Consumer Discretionary -33.41	Equal Sector 27.79	Materials 20.55	Consumer Discretionary 5.95	S&P 500 16.00	Financials 35.37	Consumer Staples 15.86	Technology 5.63	Materials 16.66	Consumer Discretionary 22.77
Equal Sector -35.16	S&P 500 26.46	Equal Sector 16.11	Equal Sector 3.30	Technology 15.46	S&P 500 32.39	Financials 15.03	S&P 500 1.38	Utilities 16.00	Financials 22.04
S&P 500 -37.00	Industrials 22.63	S&P 500 15.06	Energy 2.98	Industrials 14.86	Equal Sector 30.81	S&P 500 13.69	Equal Sector -1.37	Technology 14.82	S&P 500 21.83
Energy -38.79	Energy 21.58	Consumer Staples 13.79	Technology 2.67	Equal Sector 14.78	Consumer Staples 26.27	Equal Sector 13.41	Financials -1.60	Equal Sector 14.31	Health Care 21.70
Industrials -38.87	Health Care 19.82	Financials 11.91	S&P 500 2.11	Materials 14.74	Energy 26.16	Industrials 10.45	Industrials -4.25	S&P 500 11.96	Equal Sector 18.27
Technology -41.38	Financials 17.50	Technology 11.39	Industrials -1.02	Consumer Staples 10.72	Technology 25.97	Consumer Discretionary 9.49	Utilities -4.86	Consumer Discretionary 5.88	Consumer Staples 12.92
Materials -43.99	Consumer Staples 14.22	Utilities 5.30	Materials -10.97	Energy 5.21	Materials 25.83	Materials 7.31	Materials -8.58	Consumer Staples 5.00	Utilities 12.02
Financials -55.19	Utilities 11.41	Health Care 3.30	Financials -17.16	Utilities 1.10	Utilities 13.00	Energy -8.60	Energy -21.46	Real Estate 3.19	Real Estate 10.70
								Health Care -2.83	Energy -1.06

A few notable strong sub-sector performances included Casinos & Gaming +70%, Homebuilders +70%, Auto Parts & Equipment +46%, Personal Products +49%, Refiners +28%, Asset Mgmt. +26%, Managed Health Care +42%, Construction Machinery & Heavy Trucks +47%, Aerospace & Defense +38%, Railroads +35%, Semiconductor Equipment +58%, and Copper +41.5%.

In 2017 S&P 500 earnings grew 9.7%, the strongest growth since 2011 and Sales rose 6.2%, also the strongest since 2011. Energy and Materials were the largest contributors to the growth after facing easy Y/Y comps from a trough year, while Info Tech saw 14.5% EPS growth. For 2018 the consensus is for 11.8% earnings growth and 5.6% revenue growth. The forward 12-month P/E ratio is 18.4, above the 5-year average of 15.8.

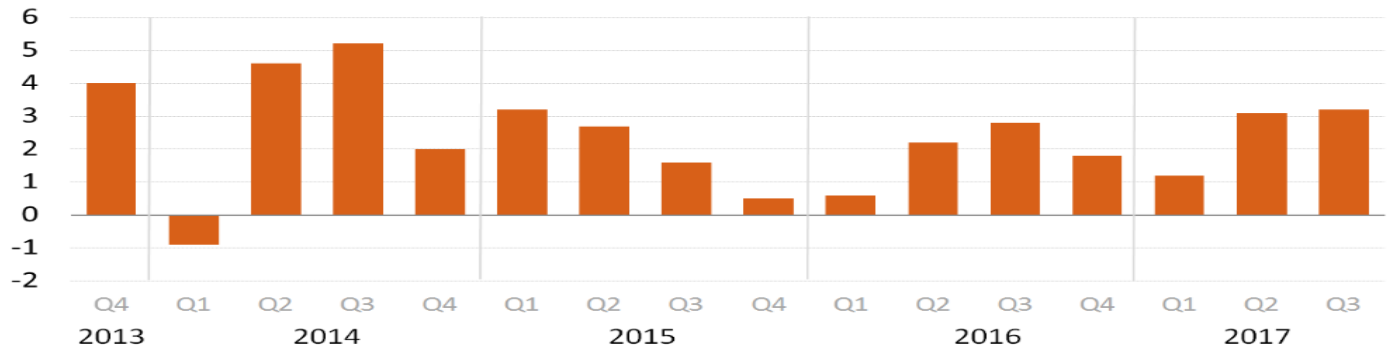


Source S&P Dow Jones Indices

The economy finishes 2017 on a strong note with synchronized global growth and GDP in the US back above the 3% level for the first time since 2014. We are also seeing strong housing data, ISM Manufacturing, Regional Fed Surveys, Employment, and Industrial Production. We remain in an accommodative environment with the US

easing off QE and raising rates while set to reduce reserves, and the ECB & BOJ continue their easing path but likely to see that shift next year in the second half. Earnings growth really picked up throughout 2017 and expected to continue with double digit growth into 2018.

Real GDP: Percent change from preceding quarter



U.S. Bureau of Economic Analysis

Seasonally adjusted annual rates

Morgan Stanley & Co. Real GDP Forecasts

	2017E		2018E			2019E		2020-2022E
	Base	Bear	Base	Bull	Bear	Base	Bull	Base
Global	3.6%	2.8%	3.8%	4.6%	2.4%	3.7%	4.7%	3.4%
G10	2.2	1.1	2.1	2.8	0.3	1.8	2.7	1.3
US	2.3	1.3	2.5	2.9	0.1	1.9	2.5	1.2
Euro Zone	2.3	1.3	2.1	2.9	0.6	1.9	3.3	1.2
Japan	1.5	0.4	1.3	2.0	0.4	1.5	2.4	1.1
UK	1.5	0.3	1.1	1.9	-0.5	0.8	1.6	1.4
Emerging Markets	4.7	3.9	5.0	5.9	3.8	5.0	6.1	4.8
China	6.8	6.0	6.5	6.9	5.7	6.3	6.8	5.6
India	6.4	6.3	7.5	8.8	6.1	7.7	8.8	7.3
Brazil	0.7	2.0	3.1	3.9	2.0	3.4	4.3	2.3
Russia	1.8	0.0	2.3	4.3	-1.0	1.8	4.2	1.8

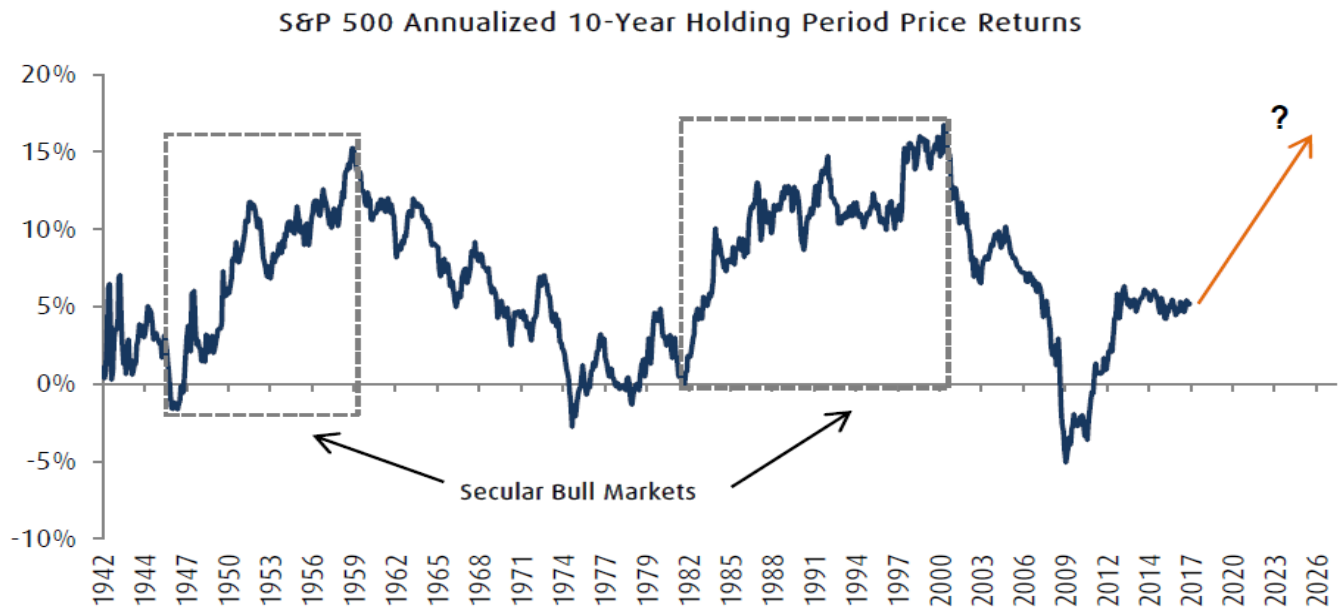
We did see a downturn in both buybacks and M&A in 2017, though both likely attributed to Tax Reform uncertainty, and I would expect both to rebound in 2018 with corporations set to see a surge in profits and repatriation unlocking overseas cash.

A Look Ahead to 2018:

We enter 2018 with strong momentum across US and Global markets, though on a technical analysis view appear to be running into resistance, the channel extension off the 2011 and 2015 highs comes into play at 2,700 in the S&P 500. Sentiment, by many indications, is also showing some signs of extreme optimism. As we turn to 2018 delivering on earnings growth will be more important than ever in the current bull cycle, as there is little to no room left for multiple expansion. Tax Reform will have a major impact on corporate profits though it will be more important to stick with the quality companies delivering organic growth because a year from now the Y/Y comps will be inclusive of the low tax rate already baked into numbers. Overall market valuation is considered rich on many levels, but valuation, in a vacuum, is never a good reason to sell a market, nor a stock for that matter. Compared to bonds, stocks still appear quite cheap and the “Great Rotation” out of bonds to stocks has yet to happen by all indications of cumulative fund flows. Pensions, and many investment managers, remain seriously underweight equities, especially US equities. The Fed is expected to raise rates 3 times in 2018, and this gradual path at this stage off historically low rates is still conducive to a bull market for equities. We have not seen a euphoric stage in markets to this point, and although not all bull market cycles have to end in euphoria,

historically the last two years of bull markets have generated outsized returns. The current cycle was born out of a lost decade, and historic data shows potential for considerably more upside as shown below.

Exhibit 7: Secular Bull Markets Are Born Out of Lost Decades



Source: BMO Capital Markets Investment Strategy Group, Bloomberg

There are plenty of risks to the market as we enter 2018, namely inflation and the potential inverting yield curve. A more hawkish Fed could also cause a rally in the US Dollar as an additional headwind. North Korea, and a few other nations, remain geopolitical risks. The impact of the Fed raising rates and cutting reserves coupled with potential ECB and BOJ “foot off the pedal” moves is another dynamic at play. China is always worth keeping a close eye on and the deleveraging efforts impact on credit and economic numbers will be in focus for 2018.

Although we remain in a pro-growth environment, the performance spread between value and growth is reaching historic levels, so the potential to shift back to value bears watching. Growth does tend to outperform value during periods of a flattening yield curve, so the move back to value is not here yet, and no guarantee it comes in 2018. There continues to be plenty of negativity out there as the scars of 2009 have yet to fade and investors seem to always have one foot out the door, many trying to pick an end to the bull market for several years straight, but fundamentals support further gains. When taking into account the dividend yield, buybacks, and GDP growth rate, a base case return for the S&P 500 is around 7.5%, which compares very favorable in an environment with the 10 year Treasury yielding 2.2%. There are signs that the recovery is in the later innings, and typically Energy outperforms in this phase.

Strategy, Theme, and Stock Ideas:

Banks remain in a very good position into 2018 from a combination of tax reform, less regulations, rising rates, strengthening economies, and more flexibility for capital returns. Energy is closing 2017 strong and sets up nicely into 2018 as the main driver of EPS/Sales growth as many of the companies are coming out of the recent downturn stronger than ever, and can easily surprise to the upside with profits. Energy has also historically been the best performing sector in an inflationary environment, and Materials should be another beneficiary. Housing has climbed sharply in 2017 but conditions remain favorable with Millennials in peak spending years, mortgage

rates low, an inventory shortage, and housing starts/sales still well below historical averages. Tech will face much tougher comps in 2018 but the overall growth outlook is still favorable with many of the strongest themes in this group such as 5G, IoT, Cloud Computing, VR/AR, AI, Big Data, and Automation/Robotics. Healthcare has a lot of questions into 2018 with potential for reform and the industry suffering from drug price scrutiny. Medical Technology is still an area we find a lot of favorite long term ideas because Healthcare spending growth tends to outpace other areas of the economy. Industrials are the wildcard in 2018 with potential for major upside on any strong Infrastructure plan out of the new administration.

In 2018 we will focus on the OptionsHawk Top 380 stock universe rotating from names on sector relative strength signals and continuing our strategy of utilizing options flows to signal impending moves. There will be some deviation outside of these 380 stocks, but with smaller allocations, and the list is fluid, meaning quarterly research into the earnings reports will cause some names to drop off and others to enter. It is always a focus for us to be invested in the "best of breed" names and capitalize on growth themes, so narrowing down the market universe can enhance our ability to quickly adapt to changing market conditions. A brief synopsis of a few new names added to the portfolio in Q4 and early Q1:

Alnylam Pharma (ALNY) is a \$12.B Biotech with strong APOLLO data recently and enters 2018 with some meaningful high probability catalysts. ALNY will present givosiran data in mid-2018 that could set it up for its 2nd commercial asset with their platform RNAi technology. ALN-GO1 recently showed clear biomarker evidence that could result in a fast pathway to market. ALNY has Sanofi (SNY) as a partner who could also be a potential acquirer. ALNY also recently saw the FDA lift a hold on fitusiran, which has big potential in the hemophilia space. Patisiran showed extremely strong data last year and is the first potential commercial asset for ALNY, potential to be a \$2B+ sales product.

Harris Corp. (HRS) is a new position entered in the first week of 2018. It is a \$17B provider of electronics and communications systems trading 20.7X Earnings, 14.3X EBITDA and 2.88X Sales. HRS is expecting accelerating revenue growth the next few years and sees EPS at \$7.75/share in 2019, up from \$5.53/share in 2017. HRS is showing robust bookings and has a major opportunity for International growth, while the strengthening balance sheet leaves room for capital deployment. HRS has business broken into Communication Systems, Electronic Systems, and Space & Intelligence Systems with a fairly even split. HRS is seeing solid FCF growth, climbing 37% over the past 5 years and increasing R&D spending. HRS is a beneficiary of the rising DoD budget and plans for Army modernization.

Proto Labs (PRLB) is also a new position. It is a \$2.75B digital manufacturer trading 40.75X Earnings, 8.4X Sales and 55.2X FCF. PRLB is a high growth name posting 14.6% growth in 2017 and forecasting 25% growth in 2018 as well as accelerating EPS growth. PRLB is taking advantage of the shorter product cycles by utilizing its technology to allow companies to beat competitors to market, ramp production quickly, and keep up with faster innovation rates. PRLB recently made a small acquisition of Rapid Manufacturing and can see it continuing to do deals to expand its capabilities, though this particular one is a negative to margins, PRLB should continue to perform well in 2018 with strength in global manufacturing and the overall shift to digital factories that has a long way to go.

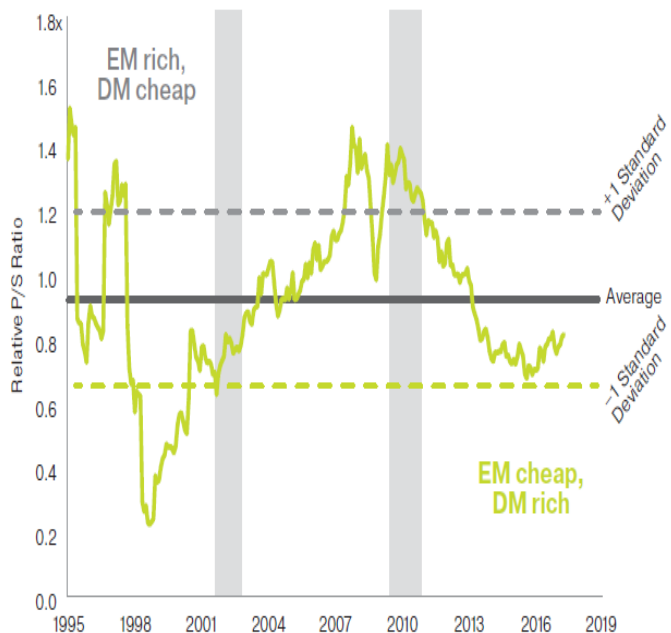
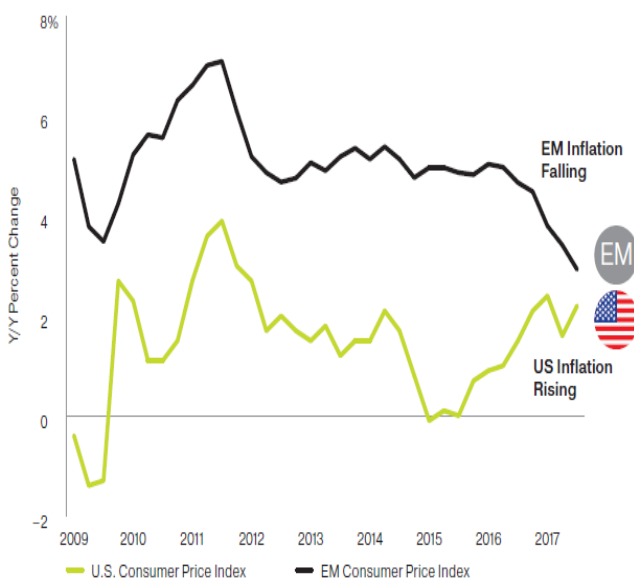
Mercado-Libre (MELI) is a call option position that we have held in 2017 and have continued to roll up the strike, the position currently has a deeply negative cost-basis, so it is a free runner. **Mercado-Libre (MELI)** with a \$14B market cap is the largest e-commerce player in Latin America, a market with some of the highest growth potential, and trades 54.25X FCF and 7X EV/Sales. E-Commerce is just 3% of total retail in Latin America compared to 11.1% in the US. MELI also has a payment solution called Mercado Pago that has 17M users and does 52M transactions. Its integrated platform also offers shipping solutions via MercadoEnvios. MELI may look

expensive at 100X Earnings, but it is growing rapidly and has a massive market left to capture, a name that looks cheap at any price when considering its potential future market cap. MELI is stepping up marketing and offering free shipping in an effort to quickly gain market share. With low penetration for internet and smartphones in its core focus regions that are set to expand sharply, MELI sets up as one of the best potential investments you can make even with the pending threat of AMZN entering the Latin American market.

A combination of fundamental, technical, and options flow analysis goes into the majority of our positions, and often we target names that we see as likely M&A targets. This, however, is not speculating on M&A, as it is investing in companies that will do well as a stand-alone, but we see upside optionality in a sale at a 25% or greater premium. A few current holdings that fit this mold include **Bunge (BG)**, **CommScope (COMM)**, **Envestnet (ENV)**, **Green Dot (GDOT)**, **New Relic (NEWR)**, **Splunk (SPLK)**, **Puma Bio (PBYI)**, **Vertex Pharma (VRTX)**, and **Xilinx (XLNX)**.

On a broader perspective, opportunities in Emerging Markets are looking more compelling into 2018 with China, India, Latin America and South America. Emerging markets offer a much stronger 3-5 year growth outlook and seeing inflation fall as US inflation rises. Emerging markets are also just starting to show expansion off a 2016 bottom in business activity, so the cycle has more room to run compared to developed markets, and valuations are comparatively cheap.

Inflation Falling in Emerging Markets
Consumer Price Index



In terms of strategies, we look to utilize more income generating strategies via covered calls and collars on positions in 2018, allowing to capture trend moves over a longer period of time. We also will look to participate more on earnings and other event-driven strategies where you can clearly define an ideal reward/risk relationship, and also utilize a small portfolio allocation to try and capture more “homeruns” in 2018 via OTM call/put options. Our strategy/structure worked very well in 2017, but I also see plenty of room for improvement on both the idea-generation and execution side.

Now, for some of our favorite bullish themes into 2018 and preferred stocks to participate in these themes:

Bullish Themes	Preferred Stock	Bullish Themes	Preferred Stock
Internet of Things - Connected Home/Auto	Silicon Labs (SLAB)	Sharing Economy	Grub-Hub (GRUB)
Fed Raising Rates	Charles Schwab (SCHW)	Home Renovation	Trex (TREX)
Inflationary Environment	Diamondback Energy (FANG)	Space Age 2.0	Raytheon (RTN)
Machine Learning/Vision	Cognex (CGNX)	Global Waste Crisis	Waste Management (WM)
5G / Fiber	Dycom (DY)	E-Commerce	Amazon (AMZN)
3D NAND	MKS Instruments (MKSI)	Water	American Water (AWR)
India Growth	HDFC Bank (HDB)	Healthy Living / Obesity	Weight Watchers (WTW)
LIDAR	Teledyne (TDY)	Online Lending	LendingTree.com (TREE)
Chinese Education	New Oriental (EDU)	New Display Technology	Universal Display (OLED)
Industrial Automation	Rockwell Automation (ROK)	Adult Gamer Growth	Take Two (TTWO)
Electronic Payments	PayPal (PYPL)	Chinese Internet Boom	YY Inc (YY)
Gene Therapy	Bluebird Bio (BLUE)	Chip Complexity	IPG Photonics (IPGP)
Swiss Tech Vendors	Alteryx (AYX)	Latin America Coming of Age	Mercado-Libre (MELI)
Autonomous Vehicles	Aptiv (APTV)	Retail "Treasure Hunt"	Five Below (FIVE)
Energy Efficiency	Owens Corning (OC)	Widening Wealth Gap	Ferrari (RACE)
Climate Change	Solar Edge Tech (SEDG)	Genetics	Illumina (ILMN)
Big Data	Splunk (SPLK)	Faster Product Cycles	ANSYS (ANSS)
Artificial Intelligence (AI)	Google (GOOG)	Flash Storage	NetApp (NTAP)
Cyber-Security	Qualys (QLYS)	Mobile Data Boom	Crown Castle (CCI)
Aging Population	Biogen (BIIB)	Digital Advertising	Facebook (FB)
Vehicle Sharing	Yandex (YNDX)	Trucking Market Tight Capacity	Old Dominion (ODFL)
Rise of the Millennials	Netflix (NFLX)	Cloud Computing	Salesforce.com (CRM)
Robotics in Med-Tech	Intuitive Surgical (ISRG)	Electric Vehicles	Tesla (TSLA)
Safety/Security in Escalating Tensions	Everbridge Tech (EVBG)		

In closing, Relativity Capital is excited to enter 2018 with a very strong market environment for active investing and our process continuing to improve every quarter. We see a number of excellent growth stock opportunities across several sectors and industries that we are targeting, while also being able to quickly adapt if conditions warrant more caution. We are also looking to constantly improve as this is an industry where complacency is a killer and requires continuous learning to stay ahead of the competition. On the personal/business side of things, we look forward to growing the portfolio, expanding our operations & meeting with prospective/current clients in the year ahead.

Sincerely,

Joseph Kunkle
Head Research Analyst
Relativity Capital Advisors

*Original letter reported “net returns greater than 33.5%” based on our calculations from the custodian’s reporting capabilities. Audited returns came in at 32.5% based on accrual accounting standards to assess incentive fees on a monthly basis versus quarterly which is used in the portfolio. We have updated the letter to show the audited numbers.

(Where not specifically sourced market data above is derived from Stockcharts.com, ThinkorSwim or Sentieo)
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