Essential Absolute Return Portfolio℠

Report for the Fourth Quarter of 2018

Philosophy

We believe that a disciplined, opportunistic approach to investing in a carefully researched set of open and closed end funds can deliver attractive risk-adjusted returns.

Objective

We seek a return that significantly exceeds the prevailing level of short term interest rates by investing for a combination of current income and short term capital appreciation. Limiting the risk of loss of principal is a secondary objective.

Essential Investment Partners

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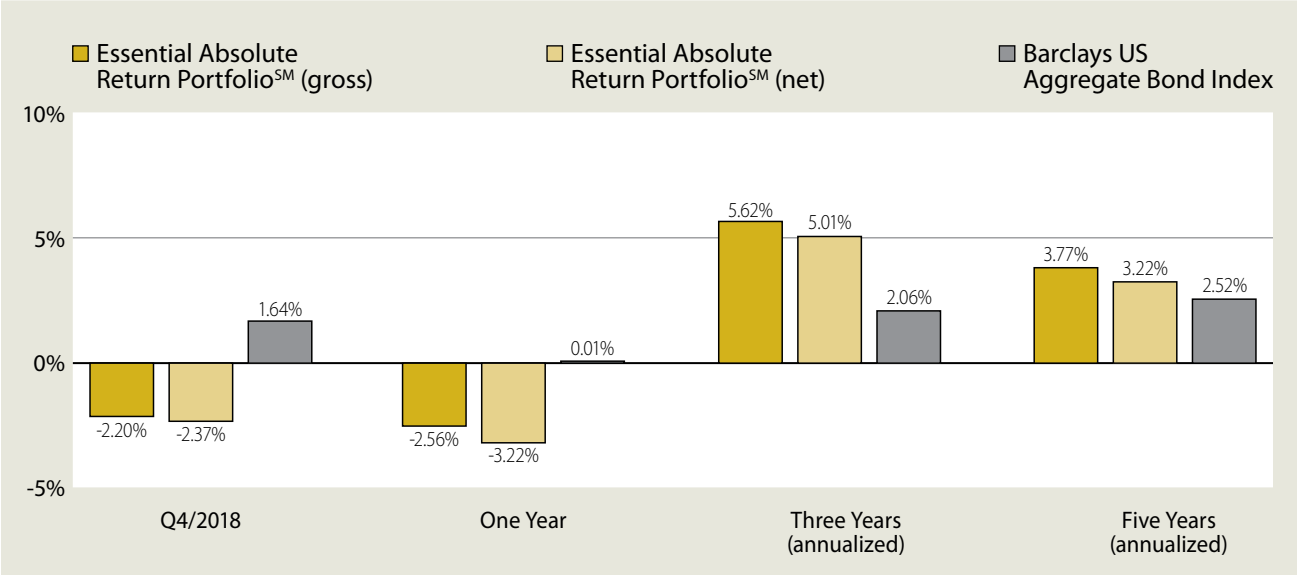
Essential Absolute Return Portfolio℠
Total Returns for Periods Ended December 31, 2018



Portfolio Manager's Commentary for Fourth Quarter of 2018

As concerns about the strength of the US economy came to the fore in the fourth quarter, yields on longer term US Treasuries declined rather sharply. At the same time, a heightened awareness of recession-risk caused spreads on investment grade and corporate debt to expand significantly. Floating rate loan values were hit particularly hard by this spread widening.

The fourth quarter was a rapidly moving market for closed end funds with several factors causing values to swing widely. Early in the quarter, with long term rates reaching multi-year highs, discounts on municipal closed end funds reached very high levels. We used the opportunity to begin adding to these types of funds. As rates started to fall on concerns about the economy, we cut back on some high yield bond funds and floating rate loan funds. While these moves were directionally correct, we should have been more aggressive. Finally, the seasonal pattern of tax loss selling took hold in December, keeping discounts at high levels across the board. We expect some snap back in early January as this tax loss selling abates.

All of these factors added up to a loss for the quarter, even while the bond index (which is driven largely by US Treasury bond returns) gained. The municipal bond investments gained ground for the quarter but the floating rate loan funds were big losers. One other investment, Special Opportunities Fund, which is run by a closed end activist investor, declared a large capital gain dividend in 2018 but shareholders didn't receive it until the first day of the new year. So that was a drag on 2018 returns and a plus for 2019 results.

Model Strategy Allocations as of December 31, 2018

Closed end fund convergence trading positions	35.5%
Core fixed income investments	41.9%
Core absolute return investments	5.4%
Closed end fund corporate action positions	0.0%
Cash and other	17.2%
	100.0%

Top Five Positions as of December 31, 2018

PIMCO Income Fund	12.5%
PIMCO Short-Term Fund	7.7%
Blackrock Strategic Municipal Opportunities Fund	6.4%
PIMCO Dynamic Credit and Mortgage Income Fund	6.4%
River North DoubleLine Strategic Opportunity Fund	6.4%

For the fourth quarter, the Essential Absolute Return Portfolio℠ composite posted losses of -2.20% gross of fees, and -2.37% net of fees, trailing the return of +1.64% for the Barclays US Aggregate Bond Index. For the full year, the Essential Absolute Return Portfolio℠ composite posted losses of -2.56% (gross of fees) and -3.22% (net of fees), while the Barclays US Aggregate Bond Index posted a gain of +0.01%.

With the changes noted above, our largest closed end fund weighting is no longer floating rate loan funds, but rather municipal bond funds. We noted last quarter that we were on the lookout for two very different risks. The first was a sharp rise in longer term rates. We said this would be a positive as discounts would widen even more dramatically, allowing us to deploy capital more aggressively. The second was a substantial widening of credit spreads. The fourth quarter brought us some of both risks. Early in the quarter, longer term rates showed signs of a sustained rise, only to be turned around as the quarter progressed, and credit spreads widened.

We believe caution is warranted at this juncture. Some of the floating rate loan funds that experienced large losses in the fourth quarter have jumped quickly as tax loss selling stopped. While we don't believe recession is likely in the short term, we don't think it is prudent at this point to test that view aggressively. We have a relatively large supply of liquidity in cash and open end funds that can be deployed opportunistically.

Jon Zeschin, CPA/PFS, CFP®
Portfolio Manager

Important Information

Essential Investment Partners, LLC ("EIP") is registered as an investment adviser with the U.S. Securities and Exchange Commission and will transact investment advisory business in states only to the extent EIP has made or is exempt from the requisite notice filings. No follow up or individualized responses to persons in other jurisdictions that involve either rendering or attempting to render personalized investment advice for compensation will be made absent compliance with applicable legal requirements, or an applicable exemption or exclusion.

Essential Absolute Return Portfolio℠ is a composite of portfolios managed by EIP in this strategy. This Portfolio may be used as a model for recommendations to other advisory clients, depending on the clients' individual needs, financial condition and risk tolerance. Holdings in an individual client's portfolio may vary from the holdings presented herein.

Composite returns are calculated as time-weighted total returns, reflecting the reinvestment of dividends and capital gains, the effects of cash holdings and the deduction of brokerage commissions on transactions. Dividends and other distributions are recorded when received in cash or additional shares, regardless of when such distributions may be recognized for income tax purposes. "EARP gross" means the total return composite for the Essential Absolute Return Portfolio℠ without the effect of management fees, and the "EARP net" reflects the "EARP gross" returns adjusted for the effect of charging fees to each account in the composite. Performance prior to 1/1/2011 reflects a hypothetical fee based on EIP's standard fee schedule of 1% of assets per annum up to $2 million, 0.75% of assets per annum on the next $3 million of assets and 0.50% of assets per annum on assets in excess of $5 million, billed quarterly in arrears, which was the highest fee schedule charged to any client during the period using the Essential Absolute Return Portfolio℠. Performance from 1/1/2011 reflects actual fees charged to clients. Actual fees may vary depending on, among other things, the applicable fee schedule and portfolio size. The composite contains all accounts which are or were managed as standalone portfolios using this strategy. The portfolio management team changed in March, 2011 and in October, 2015. *Past performance does not guarantee future results.*

This information is for illustrative purposes only; nothing contained herein is intended as investment advice or an opinion regarding the appropriateness of any investment, or a solicitation of any type.

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