MASSIFCAPITAL

January 17th, 2017

Dear Investors,

For the quarter ending December 31, 2016, the core portfolio returned +5.16% net of all fees and expenses compared to +3.82% for the S&P 500. The largest contributors to performance this past quarter were CNX Coal Resources (+2.75%) and Hallador Energy Company (+1.39%). From fund inception on June 16th, 2016 to year-end, the core portfolio returned +17.81% net of all fees and expenses compared to +10.59% by the S&P 500. Returns in separately managed accounts may differ from the core portfolio based on initial investment date. At year-end, the majority of assets were in cash.

Efforts to put further capital to work have been complicated by the continued bull market combined with the lack of any significant sell-offs in the second half of the year and the Trump rally. I expect this situation to continue and believe it may make matching this year's performance difficult. It is worth noting that the current bull market is now the second longest in history, stretching to roughly 91-months versus the 115-month dot com era bull market. Both are significantly longer than the average bull market of 52-months. While I do not profess to have any idea of the timing of the eventual turn, I cannot help but think we are closer to the end than the beginning. I believe this is enough to justify increased caution and demand a greater margin of safety from our investments.

2016 in Review – Portfolio Perspective

Coal played a significant role in the portfolio's outperformance in 2016. The portfolio was heavily invested in coal throughout the year based on the following assumptions:

A) Coal is a resource that is still of great significance to US energy infrastructure
B) Issues plaguing most coal companies in 2014 and 2015 were primarily the result of poor management rather than government policy
C) The market has been overly punitive in its assessment of the future of coal

In 2015, I started looking into smaller, less well-known coal names. This research resulted in positions in CNX Coal Resources (CNXC), an MLP spin-off from CONSOL Energy, and Hallador Energy Company (HNRG), a small-cap Illinois basin focused coal company. In both cases, management resisted the excesses of larger coal miners during the 2011 to 2012 period, thus maintaining healthy balance sheets, and had good, forward sold coal positions. Both positions were built with an eye towards an eventual return of 100% over the course of two to three years; however, we were happily rewarded by both companies doubling from average purchase price in less than 12 months. I have sold our position in Hallador but maintained our position in CNXC due to its rich unit distribution of 12% at current price levels. Unfortunately, the speed of the recovery from the bottom was quicker than expected, and I failed to put on full positions before significant moves in both stocks occurred. As a result, our returns were more limited than desired.

Volatility in the markets worked against us again when building a position in Freight Car America (RAIL) this quarter. The company was trading at a discount to net asset value and was, despite successful diversification by management, still viewed by the market (in our estimation) as a railcar company focused on coal cars. This is no longer the case. Before we were able to enter a full position, RAIL moved up +40%. I believe there is still some value left to be realized; however, our margin of safety has declined significantly enough to preclude adding more to the position.

At the current time, the portfolio's two other significant positions are Nevsun Resources (NSU) and Steel Partners Limited (SPLP). Nevsun Resources is a mid-tier copper-gold-zinc miner with one operating mine in Eritrea Africa and one high-value prospective copper-gold mine in Serbia. I have followed NSU since 2012, and I believe that management has both an eye for high-quality resources and an above average ability to execute on their plans. This is evidenced by the successful multi-stage development of the Bisha mine in Eritrea. With each expansion, the mine has advanced ahead of schedule and under budget, a rarity in the mining industry.

SPLP is an industrial conglomerate run by former hedge fund manager Warren Liechtenstein. The company has diverse holdings, ranging from Aerospace and Defense contractors to CrossFit gyms to the largest manufacturer of deli slicer blades in the US. When valued against the shares owned in publically traded companies, SPLP trades at a significant discount and has several subsidiaries of great promise. One, in particular, is WebBank, a lending facilitator to platforms such as Lending Club. While realization of value in this thinly traded small-cap will take some time, the ongoing reorganization and simplification of the business structure combined with its significant cash holdings and the excellent history of its management team leads me to believe that our patience will be well rewarded.

2016 in Review – Macro Perspective

Turning from the portfolio to the current investing landscape, 2016 ended, in my opinion, with a surprising bang. The key U.S. equity indices - the Dow, S&P 500, and Nasdaq - posted all-time highs in December. The small cap Russell 2000 and S&P 400 Mid-Cap indices gained +18.7% and +19.5%, respectively. Junk bonds enjoyed their best performance since 2009, with HYG, a high-yield bond ETF, returning +13.4%. Post Presidential election, the S&P 500 shot up roughly +10%. Trepidation about President Elect Trump and his administration quickly disappeared as markets allowed themselves to be overtaken by the assumption of upcoming deregulation, tax reform, fiscal stimulus, infrastructure spending and much more.

Looking ahead, a fundamentally improved environment for businesses appears baked into equity prices, an idea that some believe is supported by an ever-improving economy. The US economic backdrop to the Trump rally was, after all, a GDP growth rate of 3.5% in the third quarter and consumer confidence hitting the highest level since August 2001. At this point, we should be asking to what degree does the Trump rally reflect underlying corporate fundamentals? More specifically, does current market action properly reflect the overleveraged state of corporate balance sheets?

By the end of Q3, the U.S. economy was on track for the strongest credit growth since 2008; credit growth is, of course, a double edged sword, so interpreting this variable is an open question. Q3 seasonally-adjusted and annualized (SAAR) non-financial credit growth reached $2.679 trillion, which is the strongest expansion since the 2007 record of $2.503 trillion. Additionally, household mortgage credit has expanded at the fastest rate since 2007 - just as US home prices climbed above the July 2006 record.

Finally, government accounts tilted further into the red with the U.S. fiscal deficit rising one third to $587 billion, while government revenues increased 1% and spending jumped 5%. But what does this all mean?

When it comes to credit bubbles, there is a fine line between bursting and amplification. All is well as long as everyone agrees to borrow and banks agree to lend. Sadly, when this relationship comes to an end, as it often does, it does so in a way best described by Ernest Hemingway in *The Sun Also Rise:*

> '"How did you go bankrupt?" Bill Asked. "Two ways," Mike said. "Gradually and then suddenly."

In our current situation, both M&A and market movement support increased collateral values, allowing for increased borrowing. Reflexivity, as George Soros would call it, is precluding markets from finding an equilibrium as the prevailing market bias (higher) is altering corporate fundamentals and vis-a-versa. Therefore, with the indicators moving in different directions, I am left wondering does the current market suggest an equilibrium state or a far from equilibrium state?

Debt concerns are not just local. According to the Financial Times, global debt issuance reached an all-time high in 2016 ($6.60 trillion), surpassing the previous record set in 2006. Global corporate debt issuance was up +8% from 2015 to $3.60 trillion. Total Chinese debt now exceeds 250% of their yearly GDP. At year end investors appear to have allowed optimism in the present to overcome opaque concerns about the future, I believe looking at the fears of the recent past instructive in this situation.

Just as the year ended with a bang it started with one as well, the Financial Times reported that global markets lost $4.0 trillion in the first ten trading sessions of 2016 – the "worst-ever" start to a trading year. The Shanghai Composite sank -25% in January, a result of fears that a Chinese Bubble might be bursting. Next, the S&P 500 dropped -11%, the Nasdaq Composite fell -16%, and European stocks (STOXX 600) dropped almost -30%. By February, crude oil had fallen -30%, and the GSCI commodities index was trading at 2004 lows. These are significant numbers for all investors to remember; especially as they represent losses resulting from fears of a China collapse, not an actual collapse. I find the magnitude of these sell-offs unsurprising. After all, sensitivity to events increases with leverage, and leverage is significant everywhere we look.

With 2016 in our rearview mirror, the question becomes what is the "real" state of financial markets and the global economy. What reflects the truth of our current situation, the start of the year or the end? Our opinion is that year-end euphoria is just that, euphoria - an emotional response by market participants untethered to reality. We may have a year or two, or even three, left in this good run but all the while we are at risk of a significant market retreat. How significant is anyone's guess. As always, history can provide us with some perspective to inform our outlook. The following table of recent bear markets comes from the JP Morgan Guide to the Markets:

Market Corrections	Market Peak	Bear Return	Duration (Months)
Crash of 1929 - Excessve leverage, irrational exuberance	Sep-29	-86%	33
1937 Fed Tightening - Premature policy tightening	Mar-37	-60%	63
Post WWII Crash - Post-war demobilization, recession fears	May-46	-30%	37
Flash Crash of 1962 - Flash crash, Cuben Missle Crisis	Dec-61	-28%	7
Tech Crash of 1970 - Economic overheating, civil unrest	Nov-68	-36%	18
Stagflation - OPEC oil embargo	Jan-73	-48%	21
Volcker Tightening - Whip inflation now	Nov-80	-27%	21
1987 Crash - Program trading, overheating markets	Aug-87	-34%	3
Tech Bubble - Extreme valuations, .com boom/bust	Mar-00	-49%	31
Global Financial Crisis - Leverage/housing, Lehman collapse	Oct-07	-57%	17

Source: JP Morgan Guide to the Markets, December 2016

The numbers presented above suggest the next bear market will pull back in excess of 30% with the average bear market over the past 100 years resulting in a market correction of 46%. Given where we appear to be in the cycle and the magnitude of historical bear market pullbacks, thoughtful portfolio management necessitates investing only in opportunities with greater than normal margins of safety. Additionally, prudence dictates that we hold greater than normal cash reserves for deployment at the more opportune valuation levels which will likely develop during any pull back.

Looking to 2017

Looking forward, I believe that 2017 will hold some exciting opportunities for Massif Capital and our investors. In particular, it appears that concerns over lackluster economic growth and political instability in Europe have created decent buying prospects. Currently, most investors are overly focused on a negative top-down macroeconomic analysis of the situation in Europe, rather than letting bottom up corporate analysis drive decisions. The US Presidential election appears to have exacerbated this trend further, accelerating capital flows into US equities and away from European Markets. The idea that the top-down macroeconomic situation here in the US is significantly better than in Europe is misguided. Instead, since the macroeconomic situation everywhere is poor, why not focus on investing where the discount to intrinsic value appears greatest?

I have already started building positions in select European equities starting with Bollore, a French conglomerate with a story very similar to Steel Partners: strong management, complex corporate structure undergoing simplification, a mix of existing businesses that justify a valuation in excess of current price levels, and subsidiaries that may significantly increase shareholder value in the future. In addition to Europe, I continue to study several mining companies that may prove, like Nevsun, attractive investments as the companies move from being exploratory/junior miners to mid-tier players in their respective mineral focus.

The shipping, uranium mining, and off-shore oil and natural gas industries appear attractive hunting grounds as they remain some of the most beaten-down industries in the market. I am actively hunting for shorts, but have been stymied by a struggle to find companies that are not just overvalued. While I consider overvaluation necessary for a good short, I do not believe that valuation alone is a sufficient basis for the asymmetric risk-reward profile of a short.

Finally, in keeping with my concerns regarding the macroeconomic environment, I continue to study various ways of benefiting from a significant market retreat. While I have identified several prospective approaches, my principal concern is the one-way nature of bets. They are likely to either work spectacularly or be 100% losses. In short, the trades are overly binary.

In closing, I would like to highlight that while I will not allow the macroeconomic landscape to stop me from taking positions in promising companies, it has made me cautious in the sizing of portfolio positions. Additionally, I will likely continue to hold more cash than I might otherwise have done. As a result, I expect there to be further situations such as experienced with our coal trades: a profitable investment that might have been more so. As always I remain grateful for your support and your confidence. I will endeavor to deserve it. Please let me know if there is anything I can do to serve you better and never hesitate to contact me directly. I am always available for my investors.

Best Regards,

William M. Thomson