Closed-End Fund Market Update

Matisse

by Bryn Torkelson, President and Chief Investment Officer
& Eric Boughton, CFA, Portfolio Manager and Chief Analyst

+8.02% YTD 2017

Q1 2017 Performance Review:

	March 2017	Q1 2017	Annualized Since Inception
Matisse Discounted Closed-End Fund Strategy	+1.4%	+8.0%	+8.8%
S-Network Composite CEF Index	-0.3%	+5.1%	+6.6%
S&P Target Risk Growth (Balanced)	+0.9%	+4.6%	+5.5%
S&P 500	+0.1%	+6.1%	+8.1%

As a firm focused on closed-end fund (CEF) portfolio management, we want to keep you up to date on current CEF market stats/developments as well as our performance. **The Matisse Discounted Closed-End Fund Strategy composite returned +8.0% net for the first quarter of 2017.** The Strategy's current average discount to NAV is 14.2%, and its current indicated cash distribution yield is 3.5% (*see Strategy Performance Highlights*).

IN THIS ISSUE

Q1 2017 CEF MARKET REVIEW

To reiterate, our basic principle is "if you purchase high quality, deeply discounted CEFs, good things eventually happen for shareholders". Academic studies support this idea, as does our track record (*we commissioned a study with the University of Oregon MBA program in 2010*, and Rutgers University did a separate, unaffiliated study in 2014). Recent activism has also benefited several deeply discounted CEFs, which we will discuss on the next page.

Discount Levels

During Q1, overall CEF discounts narrowed by 1.2% and our portfolio narrowed by 1.9%. From a historical perspective, today's overall CEF discounts (5.3%) are bigger than normal (average 4.7%).

Our Strategy's current average discount to NAV is much wider (14.2%), which means right now our investors are sitting in an income focused strategy, but have many opportunities to gain additional total return through discount narrowing.

Asset Allocation

By definition – we own what the general investor community dislikes, which is evidenced by deep discounts (remember, we use "bottom up" security selection). Right now, in general we see investors disliking Emerging Market and Foreign Equities, resulting in our approx. 33% lookthrough allocation.

CURRENT MARKET OPPORTUNITIES

	Avg. Discount End Q1 2017	Avg. Discount Since Strategy Launch
Our Strategy	14.2%	13.4%
REITs	10.1%	8.7%
International Equity	8.6%	7.0%
US Equity	8.7%	7.7%
EM Equity	10.7%	9.2%

STRATEGY PERFORMANCE HIGHLIGHTS

Q1 2017 Return	8.0%
YTD 2017 Return	8.0%
One-Year Return	20.7%
Three-Year Annualized Return	7.2%
Five-Year Annualized Return	7.6%
Ten-Year Annualized Return	7.4%
Current Discount to NAV	14.2%
Current Distribution Yield	3.5%

Annualized Return Since Inception	8.8%
Compare to S-Network Composite CEF Index	6.6%
Compare to S&P Target Risk Growth (Balanced)	5.5%
Compare to S&P 500	8.1%

*Data (except for distribution yield) is after a 1% annual mgmt. fee

RECENT ACTIVISM IN CEFS

Recent activism in the CEF market has positively influenced pricing on several of our deeply discounted Foreign Equity CEFs. Although we do not consider ourselves activist investors, our end goal is the same – we are all value investors seeking superior rates of return.

Specifically, on March 22nd and March 28th, City of London Investment Group (CoL) made 13d filings on 13 US-traded CEFs focused on Foreign Equity (CoL is an EM CEF specialist based out of London, and manages approx. $2 B in CEFs).

About these 13 CEFs:

1) Invest in either Asia or Latin America.
2) Some are country-specific, while others are broader regional funds.
3) CoL is the largest reporting holder in all 13 CEFs, and owns between 31% and 45% of each fund (as of most recent available data).

The filings were noteworthy because up until now, CoL has maintained a "passive" filing status in each of these funds, stating they do not intend to influence or control the management of these CEFs.

However, these late-March filings have changed the game substantially. In a conference call discussing the filings, CoL's CIO Barry Olliff laid out several changes he would like to see these CEFs make, and stated that "any fund trading at greater than a 10% discount is now a target for liquidation".

In follow-up conversations with us, Mr. Olliff expressed frustration at not being listened to by certain CEFs despite the firm's large ownership positions. We pointed out that liquidation might be the only way to achieve sustainable discount improvement for CEF shareholders.

How did the market respond to the filings?

2/28/17: the 13 CEFs traded at an average 14.1% discount to NAV

3/31/17: the 13 CEFs traded at an average 10.2% discount to NAV

Shareholders experienced a 4.5% discount-narrowing gain from February to March, and they have narrowed further here in April.

Who owned these CEFs?

Our Competitors – Nothing Significant

Most of our large competitors did not own meaningful positions in most of these funds, given the small capitalization and less liquid profile of these CEFs (the average CEF from this list has < $200 M market cap).

Matisse Funds – Yes, in our Mutual Fund Prior to the CoL Announcements

We owned $13 M across 10 of these 13 CEFs, representing 12% of our fund.

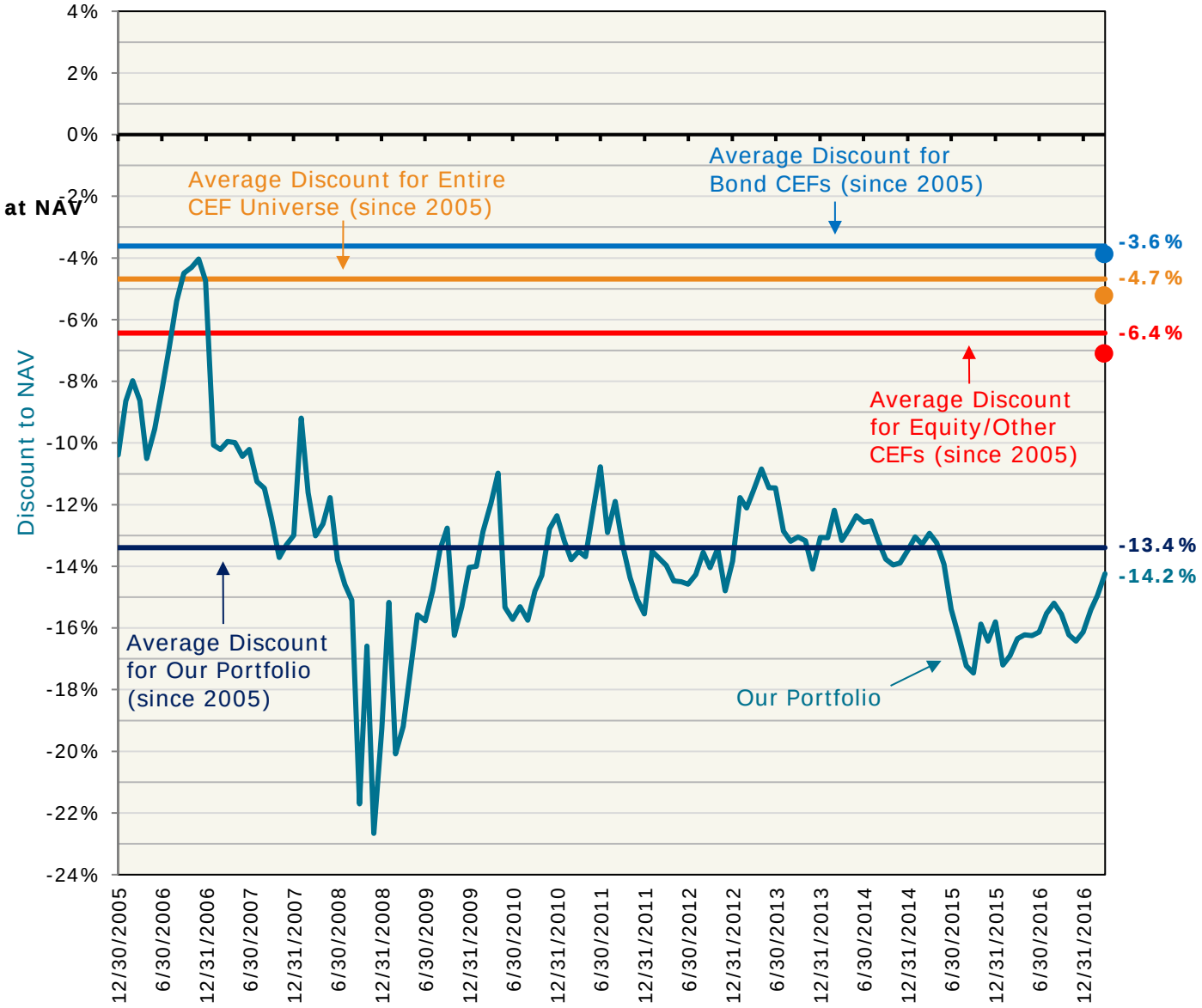
Each holding by itself was not a major impact for us, but collectively they contributed approximately +0.95% to our March return, and provided an excellent example of our flexible and opportunistic singles-hitting approach.

Going forward, we intend to assist in pressuring the boards of these CEFs to further narrow their discounts to NAV.

Our general view is that some of these funds will be liquidated, and that many of those that remain will trade much closer to NAV than they do today.

We also intend to opportunistically take advantage of open-market opportunities to increase or decrease these positions.

HISTORICAL CEF DISCOUNTS



Colored dots represent current discount levels today

Key Takeaways:

1) Our portfolio's current average discount is below its 11-year average.
2) Equity/Other CEFs are currently more discounted than normal.
3) Bond CEFs in general do not offer great value right now.

TODAY'S LOW PAYOUT ENVIRONMENT

Astute investors will note that our Strategy's indicated cash distribution yield has fallen somewhat to 3.5%, and that our mutual fund, for example, now shows a 2.8% TTM yield (per Morningstar).

Two basic factors are at play here:

1) In response to a yield environment which has continued to decline for most securities (investment-grade bonds yield less than 3% on average, and stocks yield less than 2%), CEFs have elected to reduce their "regular" cash distributions.

   In fact, there are now only 3 US-traded CEFs trading at double-digit discounts with indicated cash distribution yields over 10%.

   In many cases, those CEFs which do maintain high payouts are effectively "yield traps".

   For example, the average CEF with higher than an 11% indicated yield trades at more than a 6% premium to NAV.

2) More CEFs (even those that do pay higher cash distributions) are restating their payouts as "return of capital" rather than income or capital gains.

   This means that mutual funds (like ours) which own CEFs are forced to retain that cash within the fund rather than pay it out to investors as income distribution.

The good news is that, at least for our Strategy, the "cash distribution engine" continues to function well, even in a lower payout environment.

For example, let's look at our mutual fund throughout 2016:

- Average asset base = $115 M
- Received over $8.7 M in cash payouts from our CEFs (a cash distribution rate of over 7.5%)
- Cash was received through 380 separate dividends, paid on 100 different CEFs
- On the date we earned these distributions, the CEFs were trading at an average discount of 16.3% to NAV

As we've discussed in the past, this "dividend at a discount" phenomenon is effectively a consistent tailwind to our returns:

In 2016 we paid an average of $0.837 cents for a dividend and received $1 back, resulting in a 19.4% instant return for our shareholders!

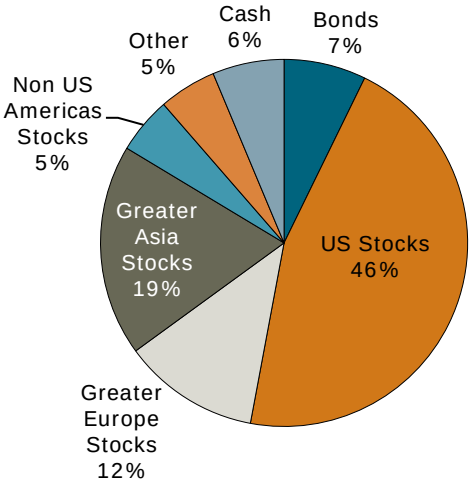
These cash distributions continue at roughly the same pace this year, and even though we are not able to distribute all of them from our mutual fund, they continue to drive very consistent excess returns for our investors.

WHAT'S HAPPENING AT MATISSE

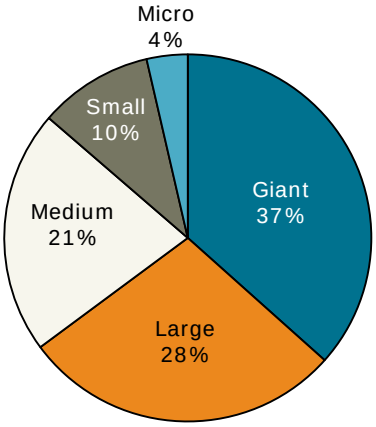
- On April 5th, Eric was featured in an article on Financial Advisor IQ talking about how CEFs can help advisors who have clients searching for yield outside of traditional bonds. To read the article, please *click here*.
- Our publicly traded mutual fund that employs our discounted CEF strategy has been a Morningstar® 5-star fund since July 2016.

TYPICAL ACCOUNT LOOKTHROUGH ALLOCATION 3.31.17

Asset Allocation



Equity Cap Allocation



Source: Morningstar®

TOP 10 HOLDINGS AS OF 3.31.17

Boulder Growth & Income
RMR Real Estate Income Fund
Central Securities Corporation
Adams Diversified Equity Fund
Source Capital Inc
Adams Natural Resources Fund
Liberty All-Star Equity
General American Investors
MS Emerging Markets
GDL Fund

Source: Morningstar®