RIVERPARK FUNDS

RiverPark Structural Alpha Fund

(RSAIX / RSAFX)

Signal Fatigue

"You don't believe what they say on the radio
You don't believe what you see on the video
Living in the shadow of a doubt today
Still waiting for the smoke to clear away"

\- *Smoke Signal*, J. R. "Robbie" Robertson - The Band

Contrary to urban myths, it isn't the tryptophan in turkey that makes people sleepy after their holiday feasts. In fact, postprandial somnolence (better known as "food coma") occurs when our bodies create too much melatonin as a by-product of digesting a heavy, carb-rich thanksgiving meal. Investors who have gorged themselves on equities and other risk assets throughout most of the month similarly felt some drowsiness in the final week of November, but overall the market posted another strong monthly return on the heels of its eighth straight week of gains. Volatility continued to be muted, and the only meaningful decline that occurred throughout the month was immediately followed by a rally of equal magnitude. In a year during which every pullback has turned out to be a buying opportunity, the mass market psychology has become decidedly bullish. Even the sentiment indicators and macro-economic news that flashed caution throughout the year have thus far proven to be false warnings, and money deployed on the short side or as a hedge has seemingly been misallocated. Not surprisingly, the persistently low levels of volatility that have accompanied this stock surge are challenging our strategy's ability to match its historic annualized rate of return. The Structural Alpha strategy is not predicated on forecasting or responding to market moves. Rather, it is designed to stay systematically long and hedged regardless of prevailing market conditions. As Ben Inker, the co-head of global asset allocation at the $112B investment management firm GMO, recently wrote, "one of the more painful lessons in investing is that the prudent investor …almost invariably must forego plenty of fun at the top end of markets." We don't pretend to forecast whether we are at or near the market's top. However, we do believe that it is usually when people start to ignore the caution signs that they miss the warning signals.

Our Observations

This year's bullishness has drawn many comparisons to the market action of 1995, and with the year-end in sight another comparison can be made. All ten sectors in the S&P 500 are up at least 10% for the first time since 1995, leaving very little doubt as to the strength and breadth of this

rally. Yet, investor bullishness seems to be driven more by monetary and fiscal policy in the U.S. than by fundamental earnings momentum and job and wage growth.
Interestingly, in a recent survey of small business owners, only a small percentage of members of the National Federation of Independent Business (NFIB)cited credit and interest rates as their biggest problem. Despite official policies that have kept rates low for a prolonged period of time, a record number of NFIB members expressed no interest in taking out a loan. This illustrates a problem with the demand for credit, not with the supply of credit. Low rates and available credit is not spurring small business owners to take risk and grow their franchises, possibly reflecting a belief that economic prospects are not that strong. Excess liquidity may be responsible for rising asset prices, but it has not translated into the economic stimulus that makes entrepreneurs invest or hire, and subsequently create sustainable economic expansion.

Despite some warning signs, we don't want to be too cynical during the holidays! Looking back again at 1995 as a historical comparison, we see that not only was the market strong in that year, but it went on to notch gains of 23% in 1996 and 33% in 1997. Just because the market is at elevated levels and historic highs, doesn't mean that it cannot go higher from here still. The S&P 500 total return year-to-date is over 29%, and December has posted positive returns almost 75% of the time. From a breadth perspective, so far only 50 S&P 500 index members are down for the year.

The mistake that investors often make is that they dial risk up or down in reaction to prevailing market conditions. This can result in dangerous emotional reactions when the unexpected happens and stocks quickly give back some of their gains. An investor's tolerance for risk shouldn't change as a result of market activity. One of the advantages of our strategy is that our risk and return profile has been fairly constant, and not reactive to changing market conditions. Just as we don't chase returns when volatility is low and stocks are strong, we also don't panic when the opposite occurs.

We have always believed that it is easier to identify and hedge risks rather than predict returns. This is why we created an investment strategy that manages market exposure by systematically harvesting risk premiums over time. As has been the case this year, risk-based portfolios designed to perform well over longer periods of time may not have the same success over shorter time horizons when volatility is low and returns are significantly higher than historical averages. The willingness to trade-off opportunities for above average gains in exchange for income that will provide a cushion, and therefore some downside protection, during market declines is core to our strategy, and it's the reason why we have trailed the major market averages year-to-date.

Our Conclusions

The conditions that have been propelling stocks for months have persisted, and until something changes these trends will likely continue. Yet, even against the backdrop of positive market action and low volatility, downturns are unpredictable and the risk of loss never goes away.

While a normal single-digit correction is something entirely different than a catastrophic collapse, both can lead to the permanent impairment of capital. We subscribe to the belief that it is better to dig your well before you're thirsty. Effective risk management doesn't involve waiting for a sign that the correction is about to occur. Bells don't ring at market tops or market bottoms to alert investors of impending inflection points. This is why our investment philosophy systematically strives to reduce risk and protect gains. Even though such hedged investing hasn't been rewarded over the course of this year, as portfolio managers we know that it is when markets become more challenging and volatility increases that we earn our investors' trust.

Sincerely,

Justin Frankel
Portfolio Manager

Jeremy Berman
Portfolio Manager

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Due to the inherent leveraged nature of options, a relatively small adverse move in the price of the underlying instrument may result in immediate and substantial losses to the Fund. Options and futures options carry a high level of risk and are not suitable for all investors. An option holder runs the risk of losing the entire amount paid for the option in a relatively short period of time. The seller of a "naked call" is subject to the risk of a rise in the price in the underlying instrument above the strike price. The seller of a "naked" put is subject to the risk of a decline in price of the underlying instrument below the strike price. Risk is reduced only by the proceeds received from selling the option.

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