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Dear Investor,

At Robotti & Company Advisors (Robotti & Co.), we often talk about the things that differentiate us from other investors. Two of our core advantages are that we have a behavioral edge and an analytical edge. Our behavioral edge is forged from decades of investing and an appreciation of volatility in security prices. Our analytical edge springs from our timeframe focus on the long-term versus the short-term news flow that dominates the chatter and causes short-term price gyrations. We have been analyzing companies for 30+ years and strongly believe in our approach even when the market does not agree with us. These are things that we take pride in at Robotti & Co.

Within that context, we have identified a new application of our investment strategy and market philosophy. We are pleased to launch the Robotti Structured Value Strategy. This strategy allows investors to capitalize on the market's frequent inability to properly value securities. The stock selection is predicated on a quantitative methodology. As with all of our strategies, we take a long-term view and see the market's short-term movements as opportunities; as periods to accumulate mispriced securities. We believe our established record as a contrarian in the marketplace gives us the ability to maintain confidence in our investment philosophy and this strategy.

When it comes to quant, our methods differ from many managers'. Often, quantitative managers use a complex and short-term oriented methodology. In this strategy, we have taken a more simplistic and long-term approach. This allows us to focus on the strengths of quantitative investing while remaining true to our value driven focus. There are numerous benefits to this strategy, including the ability to, at times, find relative value, scalability, and a consistent approach that can be understood by investors.

Background

The concept for the Structured Value Strategy was first proposed in 2011. At that time we began to look at ways to be consistent and less emotional in the investing process, while still attempting to exploit market inefficiencies. Although our core research has not changed much over the years, the ways in which we find companies have expanded, in part, because the amount of information readily available is greater than ever.

Screening is one of our primary methods used when searching for companies. This involves searching for companies based on financial criteria. We initially believed we could isolate a few criteria that defined companies that we would want to invest in, but ultimately realized we needed to use a variety of metrics to paint a complete picture.

This has potential as an investment process, because it has both the possibility for appreciation and downside protection, the proverbial "margin of safety". In order to have comfort with this quantitative strategy we needed two things. First, we needed a large enough portfolio so that we would not be burned by a few bad apples. Second, we needed to focus on companies that had strong metrics, with the intention of striking the target, but without aiming to hit the bulls-eye. Our objective was to get in the range without being so specific we potentially ignored good investments or included companies that we would have removed upon conducting further research.

Basic Theory Behind the Structured Value Strategy

Mean reversion, the theory that over time stocks will revert to fair valuations, is the primary principle of our investment philosophy. Using this principle, if the portfolio is less expensive than the market (as measured against the benchmark) yet has stronger fundamentals, then the majority of securities should appreciate to the mean.

The Russell 2500 Value Index is the benchmark and investment universe being used for the portfolio stock selection. Because this strategy is quantitative, beyond incremental metrics, no further research is conducted on a company level. All valuation and fundamental indicators will be looked at on an aggregate portfolio level. This will confirm the validity of the screening process and ensure that it is still relevant.

In Execution

At the end of December, concurrent with a time when security prices are often distorted by year-end tax selling, we generate a buy list based on our quantitative criteria. This distortion amplifies opportunities to buy mispriced companies at even bigger discounts. When structuring the portfolio we look at four key metrics: Price to Earnings (P/E), Price to Book (P/B), Return on Equity (ROE), Price to Free Cash Flow (P/FCF). In addition, we also screen for margin expansion and earnings per share growth (EPS growth). When screening for each metric, we remove outliers. Again, we want to get in the range, but not hit the bulls-eye. Removing outliers from selecting securities helps to reduce the chance that we end up with securities that we would discard upon qualitative research.

This buy list is purchased in January with an expected holding period of approximately one year. This screen will be run annually, and the portfolio will be updated and rebalanced accordingly. In addition to our annual screening process we will hold quarterly reviews of the portfolio. We believe one year gives enough time for the portfolio to appreciate closer to mean (the valuation and metrics of the Russell 2500 Value), but also keeps the portfolio fresh and with the most potential to increase in value.

Under normal circumstances, once the buy list is created, we look at the portfolio and examine key metrics relative to the benchmark. If the valuation and operating metrics compare favorably to the benchmark, therefore showing potential for mean reversion, we will invest close to 100% in equities. If they do not, we still invest in equities but will couple this with around 50% held in cash. We will not sell down to less than roughly 50% in cash, but under certain circumstances the cash position can increase/decrease from 50%. At every quarter end, we examine the portfolio against the benchmark, using the same metrics, and can vary our exposure to equities.

We do not claim to be market timers, but for this style of investing, we believe a quarterly review process gives insight into the times when opportunities are more/less prevalent and therefore when to be more cautious, or optimistic. This system is neither a “failsafe” against being invested when the market performs poorly, nor is it a guarantee we will be fully invested in times of strong market appreciation. However, we have strong conviction in our approach, and understand that protecting your assets is a high priority.

Current Probability of Mean Reversion

At year-end 2014, we generated a model portfolio that serves as the basis for your account. Both this year-end review and performing a quarterly review at the end of Q1 2015 showed that the valuation and fundamental metrics relative to the Russell 2500 Value Index gave mean reversion potential to the portfolio. Therefore, the model portfolio was near fully invested in equities. Over the past quarter the metrics we assessed have changed dramatically and the portfolio is now more expensive than the benchmark. As a result, we sold down your equity exposure to around 50% equities and 50% cash.

Valuation and Key Metrics of Model Portfolio Compared with the Russell 2500 Value[1]

June 30, 2015	P/E WAVG	P/E WHAVG	P/Sales WHAVG	P/B WHAVG	P/CashFlow WHAVG	ROE WHAVG	EV/EBITDA WHAVG
RSV Model Account compared to R2500 Value	Lower	**Higher**	Lower	**Higher**	Lower	**Lower**	Lower

[1]From FactSet Data Systems, at 06-30-2015 Close

***WAVG**: Weighted Average. Simply security weight multiplied by metric.*
***WHAVG**: Weighted Harmonic Average. This calculation is similar with weighted average, but ignores unreported figures and 0's. WHAVG does count negative values. It is used when the metric being calculated can produce extremes in values.*

At the end of Q1 2015, the portfolios averages were lower for all of the key metrics: P/E, P/Sales, P/B, P/CF, and enterprise value to EBITDA. Additionally, Return on Equity was higher.

At the end of Q2 2015, the valuation and fundamental metrics painted a different picture. P/E has gone up significantly and is now higher than the benchmark, as is P/B. Additionally, ROE is now lower than the benchmark and actually, even negative. To reiterate, we look at the portfolio in aggregate, to determine the level of equity exposure. As the model portfolio is currently more expensive than the benchmark, it runs the risk of reverting downward. Despite that, individual companies may still be inefficiently priced in the portfolio and may offer upside potential.

All metrics are examined on a weighted harmonic average basis, with the exception of P/E which is also evaluated on a weighted average basis. There are many different ways to calculate these aggregate portfolio metrics. We believe that using the same metrics for both the benchmark and the portfolio, and being consistent in how those metrics are calculated, is the most important factor.

For risk management purposes, position size and sector limits are incorporated into the strategy. No one position can be more than 10% of the portfolio. Additionally no more than 50% can be attributed to any one sector. Our concern is that although some companies within a sector, or the sector overall, might be priced inefficiently, the timing of when the market recognizes its mispricing can vary. Outsized sector weights are a recurring outcome of this strategy. When this occurs we select additional securities while excluding that sector from the portfolio. We believe that the strategy can pick good companies and also allocate to out of favor sectors. Having said that, we do not wish to be overly weighted in any one sector.

Please feel free to contact me anytime to discuss this letter, or anything else regarding your account.

Thank you for your confidence and trust.

Sincerely,

David A. Kaiser
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