Your Investments | October 2018

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Greetings,

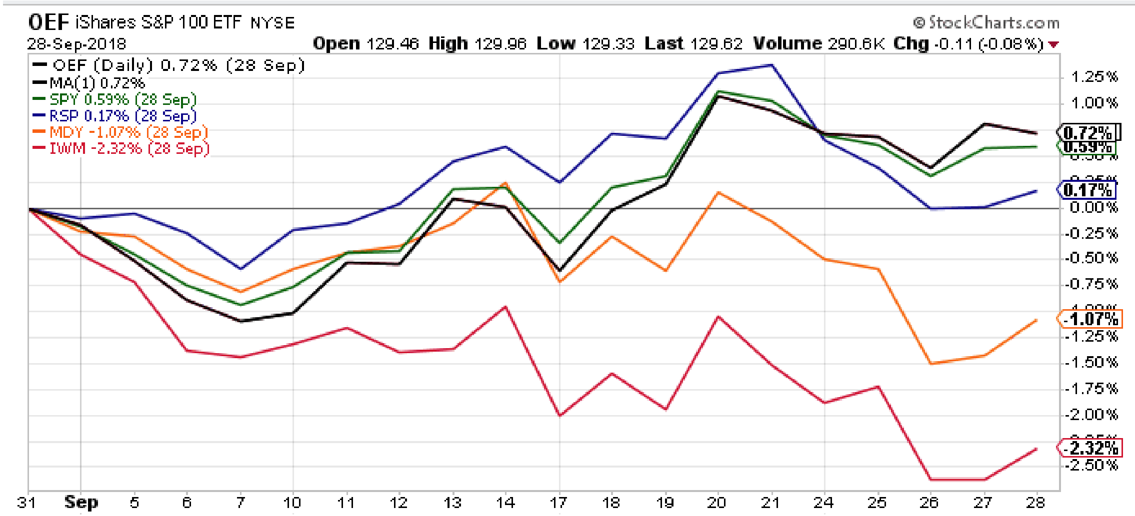
The Dow reached a new high in September for the first time in eight months, climbing 1.97%! The S&P was up 0.57%. The Nasdaq composite was down 0.07%.

The US economy continues to expand with Q3 GDP estimated to come in around 4.3% according to the Atlanta Federal Reserve. And according to FactSet, the estimated earnings growth rate for the S&P 500 is 19.3%. If 19.3% is the actual growth rate for the quarter, it will mark the third highest earnings growth since Q1 2011 (19.5%).

So where do we go from here? The economy is on fire and we believe it will stay that way for some time. Our recession indicators push the next potential recession out at least another 12-18 months. Having said that, there is some weakness in the market suggesting a small correction might be on the horizon. Let's take a look.

Market Musings

September saw a huge difference in performance based on company size.



This chart shows us that the largest 100 stocks in the S&P 500 (represented by OEF) gained just over 0.7%. The rest of the S&P on an equal-weight basis (RSP) was essentially flat. The medium-sized companies (MDY) were down over 1%, while the smaller companies (IWM) were down over 2.3%.

The overall S&P 500 made an all-time new high on September 20 on the strength of the huge companies, while the medium and smaller companies did not participate.

There are two possible explanations for September's action:

1. Profit-taking in the smaller companies after they outperformed earlier in the year;
2. Declining participation at a new market high is a sign of overall market weakness.

In support of profit-taking, small cap stocks were buoyed earlier in the year by tax reform and trade worries. Some investors, wary of large multinational companies taking a hit on trade tariffs, put their money into smaller domestic companies that would not be as severely impacted.

As the administration announced a deal with Mexico in September and made headway elsewhere with Canada and China, trade fears eased and investors rotated back into larger companies after taking profits in their small company stocks. Small companies have shown earnings growth with the new tax reform, and if they invest these extra earnings into their businesses, they will soon become attractive again.

In support of a new market high, our research has shown that nearly every major top is characterized by declining participation like we saw in September. Fewer and fewer companies are responsible for keeping the market afloat.

On balance, given the strong economy combined with strong seasonality (the Fall and Spring are typically the best seasons, and the last two years of a presidency are typically better than the first two years), we favor the profit-taking explanation. But we are keeping a close eye on things and may hedge the portfolio if the market rolls over.

The Fed

The Federal Reserve raised the "Fed Funds" interest rate in September, and strongly signaled it would raise rates again in December. The Fed Funds rate is charged by banks which loan to other banks.

The current plan calls for three more rate hikes in 2019, and another in 2020. In addition, as we have previously written, the Fed is cutting its balance sheet by not replacing bonds as they mature. This "Quantitative Tightening" reaches $50B in October and will remain $50B per month through 2020. By the Fed's own calculations, the unemployment rate will start to rise in 2021 from its restrictive policies.

The "yield curve" is the difference between the 10-year treasury yield and the 2-year treasury yield. The 2-year has been rising more rapidly than the 10-year, primarily as a result of the Fed raising the Fed Funds rates.

Economists often talk about an inverted yield curve as an early warning (6-24 months) of recession. The last time it happened was 2006. The yield curve inverts when the 10-year yields less than the 2-year. As of October 2, the 2-year yield was 2.82% while the 10-year yield was 3.01%. Very "flat" but not yet inverted. The stock market actually performs pretty well during flat yield curve periods.

While we monitor the yield curve, we also look at the difference between 2-year annualized change in GDP and the Fed Funds rate. Recessions typically occur when the 2-year annualized GDP growth falls below the Fed Funds rate. Currently, GDP has grown 4.2% over the last two years, and the Fed Funds rate is 2.25%, implying the Fed has significant room to raise rates further without wrecking the economy.

KCM Macro Trends Fund Marks 10-Year Anniversary with Five-Star Rating

Scores in Top 1% in its Category Across One-, Five- and Ten Year Periods

Kerns Capital Management ("KCM") is pleased to announce that the KCM Macro Trends Fund (KCMTX) celebrated its 10 year anniversary and received an overall five-star Morningstar rating in its category for the 10-year period ending Aug. 31.

MORNINGSTAR ★★★★★ ™

The KCM Macro Trends Fund:

- Has an overall Morningstar Rating of 5-stars, including 5-star ratings for the three-, five- and ten-year periods ending August 31 out of 301, 160 and 51 funds respectively, based on risk adjusted returns.
- Ranks in the top one percent of its Multialternative category for one-, five- and ten-year periods ending Aug. 31 out of 367, 160 and 51 funds respectively, based on total return
- Won the Thomson Reuters Lipper 2018 award for Best Fund - Alternative Global Macro - Five Years out of 208 eligible share classes
- Avoided 67% of the S&P 500's loss in value during the "Financial Crisis" from its August 4, 2008 inception through the bear market bottom on March 9, 2009, and was back to break-even in May 2009, two months later.

The Fund is an equity-focused macro fund with the flexibility to invest globally and tactically, including long/short, across all asset classes. The Fund focuses on long-term growth of capital while managing volatility and market risk, catering to investors seeking the ability to participate in the potential for upside capture while actively managing downside risk.

The fund is available in both Retail (KCMTX) and Institutional (KCMIX) classes.

To learn more about the Fund, please visit KernsCapital.com or contact Octavia Grimston, Investor Relations, at 713.993.0949, ext. 115.

How Are We Doing?

After a strong month in August, the KCM Risk-Based Models had a tougher September.

As discussed above, the overall S&P 500 made an all-time new high on September 20 on the strength of the huge companies, while the medium and smaller companies did not participate. This hurt our performance in September, as we are diversified across the spectrum of company sizes.

Model	Sept	Q3	YTD	1-Year
KCM Aggressive	-1.37%	3.17%	3.25%	12.93%
KCM Moderate	-0.94%	3.11%	3.35%	10.96%
KCM Conservative	-0.72%	2.71%	2.96%	9.21%
Morningstar Moderate Target Risk TR	-0.11%	2.52%	2.20%	6.02%
S&P 500 TR	0.57%	7.71%	10.56%	17.91%
AGG Barclays Int Bond	-0.62%	-0.08%	-1.73%	-1.31%

In Closing

The US economy continues to march along creating more wealth and jobs.

Third quarter earnings season is underway. Although it will be hard for the market to match last quarter's record earnings, we expect results to be solid. As we pointed out above, the market is seemingly skittish for the moment, and has perhaps already baked in a "weaker" quarter. If so, expect a rally should earnings surprise to the upside.

"When I went to school, they asked me what I wanted to be when I grew up. I wrote down 'happy.' They told me I didn't understand the assignment, and I told them they didn't understand life."
- John Lennon

Sincerely,

Marty Kerns
President & Chief Executive Officer

Parker Binion
Chief Investment Officer

Octavia Grimston
Investor Relations

About Kerns Capital Management

Kerns Capital Management is a leading asset management firm with a focus on quantitative, liquid alternative investment strategies, including the KCM Macro Trends Fund. We are value-oriented investors in long/short equity, credit and volatility, and apply the same attention to risk in the deployment of capital that has guided us since our inception as a fiduciary investment manager to corporate pensions, trusts and high net worth individuals. Kerns was founded in 1996, and is based in Houston, Texas.

For more information on our products, including fund performance or to sign up for this newsletter, please visit https://kernscapital.com/ or contact our Investor Relations director Octavia Grimston at 1.993.0949 x115 or ir@kernscapital.com

IMPORTANT DISCLOSURES

Performance data represents past performance and is not a guarantee of future results.
Performance current to the most recent month-end may be lower or higher, and can be obtained by calling 800-945-2125.

*Kerns Capital Management Risk-Based Portfolios. Performance figures, unless otherwise described, represent a composite of all individual portfolios managed in accordance with the investment strategy, include reinvestment of dividends and other earnings, and are after the deduction of all fees including KCM's advisory fee, brokerage or other commissions, and any other expenses that a client actually paid. Long-term capital appreciation is the primary objective of the models. As a secondary objective, the portfolios strive to preserve capital during bear markets. There is the possibility of loss. The composites contain accounts structured with mutual funds that are tactically managed with a view towards capital appreciation. Models generally included exposure to US and International equities, bonds, real estate, currencies and/or commodities.

Composites do not include 401(k) accounts which are managed differently due to Department of Labor rules.

Marty Kerns, KCM's Chief Compliance Officer, remains available to address any questions regarding this performance presentation, including its limitations. Mr. Kerns can be contacted via email at marty@kernscapital.com or toll-free at 800.945.2125.

** KCM Macro Trends Fund. Investors should carefully consider the investment objectives, risks, charges and expenses of the KCM Macro Trends Fund. This and other important information about the Fund is contained in the prospectus, which can be obtained at kernscapital.com or by calling 800.945.2125. Read the prospectus carefully before investing.
The KCM Macro Trends Fund is distributed by Northern Lights Distributors, LLC. Member FINRA/SIPC. Kerns Capital Management, Inc. and Northern Lights Distributors, LLC are not affiliated.

Morningstar Rankings. The KCM Macro Trends Fund (KCMTX) ranks in the top 1% of its Morningstar Multi-alternative category out of 367, 160 and 51 funds, respectively, for the one-, five- and ten-year periods ending August 31, 2018 based on total return. KCMTX also ranks in the top 2% out of 301 funds for the three-year period ending August 31. Rankings are just one form of performance measurement.

Morningstar Ratings. The Morningstar RatingTM for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. KCMTX received ratings of five stars for the three-, five- and ten-year periods as at August 31, 2018 out of 301, 160 and 51 funds respectively.
Morningstar Multialternative Category includes funds that have a majority of their assets exposed to alternative asset strategies, including long/short, and can include funds with static allocations to alternative strategies and funds tactically allocating among alternative strategies and asset classes.

*** Source: Lipper, Inc. The Best Alternative Global Macro Fund award is granted to the fund in the Alternative Global Macro category with the highest Lipper Leader score for Consistent Return over the 5-year period as of 11.30 of the prior year. Lipper awards are granted annually to the funds in each Lipper classification that achieve the highest score for Consistent Return, a measure of funds' historical risk-adjusted returns, relative to peers. Thomson Reuters Lipper Awards, © 2018 Thomson Reuters. All rights reserved. Used by permission and protected by the Copyright Laws of the United States. The printing, copying, redistribution, or retransmission of this Content without express written permission is prohibited. Lipper, a wholly owned subsidiary of Thomson Reuters, is a leading global provider of mutual fund information and analysis to fund companies, financial intermediaries and media organizations.

The S&P TR 500 Index is an unmanaged composite of 500 common stocks. This index is widely used by professional investors as a performance benchmark. Total return includes reinvestment of dividends. You cannot invest directly in an index. The Dow Jones Industrial Average is a price-weighted average of 30 of the largest and most widely held stocks traded on the New York Stock Exchange and the Nasdaq. The Nasdaq Composite Index is a market-capitalization weighted index of the more than 3,000 common equities listed on the Nasdaq stock exchange. The types of securities in the index include American depository receipts, common stocks, real estate investment trusts (REITs) and tracking stocks. The iShares Core U.S. Aggregate Bond Index is an ETF (AGG) that seeks to track the investment results of an index composed of the total U.S. investment-grade bond market. The Morningstar Moderate Target Risk Index is based on a well-established asset allocation methodology from Ibbotson Associates, a Morningstar company and a leader in the field of asset allocation theory. The securities selected for the asset allocation indexes are driven by the rules-based indexing methodologies that power Morningstar's comprehensive index family. Morningstar indexes are specifically designed to be seamless, investable building blocks that deliver pure asset-class exposure. Morningstar indexes cover a global set of stocks, bonds, and commodities.