Dear Investors,

The AlphaOne NexGen Technology fund returned 2.10% in Q2 with the Technology Hardware and Equipment subsector contributing most to our gains driven by Apple. Apple gained 13% during the quarter and contributed more than 1% to our returns. Apple was driven by solid Q1 results, bullish sentiment around their services revenues, an increase in their capital return and positive market sentiment from Warren Buffett increasing his position. Though we believe this optimism will be misplaced by year-end, we have not forgotten how blind belief on Wall Street of an iPhone upgrade supercycle drove the stock in 2017.

On a longer-term basis for Apple, in CQ2:18 iPhone units were down 13% from CQ2:15 w/ revs down 5%. Services (18% of revs) and Other revenues (7%) have grown over that time 73%. But we would note that roughly half of services revenues is still driven by iPhone units which have clearly stalled. Services revenues decelerated from up 31% y/y in the June quarter to up 28% in the June quarter and we believe will drop further in the September and December quarters as the benefits of the new search agreement struck with Google in 2016 start to even out.

For the smartphones industry, units have been down year-over-year for the past three quarters. This is the first time they have been down year-over-year in history. We believe the smartphone industry is where the PC industry was in 2011, the last year the PC industry saw unit growth. The PC industry has not grown units for the past six years as the upgrade cycle elongated. For Apple, maybe they can continue to sell iPhones at over $700 while the rest of the industry is below $300 but this is also the reason that Huawei just passed them in Q2 to become the second largest smartphone unit vendor in the world. We believe it may take Q3/Q4 results to finally convince investors that Apple cannot sell higher priced phones (average selling prices up 20% year-over-year in the June quarter) indefinitely to offset their lackluster unit growth.

We do like investments in companies supplying new 3D sensing technologies going into the Apple iPhones where Lumentum is our favorite holding. We believe Lumentum which supplies the lasers for Apples 3D sensing technology will benefit over the next several years as 3D sensing moves to tablets, PCs and also to the rear of the phone for exciting augmented reality and virtual reality features. On a short-term basis we traded around the position, given some of the concerns about optical demand given the ban on shipping to ZTE. Despite Lumentum being down 9% in Q2, it was our third most profitable position during the quarter. We strongly believe that the combination of its low PE, a recovery in China and great long-term growth prospects for 3D sensing could make this one of the best stocks to own in all of technology over the next twelve months.

A strong economy and increase in capital spending should also benefit IT spending and associated "legacy" vendors such as Microsoft (up 8% in Q2). Enterprise spending seems to be picking up in 2018 and hyperscale spending also is inflecting higher. Workloads also continue to be outsourced to the cloud. Microsoft is benefitting from both strong cloud demand in their Azure business and positive PC unit growth for the first time since 2012. Intel, despite positively pre-announcing results and guiding the full year higher, is struggling as their 10nm production is now expected in the second half of 2019 with server production expected in 2020. This seems to validate AMD's expectations of getting from 1% server unit market share to 5% by the end of 2018 and double digits by 2020. This is also why AMD's stock was up 49% for the quarter despite estimates having to be cut for their September quarter as their crypto revenues collapsed to near zero. As we mentioned earlier, PC units also grew on a quarterly basis year-over-year for the first time since early 2012 which also benefits these legacy vendors. Microsoft was our fourth biggest individual contributor to the funds performance in the quarter.

Time Spent Online vs Watching TV continues to Grow Benefitting Facebook and Google. The time that used to be spent watching linear TV is now being spent online. In 2017, internet advertising was for the first time bigger than traditional television advertising to become the world's biggest advertising medium, accounting for 37% of total ad expenditure. Global advertising expenditure is expected to grow 4.1% in 2018 and reach a total spend of $578 billion by year's end with internet advertising growing at nearly triple that rate. With some of the recent controversy around consumer privacy, Google and Facebook trade at only a small price to earnings valuation premium to the overall market despite growing revenues at over double the rate with incredibly profitable business models. Google and Facebook combine many of the investment attributes we like: long lasting growth trends, high profitability, low valuation and wide business moats. Facebook was our second most profitable position in the fund for the quarter and contributed just under 1% as we bought in after the beating the stock received around its data privacy issues with Cambridge Analytica. We fortunately cut the position and were underweight the stock going into their earnings release given some of our concerns around ramping expenses and slowing revenues which were more severe than we expected.

We are starting to build positions in China internet names that in some cases are down 50% or more from their highs given the long-term trends are much more positive than in the US. On a macro basis, a slowing Chinese economy, trade issues with the US and a depreciating yuan have all contributed to a pullback in the Chinese stock market of over 20% from its highs in January. Specific to the internet sector, Chinese regulators have frozen license approvals for online, mobile and console video games ever since the leadership changes earlier this year. In addition, the FIFA World Cup diverted normal internet viewing habits as users watched the most popular sporting event in the world. But on a long-term basis, China's internet market has even better trends than that of the US. In the US, 96% of the population is online but this is only 312M users. In China, only 55% of their population is online but this is 772M users and it continues to grow each year by nearly 40M users. The US e-commerce market is about $340B (up 16% and 9% of total retail sales in 2017) but China is almost double the size at $670B (growing 2x faster and at 23% of total retail sales.) The US is growing less than the Global e-commerce market of $2.3T that was up 25% in 2017 while China is growing much faster. Also, many of these names now have PE multiples that are lower than that of their counterparts in the US despite much faster long-term growth prospects. We are waiting for poor results and guidance to initiate positions which we are then increasing. A catalyst for these names will be Chinese regulators restarting approvals which should be a major catalyst for names in the gaming sector.

The good news is the big US internet companies like Google, Facebook and Amazon have been effectively locked out of the Chinese market, so they do not really care if the tariff situation gets worse. We own all three of them with Google being our favorite. Google was the fifth largest contributor to the funds' performance for the quarter. Google's Traffic Acquisition Costs paid to distribution is finally starting to grow less quickly at 47% in June after ramping from 6% y/y in June of 2015 to 61% in March of 2018. They beat revenues and operating profit both for the first time in three quarters as a result in June. In sharp contrast for Apple, China was 18% of revenues in CQ2 and was up 19% y/y versus 17% for the entire company. So, China is driving Apple's revenue growth but the stock is at an all-time record high. Maybe it continues to go up because investors like the fact that Warren Buffet is buying the stock, new iPhones will be launched in September and at some point next year, they have hinted at launching a TV service, but it seems risky to me to assume the issues in China will not impact the sales of high-end iPhones. We would rather own the US internet names that still are seeing strong secular growth that have no China exposure or Chinese internet names that have been beaten down but are not affected by US tariffs.

Finally, we have more of a defensive long in AT&T whose stock seems to have finally stabilized in the low-$30s as Time Warner investors who got AT&T when they merged seems to be finally done selling. Looking back to July 2015 around when the DTV deal closed, there was about a month of pressure with a ~10% drawdown (TWX closed June 15 and T was $33.15 but hit $30.25 after earnings on July 25th), which was followed by a monster ~50% rally off the lows over the following few months.

At the time of this writing, AT&T's stock is down -17% YTD vs the SPX +6% and VZ -1%. The company recently guided the 2018 EPS to roughly $3.60. At $32, AT&T trades at less than 9x earnings vs. the 5-year average of 12.5x, with a 6.2% div yield which is near a 5-year high. AT&T is also trading at one of the widest spreads ever compared to its closest comp, Verizon, which has a 4.5% dividend yield and trades at 11.4x.

On a fundamental basis, the four national wireless carriers and cable MVNOs added a total of 1.2M postpaid phone subscribers in 2Q18, up from 900k in 2Q17. This is the 5th consecutive quarter of higher y/y net adds and the first time every major provider has had positive 2Q postpaid phone net adds. The expansion seems to be from prepaid customers, roughly 70M today, switching to unlimited postpaid plans with many having bundled video. This trend could continue for a while. The lowest smartphone upgrade rate in history is also helping margins and we think there is a good chance that AT&T will boost their dividend in December.

For the market, over 20% earnings growth year-over-year in Q1 and Q2 for the S&P has helped keep valuations on a short-term basis only slightly above their one year forward average of 17x. On a longer-term basis, valuations are still the highest since the time periods around the tech bubble and 1929. The Shiller Cyclically Adjusted PE (CAPE), which is an inflation adjusted measure over 10 years, has risen from 15x at the beginning of 2009 to 33x today. An optimist can note that this is still lower than 44x at the peak of the tech bubble.

We believe that a global economic expansion, multi-decade lows in unemployment, rising wages, year-over-year gains in energy prices, rising home prices/rents and the recently enacted tax cuts driving more growth will drive treasury yields higher through the year. As a result, the Fed may raise rates more quickly than the market expects. The bout of volatility seen in February and March is a dramatic departure from the environment seen in 2017 and we feel is here to stay as interest rates head higher and trade tensions continue.

On a positive note, we believe a true recession is not on the near-term horizon and therefore any downdraft in stocks will be limited. The obvious exception would be if the US engages in an all-out trade war with China which is not our base case but cannot be ruled out. We believe a permanent resolution is not likely till the US mid-term elections in November. We would also note that the US stock market is within a couple of percent of its all-term highs while the Chinese stock market is down over 20% from its highs in January. The market has correctly concluded that China with a $350B trade surplus has much more to lose than the US in a tariff war. Hopefully the pain is getting great enough that this will lead to a willingness to renegotiate on China's part.

Looking forward, we believe that fundamental stock picking and downside protection is finally increasing in value as investors once again realize that it is possible to lose money in the stock market and volatility is not dead. Record accommodation by Central

Banks continues to reverse as well. This should put an end to increasing market multiples when treasury yields become a viable alternative to chasing dividend yields and stock prices. Every dip has been viewed as a buying opportunity in such a long-lived bull market for growth-oriented names. The ability to expand profits or generate cash flow has not been that relevant to stock price performance. We hope this is starting to finally change given the market action in February and now March.

My strongest attributes over the past 14 years of managing a portfolio and the past 27 years of being on Wall Street have been flexibility and adaptability. Now that investors are once again concerned about losing money in 2018, stock moves around fundamental information seems more consistent. I have for a long time drawn inspiration from Charles Darwin who said, "It's not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change." After nine years of a relentless bull market, we believe change may be upon us later this year with the recent correction being a taste of what the future may hold. I continue to do work on promising investment ideas, and have confidence in the philosophy and investment process that has served me well for over two decades on Wall street.

In summary, I anticipate that fundamental analysis will be more valuable to alpha generation in an environment less distorted by Central Bank policy and more by economic/fundamental prospects. This environment has historically been the one that I operate the best in. I therefore remain optimistic about the opportunities for generating profit going forward, while containing drawdown risk.

I thank all of you who continue to put your faith in me and the AlphaOne organization.

Sincerely,

Dan Niles

Daniel T. Niles
Senior Portfolio Manager