VIVALDI
CAPITAL MANAGEMENT

Investor Letter

Second Quarter 2019

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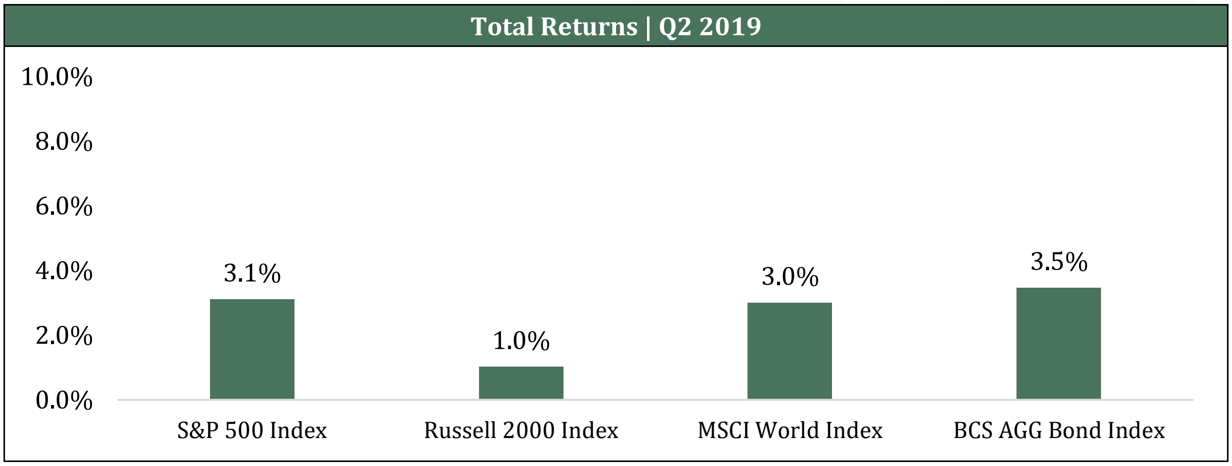
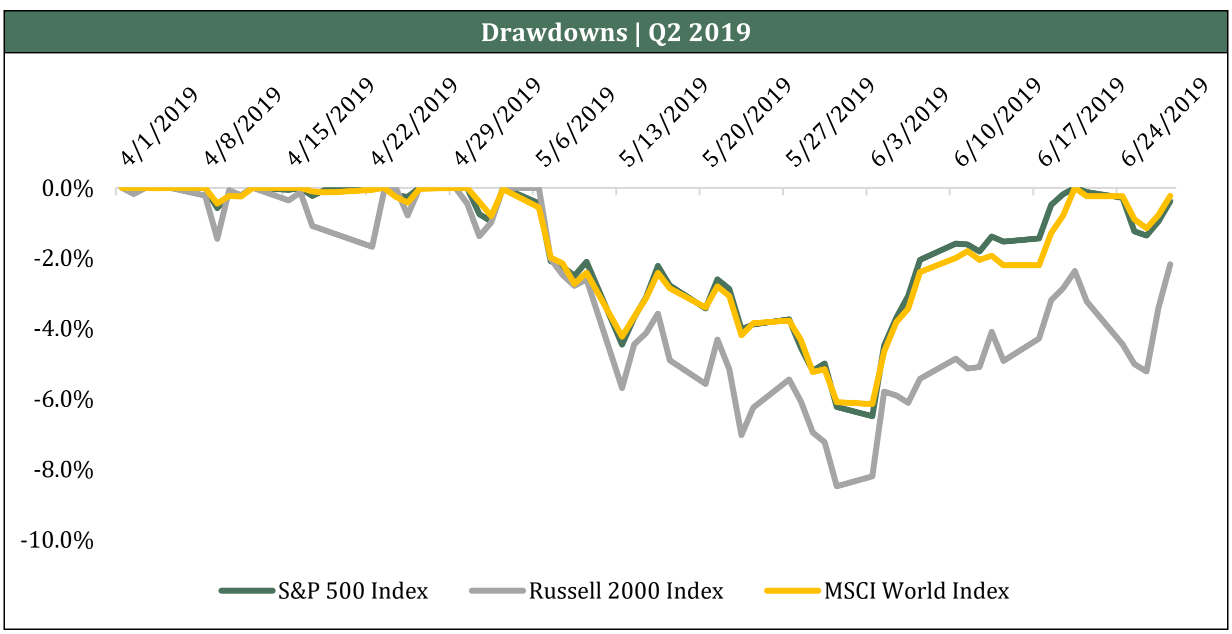
Market Perspective

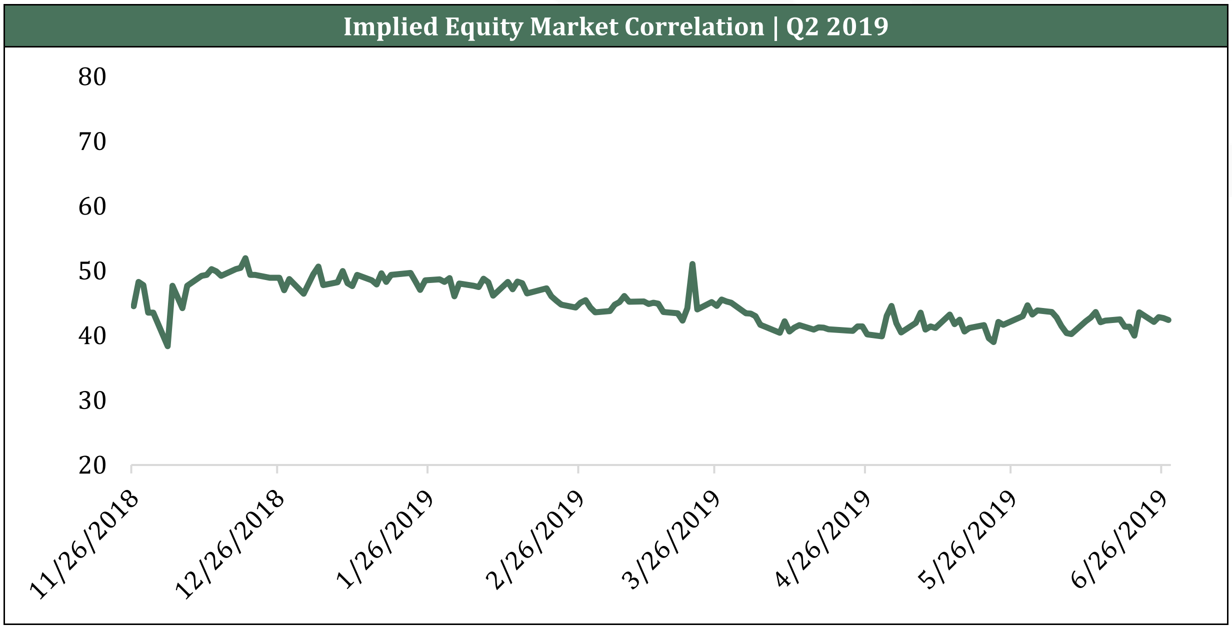
The second quarter of 2019 looks uneventful when surveying the point-to-point returns for most major market benchmarks.



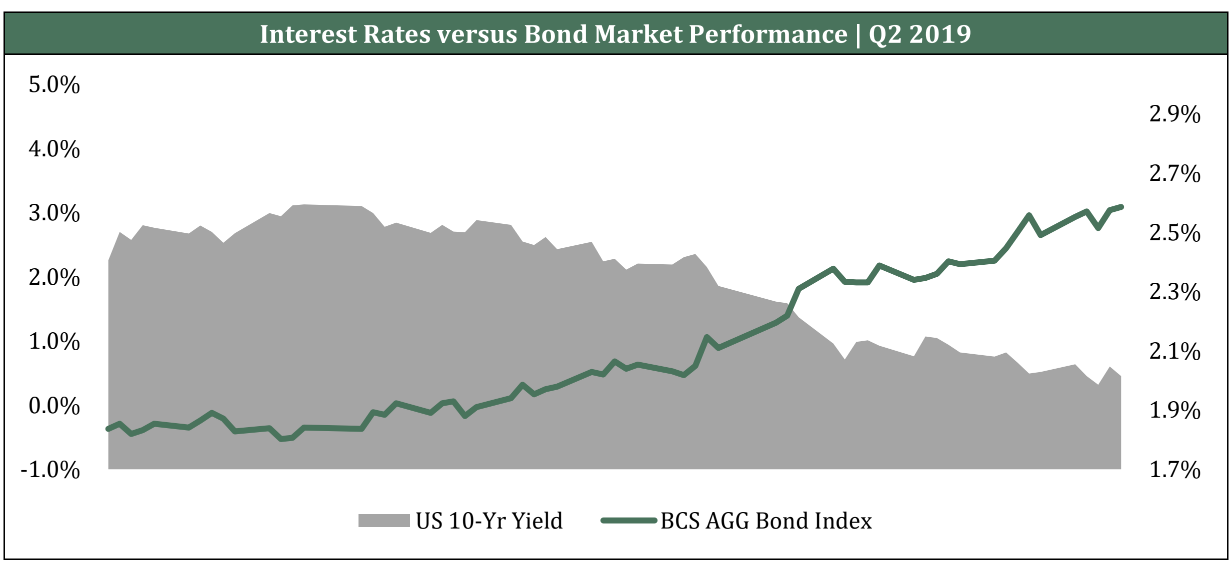
However, that narrow view belies the whip-saw moves experienced by equities during the quarter. While April was a strong month for equity markets, May saw the largest drawdown for most major benchmarks since December of last year, while June saw yet one more V-shaped recovery off those lows. Market spectators may have become somewhat numb to these dramatic risk-off/risk-on periods, particularly when the third quarter begins with most traditional benchmarks touching fresh all-time-highs. With that said, VIR believes that it is worth digging into a few undercurrents between asset classes that could have large implications for the second half of the year.



One positive force that we have seen to date in 2019 is the return of sustained dispersion within equity markets. As fundamental investors, these periods tend to be more constructive for strategies we prefer than periods that are typified by higher correlations and more extreme market volatility. Despite the bouts of equity market volatility that we have seen at the close of 2018 and the middle of 2019, dispersion has remained healthy. Given that backdrop, we are not surprised to see our strategies doing fairly well this year.



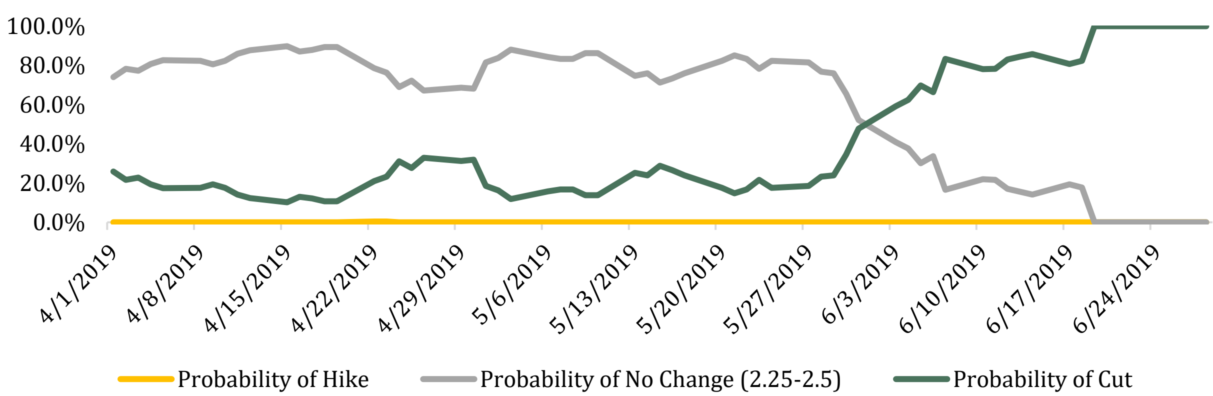
One of the areas where the VIR team is seeing some questionable or confusing activity is the fixed income market. The rally in rates that accompanied the equity market sell off in May was relatively typical in nature. As the risk-off move in equities became more extensive, rates came under pressure from both a flight to quality as well as a notable increase in the probability of a near-term interest rate cut by the Federal Reserve. That rationale strained credibility as equity markets rebounded notably in June, and yet rates continued to rally. The prevailing view apparently was that near-term rate cuts would be a bigger tailwind to risk markets than any headwinds from broadly slowing growth or the tail risks from an episodic focus by the market on Trade War outcomes.



As we have made our way into the third quarter, it appears we are in a situation where good fundamental economic news is actually bad news for equity markets, as it undermines the case for more aggressive rate cuts from the Federal Reserve. Around the Independence Day holiday, a particularly strong jobs number spooked markets. We are not big fans of attempting to read the tea leaves of Federal Reserve policy, but the simple fact that the market continues to price in a near-certain probability of a rate cut at the next Fed meeting likely ties the Fed's hands even if we continue to see upside surprises in economic data.

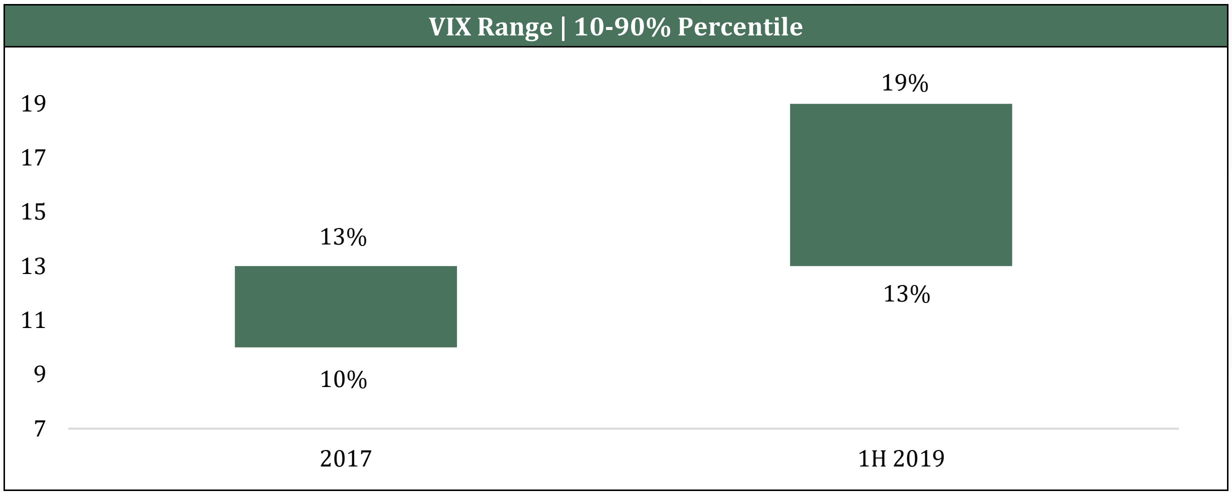
Fed Funds | Future & Historical Implied Probability

	Hike Prob	Cut Prob	1.00-1.25	1.25-1.50	1.50-1.75	1.75-2.00	2.00-2.75	Fwd. Rate
7/31/2019	0%	100%	0.0%	0.0%	0.0%	2.5%	97.5%	2.13%
9/18/2019	0%	100%	0.0%	0.0%	1.7%	67.3%	31.0%	1.96%
10/30/2019	0%	100%	0.0%	0.6%	23.9%	55.0%	20.5%	1.88%
12/11/2019	0%	100%	0.2%	10.0%	36.5%	41.0%	12.2%	1.78%
1/29/2020	0%	100%	2.9%	17.3%	37.8%	33.1%	8.9%	1.71%
3/18/2020	0%	100%	5.5%	21.0%	36.9%	28.7%	7.2%	1.66%
4/29/2020	0%	100%	7.8%	23.4%	35.7%	25.5%	6.2%	1.63%
6/10/2020	0%	100%	10.7%	25.7%	33.8%	21.9%	5.0%	1.58%
7/29/2020	0%	100%	12.6%	26.7%	32.3%	19.8%	4.4%	1.55%



It always prompts some level of concern from our team when we see imbalances begin to build in these major asset class benchmarks because they can effectively increase the risk of an outright reversal in which the market needs to reprice asset classes quickly as the rubber-band of relative valutions/correlations becomes too stretched. While we do not look to position portfolios to "trade" these types of moves, we are cognizant of them as they have far reaching implications for the forward looking risk profile of a given portfolio.

Another market dynamic that we often touch on in these updates is the more normalized level of market volatility that we have been seeing thus far this year. While still running a bit below longer-term averages of implied volatility, the roughly 13-19 range we have seen for the first half of 2019 to us is much healthier than the 10-13 range that took hold for much of the 2016-17 timeframe. A more reasonable level of implied volatility equates to a higher risk premium, which we also view as constructive for fundamental investors.



It is worth highlighting that 2019 to date has been a strong period for returns for nearly every asset class and investment strategy. It has been quite some time since we have seen such broad-based tailwinds across credit, rates, and equities. Somewhat counterintuitively, these are the exact timeframes when VIR is most focused on keeping our client portfolios balanced by those major risk factors, as we understand that such sanguine backdrops will not remain in unison forever. The unwinds or dislocations that can occur if/when investors look to rotate substantial alloactions across these major risk factors become VIR's primary focus from a risk management perspective. As such, we will continue to be vigilant with portfolio positioning, despite the admitedly strong year-to-date performance for our portfolios.

Highlighted Investment Opportunity

In this segment of our letters, we tend to either highlight an investment opportunity that we believe is particularly compelling or speak to some aspect of our research process that we believe our clients may benefit from understanding in a more detailed way. This quarter, we will do a little bit of both.

In the second half of 2019, we are likely to be speaking with our clients about investing in the next iteration of drawdown or "vintage" funds being raised by groups that we have previously invested with. Across the industry, this is referred to as "re-upping". It would seem logical to invest again with a strategy and team that has recently delivered strong results in their most recent on-the-run vintage. These follow-on opportunities can be compelling from VIR's perspective, as our team has often spent the preceding years becoming more comfortable with the strategy itself, building more domain expertise in understanding the strategy's opportunity set. We have had the chance to become more acquainted with the team or firm, which could have been new to us at the time of initial underwriting. We also receive the benefit of getting to evaluate how our range of outcomes (downside, base, upside) look in retrospect, were we too sanguine on potential risks to strategy returns or, conversely, did we underestimate a team's ability to execute? All these datapoints are more meaningful when we have had actual dollars at risk, as our continuous oversight via at least quarterly calls and an annual onsite meeting allow VIR to dig into the strategy details extensively on a recurring basis.

With that said, it is important to note that we begin the evaluation of the next vintage of any fund with the foundational question: has anything changed for the worse in the opportunity set? A core tenet of VIR's research process is that the broader opportunity set is ever evolving. These shifts can be cyclical and secular in nature, and a large part of the value-add that we add as a research team is in our ability to ascertain some degree of insight based on the wide net that we cast across various asset classes, strategies and markets. In other words, it is not a guarantee that we will "re-up" for a given investment just because the most recent fund has done well. We begin that underwriting process from square one again, though often with the benefit of a much deeper and richer understanding of what we're evaluating than we may have possessed on the first go-round.

By way of brief example, one opportunity that exemplifies that "virtuous cycle" nature of this process is with our Commercial Mortgage Backed Security ("CMBS") B-Piece specialist. We first invested with this team in their first fund looking to exploit this particularly opportunity set in late 2015. That first fund has delivered net IRRs that are already running within our "upside" case scenario with potential incremental upside as the fund continues to season. More importantly, the team has certainly proven their ability to execute on a strategy that was, at the time of our first underwriting the investment, new to the team. The underlying opportunity set for the strategy has changed in several nuanced ways, but our estimation of the likely base case returns has remained in a similar range. In addition, our updated estimation of the ultimate downside risk in the strategy has been made more robust by our experience in Fund I. We would also note that our history as a material allocator in Fund I has allowed us to negotiate a modest discount on asset management fees for Fund II.

Highlighted Research Process

To piggy-back on that point, VIR is always looking for ways to benefit our clients by aggressively pushing for lower fees or secondary sources of economics within a given investment. While we would never make an investment solely because of our ability to drive economics, we also almost never get through the full diligence process on an investment without asking a manager to adjust or amend some fee or term of their fund to the benefit of our clients.

In the first half of 2019, we approved and/or made initial investments with 5 new funds/firms. In each instance, we negotiated some concession from the underlying manager to the benefit of our advisory clients. These concessions included: lowering investment minimums, lower management fees, higher incentive fee hurdles, charging management fees on invested as opposed to committed capital, as well as two separate situations where VIR secured an ownership interest or revenue participation in the underlying fund/business that creates an entirely secondary economic return stream for Vivaldi's clients.

In addition to this important work around underlying fund economics, our Operational Due Diligence team nearly always presses a manager to improve some aspect of their internal controls or procedures in advance of VIR approving an investment. Thus far this year, this has included getting firms to: engage a more institutional third party administration relationship, institute a cap on fund operating expenses, better clarify what type of operating expenses can be run through a fund, and changing cash control procedures at an underlying firm to better protect investors from possible bad actors. There were also two separate occasions where our ODD team found errors in fund statements that triggered corrections from the underlying manager. VIR is proud of the terms negotiation and structural controls work that we do in tandem with our more fundamentally-focused investment underwriting and we hope that our clients benefit from both of those core competencies over time.

Organizational Update

As some clients have already noticed, Vivaldi was recently named one of the top 50 fastest growing RIAs in the country by Financial Advisor magazine. In addition, Vivaldi was also included on the list of Top 300 RIAs as ranked by the Financial Times. While it is nice to be recognized for our quality and growth, the thing we are proudest of as a team is the commitment we have always made toward investing in our people, technology, and infrastructure. In this section of our letter, we have highlighted additions of new team members as well as large scale investments we have made to improve our operations. In the second quarter, we are pleased to announce the addition of a new member to our firm, Jacob Horwitz. Jacob is an Advisory Associate as a member of the Advisory

Support team where he is responsible for assisting advisors and clients meet their goals. Before joining full time, Jacob was a summer intern at Vivaldi where he also supported the Advisory team. Jacob graduated from the University of Wisconsin-Madison with bachelor's degrees in Finance, Investment & Banking; Risk Management & Insurance; and Economics, with a certificate in Wealth Management & Financial Planning. During undergrad he was the Editor-In-Chief of an academic journal on campus.

As always, we thank you for your continued support and intend to work hard to maintain it.

Kind Regards,

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