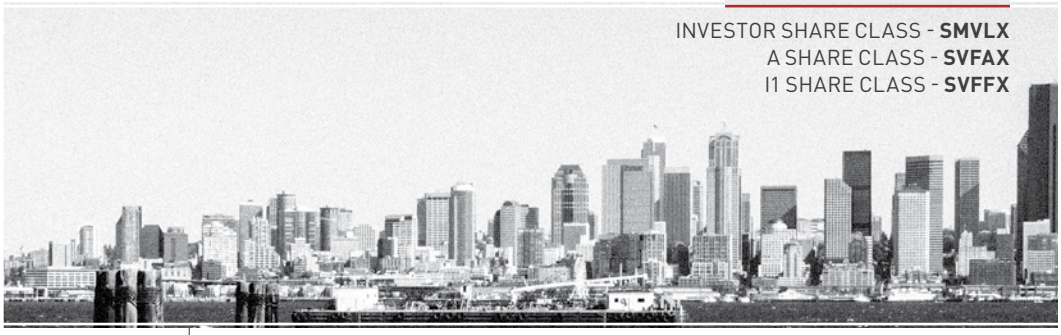
INVESTOR SHARE CLASS - **SMVLX**
A SHARE CLASS - **SVFAX**
I1 SHARE CLASS - **SVFFX**



SMEAD
value fund

877.701.2883 | SMEADCAP.COM

3RD QUARTER 2015 (09/30/15)

Performance

Average Annualized Total Returns as of September 30, 2015

	QTR	YTD	ONE YEAR	THREE YEAR	FIVE YEAR	ANNUALIZED SINCE INCEPTION 1/2/2008
SMVLX	-5.93%	-3.26%	3.76%	15.42%	17.46%	7.28%
SVFAX (w/ load)	-11.34%	-8.84%	-2.20%	13.01%	15.87%	6.25%
SVFAX (w/o load)	-5.92%	-3.27%	3.76%	15.27%	17.25%	7.06%
SVFFX	-5.87%	-3.09%	4.05%	15.72%	17.76%	7.48%
RUSSELL 1000 VALUE	-8.39%	-8.96%	-4.42%	11.59%	12.29%	4.53%
S&P 500 INDEX	-6.44%	-5.29%	-0.62%	12.40%	13.34%	5.80%

Investor Shares Gross Expense Ratio 1.37%
A Shares Gross Expense Ratio 1.38%
I1 Shares Gross Expense Ratio 1.10%

Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling 877-807-4122. Performance for SVFAX (w/load) reflects maximum sales charge of 5.75%. Performance for SVFAX does not reflect maximum sales charge of 5.75%. If reflected, the load would reduce the performance amount quoted. SVFAX imposes a 1.00% redemption fee on purchases of $1,000,000 or more that are redeemed within 18months of purchases. Performance data does not reflect the redemption fee. If it had, returns would be reduced.

Investor Class shares of the Fund commenced operations on January 2, 2008. I1 Class shares of the Fund commenced operations on December 18, 2009. Performance shown for I1 Class shares prior to its inception reflects the performance of Investor Class shares. Class A shares of the Fund commenced operations on January 24, 2014. Performance shown for Class A shares prior to its inception reflects the performance of Investor Class shares, adjusted to reflect Class A expenses.

Dear Shareholder

The inevitability of market fluctuations caught up with the U.S. stock market and the Smead Value Fund (SMVLX) in the third quarter of 2015. The fund fell 5.93%, while the S&P 500 Index fell 6.44% and the Russell 1000 Value Index fell 8.39%. We were pleased with how our portfolio held up in the decline, but are realistic with our investors about the likelihood that there are periods when our fund will either decline in value and/or underperform the indexes we measure ourselves against.

We used the declining prices in the quarter to reduce the number of companies we own and to raise the quality and cheapness of our holdings. Our stocks that contributed the most alpha in the quarter were H&R Block (HRB), NVR (NVR) and Chubb (CB). H&R Block announced a massive stock-buyback totaling 35% of outstanding shares and a Dutch-auction tender offer for $1.5 billion of its shares. NVR has continued to have the wind behind them as home building recovers from a population-adjusted depression in household formation and home buying from 2007-12. Chubb was taken over by Ace LTD at a sizable premium and was sold during the quarter.

Among the worst drags on performance was Tegna (TGNA), which fell sharply after splitting from Gannett. Tegna's ownership of network-affiliated TV stations got caught in cord-cutting and advertising revenue competition fears. We find this ironic. As the value of cellular spectrum increases and a blowout political advertising season looms in 2016, we get very excited about their future. Even today, 55% of adults in America use local TV news as their prime form of news.

PayPal (PYPL) suffered from its popularity prior to the split with Ebay (EBAY). Many major companies covet their 75% share of the secure online payments market and it has corrected along with other stocks with above-average P/E ratios. Navient (NAVI) disappointed investors during the quarter. They have experienced unusual loan losses in their portfolio and we sold the stock during the quarter.

The Red, Green, and Beige Room

One of the great investing books of the last 40 years was David Dreman's, *Contrarian Investment Strategy*. He started it by telling of a hypothetical gaming casino with two separate, but adjoining, rooms: the red room and the green room. The red room was packed with people and excitement and almost every day someone hit a huge jackpot setting the building on fire with electricity. Every seat was packed, others waited their turn to play and the anticipation was palpable. Yet most of the players left the casino each night without their money, because the odds were stacked heavily in the house's favor.

The green room was relatively quiet and included many empty seats. Players sat patiently and most of them had amassed large chip stacks. Virtually nobody hit it big each day, but with through patience and odds stacked heavily in their favor most the participants in the green room created wealth.

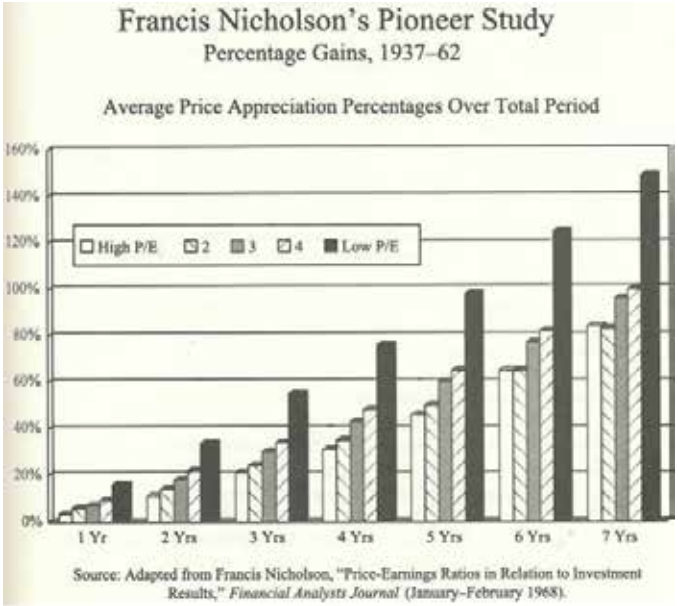
In the last 20 years, we think a new room should be added to Dreman's imaginary casino. We call it the "beige" room. This room is filled with investors who had the natural reaction to bad experiences in the red room, but lacked the patience to succeed in the green room. In this room you will find participants in passive indexes. Additionally, we think stock market difficulties since 2000 triggered former green room participants to lose their patience, thus contributing to the popularity of being average.

Dreman was trying to explain the difference between investing in common stocks based on excitement about future prospects versus buying stocks based on value or intrinsic value. This has been over simplified by using monikers such as growth stock and value stock. For the sake of our discussion, let's say that a value stock is one priced below the average stock and a growth stock is one priced above the average. The most common averages used are the price-to-earnings ratio (P/E) and the price-to-book ratio (P/B).

Every academic study we've seen shows that over one, three, five and seven-year time periods the cheapest stocks outperform the average and most expensive stocks. The most famous of these studies are the ones in Dreman's book (see below), Fama and French's P/B study and Francis Nicholson's study from 1937-1962.

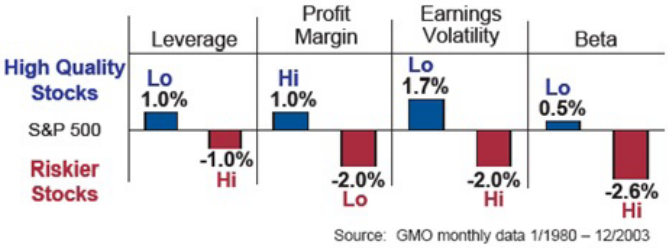
Dreman used P/E quintiles, while Fama and French used P/B ratios and both studies rebalanced at the end of each year. They argued that excess return could be had by simply starting the year with the cheapest stocks in the S&P 500 Index and replacing the ones which found favor during the year with the latest ones to find the doghouse. These studies led to the "Dog's of the Dow" strategy, where an investor purchases the 10 cheapest stocks in the index based on dividend yield (another measurement of cheapness).

We found Nicholson's study (see below) even more fascinating because his portfolio was static. It showed that cheap stocks at the beginning not only outperform in the next 12 months, but that their outperformance continues on for seven years. We like to say that cheap stocks are the gifts which keep on giving.



Warren Buffett, the number one disciple of the father of value investing, Benjamin Graham, started out being a green room common stock investor and continues to do so in the private equity realm as well. In the 1960's, he ran into his investing partner, Charlie Munger. Mr. Munger advocated for a qualitative addition to these quantitative strategies. He and Buffett believe that the long duration investor, with great patience, can benefit from owning very high quality businesses purchased at a time of distress. They believe that the primary responsibility of the wise long duration investor is to wait until a splendid business gets in the doghouse due to a bear market in stocks or a temporary corporate stumble. Then they pounce on that opportunity by "backing up the truck" and loading up on shares.

Munger's theory was proven correct in a seminal study done by Ben Inker at Grantham, Mayo and Van Otterloo (see below). His study showed that certain qualitative characteristics like low leverage, high and sustainable profitability, low earnings volatility and low volatility in stock trading have proven to add alpha over long durations.



We at Smead Capital Management start our research by leaning toward Dreman's study, because "valuation matters dearly." We love Nicholson's study because the seven-year holding period shows that you can own businesses for a long time and keep your portfolio turnover down. Turnover is a huge annual tax on large-cap equity portfolios and the cost averages 81 basis points or 0.81% annually among large-cap U.S. equity funds.

However, we at Smead Capital are risk averse and recognize that human nature gets in the way of holding businesses for a long time, especially in the low-quality arena. This is where Munger and Inker, with their focus on high-quality, come into play and how we seek to reduce portfolio risk proactively.

In late 2008, after getting clobbered all year, we received many calls to the effect of "Bill, we know you want to own stocks for a long time and we believe in what you are doing. But shouldn't we get out of the way of this decline in case we have a total economic meltdown like in the 1930s?"

Our answer was simple. The only "safe" alternative was investing in Treasury bills/bonds or government-insured certificates of deposit. We pointed out that the merit of those "safe" investments was the backing of the U.S. government. Our government's guarantee is no better than its ability to collect income taxes. Those taxes are paid by the largest companies in the U.S. and their employees. Therefore, the safety of Certificates of Deposits and T-bonds came from the safety provided by the qualitative characteristics of the stocks in our portfolio. Selling quality stocks at a time of distress was an especially bad idea, in our opinion.

What does the red room look like today? It is filled with investors seeking above-average returns by paying extremely high P/E and P/B ratios for companies with perceived "bright" futures in an attempt to hit the jackpot. Red room regulars are excited about social media, internet-based information/advertising, online shopping, fast food, cloud computing and the "sharing" economy. It is enough to make you want to open a bureau in Silicon Valley.

What is going on in the beige room lately? The beige room (index investing) has a tendency to work great in an uninterrupted bull market like the one we enjoyed from March of 2009 to the peak in the summer of 2015. There is historical evidence of the index becoming overloaded with shares of the previous era's most successful companies, ala tech stocks in 1999. In effect, valuation works against the index when it has been particularly effective in the prior five to ten years.

The S&P 500 Index has enjoyed the tailwinds of its overweight position in multi-national companies, who drafted on emerging market growth in staple products, heavy industrial infrastructure investments in China and technology purchases everywhere. Since we are of the opinion that the U.S. economy will do better in the next ten years as compared to the last ten years, we contend that the index is at a disadvantage because nearly half of its revenue comes from abroad.

Lastly, there are some pretty persuasive arguments which surround the idea that index returns will be in the 6% area going forward. These theories take into account dividends that are lower than historical averages and interest rate increases over time which would reduce historically high profit margins. Our opinion is that the beige room is appropriate for those who are incapable of investing in the green room or unable to figure out whom is. Owning U.S. large-cap equity for a long time is preferable to most other liquid investments and you can get average performance from an attractive asset class in the beige room.

Where are folks congregating in the green room? They are rummaging around in financial service companies like banks and insurance, which have low P/E and P/B

ratios. The death of traditional media and advertising is a foregone investor conclusion and the lowest P/E and P/B ratios lists are sprinkled with TV content and broadcasting companies, network-affiliate station owners and newspaper/magazine publishers. We are always on the lookout for companies on the cheapest list which meet our eight criteria for stock selection because valuation matters dearly, we want to own companies for a long time and to do that we must own very high quality companies. Thank you for your ongoing confidence in our methodology.

William Smead
Portfolio Manager

Tony Scherrer, CFA
Co-Portfolio Manager

Cole Smead, CFA
Co-Portfolio Manager

SMEAD
value fund

Mutual fund investing involves risk. Principal loss is possible.

As of 09/30/2015 the fund held, 6.02% of NVR Inc., 5.61% of Amgen Inc., 5.17% of Tegna Inc., 5.04% of Berkshire Hathaway Inc. Class B, 5.01% of American Express Co., 4.81% of JPMorgan Chase & Co., 4.42% of Bank of America Corporation, 4.34% of H&R Block Inc., 4.33% of Aflac Inc., and 4.29% of Wells Fargo & Co. Fund holdings are subject to change at any time and should not be considered recommendations to buy or sell any security. Current and future portfolio holdings are subject to risk.

The S&P 500 Index is a market-value weighted index consisting of 500 stocks chosen for market size, liquidity, and industry group representation. The Russell 1000 Value Index is an index of approximately 1,000 of the largest companies in the U.S. equity markets; the Russell 1000 is a subset of the Russell 3000 Index. The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. Price/Earnings (P/E) is the ratio of a firm's closing stock price and its trailing 12 months' earnings/ share. Price / Book (P/B) is the current price divided by the most recent book value per share. Alpha is the excess return of a fund relative to the return of its benchmark. Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. Beta is used in the capital asset pricing model (CAPM), a model that calculates the expected return of an asset based on its beta and expected market returns. A Dutch auction tender for public offer is a structure in which the price of the offering is set after taking in all bids and determining the highest price at which the total offering can be sold. In this type of auction, investors place a bid for the amount they are willing to buy in terms of quantity and price.

Small- and Medium-capitalization companies tend to have limited liquidity and greater price volatility than large-capitalization companies.

Active investing generally has higher management fees because of the manager's increased level of involvement while passive investing generally has lower management and operating fees. Investing in both actively and passively managed funds involves risk, and principal loss is possible. Both actively and passively managed funds generally have daily liquidity. There are no guarantees regarding the performance of actively and passively managed funds. Actively managed mutual funds may have higher portfolio turnover than passively managed funds. Excessive turnover can limit returns and can incur capital gains.

The Smead Value Fund is distributed by ALPS Distributors, Inc. ALPS Distributors, Inc. and Smead Capital Management are not affiliated. Frank Russell Company is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell ® is a trademark of Russell Investment Group.

SMEAD CAPITAL MANAGEMENT
600 University Street, Suite 2412
Seattle, WA 98101

Shareholder Services 877.807.4122
Sales Desk 877.701.2883

info@smeadcap.com

SMEADCAP.COM

SVF000168 Exp 1/31/2016