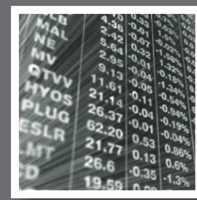
CASTLE FOCUS FUND



Commentary :: Q1 2012

Investor Class: MOATX   Class C: CASTX

Portfolio Manager Commentary

"What Else Am I Going To Do?"
Is Not A Compelling Reason To Invest

MOATX
CASTX

April 17, 2012

FIRST QUARTER LETTER

MARKET COMMENTS

The S&P 500 finished the first quarter with its biggest gain since 1998, up 12%. Technology stocks rose 21.1% with financials up 21.5%, leading all sectors. Apple, the world's largest company by market value, accounted for about 14% of the S&P 500's rise.

Although investors who bought stocks at the peak of the market in October 2007 still remain underwater by 10% in terms of price, by the end of the first quarter they were back to breakeven for the first time on a pre-tax basis, assuming reinvestment of dividends. The rise of the total return version of the S&P 500 to a new high comes as the market rally takes stock prices to their highest since May 2008.

Howard Marks, the chairman of Oaktree Capital Management, is known for his insightfulness on market opportunity and risk. In his May 2011 book The Most Important Thing: Uncommon Sense for the Thoughtful Investor, Marks summarizes market behavior:

"Much of the time, assets are overpriced and appreciating further, or underpriced and still cheapening. Eventually these trends have a corrosive effect on investors' psyches, conviction and resolve. The stocks you rejected are making money for others, the ones you chose to buy are lower every day, and concepts you dismissed as unsafe or unwise — hot new issues, high-priced tech stocks without earnings, highly levered mortgage derivatives — are described daily as delivering for others.

As an overpriced stock goes even higher or an underpriced stock continues to cheapen, it should get easier to do the right thing: sell the former and buy the latter. But it doesn't. The tendency toward self-doubt combines with news of other people's successes to form a powerful force that makes investors do the wrong thing, and it gains additional strength as these trends go on longer. It's one more influence that must be fought."

Financial markets, especially stock markets, often appear to behave irrationally. We witness trends that run counter to fundamentals continue for much longer than we believe possible. This is because markets are driven by emotion. Price and value eventually converge, but the gap between them can remain wide for frustratingly long periods of time.

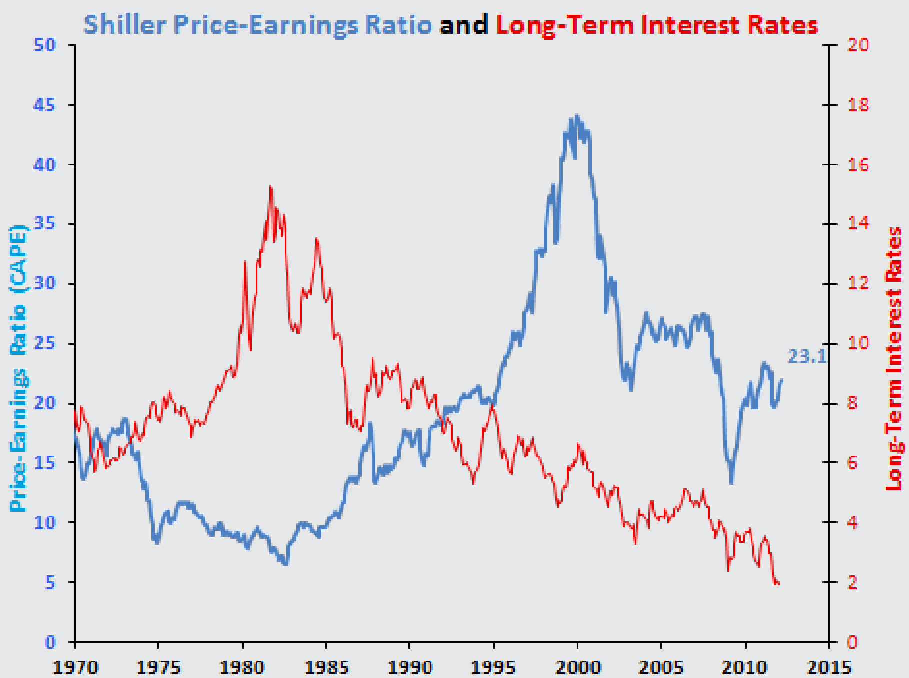
As value investors, we accept the gap between price and value as a fact of everyday investment life. Speculators and investors constantly seek ways to take advantage of this gap between price and value. As such, because monetary inflation distorts relative prices, these gaps are most common and most pronounced during periods when the supply of money is changing rapidly.

Peter Lynch famously said that spending 13 minutes each year thinking about economics means wasting 10 minutes. We freely admit that forecasting macroeconomic events and translating them into practical and profitable investment conclusions is not our strong suit, as we like to think that we enjoy the luxury of being disciplined stock-pickers. And yet we cannot shake the notion that today all securities in all asset classes appear to move up and down in tandem.

We see the stock market's uninterrupted first quarter rise as a byproduct of limitless money creation. The market experienced similar environments in 2010 and 2011. Investors, as opposed to speculators, understand that liquidity created by central banks does not increase the intrinsic value of stocks. Money printing can certainly impact stock prices in the short run, but this effect is only temporary and will fade at some point in the future. This is because money printing pushes up price-earnings (P/E) ratios which only serve to pull future stock market returns into the present.

Long-term value investors recognize and appreciate the inverse relationship between P/E ratios today and total investment returns in the future. Despite what one hears in the financial media, we believe the stock market remains expensive with the top justification for buying stocks today that they are "better than bonds".

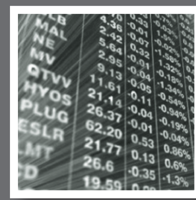
While stocks may be more attractive than bonds in the short run, consider how expensive stocks are when one extends their view back to the period since 1971, the same year the U.S. dollar completely decoupled from gold. The Shiller P/E ratio is an important measure of valuation because it rounds out peaks and troughs in earnings due to the business cycle. This ratio, developed by Yale professor Robert Shiller, is calculated by dividing the S&P 500 price by the average inflation-adjusted earnings from the previous 10 years. Over the last forty years, the Shiller P/E ratio has ranged from a low of 6 in 1982 to a high of 44 in 2000. If we exclude the technology bubble, the long-term Shiller P/E averages 15 with bear markets bottoming around 7.



source: http://www.econ.yale.edu/~shiller/data.htm

Starting valuation is crucial to one's long-term investing results. We can think of no other certain way to lose money than to overpay for stocks near a market peak. A simple way to view P/E multiples is to consider the multiple as the payback period in years for the return of money one invests to purchase a stock. Secular, or long-term, bull markets are best defined as periods of rising valuations, while bear markets are best defined as periods of falling valuations. Near market peaks, investors grow overly optimistic and willing pay high earnings multiples for stocks.

Perhaps the biggest driver of the Shiller P/E ratio is changes in long-term interest rates. Declines in long-term interest rates from high levels make stocks more competitive with bonds. Today bond yields are down around 2%, leaving little room to go much lower. If rates did trend lower, they would severely impact the banking, insurance and pension retirement fund system. Yet even with lower long-term rates, the impact on stocks would be weaker because bonds are already unattractive as long-term investments. On the other hand, if yields rose, bonds would grow more attractive, creating a head wind for stocks.
Based on simple logic, the supply of new bonds will increase as the U.S. government funds its large and growing operating deficit. With a drastic increase in supply, bond yields should eventually rise. Yet the Federal Reserve remains determined to prevent yields from rising, which is certainly possible -- but with limits. If the Federal Reserve wants to limit long-term bond yields from rising while the rest of the market sells bonds, the Federal Reserve will have to create more dollars to pay for all the bonds offered into the market. In other words, the Federal Reserve can influence long-term interest rates, but it is not bigger than the market itself. If investors and savers lose confidence in the integrity of the U.S., the Federal Reserve would need to take extreme measures. This could include increasing its balance sheet to multiples of its current $2.9 trillion by monetizing trillions more in Treasuries. Yet this action, in response to a flight out of Treasuries, would probably worsen the flight out of Treasuries.



We have little doubt that the credit crisis changed peoples' behavior. They wised up and no longer wish to borrow, but rather now wish to reduce debt. The credit crisis has left us all with an acute sense of financial insecurity. Despite almost a 30% increase in the S&P 500 off last October's lows, the individual retail investor stills maintains a healthy dose of skepticism. In the week ended March 28, domestic equity mutual funds experienced another $3.5 billion in equity redemptions: the biggest since the start of 2012. Color us skeptical, but it appears Wall Street may be waiting for the opportunity to unload their inventory of stocks on the individual investor.

INVESTMENT PHILOSOPHY

Anyone who acknowledges that the market is being propped up temporarily by growing money supplies cannot help but feel frustrated. This stock market has lately taken on the characteristic of what Jeremy Grantham at GMO calls a "career risk" rally. In today's investment climate, the vast majority of investment managers do not stay in business if they think too independently. If an investment manager decides to not participate in a rally because valuations or fundamentals simply do not warrant investing, they can quickly fall out of favor with clients if expectations are not met. Although it can be painful to go against the crowd, doing so helps one avoid the biggest mistakes in investing — growing too bullish at market tops and too bearish at market bottoms.

When asked about the impact of the credit crisis on investor behavior, Jeremy Grantham had a wonderful response, suggesting people learn a lot in the short term, a little in the medium term and nothing in the long term. In our opinion, many investors have learned little if anything from the credit crisis, reverting almost immediately back to bad investment habits.

Collectively, U.S. equities are still expensive and, with the rise of passive indexing, many people want to be fully invested all the time. The short-term focus of most market participants, coupled with their obsession for relative returns, causes them to repeat their bad behavior when markets go up. Of course none of this stops people who want to sell you equities from talking about how attractive stocks are, especially when compared to bonds. However, "What else am I going to do?" is not a compelling reason to invest.

Economist Thomas Phelps once said that "a great deal of investing is on par with the instinct that makes a fish bite on an edible spinner because it is moving." Investors too often bite on what is moving and cannot stand to hold a company's stock that is not going anywhere. And they typically lose patience with a stock that is moving against them. This emotional call to action leads to excessive trading, as market participants crave activity. Wall Street is built on activity and the media feeds on Wall Street activity.

Investors must understand the difference between activity and results. At St. James, it is not that difficult — if there is nothing to do, we do nothing. Absolute standards of valuation get us away from the idea that we have to be doing something, which is the foundation of the teachings of Benjamin Graham. Graham urged investors to focus on businesses and valuations, not market prices. And Graham was fully prepared to hold cash when there were no compelling investment opportunities. Howard Marks' often relates the concept of the "I know" versus the "I don't know" investor. The "I know" investor thinks knowledge of the future directions of economies, interest rates and markets is essential for investment success. The "I know"



investor is confident that not only can he have such knowledge but he will have it first as well. The "I don't know" investor does not believe that you need to know the future or even that you can possibly determine the future, so he spends most of his time determining how big the margin of safety is and in assessing what risks can result in the permanent impairment of his capital.

Consider St. James a firm member of the "I don't know" contingent.

Kind regards,

Robert J. Mark
Portfolio Manager

Larry J. Redell

The Castle Focus Fund's prospectus contains important information about the Fund's investment objectives, potential risks, management fees, charges and expenses, and other information and should be read and considered carefully before investing. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. You may obtain a current copy of the Fund's prospectus by calling 1-877-743-7820. Distributed by Rafferty Capital Markets, LLC-Garden City, NY 11530, Member FINRA.

The risks associated with the Fund, detailed in the Prospectus, include the risks of investing in small and medium sized companies and foreign securities which may result in additional risks such as the possibility of greater price volatility and reduced liquidity, fluctuations in currency exchange rates, and political, diplomatic and economic conditions as well as regulatory requirements in foreign countries. There also may be risks associated with the Fund's investments in exchange traded funds, real estate investment trusts ("REITs"), significant investment in a specific sector, and non-diversification.