JULY 10, 2014

"The arrogance of success is to think that what we did yesterday is good enough for tomorrow"
– William Pollard

Dear Investor,

After a slow start to the calendar year, the equity markets quietly gained ground during the second quarter. The S&P 500 rose 5.2%, bringing year-to-date returns to approximately 7%. Our equity portfolios advanced slightly more than the S&P 500 during the quarter and are roughly in-line with the index for the year. The bond markets, following losses in 2013 and consensus expectations of further losses in 2014, also have gained materially this year.

The markets, both equity and credit, have exhibited unusual calm – or perhaps complacency – these past few months. Volatility, as measured by the VIX index, is at a multi-year low. Credit spreads are extremely low in historical terms, and absolute yields for low-rated corporate bonds are now at their historical all-time lows. The amount of 'junk' debt being issued is near the highs of 2006, pre-credit crisis. It seems that investors have forgotten that one of the core reasons behind the crisis of 2008 was too much credit being issued to too many weak firms, for too little return, and with too few protections.

The enablers of this risk-taking are a Federal Reserve discount rate near 0% and a 10-year treasury rate currently at 2.60%. A consensus has formed that interest rates will remain low for much longer. The Fed seems more focused on enforcing this notion than it is on the current asset price inflation. Its intention is to stimulate further economic activity and hiring. But the price is an increased flow to riskier assets in a search for yield.

Importantly, we do not believe the environment will result in systematic global failure similar to 2008. The leverage is not as pervasive and unchecked as pre-2008, and does not permeate the large financial institutions to the same extent. The mortgage market, which is much larger and potentially destabilizing than the high yield debt market, has been relatively well behaved in its credit standards. The economic cycle is actually in its early stages as hiring, business investment and spending are just now gaining steam. But there is enough complacency that we do believe a significant correction in both equity and credit markets may occur. To us, this might be a buying opportunity. Notwithstanding the risk-taking that fueled recent gains, the economic cycle – and therefore profits – will continue to improve for the foreseeable future.

Our Portfolio

During the quarter, we made one new purchase and exited two names entirely.

147 EAST 48TH STREET, NEW YORK, NY, 10017 SPEARSABACUS.COM
T 212-230-9855 F 212-230-9861

The purchase is a familiar name, but – for obvious reasons – is a very different company than before. There are few companies as well known as, or perhaps as reviled as, AIG. There are also few companies that have undergone as much scrutiny by regulators and their own management over the last few years. Today, the company has the largest, and we believe undervalued, insurance franchise in the world and little, if any, of the risky businesses that led it into trouble. The company continues to work through reputational issues, an overhaul of its underwriting process and an inefficient cost structure – but we believe it trades at a significant discount to its true value. In conjunction with this purchase, we sold our long held position in AON. We made significant gains in this stock (roughly 120%) as our original thesis played out over a little more than four years. We like the discounted value of AIG in the insurance space more than the fully valued shares of AON.

We also sold our position in eBay at a small loss. In short, we grew uncomfortable about the potential for slowing trends in the Market Place business and the likelihood of additional investment in the PayPal segment to fend off growing competition. When our thesis is at risk, it is often best to walk away.

Concluding Thoughts

We have little to add to the continuing debate about central bank policy and the direction of interest rates. We do, however, believe it imperative to understand where potential risks reside. Rates may indeed stay low for an extended amount of time, but we believe this poses very little near-term risk to our investment portfolio, and in fact may be a very good back-drop. In contrast, a rise in interest rates, depending entirely on how fast and for what reasons, would pose a more immediate risk to markets. U.S. equities have appreciated significantly and could experience a normal pull-back (in the range of 10%) at any time. However, we do not see the ingredients necessary for a more dramatic pullback on the scale of 2008 or 2000.

The biggest risks we see today are found in investments whose value is solely dependent on low rates – and these risks may reside in unexpected places. The aforementioned high yield debt market worries us. Mutual funds that invest in those securities worry us even more. There have been recent press accounts of regulators' mulling over 'exit fees' on these funds aimed at slowing a potential stampede in redemptions. The fees are unlikely to happen, but do raise a red-flag for investments that most investors view as safe. In fact, they can be quite dangerous. As the Financial Times quoted former Fed Governor Jeremy Stein, the funds give a "liquid claim on illiquid assets." In other words, if there is a flow of investments away from high yield bonds because of a rise in rates, a rise in defaults, or both, the redemptions in these funds will force them to sell more bonds, which will make prices drop further, leading to more redemptions, and a very serious spiral may begin. The new structure of the bond markets, with the major banks effectively out of the business of buying them for inventory to steady markets, may exacerbate this cycle even more. These higher yielding funds have been good returning investments for many years, but we warn investors to be wary of the "arrogance of success."

As for our portfolios, we continue to believe that well selected and well valued securities – stocks and bonds – will provide the best long-term returns. As rates rise we will see an unwinding of investments tied to low rates. But, as we have said in our recent quarterly commentaries, we believe an improving economy will matter more to a well allocated portfolio.

Sincerely,

Spears Abacus

Appendix

AIG

In 2008, many observers believed that AIG would never recover from the reputational and financial strain imposed by its near collapse. Today, AIG is a fraction of its former size, but the business has stabilized, the balance sheet has been repaired, and the government has been repaid.

Despite this progress, AIG shares trade at 75% of tangible book value, suggesting that investors remain skeptical. To some degree this skepticism is understandable as AIG's operational recovery has lagged its balance sheet restructuring. We believe that AIG's stubbornly high property and casualty combined ratio (a key insurance profitability ratio that expresses cost as a percentage of revenue where lower is better) hides the progress that has been made overhauling the firm's underwriting and claims processing systems and procedures. In fact, a closer look reveals that accident year loss ratios are improving but have been offset by elevated spending on system implementation and personnel. We believe that, as spending on operational improvement moderates and premium growth resumes, AIG's expense ratio will decline towards global peer levels of ~30%. This alone should reduce AIG's combined ratio from today's breakeven levels to a more respectable mid-90's percent level by 2016.

Although AIG has been designated as a non-bank SIFI (Systemically Important Financial Institution), we believe that excess capital return will also be part of the story and expect that AIG will return over $16 billion of cash (20% of current market cap) to shareholders through 2016.

We believe that this turnaround will cause investors who left AIG for dead – many swearing never to return – to take a fresh look at the company. This should drive multiple expansions, and we believe that AIG shares could trade at 1x our 2016 tangible book estimate of $77.

Spears Abacus BeeHive Fund Performance (Net)

2012	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
The BeeHive Fund	6.28%	4.00%	1.31%	-2.24%	-8.30%	3.95%	0.65%	3.40%	2.67%	-2.08%	0.97%	1.10%	11.50%
S&P 500	4.48%	4.32%	3.29%	-0.63%	-6.01%	4.12%	1.39%	2.25%	2.58%	-1.85%	0.58%	0.91%	16.44%

2013	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
The BeeHive Fund	5.28%	-0.09%	3.43%	1.28%	3.87%	-1.78%	6.10%	-1.01%	4.78%	1.80%	4.26%	2.92%	35.13%
S&P 500	5.18%	1.36%	3.75%	1.93%	2.34%	-1.34%	5.09%	-2.90%	3.14%	4.60%	3.05%	2.53%	32.39%

2014	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
The BeeHive Fund	-4.22%	4.86%	0.00%	-0.36%	2.83%	3.67%							6.69%
S&P 500	-3.46%	4.57%	0.84%	0.74%	2.35%	2.07%							7.14%

Trailing 12 months (6/30/14)	
The BeeHive Fund	28.25%
S&P 500	24.61%

Annualized Since Inception (9/2/08)	
The BeeHive Fund	10.07%
S&P 500	10.03%

Spears Abacus Municipal Bond Performance (Net)

2012	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
SA Bond Account	1.09%	-0.56%	-0.14%	0.74%	0.41%	0.11%	0.89%	0.20%	0.42%	0.13%	0.41%	-0.41%	4.06%

2013	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
SA Bond Account	0.09%	0.12%	-0.09%	0.48%	-0.56%	-1.15%	-0.20%	-0.46%	1.08%	0.28%	-0.24%	-0.13%	-0.70%

2014	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
SA Bond Account	1.10%	0.63%	0.15%	0.96%	1.04%	0.17%							4.11%

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment in The BeeHive Fund will fluctuate so that the shares in The BeeHive Fund owned by an investor, when redeemed, may be worth more or less than their original cost. The current performance of The BeeHive Fund may be lower or higher than the performance data quoted. Spears Abacus Advisors LLC ("SA") has contractually agreed to waive fees and expenses through at least April 30, 2015 so that the net expenses of the fund do not exceed 0.99%. Investors who would like to obtain performance data for The BeeHive Fund that is current to the most recent month-end should call 866-684-4915 (toll free).

1.04%: The total annual fund operating expense ratio, gross of any fee waivers or expense reimbursements, as stated in the fee table of the fund's prospectus, pursuant to FINRA Rule 2210(d)(5).

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The Fund performance information shown is for The BeeHive Fund, a series of Forum Funds, an investment company registered under the Investment Company Act of 1940. The BeeHive Fund, which is managed by SA, seeks capital appreciation by investing in a concentrated portfolio of companies believed to have dynamic businesses with defensible market positions. The BeeHive Fund invests primarily in equity securities. Performance information for The BeeHive Fund is presented for 2012, 2013 and 2014.

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SA Municipal Bond Performance

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