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Frank Value Fund
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FRNKX, FNKCX, FNKIX

Second Quarter, 2015

To our fellow shareholders,

The Frank Value Fund Investor Class returned -2.88% YTD at the end of Q2 2015 versus 1.23% for the S&P 500 Total Return Index. Please refer to the end of this letter for more detailed performance information.

Three major events clustered at the end of June after a largely uneventful, flat, low-volume quarter. Most important to Frank Value Fund shareholders, on July 1, 2015, Paypal offered to buy Xoom for $25 per share. This represents a quick, 66.7% return on our money in just eight months. Roughly half the gains occurred after the close of the second quarter, boosting Frank Value Fund performance. We are also currently watching competitors like Western Union to see if they will outbid Paypal. Xoom has sparkling technology and it will bolster the competitive advantage of the highest bidder. We believe all our small cap companies are takeover targets and can similarly help acquirers like Xoom will.

The other two major events were on the macro level. First, Greece defaulted on its debt payment to the International Monetary Fund and consequently agreed to a third bailout with tough conditions. Second, the Chinese stock market crashed and the Chinese government subsequently engaged in heavy-handed manipulation to halt the decline. Rather than build a false narrative to connect these dots, investors looking for a positive or negative catalyst to shock the US market out of its Q2 doldrums are better suited to look at the micro. Here, we present one of Frank Value Fund’s major holdings, the story of Microsoft.

If you hang around stocks long enough, you will inevitably hear the phrase “earnings drive stocks in the long-run.” This sounds like a fundamentally-sound belief, and our argument is yes, earnings matter, but what matters a whole lot more is the valuation you place on earnings. Microsoft is an obvious counterexample to bolster our case. In the year 2000, at the height of the technology bubble in the United States, Microsoft’s marketcap was $663 billion and its operating income was $11 billion for an earnings yield (operating income / marketcap) of 1.72%. Ten years later, Microsoft’s highest marketcap in 2010 was $281 billion and its operating income was $24 billion for an earnings yield of 9.60%. This means if you bought MSFT in 2000 you would have lost 57% of your investment over the next ten years while operating income increased 118%. Earnings did not drive stock performance. You were dead-right about an increase in earnings and dead-wrong about the stock. The key is valuation. Accepting a 2% earnings yield is entirely too low, even if the company more than doubles its operating income in the next ten years. As of this writing, the average earnings yield of the more expensive half of the entire stock market is 1.85%.

If we eliminate the numerous small companies with negative earnings and focus on companies larger than $1.5 billion market capitalization, the average earnings yield on the top half is 4.21%. Does that sound acceptable? Pundits would have you compare that to bond yields near 0% and lead you into the trap of relative valuation. After the tech bubble burst and Microsoft stock declined over 50% from a high of $120 in 2000 to a low of $41.50 in 2001, purchasing MSFT at a 4.21% earnings yield would equate to a marketcap of about $330 billion. You avoided an extreme loss in 2000 but receiving a 4.21% earnings yield is little consolation. Ten years later in 2011 the highest market cap MSFT achieved that calendar year was $253 billion, resulting in another ten year loss of 23%.

We may not be in the obvious bubble territory of 1999-2000 but the valuations available today are still among the worst in history. Valuations are the highest in history if you look at median instead of average. Furthermore, most large companies will not experience the rapid earnings growth in the next ten years that Microsoft enjoyed from 2000 – 2010, making most investment cases even weaker than the money-losing decision to buy MSFT any time in the years 2000 or 2001.

The Frank Value Fund purchased Microsoft in February 2009 at a market cap of $160 billion, operating income of $22 billion and an earnings yield of 16.06%. Currently MSFT trades at $370 billion, with operating income of $28 billion and an earnings yield of 9.08%. This is above our floor absolute valuation and a tremendous discount to the median stock valuation and the reason we are continuing to hold. Low valuation is the key to our great returns on MSFT compared to starting points at much higher valuations.

If this and our previous letter to shareholders have taken a turn towards more numbers and graphs, it is because in times of extremes we focus even more on fundamentals and quantitative analysis. Be on guard, as today most stocks trade at extreme valuations! Relying on numbers is how we remove emotion from investing and maintain the best long-term course for our money and yours. There were just as many non-quantitative reasons not to buy in 2009 as there are to buy today. At both extremes and in between we let the numbers dictate our actions.

Macro events like Greece, China, and Puerto Rico could spill over into the US economy and business fundamentals could be negatively affected. However the above should show that catalysts are unnecessary. Valuation drives returns over the longer-term, and all the adages, catch-phrases, and soundbites in the world are powerless against actual, cold- hard numbers. Deviating from the plan is usually a product of greed or fear, and neither emotion proves to be a money-maker in the longer term.

Summary of Q2 15 activity:

Q2 Sales: Vera Bradley

Vera Bradley (NYSE: VRA)

We sold our Vera Bradley at a loss in the second quarter. Our research did have a focus on whether or not Vera's signature flowery handbags were a fad, but it appears we overestimated the staying power of the brand. Management is now scrambling to replace their core handbag sales with less flamboyant options. Meanwhile they continue to open stores and repurchase stock, burning cash at a moment when they should be conserving it. Most of our success stories in retail have been with distribution models like DSW and Wal-mart rather than brands. We have taken this to heart and consequently avoided similar mistakes in the past few months.

Q2 Purchases: None

For the second straight quarter, not one stock met our combination of value and quality criteria. We believe that the vast majority of gains investors are showing are merely on paper and will reverse significantly in the future. Until then, we maintain our discipline and wait for a company with reasonable growth prospects to trade above our floor of an 8% earnings yield. We still own several small companies on par with Xoom in terms of valuation, quality of business, and takeover potential. Our research every day is devoted to finding additional companies with similar positive characteristics. We believe our portfolio will outperform the averages and our peers at a level over the next ten years that is multiples of what we have done in the previous ten. The key is valuation.

Thank you for your investments.

Very truly yours,
Brian Frank
Frank Value Fund Portfolio Manager

Performance as of 6/30/15	Average Annualized Total Returns						Total Return
	1 Yr. %	**3 Yr. %**	**5 Yr. %**	**7 Yr. %**	**10 Yr. %**	**Since 7/21/04 %**	**Since 7/21/04 %**
Investor Class (FRNKX)	-0.06	13.38	15.47	9.48	8.17	8.17	136.02
Class C (FNKCX)	-0.78	12.53	14.72*	8.73*	7.42*	7.42*	
Institutional Class (FNKIX)	0.21	13.67	15.72*	9.73*	8.42*	8.42*	
S&P 500 Total Return	7.42	17.31	17.33	9.42	7.89	8.10	134.53

* Represents an estimate based on the performance of the fund's oldest share class, adjusted for fees.

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Non-FDIC insured. May lose value. No bank guarantee. The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the Fund, and it may be obtained by calling 1-800-869-1679. Please read it carefully before you invest or send money.

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