Wednesday, October 07, 2015

The Fund aims to provide investors with current income and capital appreciation by investing primarily in large and mid-cap master limited partnerships (MLPs) of domestic midstream energy companies. Recently, the overall MLP sector has experienced a substantial increase in volatility, as energy sentiment remains poor and investors have reduced exposure to the asset class. This volatility reached a crescendo at the end of September when the Alerian MLP Index experienced back-to-back declines of nearly 6% due to the combination of quarter-end deleveraging by some funds, a widely distributed (and we believe unfounded) negative article about the asset class, and continued poor sentiment.

As described in the Fund's prospectus, because the Fund, unlike most mutual funds, is taxed as a "C" corporation, it accrues a deferred tax asset balance, which reflects an estimate of the Fund's future tax benefit associated with net operating losses, capital loss carryforwards and unrealized losses. Any deferred tax asset balance increases the Fund's net asset value. To the extent the Fund has a deferred tax asset balance, the Fund assesses whether a valuation allowance, which would offset the value of some or all of the Fund's deferred tax asset balance, is required, considering all positive and negative evidence related to the realization of the Fund's deferred tax asset. The Fund assesses whether a valuation allowance is required to offset some or all of any deferred tax asset balance in connection with the daily calculation of the Fund's net asset value; however, to the extent the final valuation allowance differs from the estimates of the Fund used in calculating the Fund's daily net asset value, the application of such final valuation allowance could have a material impact on the Fund's net asset value. From time to time, the Fund may adjust its estimates or assumptions regarding its deferred tax asset balance as new information becomes available. Such adjustments, changes in generally accepted accounting principles or related guidance or interpretations thereof, limitations imposed on net operating and capital losses (if any) and changes in applicable tax law could result in increases or decreases in the Fund's net asset value per share, which could be material.

One adjustment occurred in connection with the review of the year end financials, which caused the value of Highland Energy MLP Fund (the "Fund") to decline. In connection with the review of the Fund's financial statements, and following initial discussions with the Fund's Board of Trustees, Highland Capital Management Fund Advisors, L.P., the Fund's adviser (the "Adviser") determined that a valuation allowance should be applied to partially offset the Fund's deferred tax asset. The Adviser believes this allowance was necessary after a review of its analysis in response to changes in market conditions. The balance of the Fund's deferred tax asset and the valuation allowance remain subject to review, and may change in the future. Although no assurance can be given regarding the future performance of the Fund or MLPs generally, however the Adviser still believes that the Fund will recover the full value of this asset in the future through the normalization of MLP market prices. The adjustment doesn't reflect a change HCMFA's overall view of MLPs, which HCMFA continues to believe represent one of the best values in the market. In fact, now that some of the technical factors noted above have passed, we have experienced a substantial improvement in the Fund's performance, with some positions increasing well over 25% from their end of September lows. Although no assurance can be given, we believe that we are well-positioned to benefit from the market's normalization and better recognition of the value of the Fund's midstream energy assets.

Nothing herein should be construed as investment advice. The investment views expressed herein may change over time, and the Fund and HCMFA expressly disclaim any obligation to update this information. Investing in MLPs involves additional risks as compared to the risks of investing in common stock, including risks related to cash flow, dilution and voting rights. Each Fund's investments are concentrated in the energy infrastructure industry with an emphasis on securities issued by MLPs, which may increase price fluctuation. Energy infrastructure companies are subject to risks specific to the industry such as fluctuations in commodity prices, reduced volumes of natural gas or other energy commodities, environmental hazards, changes in the macroeconomic or the regulatory environment or extreme weather.

Investors should consider the investment objectives, risks, charges and expenses of the Highland Funds carefully before investing. Please call 1-877-665-1287 or visit www.highlandfunds.com for more information on the Funds. Please read the prospectus carefully before you invest.

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