

February 2018 Commentary and Strategy Review

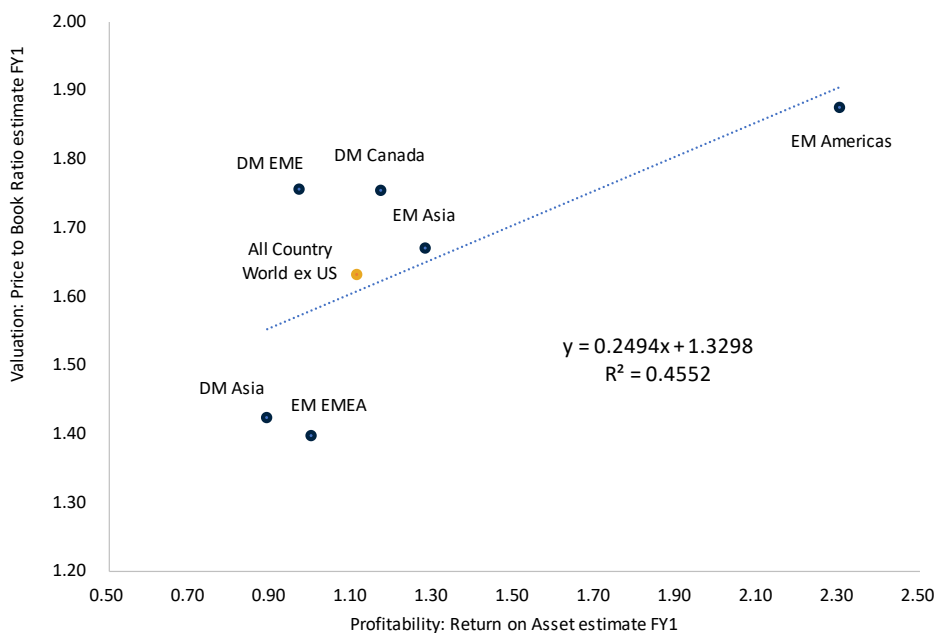
About the Strategy

The Country Rotation Portfolio (“CRP”) provides market exposure to over 40 international equity markets and global fixed income via exchange-traded funds. Innealta’s Investment Team manages the CRP strategy to a balanced benchmark of 70% MSCI All Country World ex U.S. Index (“ACWX”) and 30% Bloomberg Barclays Global Aggregate Bond Index. This benchmark reflects the average desired weight of equity and fixed income investments through a business cycle. Innealta Capital utilizes a proprietary quantitative framework that combines traditional corporate fundamental, macroeconomic and behavioral data to produce risk and return forecasts. The Investment Team then employs those forecasts along with trading optimization techniques and portfolio design research to create a unique portfolio, that, in our opinion, best suits a client’s risk-adjusted goals within international equity and global fixed income.

Outlook

Despite the increase in equity market volatility we remain positive on the international equity opportunity set, particularly Emerging Market equities. Macroeconomic growth indicators continue to imply growth, and consumer sentiment remains high. Earnings growth of Emerging Markets, as measured by the difference between one-year forward earnings-per-share and two-year forward earnings-per-share, are 11% versus expected growth in Developed Markets ex. U.S. of 7%. Within Western European equity markets, particularly the larger economies, we are concerned that valuations do not match the underlying profitability. For instance, the “Chart of the Month,” shown below, encapsulates our apprehensions. The chart plots the expected return on assets of an equity region next year (profitability) versus the expected price-to-book ratio next year (valuation). The trend line, which does not include the ACWX, shows that Developed Market Asia, Emerging Market Asia, and Emerging Market EMEA (Europe, Middle East and Africa) offer cheaper valuations per unit of profitability.

Chart of the Month



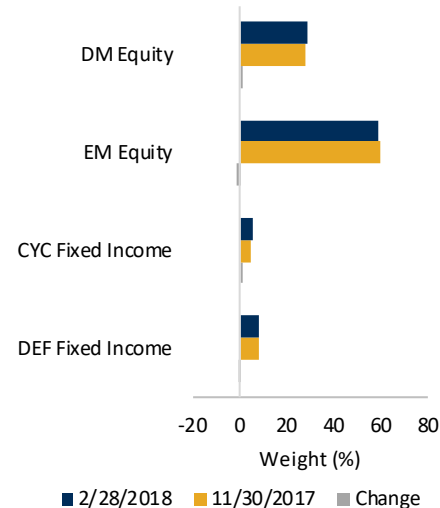
SOURCE: Innealta Capital using data from Bloomberg as of 02.28.2018.

Strategy Statistics

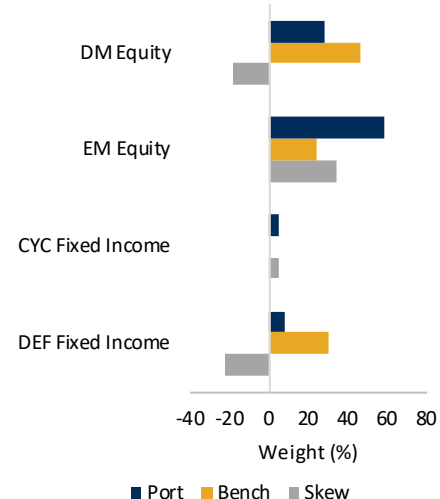
	Port	Benchmark
Alpha	2.96	0.00
Beta	0.40	1.00
R-Squared	0.56	1.00
Std. Dev.	6.08	11.23

SOURCE: Innealta Capital using data from Bloomberg. Data from 12.31.2009 to 02.28.2018. Benchmark represents a 70/30 blend of the MSCI ACWI ex US NR Index and the Bloomberg Barclays Capital Global Aggregate Bond Index. Inception date for the portfolio is December 31, 2009.

Portfolio Changes



Portfolio Skews



SOURCE: Innealta Capital using data from Innealta Capital and Bloomberg as of 02.28.2018

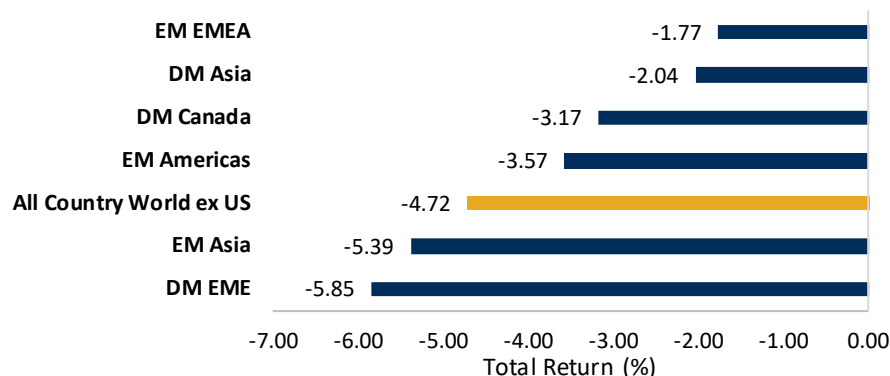
Performance

Global equity markets reacted negatively as the episodic volatility spike that started in U.S. markets spread to other markets and increased risk aversion. The MSCI All Country World ex U.S. Index returned -4.72%. The top performing region during the month was Emerging Market EMEA, returning -1.77%. The worst performing region in February was Developed Market EME (Europe and Middle East), returning -5.85%. The recent trends in the foreign exchange market reversed as the U.S. Dollar Index returned +1.66%.

As we have mentioned in previous commentaries, the relationship between equities and fixed income continues to evolve. For instance, Figure 2 below shows the rolling 52-week correlation between the MSCI All Country World ex U.S. Index and the German 10-year yield. From 2001 until 2013, the correlation was generally positive which means that when stock performance declined, German 10-year yields decreased, and a portfolio consisting of equity and fixed income was slightly insulated. Over the past few years, the correlation has changed implying that when stock performance declines, bond performance also declines.

In February, the Innealta Country Rotation Portfolio, on a gross of fee basis, and its benchmark returned -4.34% and -3.60% respectively. The top two contributors to the portfolio's performance during the month were an equity allocation to Thailand and an allocation to short-term fixed income. The portfolio closed the month with overweight allocations relative to the benchmark in Emerging Market equities and Cyclical Fixed Income, while underweight allocations in Developed Market equities and Defensive Fixed Income. There were no significant changes to the portfolio during February.

FIGURE 1: Benchmark Performance, Trailing 1-Month



SOURCE: Innealta Capital using data from 01.31.2018 to 02.28.2018 from Bloomberg.

FIGURE 2: International Equity/Fixed Income Correlation



SOURCE: Innealta Capital using data from 12.31.2000 to 02.28.2018 from Bloomberg.

Top Contributors

1. iShares MSCI Thailand Capped Index ETF (THD)
2. Vanguard Short-Term Bond ETF (BSV)

Bottom Contributors

1. iShares MSCI South Korea Fund ETF (EWY)
2. iShares MSCI Poland Capped Fund ETF (EPOL)

SOURCE: Innealta Capital using Innealta Capital data from 01.31.2018 to 02.28.2018.

Strategy Performance

	Gross	Net	Benchmark
1-Month	-4.34	-4.35	-3.60
3-Month	4.68	4.47	2.19
YTD	1.10	0.92	0.50
1-Year	18.88	17.82	16.79
3-Year	6.86	5.67	5.23
5-Year	5.03	3.73	4.87
Inception	6.51	5.19	4.89

SOURCE: Innealta Capital using data as of 02.28.2018. Benchmark is a 70/30 blend of the MSCI ACWI ex US NR Index and the Bloomberg Barclays Capital Global Aggregate Bond Index. Inception date for the portfolio is December 31, 2009.

Disclosures & Important Information

The U.S. Dollar is the currency used to express performance. The strategy includes portfolios charged bundled or wrap fees and portfolios charged transaction fees or trading costs. Bundled fee portfolios pay a fee based on a percentage of assets under management in place of a transaction fee. They include the advisor's fee and, in most cases, also include a fee for investment management and portfolio monitoring. Live returns are presented net of management fees, gross of withholding taxes on any dividends, interest or capital gains, and include the effects of trading costs and reinvestment of all income. Net of fee performance was calculated using actual management fees charged to the client. Gross returns are shown as supplemental information, include the effects of the reinvestment of all income, and are stated gross of all fees except for transaction fees, when charged.

Past performance is no guarantee of future results.

Investing involves risk, principal loss is possible, and there can be no assurance that investment objectives will be achieved. Past performance is not indicative of future results. Exchange traded funds (ETFs) are subject to risks similar to those of stocks, such as market risk, and investors who have their funds invested in accordance with the portfolios may experience losses. Additionally, fixed income (bond) ETFs are subject to interest rate risk, which is the risk that debt securities in a portfolio will decline in value because of increases in market interest rates. Investments in foreign investments may incur greater risks than domestic investments. For more information on the risks associated with investment in ETFs, please refer to AFAM Capital's Form ADV Part 2A.

Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. Actual investment management fees will vary, beginning at 1.5% per annum. Our full management fee schedule is described in more detail in AFAM's Form ADV Part 2A.

Alpha is a measure of the difference between a portfolio's actual returns and its expected performance, given its level of risk as measured by beta. **Beta** is a measure of volatility, or systematic risk, of a portfolio in comparison to a benchmark. A beta greater than one indicates more volatility, while a beta less than one indicates less volatility than the relevant benchmark. **Annualized Standard Deviation** is a measure of the dispersion of investment returns from the mean. A higher standard deviation indicates higher volatility. **R Squared** is a measure of how close the relationship is between a portfolio and its benchmark.

For comparison purposes, the composite is measured against a blended benchmark: 70% MSCI ACWI ex US NR Index / 30% Bloomberg Barclays Global Aggregate Bond NR Index. **The MSCI ACWI ex US NR Index** captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries (excluding the US) and 24 Emerging Markets (EM) countries. **The Bloomberg Barclays Global Aggregate Bond NR Index** is a measure of global investment grade debt from twenty-four different local currency markets. This multi-currency benchmark includes fixed-rate treasury, government-related, corporate and securitized bonds from both developed and emerging markets issuers. **The MSCI Emerging Markets (EM) Latin America Index ("EM Americas")** captures large and mid cap representation across 5 Emerging Markets (EM) countries in Latin America. **The MSCI Emerging Markets (EM) Asia Index** captures large and mid cap representation across 9 Emerging Markets countries. **The MSCI Emerging Markets EMEA Index** captures large and mid cap representation across 10 Emerging Markets (EM) countries in Europe, the Middle East and Africa (EMEA). Net total return indexes reinvest dividends after the deduction of withholding taxes, using (for international indexes) a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties. **The MSCI Europe and Middle East Index ("DM EME")** captures large and mid cap representation across 15 Developed Markets (DM) countries in Europe together with Israel in the Middle East. **The MSCI Pacific Index ("DM Asia")** captures large and mid cap representation across 5 Developed Markets (DM) countries in the Pacific region. **The MSCI Canada Index ("DM Canada")** is designed to measure the performance of the large and mid cap segments of the Canada market.

Net total return ("NR") indexes reinvest dividends after the deduction of withholding taxes, using a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treaties.

It is not possible to invest directly in an index. Blended benchmarks are calculated daily and rebalanced quarterly.

Innealta Capital is a division of AFAM Capital, Inc., a Registered Investment Advisor to individually managed client accounts and certain mutual funds. The firm only transacts business in states where it is properly registered or exempt from registration. Registration of an investment adviser does not imply any certain level of skill or training.

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