Innealta CAPITAL

Innealta Capital Country Rotation Strategy

March 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

Starting in March, financial markets experienced their first challenge to the prevailing market expectation that above-average and improving macroeconomic growth was a guarantee. In late February, U.S. President Donald Trump hinted at issuing tariffs on imported aluminum and steel (10% and 25%, respectively). Retaliation threats were issued by China and the European Union. The order that put them into effect was signed on March 8th, with an important caveat: many countries were, at least temporarily, exempted (e.g., Canada, Mexico, Brazil, and the entire EU), with the notable exception of China. Then on March 22nd, President Trump announced tariffs across a broad spectrum of Chinese goods, asking that China reduce its annual trade deficit with the U.S. by $100 billion. At first, it was only known that imports worth $60 billion would be taxed, and the list of specific goods was not released until more than a week later. In the meantime, stocks of likely targets for retaliation lost significant value (e.g., Boeing). As a tax on either imports, or exports, or both, tariffs are likely to decrease actual and expected macroeconomic growth. Moreover, the rhetoric on both sides has unleashed fears of a prolonged trade war.

During March, the multiple announcements of tariffs from the U.S. and other countries created a drag on risky markets, and increased overall levels of market volatility, both implied and realized. During March, the S&P 500 declined 2.69%, while the CBOE VIX index rose from 19.85 to 19.97. The VIX however remains above its 2017 average level of 11.09. The most significant potential global trade strain would be between the United States and China. Estimating the global impact of a trade war with China and other countries is beyond the scope of this paper. What is clear is that a trade war between the US and its top trading partners – China, Canada, and Mexico – could impact over 60% of U.S. trade, which accounted for 27% of the U.S. Gross Domestic Product in 2016 (World Bank). From a Chinese perspective, exports to the U.S. represent 20% of their exports, but the surplus with the U.S. – estimated to be $375 billion by the Commerce Department – accounts for 65% of their overall trade surplus. Chinese trade represented 37% of China's Gross Domestic Product in 2016 (World Bank).

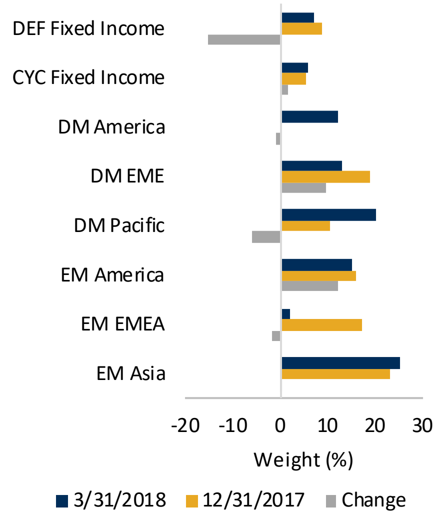
In the current environment, we anticipate headline risk (i.e. new announcements) around trade to dominate the market's focus. During April we expect that various macroeconomic surveys and behavioral data will provide more insight on whether macroeconomic growth will decline, or the market will revert to previous sustained growth expectations. Between now and then, we expect elevated market volatility to persist and, as such, are positioning our portfolios in a more defensive posture.

Strategy Statistics

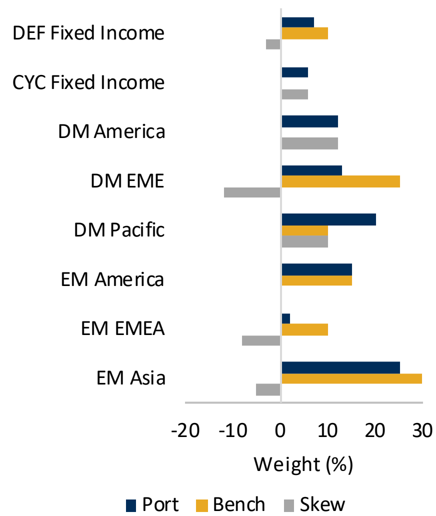
	Port	Benchmark
Alpha (%)	2.87	0.0
Beta (%)	0.41	1.0
R-Squared (%)	56.21	100.0
Std.Dev (%)	6.07	11.18

SOURCE: Innealta Capital using data from Bloomberg. Data from 12.31.2009 to 03.31.2018. 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 03.31.2018

Performance

Concerns about a global trade war negatively impacted international equity markets during March. The MSCI All Country World ex U.S. index fell 1.76%. Across geographic regions, the Emerging Market Europe, Middle East, and Africa region performed the worst, down -4.91%, while Canada performed the best, down only -0.24%. The Innealta Capital Country Rotation Portfolio ("CRP") returned -0.68% and -0.70% on a gross-of-fee and net-of-fee basis, while its blended benchmark – 70% MSCI All Country World ex U.S. index and 30% Bloomberg Barclays Global Bond Aggregate – returned -1.02%. The top contributors to CRP's monthly performance were equity allocations to South Korea and Taiwan while the top detractors to CRP's monthly performance were equity allocations to Indonesia and Poland. The investment committee did not make any significant changes to the portfolio during March.

Top Contributors

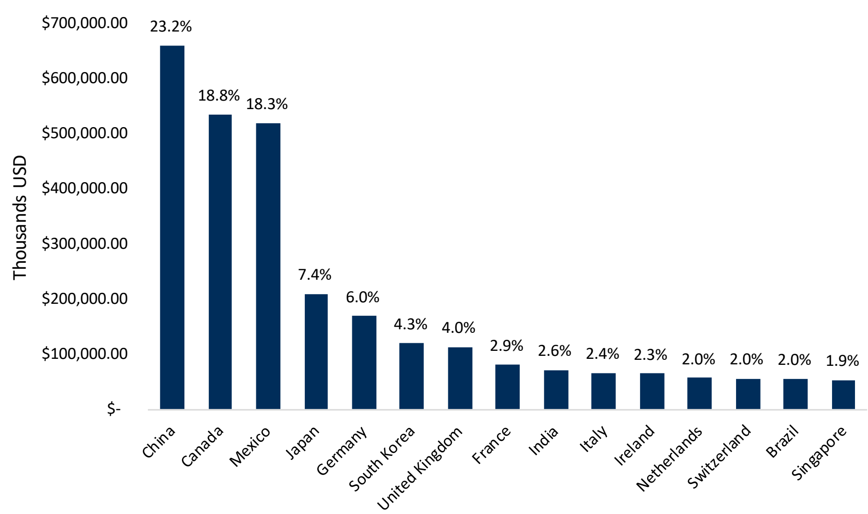
1. iShares MSCI South Korea ETF (EWY)
2. iShares MSCI Taiwan ETF (EWT)

Bottom Contributors

1. iShares MSCI Indonesia ETF (EIDO)
2. iShares MSCI Poland Capped Fund ETF (EPOL)

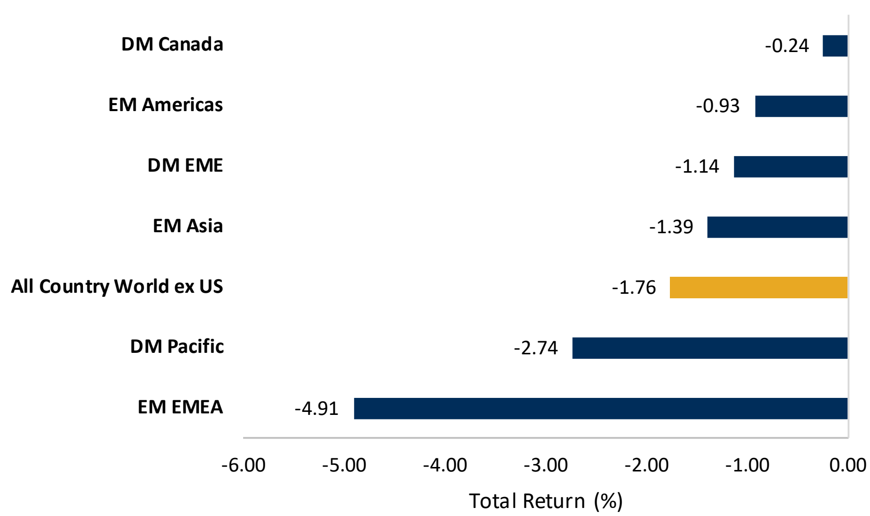
SOURCE: Innealta Capital using Innealta Capital data from 02.28.2018 to 03.31.2018.

FIGURE 1: Top U.S. Trading Partners



SOURCE: Innealta Capital using data from Bloomberg as of 12.31.2017.

FIGURE 2: Benchmark Performance, Trailing 1-Month



SOURCE: Innealta Capital using data from 02.28.2018 to 03.31.2018 from Bloomberg.

Strategy Performance

	Gross (%)	Net (%)	Benchmark(%)
1-Month	-0.68	-0.7	-0.92
3-Month	0.41	0.2	-0.42
YTD	0.41	0.2	-0.42
1-Year	15.51	14.45	13.63
3-Year	6.69	5.49	5.42
5-Year	4.86	3.56	4.67
Inception	6.36	5.05	4.72

SOURCE: Innealta Capital using data as of 03.31.2018. 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.*

DEF Fixed Income*: Defensive Fixed Income refers to any debt type contained within the Bloomberg Barclays U.S. Aggregate Bond or the Bloomberg Barclays Global Aggregate Bond index as well as inflation protected debt and municipal debt.* **CYC Fixed Income***: Cyclical Fixed Income refers to Emerging market debt, both USD and locally denominated, and U.S High Yield.* **DM America***: Developed Market Americas refers to Canada.* **DM EME***: Developed Market Europe and Middle East refers to Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and United Kingdom.* **DM Pacific***: Developed Market Pacific refers to Australia, Hong Kong, Japan, New Zealand, and Singapore.* **EM America***: Emerging Market Americas refers to Brazil, Chile, Colombia, Mexico, and Peru.* **EM EMEA***: Emerging Market Europe, Middle East, and Africa refers to Czech Republic Egypt, Greece, Hungary Poland, Qatar, Russia, South Africa, Turkey, and United Arab Emirates.* **EM Asia***: Emerging Market Asia refers to China, India, Indonesia, Korea, Malaysia, Pakistan, Philippines, Taiwan, and Thailand.*

*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.

12117 FM 2244 | Building 3, Suite 170 | Austin, Texas 78738 | p: 512.354.7041 | f: 512.402.1014 | www.innealtacapital.com

013-INN-4/30/2018