Innealta CAPITAL

Innealta Capital Country Rotation Strategy

May 2018 Commentary and Strategy Review

About the Strategy

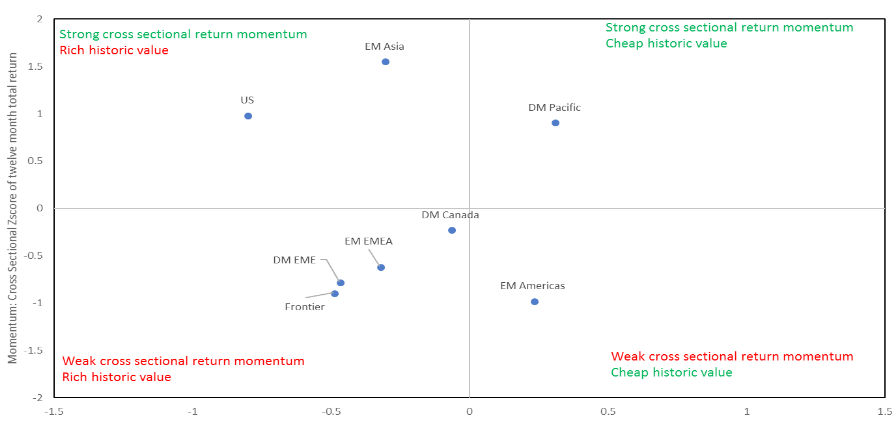
The Country Rotation Portfolio ("CRP") provides market exposure to over 40 international equity markets and global fixed income via exchange-traded funds. Innealta's Investment Team manages the CRP strategy to a balanced benchmark of 70% MSCI All Country World ex U.S. Index ("ACWX") and 30% Bloomberg 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

Momentum and valuation are two of the many core analytical techniques utilized in Innealta Capital's investment framework to evaluate opportunities within financial markets. Empirical research has shown that return streams based on momentum and value strategies tend to provide positive alpha and have a low correlation with one another. Figure 1 applies a valuation metric, calculated as a z-score based on its unique history and a momentum metric, calculated as a cross-sectional z-score using twelve-month total return, across the equity universe.

The figure provides a few key takeaways. Both U.S. and Emerging Market Asia equities have relatively weak return momentum. Equity markets in Canada ("DM Canada"), Emerging Market Europe, Middle East and Africa ("EM EMEA"), Developed Market Europe and Middle East ("DM EME"), and Frontier markets have all now moved into less attractive momentum and value regimes. To be fair, not all countries within a given region should be treated equally. EM Asia equities seem to offer a reasonable trade-off between strong momentum and value. Developed Market Pacific appears quite attractive relative to peers in terms of both valuation and momentum. Australia and New Zealand do offer opportunities, particularly their sensitivities to the commodities cycle. We have a positive view on commodities. Japan, however, we are less excited as the major driver of relative performance has been the currency not an improving economy. When the yen depreciates, we generally expect that the Nikkei would outperform on a relative basis given the country's export-based economy. Although we are not trying to forecast when the Bank of Japan will remove monetary stimulus, any reduction is likely to make Japanese sovereign debt more attractive, and thus help support yen appreciation. We believe other markets offer better reward per unit of risk, such as Australia and New Zealand.

FIGURE 1: Cross-Sectional Value and Momentum Analysis



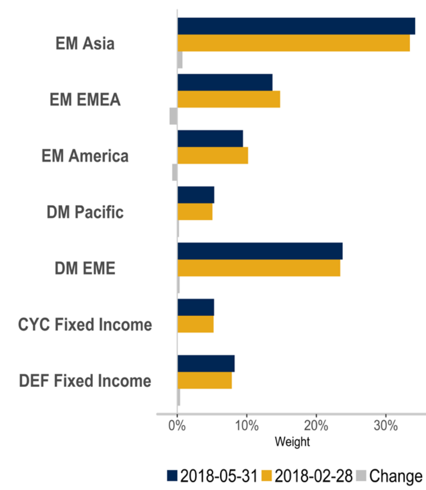
Source: Innealta Capital using Bloomberg data. Time frame 05/31/2008 to 05/31/2018, frequency weekly. "US" refers to the S&P 500 index. "EM Asia" refers to the MSCI EM Asia Index. "EM EMEA" refers to the MSCI EM Europe, Middle East and Africa index. "EM Americas" refers to the MSCI EM Americas index. "DM Canada" refers to the MSCI Canada index. "DM EME" refers to the MSCI Europe and Middle East index. "DM Pacific" refers to the MSCI Pacific index.

Strategy Statistics

	Port	Bench
Alpha (%)	2.17	0.0
Beta (%)	0.41	1.0
R-Squared (%)	54.51	100.0
Std.Dev (%)	6.2	11.09

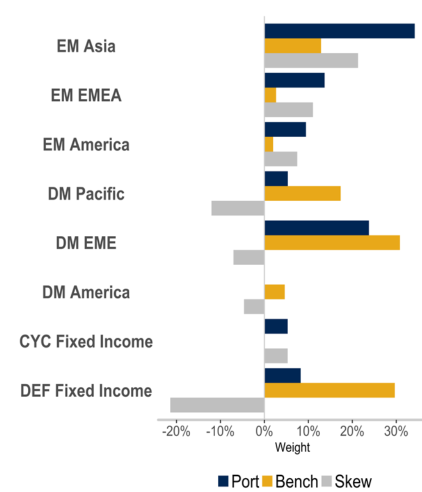
SOURCE: Innealta Capital using data from Bloomberg. Data from 12.31.2009 to 05.31.2018. Benchmark represents a 70/30 blend of the MSCI ACWI ex US NR Index and the Bloomberg Barclays Capital Global Aggregate Bond Index. Inception date for the portfolio is December 31, 2009.

Portfolio Changes



SOURCE: Innealta Capital using data from Innealta Capital and Bloomberg as of 05.31.2018.

Portfolio Skews



SOURCE: Innealta Capital using data from Innealta Capital and Bloomberg as of 05.31.2018.

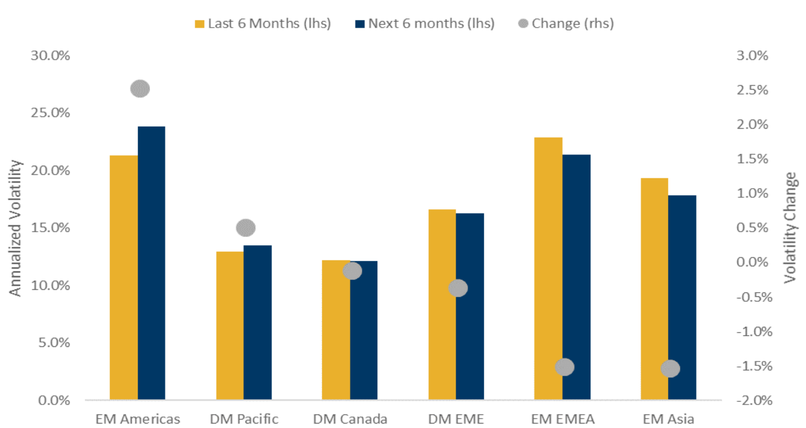
Performance

International equity market performance was negative in U.S. dollar terms during May. The MSCI All Country World ex U.S. Index ("ACWX") declined 2.31%, while the only positive returning region, Developed Market Canada returned 3.24%. While strong dollar appreciation acted as a headwind for Emerging Market performance in April, idiosyncratic situations in Brazil and Turkey were the main story in May. In Brazil, transportation strikes due to rising gasoline prices and calls for a new government triggered Brazilian equity market weakness as the MSCI Brazil USD index fell 16.53%, the largest decline since September 2014. In Turkey, rising inflation rates and desire to keep interest rates low, handcuffed the Turkish Central Bank from, in our opinion, reacting quickly. Simultaneously, the country's deteriorating current account situation and weakening consumer confidence has contributed to a depreciating currency and declining equity market. In May, the MSCI Turkey index declined 3.56% after declining over 9% in April.

We continue to believe that the dollar strength observed in 2018 was caused more by a short-term change in positioning rather than a long-term change in the fundamentals. In the case of Turkey, the country's equity market relative to the ACWX appears attractive as a value investment, although we would like to see more stability in the currency before investing. Brazil also has a depreciating currency relative to the dollar; however, in the case of Brazil, we find that the above average corporate profitability, relative to the ACWX, the strong sensitivity to an improving commodities market, and the strong international monetary reserve level as supportive to the equity market over the long-run. In the case of Brazil, we find that the above average corporate profitability, relative to the ACWX, the strong sensitivity to an improving commodities market, and the strong international monetary reserve level as supportive over the long-run to the equity market.

Looking forward to the next six months, we would expect market volatility across most major equity regions to fluctuate only slightly. Developed Market equity volatility will likely remain below Emerging Market equity volatility.

FIGURE 2: Volatility Forecast



Source: Innealta Capital using Bloomberg data. Time frame 05.25.2008 to 05.25.2018. Current volatility refers to the annualized volatility calculated using weekly returns from 11.24.2017 to 05.25.2018. Projected volatility refers to the predicted annualized volatility using weekly returns from 05.25.2008 to 05.25.2018.

The Innealta Capital Country Rotation Strategy returned -3.26% on a gross of fee basis, while its blended benchmark returned -1.85%. During May, the top contributors to the strategy's performance were allocations to China and Taiwan, while the top detractors to the strategy's performance were allocations to Brazil and Poland. The current portfolio has overweight allocations, relative to its benchmark, in the Emerging Market Asia region, the Emerging Market Europe, Middle East and Africa region, and the Emerging Market America region. The portfolio has underweight allocations, relative to its benchmark, in defensive fixed income investments, and the DM Pacific region. During May, the Investment Committee did not rebalance the portfolio.

Top Contributors

1. SPDR S&P China ETF (GXC)
2. iShares MSCI Indons Invstbl Mrkt Indx ETF (EIDO)

Bottom Contributors

1. iShares MSCI South Korea Index ETF (EWY)
2. iShares MSCI Brazil Index ETF (EWZ)

SOURCE: Innealta Capital using Innealta Capital data from 02.28.2018 to 05.31.2018.

Strategy Performance

	Gross (%)	Net (%)	Benchmark(%)
1-Month	-3.26	-3.3	-1.85
3-Month	-5.72	-5.9	-2.13
YTD	-4.68	-5.05	-1.64
1-Year	5.95	5.04	7.27
3-Year	4.07	2.95	4.24
5-Year	3.89	2.64	4.32
Inception	5.57	4.27	4.47

SOURCE: Innealta Capital using data as of 05.31.2018. 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 fund. 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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