Innealta CAPITAL

Innealta Capital Fixed Income Strategy

January 2018 Commentary and Strategy Review

About the Strategy

The Fixed Income Portfolio ("FI") provides market exposure across various sectors within global fixed income via exchange-traded funds. Innealta's investment team manages the FI strategy relative to the Bloomberg Barclays U.S. Aggregate Bond index. 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 utilizes 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 the fixed income space.

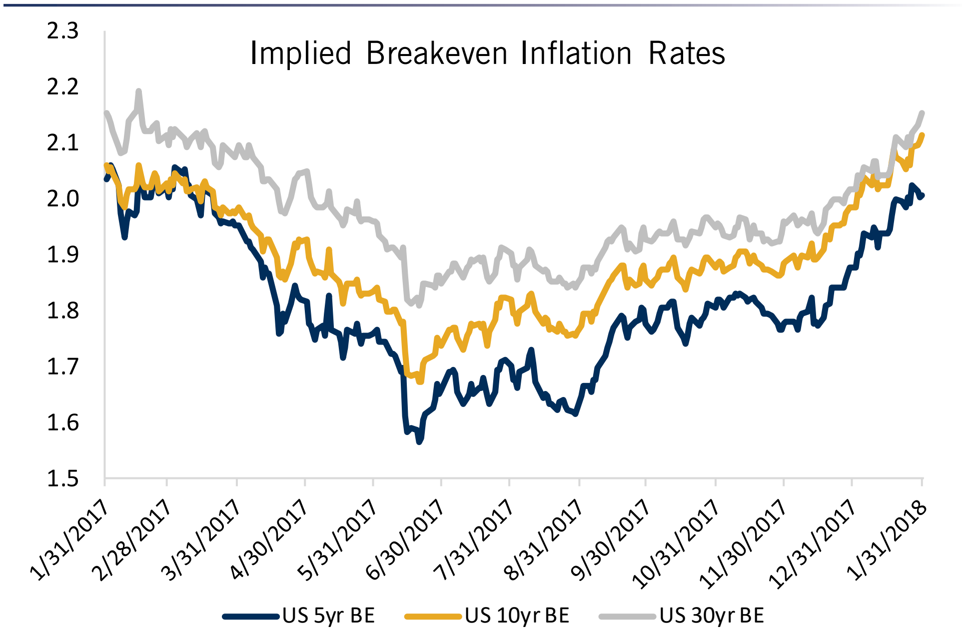
Outlook

Overall, we remain positive on the fixed income environment as increasing inflation expectations and term premiums continue to create opportunities. Over the medium-term, we expect tightening U.S. monetary policy to create a headwind for duration sensitive fixed income sectors. Additionally, tightening U.S. monetary policy will likely lead to overall higher financial market volatility both in fixed income and other asset classes. An increase in market volatility is likely to increase term premiums, as investors demand more return for lending money at longer maturities.

During January, market sentiment became increasingly focused on inflation. Greater than expected readings of CPI changes, average hourly earnings, and Institute of Supply Management Prices Paid survey helped drive higher prices of market-based inflation expectations. The "Chart of the Month" below shows that U.S. inflation breakeven indices for five-year, ten-year and thirty-year maturities increased across all maturities. The key takeaway in this chart is the parallel shift higher in inflation expectations across all maturities in January, not just one maturity. We continue to expect a gradual increase in inflation that will likely create a headwind for all fixed income.

As the fixed income market reacts to changing inflation expectations and changing term premiums, the opportunity set within fixed income grows. For example, shorter-duration and floating rate sectors currently appear attractive due to the drivers mentioned above while longer-dated duration sectors, such as ten-year and thirty-year U.S. Treasuries, do not.

Chart of the Month



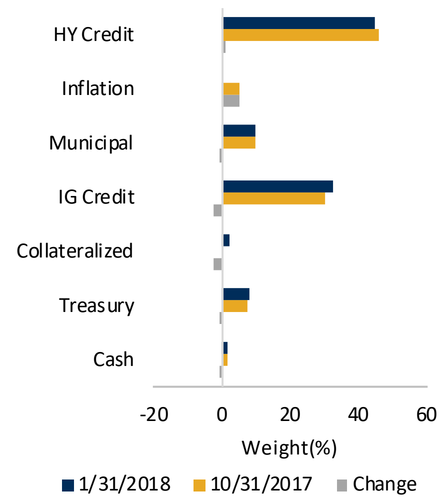
SOURCE: Innealta Capital using Bloomberg data from 01.31.2017 to 01.31.2018

Strategy Statistics

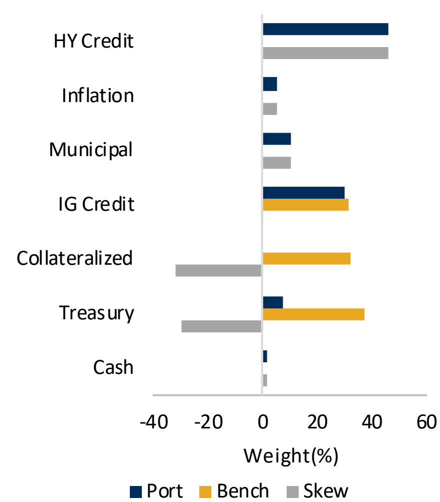
	Port	Benchmark
Alpha	0.25	0.00
Beta	0.78	1.00
R-Squared	0.43	1.00
Std. Dev.	3.31	2.77

Source: Innealta Capital using data from Bloomberg. Data from 12.31.2009 to 01.31.2018. Benchmark represents the Bloomberg Barclays U.S. Aggregate Bond Index. Inception date for the portfolio is December 31, 2009.

Portfolio Changes



Portfolio Skews



SOURCE: Innealta Capital using data from Innealta Capital as of 01.31.2018

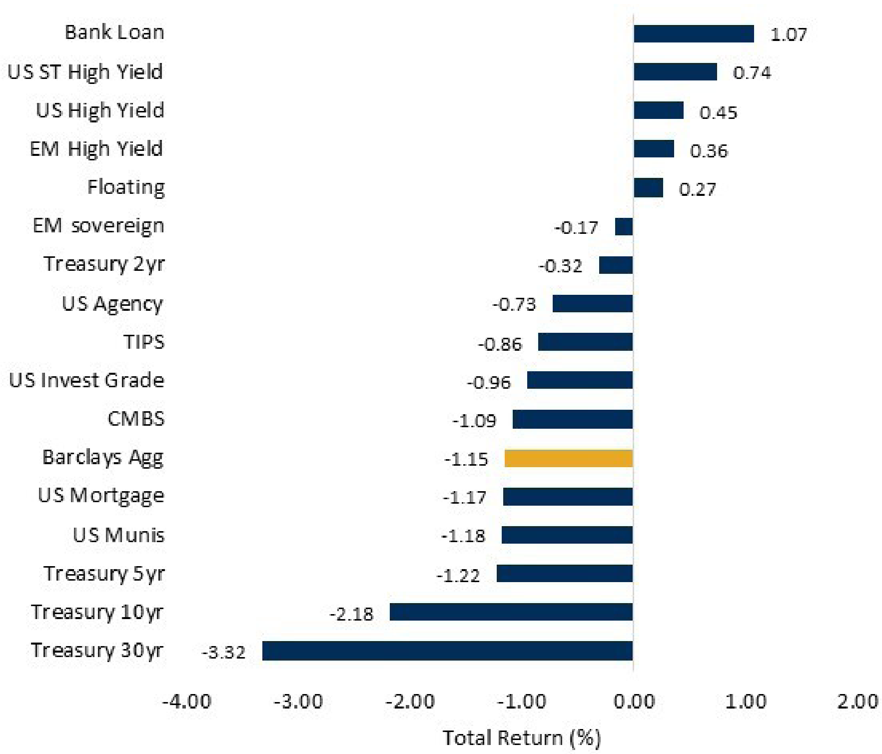
Innealta Capital Fixed Income Strategy

Performance

As inflation concerns increased simultaneously with term premium, domestic fixed income markets experienced negative returns during January. A broad measure of U.S. fixed income performance, the Bloomberg Barclays U.S. Aggregate Bond index, returned -1.15%. The bar chart below shows the January 2018 total return performance for various fixed income sectors. The clear theme during the month was that credit and alternative sectors, such as floating rate and bank loans, outperformed while more duration-sensitive sectors underperformed. Floating rate and bank loan sectors, which offer more protection against rising rates, outperformed all other sectors when adjusting for volatility (not shown). Finally, credit-sensitive sectors, such as U.S. High Yield and Emerging Market local debt, outperformed on an absolute basis.

During January, the Innealta Capital Fixed Income Portfolio returned -0.74% while its benchmark, the Bloomberg Barclays U.S. Aggregate Bond index, returned -1.15%. The top two contributors to the portfolio's performance were allocations to short-duration U.S. High Yield and Emerging Market High Yield. The bottom two contributors to the portfolio's performance were allocations to U.S. Investment Grade Credit and long-dated U.S. Treasuries. During the month, the portfolio reduced positions in U.S. Agencies and U.S. medium-dated Treasuries and increased positions in U.S. Treasury Inflation Protected Securities and long-dated U.S. Treasuries.

FIGURE 1: Benchmark Performance, Trailing 1-Month



SOURCE: Innealta Capital using data from 12.31.2017 to 01.31.2018 from Bloomberg.

Top Contributors

1. PIMCO 0-5 Yr HY Corp. Bond Index ETF (HYS)
2. VanEck Vectors EM High Yield Bond ETF (HYEM)

Bottom Contributors

1. iShares iBoxx USD IG Corporate Bond ETF (LQD)
2. iShares Barclays 20+ Yr Treasury Bond ETF (TLT)

SOURCE: Innealta Capital using Innealta Capital data from 12.31.2017 to 01.31.2018.

Strategy Performance

	Gross	Net	Benchmark
1-Month	-0.74	-0.91	-1.15
3-Month	0.01	-0.18	-0.83
YTD	-0.74	-0.91	-1.15
1-Year	2.96	2.08	2.15
3-Year	1.62	0.81	1.14
5-Year	1.17	0.41	2.01
Inception	3.58	2.92	3.43

SOURCE: Innealta Capital using data as of 01.31.2018. Benchmark is the Bloomberg Barclays U.S. 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 strategy is measured against the Bloomberg Barclays US Aggregate Bond Index.

*"Barclays Agg" refers to **The Bloomberg Barclays US Aggregate Bond Index** which is representative of the entire universe of taxable fixed-income investments. It includes issues of the US Government and any agency thereof, corporate issues of investment grade quality (Baa/BBB or better), and mortgage-backed securities."Treasury 2yr" refers to the **The Merrill Lynch 2-year U.S. Treasury Futures Total Return Index** which measures the performance of a fully collateralized rolling 2-year U.S. Treasury futures position. "Treasury 5yr" refers to **The Merrill Lynch 5-year U.S. Treasury Futures Total Return Index** which measures the performance of a fully collateralized rolling 5-year U.S. Treasury futures position. "Treasury 10yr" refers to **The Merrill Lynch 10-year U.S. Treasury Futures Total Return Index** which measures the performance of a fully collateralized rolling 10-year U.S. Treasury futures position. "Treasury 30yr" refers to **The Merrill Lynch 30-year U.S. Treasury Futures Total Return Index** which measures the performance of a fully collateralized rolling 30-year U.S. Treasury futures position. "US High Yield" refers to **The iBoxx USD Liquid High Yield Index** which is an index composed of U.S. dollar-denominated, investment-grade corporate bonds. "TIPS" refers to **The Bloomberg Barclays US Treasury Inflation Notes TR Index Value Unhedged USD Index** which consists of inflation-protection securities issued by the US Treasury. They must have at least one year until final maturity and at least $250 million par amount outstanding. They are rated investment grade by at least two of the following rating agencies: Moody's, S&P, Fitch. They must be fixed rate, dollar denominated and non convertible. "US Munis" refers to **The S&P Municipal Bond Index** which is a broad market value weighted index that seeks to measured the U.S. municipal bond market. "US Invest Grade" refers to **The iBoxx Investment Grade Index**, which is composed of U.S. dollar-denominated, investment-grade corporate bonds. "US Mortgage" refers to **Bloomberg Barclays US MBS Index Total Return Value Unhedged USD**, which measures the performance of investment grade fixed-rate mortgage-backed pass through securities of GNMA, FNMA, and FHLMC. "US Agency" refers to the **Barlcays U.S. Agency Index**, which measures performance of callable and non-callable agency securities issued by US government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed bye the U.S. government. "EM sovereign" refers to the **JPMorgan EMBI Global Core Index**, which measures a broad, diverse U.S. dollar denominated emerging market debt instruments. EM High Yield" refers to the **Morningstar Emerging Markets High Yield Bond Index**, which tracks the performance of the below-investment grade U.S. dollar denominated emerging market sovereign and corporate bond market. "Bank Loan" refers to the **S&P/LSTA U.S. Leveraged Loan 100 Index**, which measures the performance of the largest facilities in the leveraged loan market. "CMBS" refers to the **Bloomberg Barclays U.S. CMBS Investment Grade Index**, which measures the market of conduit and fusion CMBS deals with a minimum current deal size of $300 million. "Floating" refers to the **Bloomberg Barclays US FRN <5 Years Index**, which is a subset of the US Floating-Rate Note (FRN) Index, which measures the performance of USD denominated, investment grade, floating-rate notes across. "US ST High Yield" refers to the **Markit iBoxx USD Liquid High Yield 0-5 Capped Index** which tracks exposure to liquid high yield corporate bonds maturing between 0 and 5 years. "US 5yr BE, US 10yr BE, and US 30yr BE" refers to the **US Breakeven Indices**, which measure the breakeven inflation rate by subtracting the real yield of the inflation linked maturity curve from the yield of the closest nominal Treasury maturity. The result is the implied inflation rate for the term of the stated maturity.*

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

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