

May 2018 Commentary and Strategy Review

About the Strategy

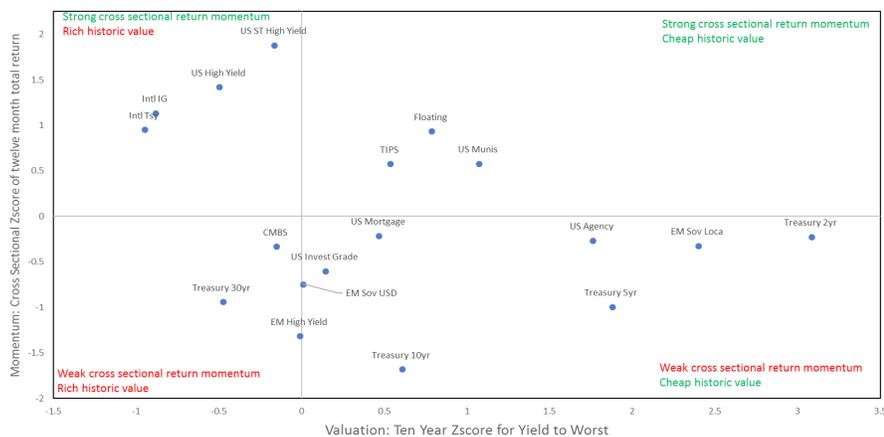
The Fixed Income Portfolio (“FI”) provides market exposure across various sectors within global fixed income via exchange-traded funds. Innealta’s Investment Team manages the FI strategy relative to the Bloomberg Barclays U.S. Aggregate Bond index. Innealta Capital utilizes a proprietary quantitative framework that combines traditional corporate fundamental, macroeconomic and behavioral data to produce risk and return forecasts. The Investment Team then 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 the fixed income space.

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 a cross-sectional z-score using twelve-month total return, across the fixed income universe.

The figure has four key takeaways. Emerging Market Local Sovereign debt still screens attractive on both a momentum and valuation basis, despite the recent negative performance. A position in this sector should be scaled accordingly, as the sector has historically higher volatility than other fixed income sectors. Short-dated U.S. Treasuries in the two-year and five-year maturities are offering significant value relative to their historical averages. The FED is likely to increase interest rates, but earning 2.54% assuming they are held-to-maturity with less than 2% annualized volatility in two-year U.S. Treasuries, appears much more attractive from a risk-return perspective than thirty-year U.S. Treasuries, which are currently yielding slightly above 3%. Emerging Market High-Yield debt, Emerging Market Sovereign USD, and thirty-year U.S. Treasuries are exhibiting poor momentum and relatively little valuation benefit. We don’t see an immediate catalyst for reversal in those Emerging Market debt sectors. Finally, there is a trade-off between strong momentum and rich valuation in the International Investment Grade credit and International Treasury. We still own these debt markets; however, we are becoming more cautious as the likelihood of slowdown in European monetary stimulus.

FIGURE 1: Cross-Sectional Value and Momentum Analysis



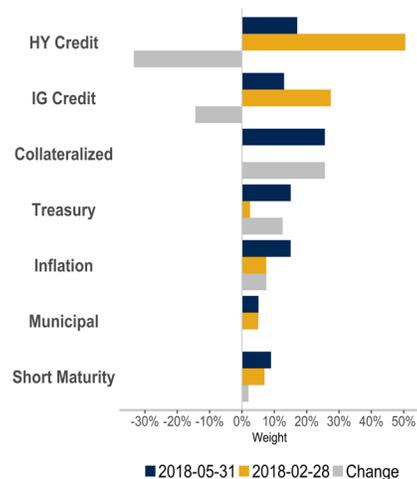
Source: Innealta Capital using Bloomberg data. Timeframe 05/31/2008 to 05/31/2018, frequency weekly. “Treasury 2yr” refers to the Bloomberg Barclays US Treasury Bellwethers 2 Year TR Index. “Treasury 5yr” refers to the Bloomberg Barclays US Treasury Bellwethers 5 Year TR Index. “Treasury 10yr” refers to the Bloomberg Barclays US Treasury Bellwethers 10 Year TR Index. “Treasury 30yr” refers to the Bloomberg Barclays US Treasury Bellwethers 30 Year TR Index. “US Invest Grade” refers to the Bloomberg Barclays US Corporate Total Return Index. “US High Yield” refers to the IBOXX High Yield Index. “US ST High Yield” refers to the Markit Iboxx USD Liquid High Yield 0-5 Index. “US Munis” refers to the Bloomberg Barclays Municipal Bond Index. “CMBS” refers to the Bloomberg Barclays CMBS Erisa Eligible Unhedged USD Index. “US Mortgage” refers to the Bloomberg Barclays US MBS Index. “US Agency” refers to the Bloomberg Barclays US Agg Agency Total Return Index. “TIPS” refers to the Bloomberg Barclays US Treasury Inflation Notes TR Index. “EM Sovereign” refers to the Bloomberg Barclays EM USD Aggregate Total Return Index. “EM High Yield” refers to the Bloomberg Barclays Emerging Markets High Yield Total Return Index. “Bank Loan” refers to the S&P/LSTA US Leverage Loan 100 Index. “Floating” refers to the Bloomberg Barclays US FRN less than 5yrs Total Return Index.

Strategy Statistics

| | Port | Bench |
|---------------|-------|-------|
| Alpha (%) | -0.13 | 0.0 |
| Beta (%) | 0.81 | 1.0 |
| R-Squared (%) | 45.11 | 100.0 |
| Std.Dev (%) | 3.35 | 2.78 |

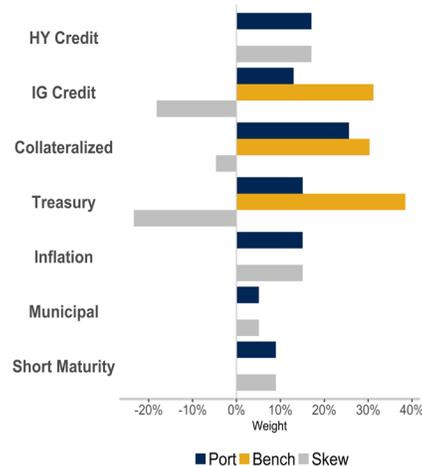
Source: Innealta Capital using data from Bloomberg. Data from 12.31.2009 to 05.31.2018. Benchmark represents the Bloomberg Barclays U.S. Aggregate Bond Index. Inception date for the portfolio is December 31, 2009.

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 as of 05.31.2018.

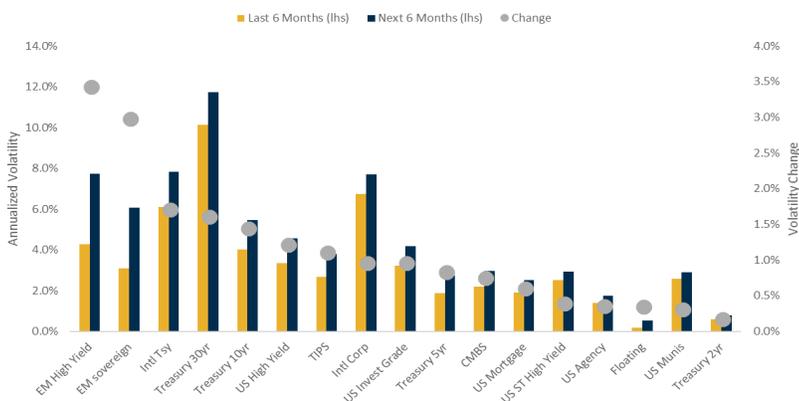
Performance

Fixed Income markets in May posted modest returns, with the Bloomberg Barclays U.S. Bond Aggregate (“AGG”) returning +0.71%. Yet the main story within fixed income markets, like equities, was the weakness of Emerging Markets. Dollar denominated Emerging Market sovereign debt and Emerging Market High Yield debt were the largest underperformers, returning -0.73% and -2.06%, respectively. Given the weakness in equity markets, U.S. treasury markets performed well in May, as the thirty-year Treasury market returned approximately 2.19%.

During May, the Innealta Capital Fixed Income Portfolio returned 0.07% on a gross-of-fee basis. Within the portfolio, the top detractor to performance was an allocation to Emerging Market sovereign debt local, while the top contributors to performance were allocations to Mortgage-backed securities and longer-dated U.S. Treasuries. The portfolio experienced negative attribution, relative to its benchmark, for investments in high-yield securities and inflation-protected securities, while the portfolio experienced positive attribution, relative to its benchmark, for investments in investment grade credit and municipals. The Innealta Capital investment committee did not rebalance the portfolio during May.

Looking forward to the next six months, we expect an increase in market volatility across most major debt sectors. Many of these sectors have experienced record low volatility relative to their historical averages and a return to average volatility may occur. Specifically, we foresee large volatility increases in Emerging Market debt, International Treasuries, and medium to longer-dated U.S. Treasuries. All three of these debt markets have near-term catalysts that could increase volatility and yields. We do not foresee a major increase in the market volatility of Floating Rate and Short-Term U.S. High Yield debt markets; which, based on our momentum and valuation analysis makes these sectors attractive for a well-diversified fixed income portfolio.

FIGURE 2: Volatility Forecast



Source: Innealta Capital using Bloomberg data. Timeframe 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 05/25/2018 to 11/23/2018.

Top Contributors

1. iShares MBS ETF (MBB)
2. iShares IBoxx \$ Invest Grade Corp Bond ETF(LQD)

Bottom Contributors

1. VANGUARD CHARLO/TOTAL INTL BD ETF (BNDX)
2. VanEck Vectors J.P. M EM LC Bond ETF (EMLC)

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

Strategy Performance

| | Gross (%) | Net (%) | Benchmark(%) |
|-----------|-----------|---------|--------------|
| 1-Month | 0.07 | 0.06 | 0.71 |
| 3-Month | -0.53 | -0.65 | 0.61 |
| YTD | -2.9 | -3.18 | -1.5 |
| 1-Year | -1.5 | -2.26 | -0.37 |
| 3-Year | 0.3 | -0.47 | 1.39 |
| 5-Year | 0.73 | -0.03 | 1.98 |
| Inception | 3.17 | 2.52 | 3.25 |

SOURCE: Innealta Capital using data as of 05.31.2018. 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 measure 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 **Barclays 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 by 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.

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.

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

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