

June 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.

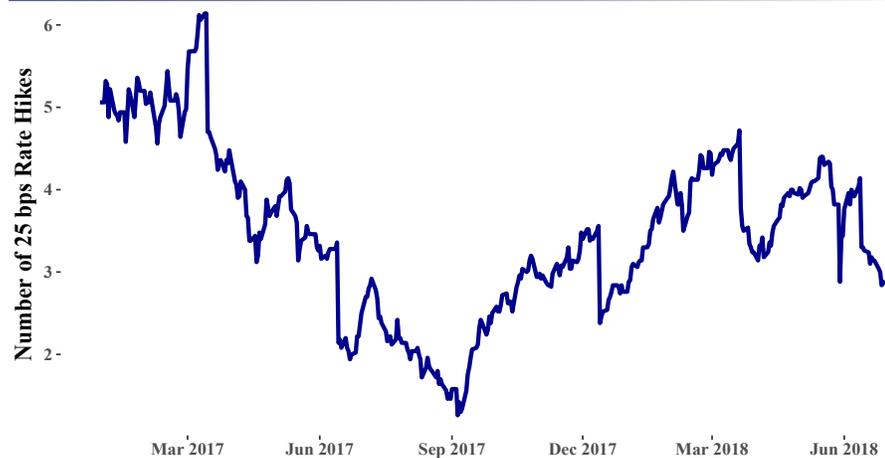
Outlook

Fixed income markets in June experienced opposing drivers as improving growth expectations and declining trade tensions supported investor optimism while inflation and monetary policy created a headwind. Overall we perceive the current environment as having high growth expectations, increasing inflation, tightening U.S. monetary policy, low equity implied volatility and low rates implied market volatility. In this environment, which we expect to continue, we anticipate that high yield credit and floating rate debt will outperform other fixed income debt sectors.

We continue to prefer high yield credit, both U.S. and Emerging Market, for slightly different reasons. In the U.S. unsecured high yield debt and senior bank loans offer positive beta to improving U.S. economy growth. In Emerging Market debt, we have a similar view in wanting positive beta to improving global macroeconomic growth. Additionally we believe Emerging Market debt offers a good value opportunity as yields have risen over the past two months as the U.S. dollar appreciated.

As we noted in our May commentary, we perceive the short end (less than three years) of U.S. Treasury markets as attractive given how much yields have increased. The market currently has three 25 bps rate hikes priced in to the end of 2019 and we assume another 25 bps rate hikes will occur in 2019. With the U.S. Treasury two-year yielding approximately 2.5% and the realized annual volatility of less than 1%, the short-end is very attractive on a risk-adjusted basis and good alternative to cash.

FIGURE 1: Number Fed Rate Hikes priced to December 2019

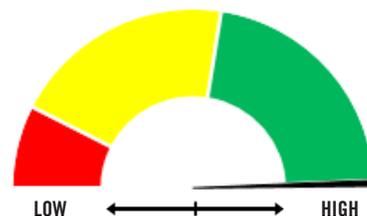


Source: Innealta Capital using Bloomberg data. Time frame 06.30.2017 to 06.30.2018. Figure represents the number of implied 25 bps rates hikes using the 30-day Fed Funds futures contract that settles on December 31, 2019

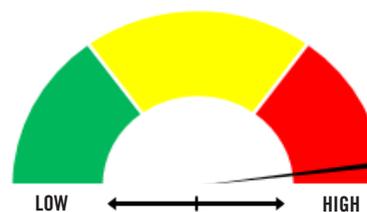
Macro View Snapshot Gauges

Positive Caution Negative

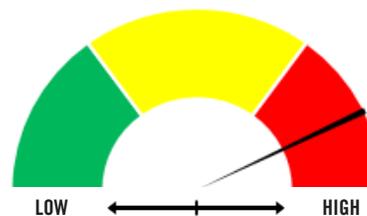
Gauge 1: Growth



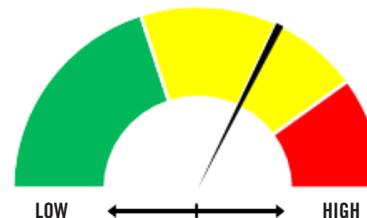
Gauge 2: Inflation



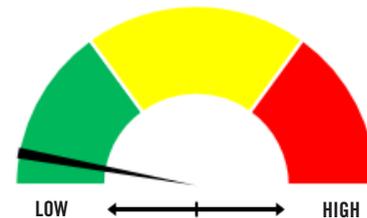
Gauge 3: Fed Short-Term Rates



Gauge 4: Equity Implied Volatility



Gauge 5: Rates Implied Volatility



Source: Innealta Capital. All gauge charts reflect the opinion of the innealta capital investment team view of various indicators.

Performance

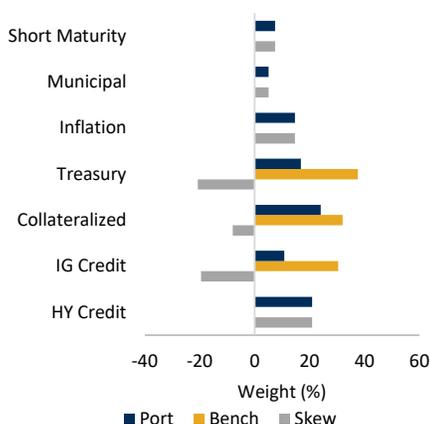
Fixed Income markets in June posted mixed results as the Bloomberg Barclays U.S. Bond Aggregate (“AGG”) returned -0.12%. Return dispersion across fixed income sectors has increased given the recent negative performance of Emerging Market debt however broad fixed income realized volatility levels remain low. During June the Innealta Capital Fixed Income strategy returned -0.18% gross-of-fees. The top contributors to the strategy’s performance were allocations to TIPs and currency-hedged international sovereign debt. While the top detractors to the strategy’s performance were allocations to Emerging Market debt remains elevated given the recent negative performance of Emerging Market debt denominated in local currency and U.S. investment grade credit.

During June, the Innealta Capital investment team rebalanced the Fixed Income Strategy to take advantage of some market dislocations. The strategy increased its holdings in senior bank debt, Emerging Market debt denominated in local currency, floating rate, U.S. high yield, and 1-3 year U.S. treasuries. The strategy decreased its holdings in U.S. mortgage-backed securities, TIPs, U.S. investment grade credit, and long duration - greater than 20 years - U.S. treasuries. Net the strategy maintains an overweight for High Yield credit, municipals, and inflation protected debt while using short duration (1-3 year) U.S. treasuries and other short maturity products to manage risk.

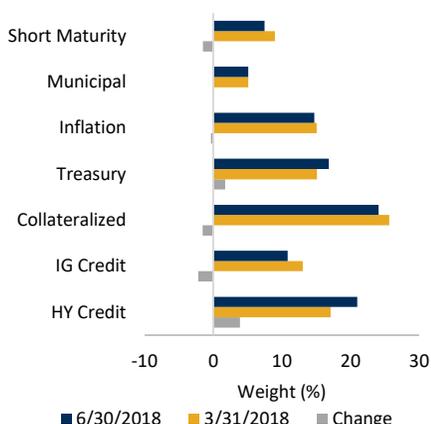
Strategy Performance

	Gross (%)	Net (%)	Benchmark(%)
1-Month	-0.18	-0.19	-0.12
3-Month	-1.17	-1.28	-0.16
YTD	-3.07	-3.36	-1.62
1-Year	-1.41	-2.17	-0.4
3-Year	0.61	-0.16	1.72
5-Year	1.1	0.35	2.27
Inception	3.12	2.47	3.2

Portfolio Changes Trailing 3 Months

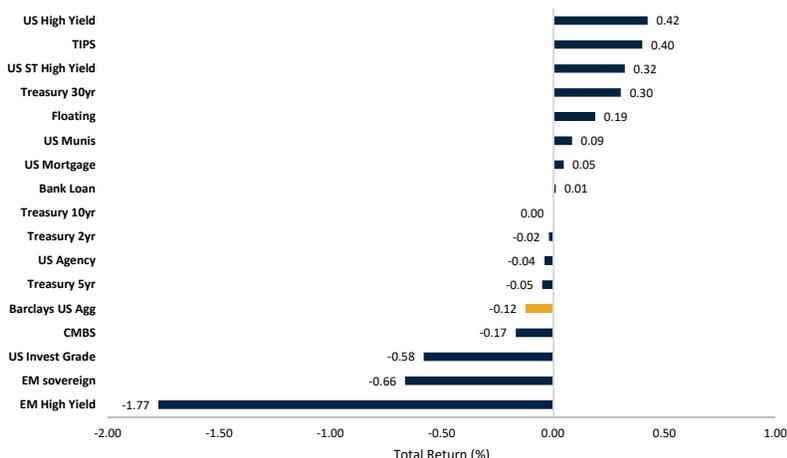


Portfolio Skews As of 06.30.2018



Source: Innealta Capital using Bloomberg data. Time frame 03.31.2018 to 06.30.2018. Bench refers to the Bloomberg Barclays U.S. Aggregate Bond index.

June Performance Across Various Debt Sectors



Source: Innealta Capital using Bloomberg data. Time frame 05.31.2018 to 06.30.2018.

¹
SOURCE: Innealta Capital using data as of 06.30.2018. Benchmark is the Bloomberg Barclays U.S. Aggregate Bond Index. Inception date for the portfolio is December 31, 2009.

Strategy Statistics

	Portfolio	Bench.
Alpha (%)	-0.15	0.00
Beta (%)	0.81	1.00
R-Squared	45.26	100.00
Std. Dev (%)	3.33	2.77

Source: Innealta Capital using data from Bloomberg. Data from 12.30.2009 to 06.30.2018. Bloomberg Barclays US 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 Bloomberg Barclays U.S. Treasury Bellwethers 2 Year TR Index. "Treasury 5yr" refers to Bloomberg Barclays U.S. Treasury Bellwethers 5 Year TR Index. "Treasury 10yr" refers to Bloomberg Barclays U.S. Treasury Bellwethers 10Year TR Index. "Treasury 30yr" refers to Bloomberg Barclays U.S. Treasury Bellwethers 30 Year TR Index. "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 Bloomberg Barclays U.S. Municipal Bond TR Index. "US Invest Grade" refers to **Bloomberg Barclays U.S. Corporate Total Return Index**. "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 Bloomberg Barclays U.S. Agency Index. "EM sovereign" refers to the Bloomberg Barclays EM USD Aggregate Total Return Index. EM High Yield" refers to the Bloomberg Barclays Emerging Market High Yield Total Return Index. "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.

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

Innealta Capital, LLC is an independent registered investment advisor and is the investment advisor for certain mutual funds. AFAM Capital, Inc. is an independent registered investment advisor and is the investment advisor to individually managed client accounts and certain mutual funds. Investing involves risk, principal loss is possible, and there can be no assurance that investment objectives will be achieved. Past performance is no guarantee of future results. Innealta Capital, LLC and AFAM Capital, Inc. only transact business in states where each is properly registered or exempt from registration. Registration of an investment adviser does not imply any certain level of skill or training. Innealta Capital, LLC and AFAM Capital, Inc. are not affiliated.

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