Innealta
CAPITAL

Innealta Capital Global All Asset Strategy
Moderate

February 2018 Commentary and Strategy Review

About the Strategy

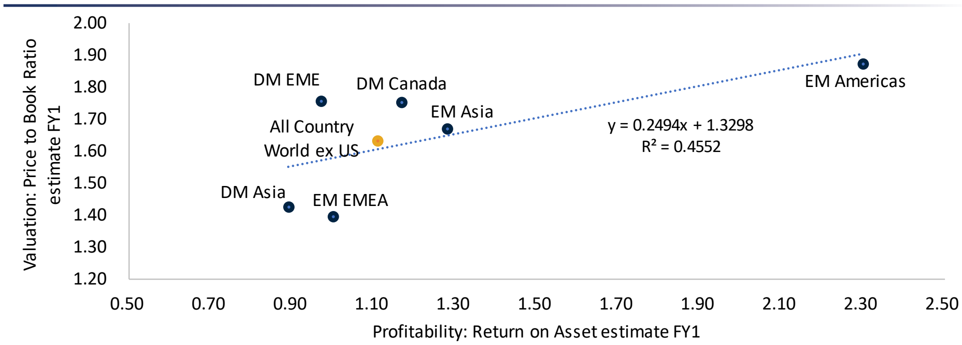
The Global All Asset Strategy ("GAA") provides market exposure across the six major assets -equities, sovereign fixed income, commodities, currencies, credit fixed income, and real estate- via exchange-traded funds. The Innealta Capital investment team creates three different portfolios – Conservative, Moderate, and Growth – that have varying risk levels, based on the GAA framework. The investment team manages each portfolio relative to a unique, balanced benchmark. For example, Innealta's Investment Team manages the Global All Asset Moderate strategy ("GAAM") to a balanced benchmark of 40% Bloomberg Barclays Global Aggregate Bond Index, 24% MSCI All Country World ex U.S. Index, 21% Russell 3000 Index, 9% S&P GSCI Total Return Index, and 6% Dow Jones Global Select Real Estate Securities Index. The benchmark reflects the desired average weight of each asset class 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 across all major asset classes.

Outlook

Despite the increase in financial market volatility during February, we believe the global growth story remains intact. Global manufacturing surveys continue to forecast growth and earnings expectations are increasing across most Developed and Emerging Market countries. For example, the expected growth rate between rolling one-year forward and rolling two-year forward earnings of Emerging Market equity earnings is 11.0% while the same growth rate for Developed Markets ex U.S. equities is 6.8%. Developed Market ex U.S. equity valuations remain high relative to their historic averages while Emerging Market equity valuations appear more attractive relative to their history. Overall, we remain positive on growth-sensitive assets such as equities and commodities and neutral on rate-sensitive assets such as fixed income and real estate. Comparing current expected valuations to current expected measures of profitability – shown below in the "Chart of the Month" – we see that Emerging Market Americas, Emerging Market EMEA (Europe, Middle East, and Africa), and Developed Market Asia appear the most attractive. We believe that over the long-term, equity markets reflect macroeconomic growth and while equity markets and economies continue to show signs of growth, the GAA portfolios will likely continue to overweight equities.

Across fixed income, we are concerned about sovereign debt issued by Developed Market nations and optimistic about high yield corporate debt and alternative fixed income, such as municipals and floating rate securities. Over the medium-term, we expect that tightening U.S. monetary policy and potential monetary policy tightening from the European Central Bank and Bank of Japan will create a headwind for duration-sensitive fixed income sectors. At this point, we believe the majority of Fed rate hikes have been priced into short-term U.S fixed income markets.

Chart of the Month



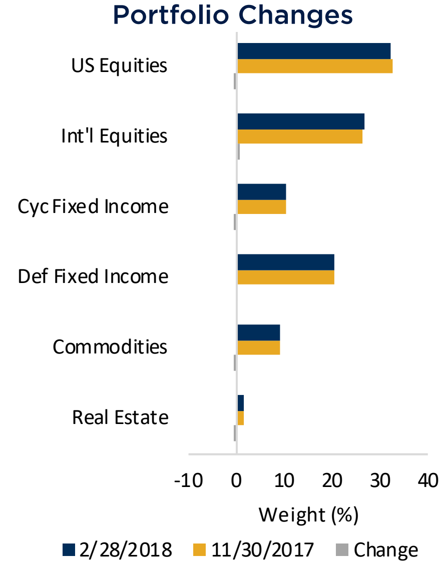
SOURCE: Innealta Capital using Bloomberg data as of 02.28.2018. In the chart above, "Price to Book Ratio" is a ratio used to compare a stock's market value to its book value, calculated by dividing the current closing price of the stock by the latest quarter's book value per share. "Return on assets is a financial ratio that shows the percentage of profit a company earns in relation to its overall resources.

Strategy Statistics

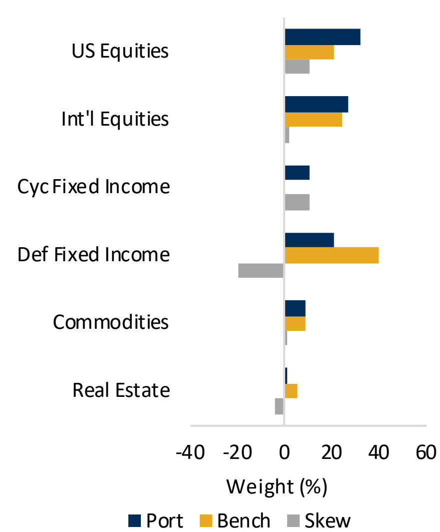
	Port	Benchmark
Alpha	0.89	0.00
Beta	0.98	1.00
R-Squared	0.92	1.00
Std. Dev.	8.96	8.77

SOURCE: Innealta Capital using data from Bloomberg for the Global All Asset - Moderate Portfolio. Data from 12.31.2009 to 02.28.2018. The benchmark is 21% Russell 3000 Index / 24% MSCI ACWI ex US NR Index / 6% Dow Jones Global Select Real Estate Securities NR Index / 9% S&P GSCI Total Return CME / 40% Bloomberg Barclays Global Aggregate Bond NR Index. Inception date for the portfolio is December 31, 2009.

Portfolio Changes



Portfolio Skews



SOURCE: Innealta Capital using data from Innealta Capital as of 02.28.2018

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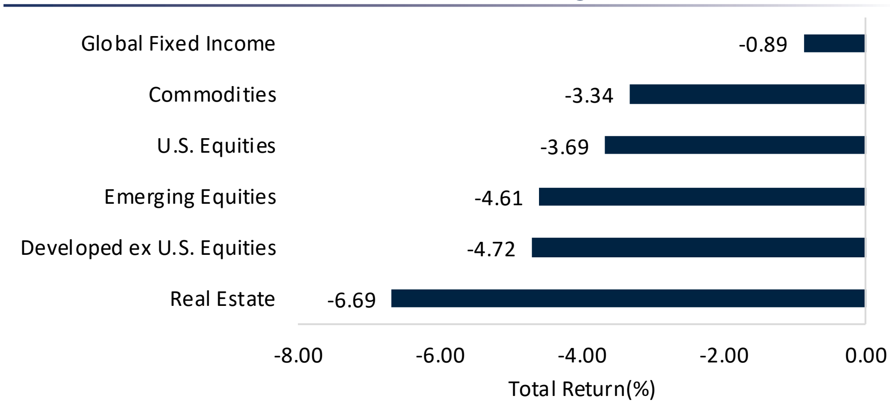
Performance

Broad asset class performance during February was negative as global financial markets experienced an episodic volatility event. The market narrative during February shifted from continued global growth to concerns about rising inflation and liquidity issues in some esoteric U.S. volatility ETFs. The CBOE Volatility Index (“VIX”), shown in Figure 2, closed January at 13.50, reached a peak daily close value of 37.32 on 02/05/18 and closed February at 19.85. Global fixed income, as measured by the Bloomberg Barclays Global Aggregate Bond Index, declined only 0.89% while global real estate, as measured by the Dow Jones Global Real Estate Securities Index, declined 6.69%. Real estate has been an underweight position within the GAA portfolios as the investment team believes the historically high dividend payout ratios of REITs, combined with a likely rise in interest rates, will create pressure on the ability of REITs to deliver attractive dividend yields. Across equity markets, U.S. equities outperformed both Emerging and Developed ex. U.S. equities. We remain convinced that our global reflation thesis – higher global growth and higher interest rates – remains intact. Over the past three months, asset classes and regions perceived to be more likely to benefit from global growth, such as Emerging Market equities and commodities, have outperformed.

During February, the Global All-Asset Moderate portfolio declined 3.40% while its blended benchmark declined 2.98%. The GAAM portfolio benefitted from underweight allocations, relative to the benchmark, in Real Estate and Developed Market ex U.S. equities. The top contributors to the portfolio’s performance were allocations to short duration U.S. high yield debt and mortgage-backed securities while allocations to U.S. equities and Emerging Market equities were the top detractors to the portfolio’s performance. During February 2018, the Global All-Asset portfolios did not experience any significant allocation changes.

FIGURE 1: Benchmark Performance, Trailing 1-Month



SOURCE: Innealta Capital using Bloomberg data from 01.31.2018 to 02.28.2018

FIGURE 2: CBOE VIX Index, Trailing 12-Months

SOURCE: Innealta Capital using Bloomberg data from 02.28.2017 to 02.28.2018

Top Contributors

1. PIMCO 0-5 Year High Yield Corp Bond ETF (HYS)
2. Vanguard Mortgage-Backed Securities ETF (VMBS)

Bottom Contributors

1. Vanguard Total Stock Market ETF (VTI)
2. iShares Core MSCI Emerging Markets ETF (IEMG)

SOURCE: Innealta Capital using Innealta Capital data from 01.31.2018 to 02.28.2018.

Strategy Performance

	Gross	Net	Benchmark
1-Month	-3.40	-3.40	-2.98
3-Month	1.08	0.76	1.47
YTD	-0.35	-0.67	0.10
1-Year	11.91	10.71	11.36
3-Year	5.75	4.53	4.29
5-Year	5.30	4.17	4.30
Inception	7.25	6.16	5.36

SOURCE: Innealta Capital using data from Bloomberg for the Global All Asset - Moderate Portfolio. Data from 12.31.2009 to 02.28.2018. The benchmark is 21% Russell 3000 Index / 24% MSCI ACWI ex US NR Index / 6% Dow Jones Global Select Real Estate Securities NR Index / 9% S&P GSCI Total Return CME / 40% Bloomberg Barclays Global Aggregate Bond NR 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 a blended benchmark: 21% Russell 3000 Index, 24% MSCI ACWI ex US NR Index, 6% Dow Jones Global Select Real Estate Securities NR Index, 9% S&P GSCI CME Index, 40% Bloomberg Barclays Global Aggregate Bond NR Index. ***The Russell 3000 Index*** *measures the performance of the largest 3,000 U.S. companies.* ***The MSCI All Country World Index ex US NR*** *captures large- and mid-cap representation across 22 of 23 developed markets countries-excluding the United States.* ***The Dow Jones Global Select Real Estate Securities NR Index*** *represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded globally.* ***The S&P GSCI CME Index*** *is a measure of general commodity price movements and inflation in the world economy. Index is calculated primarily on a world-production-weighted basis comprised of the principal physical commodities futures contracts.* ***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. 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.* ***The MSCI World ex USA Index*** *is a free-float weighted equity index that captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries - excluding the United States.* ***The MSCI Emerging Markets Index*** *captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 846 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.*

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

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