Innealta Capital Global All Asset Strategy

Moderate

March 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

Starting in March, financial markets experienced their first challenge to the prevailing market expectation that above-average and improving macroeconomic growth was a guarantee. In late February, U.S. President Donald Trump hinted at issuing tariffs on imported aluminum and steel (10% and 25%, respectively). Retaliation threats were issued by China and the European Union. The order that put them into effect was signed on March 8th, with an important caveat: many countries were, at least temporarily, exempted (e.g., Canada, Mexico, Brazil, and the entire EU), with the notable exception of China. Then on March 22nd, President Trump announced tariffs across a broad spectrum of Chinese goods, asking that China reduce its annual trade deficit with the U.S. by $100 billion. At first, it was only known that imports worth $60 billion would be taxed, and the list of specific goods was not released until more than a week later. In the meantime, stocks of likely targets for retaliation lost significant value (e.g., Boeing). As a tax on either imports, or exports, or both, tariffs are likely to decrease actual and expected macroeconomic growth. Moreover, the rhetoric on both sides has unleashed fears of a prolonged trade war.

During March, the multiple announcements of tariffs from the U.S. and other countries created a drag on risky markets, and increased overall levels of market volatility, both implied and realized. During March, the S&P 500 declined 2.69%, while the CBOE VIX index rose from 19.85 to 19.97. The VIX however remains above its 2017 average level of 11.09. The most significant potential global trade strain would be between the United States and China. Estimating the global impact of a trade war with China and other countries is beyond the scope of this paper. What is clear is that a trade war between the US and its top trading partners – China, Canada, and Mexico – could impact over 60% of U.S. trade, which accounted for 27% of the U.S. Gross Domestic Product in 2016 (World Bank). From a Chinese perspective, exports to the U.S. represent 20% of their exports, but the surplus with the U.S. – estimated to be $375 billion by the Commerce Department – accounts for 65% of their overall trade surplus. Chinese trade represented 37% of China's Gross Domestic Product in 2016 (World Bank).

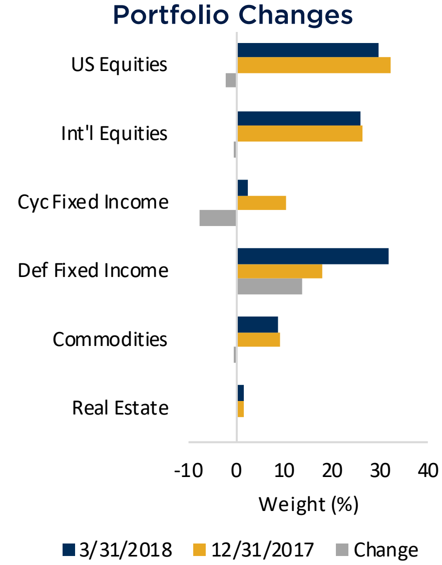
In the current environment, we anticipate headline risk (i.e. new announcements) around trade to dominate the market's focus. During April we expect that various macroeconomic surveys and behavioral data will provide more insight on whether macroeconomic growth will decline, or the market will revert to previous sustained growth expectations. Between now and then, we expect elevated market volatility to persist and, as such, are positioning our portfolios in a more defensive posture.

Strategy Statistics

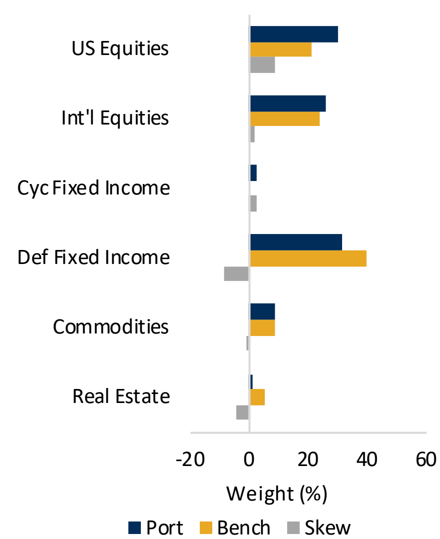
	Port	Benchmark
Alpha (%)	0.94	0.0
Beta (%)	0.98	1.0
R-Squared (%)	91.8	100.0
Std.Dev (%)	8.91	8.73

SOURCE: Innealta Capital using data from Bloomberg for the Global All Asset - Moderate Portfolio. Data from 12.31.2009 to 03.31.2018. 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 03.31.2018

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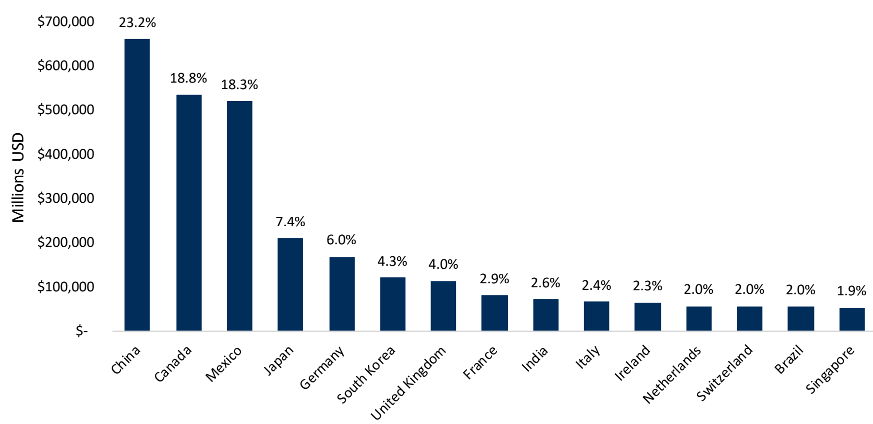
Performance

Broad asset class performance during March was mixed as equity markets, regardless of geography, depreciated while real estate, commodities, and global fixed income appreciated. Concerns about an expanding trade war impacted growth sensitive assets such as equities. Commodity markets, particularly oil, appreciated during the month as inventories continue to decline relative to demand.

During March, the Innealta Capital Global All-Asset Moderate portfolio returned 39 bps and 38 bps gross of fees and net of fees respectively while its blended benchmark returned -8 bps. The portfolio benefitted from overweight, relative to the benchmark, allocations in International equities and US equities. The top contributors to the portfolio's performance were allocations to commodities and small-capitalization U.S. equities.

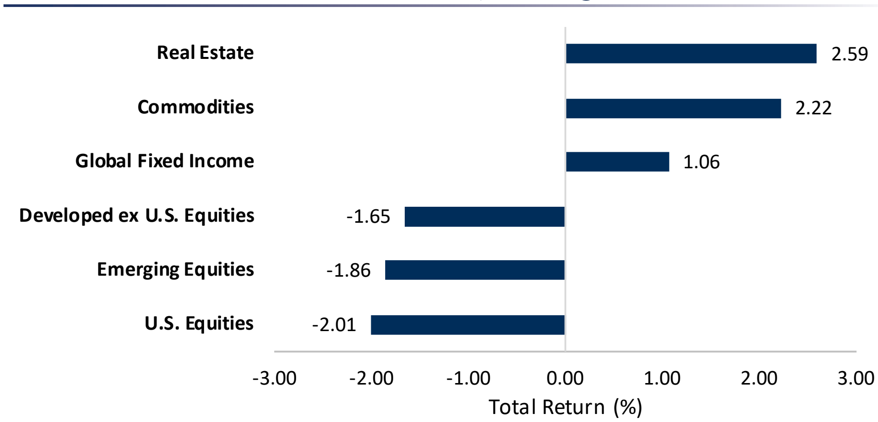
During March, the Investment Committee ("IC") rebalanced all the Global All Asset portfolios to reflect changing market conditions. Overall the IC elected to increase defensive fixed income allocations, decrease U.S. equity allocations and decrease cyclical fixed income allocations. The changes reflect the IC's view that financial market volatility will likely be higher in the current year relative to the past year. The IC expects that macroeconomic growth will remain positive, inflation muted, fiscal policies supportive, and monetary policy to be less accommodative. A more detailed note can be found here.

FIGURE 1: Top U.S. Trading Partners



SOURCE: Innealta Capital using data from Bloomberg as of 12.31.2017.

FIGURE 2: Benchmark Performance, Trailing 12-Months



SOURCE: Innealta Capital using Bloomberg data from 02.28.2018 to 03.31.2018

Top Contributors

1. PowerShares DB Optimum Yld Commodity (PDBC)
2. iShares Core S&P Small-Cap ETF (IJR)

Bottom Contributors

1. Vanguard Total Stock Market ETF (VTI)
2. Financials Select Sector SPDR ETF (XLF)

SOURCE: Innealta Capital using Innealta Capital data from 02.28.2018 to 03.31.2018.

Strategy Performance

	Gross	Net	Benchmark
1-Month	0.39	0.38	-0.08
3-Month	0.05	-0.29	0.01
YTD	0.05	-0.29	0.01
1-Year	11.72	10.51	10.99
3-Year	6.13	4.90	4.82
5-Year	5.14	4.00	4.07
Inception	7.22	6.15	5.30

SOURCE: Innealta Capital using data from Bloomberg for the Global All Asset - Moderate Portfolio. Data from 12.31.2009 to 03.31.2018. 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.*

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.*

*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.

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019-INN-4/30/2018