Genesis Wealth Advisors

A Wealth of Possibilities

Quarterly Update

April 2017

Key Takeaways

- ***Suppressed financial and economic volatility continues to drive financial asset prices higher***
- ***Hard economic and fundamental data remain disconnected from soft data (e.g., sentiment)***
- ***The bloom is off the rose for the Trump reflation trade as the timing and scope of fiscal change remains in question***

Overview

- First quarter 2017 market results for riskier assets moved higher as volatility, along with growth and inflation, remained at low levels.
- High beta and growth outpaced value and low volatility equities during the quarter as investors continued to reach for return.
- Bonds finished the quarter slightly higher, albeit with higher volatility. Bond yields moved above the 2.60% threshold only to fall back to levels near 2.30% on the absence of inflation.
- The lack of price trends in many non-correlated asset strategies continued to negatively impact liquid alternative strategies with a trend following focus (e.g., systematic managed futures).

Areas of Opportunity & Concern

- Despite hopes of market-friendly fiscal measures, such as tax and regulatory reform, our near term outlook for stocks and bonds remains cautious. Valuations are rich at a time when retail flows are pouring into ETFs on borrowed money and insider selling outnumbers buying.[1]
- Eight years into a sluggish recovery, the economy still lacks a catalyst to push growth rates back to the long-term averages. Assets should be positioned to weather both a pickup in volatility and the higher odds of an unexpected event.
- The risk premium for equities remains positive, but continues to contract, which suggests a neutral or slight over weight position relative to bonds.
- We believe we are at a stage in the market and business cycle where assets need to be diversified by common factors across asset classes, while a portion of portfolios should be hedged to protect for increasing risks to the downside.

[1] *Source: Wall Street Journal*

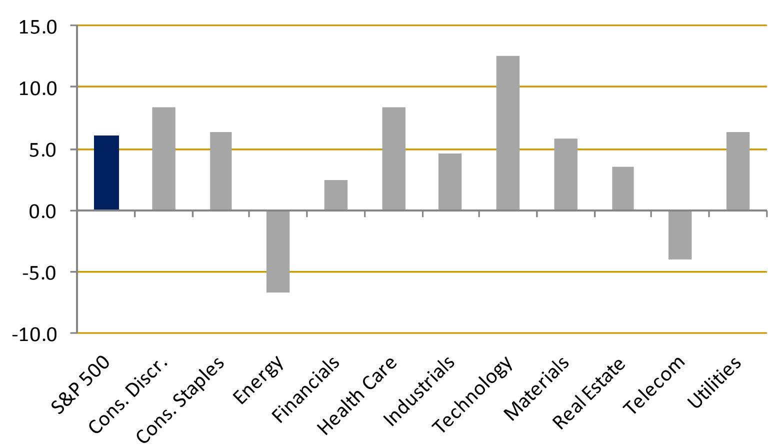
Key Market & Economic Indicators

Bullish | Favorable | Neutral | Cautious | Bearish

Equities	March 2017	Trailing 3 Months	Trailing 1 Year	Current View
U.S. Large & Mid Cap	0.12%	6.07%	17.17%	Neutral
U.S. Small Cap	0.13%	2.47%	26.22%	Cautious
International	2.75%	7.25%	11.67%	Cautious
Emerging Markets	2.52%	11.45%	17.22%	Cautious
Fixed Income				
U.S. Aggregate	-0.05%	0.82%	0.44%	Neutral
U.S. Government	-0.04%	0.68%	-1.34%	Cautious
U.S. Corporate	-0.15%	1.30%	2.96%	Favorable
U.S. High Yield	-0.22%	2.70%	16.39%	Neutral
Non-U.S. Developed	0.12%	1.72%	-4.97%	Cautious
Emg Market Debt	2.14%	6.41%	5.59%	Bearish
Alternatives				
REITs	-2.29%	1.16%	3.56%	Neutral
Commodities	-3.91%	-5.05%	8.45%	Bearish
Managed Futures	-1.45%	-3.63%	-4.21%	Cautious
Hedge Fund	0.03%	1.66%	6.19%	Favorable

Source: Morningstar *Data as of 03/31/2017*

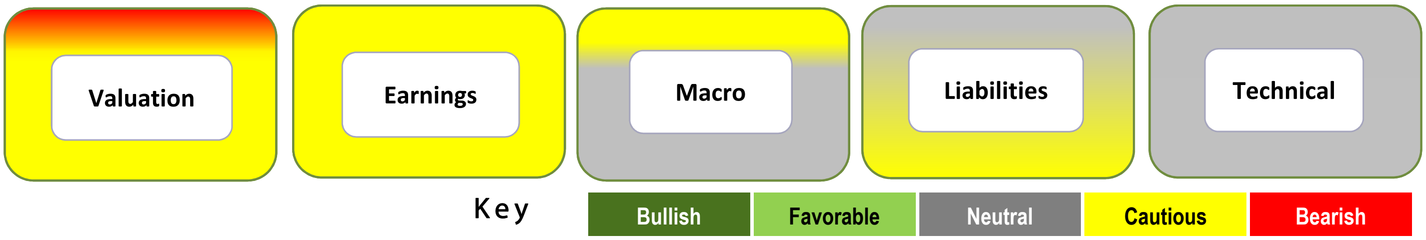
S&P 500 Sector Returns (%)
First Quarter 2017



Source: Morningstar

Risk Examination

A quarterly update on our views of the complex risk factors in global markets



Valuation

- Equity valuations appear rich and may continue to be for the immediate future as interest rates remain low and inflation dormant. A contrarian valuation approach needs to be balanced with risk exposures to other areas of the market, such as lower volatility and high quality. Valuations are more attractive in select Asian markets and Europe. Bond valuations remain rich with the aggregate bond index duration at its upper historical range.

Earnings

- Post 2008, corporate earnings have contributed a much smaller percentage to stock returns relative to P/E multiple expansion. Top line price-to-sales remains flat for the U.S. equity market with only select sectors showing year-over-year earnings growth with positive momentum.
- In our view, we believe price-to-sales, price-to-operating cash flow, and net profit margins are better indicators of investment success rather price-to-earnings, which can be massaged and masked by accruals, buybacks, and other accounting gimmicks.

Macroeconomic

- With real economic growth still below 3.0%, and inflation below or near the Fed's target of 2.0%, coupled with high debt and low productivity levels, we feel the biggest risk on the monetary front is that the Fed raises rates too quickly and too high.
- The lack of a specific fiscal plan to stimulate economic growth, combined with unfavorable demographics and a wider economic divide, suggests that economic uncertainty will remain high.

Liabilities

- Public and private debt continues to move higher, with the debt levels higher in the government, corporate, and household sectors.[2] This, along with an aging population, and underfunded pension liabilities at all levels, poses a constraint to economic growth.
- Rapid growth in the financial markets has benefited the top 10% but not the bottom 90%. Debt growth in the bottom 90% has mushroomed in the auto and student loan sectors while real wage growth continues to be flat.

Technical

- Record retail flows into ETFs continues.
- Stock margin debt levels are elevated and growing.
- On the corporate side, insider selling continues to outpace buying by a high margin.

[2] *Source: dshort.com*

2017 Scenarios

Our assessment of potential macro scenarios

	Black Swan	**Ordinary Correction**	**Slow and Choppy**	**Upside Surprise**
Economy / Geopolitical	▪N. Korea / China conflict leads to military intervention ▪Syria / Russia crisis ▪Terrorist Cyber attack ▪Populist Party victory	▪Valuation contraction ▪Economic recession ▪Central bank policy error ▪Trade tariffs and isolation	▪Continued slow slog ▪Below trend real economic growth ▪Low inflation ▪Slow / Mixed fiscal response	▪Productivity gains ▪Earnings & growth increases ▪Political harmony & effective fiscal response
Markets	▪Sharp sell off across risk assets ▪Elevated correlations suggest minimal diversification benefit	▪Equities decline between 10-20% (risk off) ▪Higher quality bonds gain modestly	▪Equity markets choppy but plod higher (high volatility) ▪Interest rates only modestly higher	▪Stocks & all risk assets head higher ▪Bond returns challenged by higher rates
Focus	▪Flight to quality: U.S. Treasuries, U.S. Dollar benefit, Bitcoin & Gold benefit	▪Bonds outperform stocks ▪Diversified factor equity exposure with defensive tilt	▪Faster growth economies and segments, with attractive valuations	▪Fully invested, but highly diversified
Prospects	< 10%	35%	40%	15%

< < < **Downside** < < < | > > > **Upside** > > >

Risks

- Diverging central bank policies; mishandled rate normalization; Greek default / Euro collapse, Brexit
- Populist movement, growing inequality, and trade wars
- Recession or sharp global slowdown
- High geopolitical risk leads to major conflict

- Central banks thread policy needle
- Confidence builds, corporate investment resumes
- Economic and productivity growth rise above 3.0%
- Swift and comprehensive fiscal action

Asset Class Positioning

<table>
<tr><th>PORTFOLIO SEGMENT / SEGMENT OBJECTIVE</th><th>SEGMENT CONSTITUENTS</th><th>SEGMENT COMMENTS</th></tr>
<tr><td>Equity
Low-Cost, Systematic, and Factor Exposure</td><td>▪ Global Systematic Equity
▪ Diversified factor exposure with emphasis on quality, value & larger size</td><td>▪ Favor higher quality equities
▪ Favor higher growth regions and sectors with attractive valuations
▪ Longer term, market driven by value, but in shorter-term growth and momentum can dominate</td></tr>
<tr><td>Fixed Income
Seeks to Preserve Capital and Generate Income</td><td>▪ Active, Multi-Sector Fixed Income
▪ Actively-managed Mortgage Backed Securities
▪ Intermediate High Quality Credit
▪ Senior Bank Loans
▪ Shorter duration high yield</td><td>▪ Favor intermediate duration or less
▪ Favor quality credit over rates
▪ Selective, short duration high yield
▪ Issuer selection critical</td></tr>
<tr><td>Opportunistic
Reflecting Ideas Based on 12-24 Month Proprietary Forecasts</td><td>▪ Active Beta Emerging Mkt Equity
▪ Global Real Estate
▪ Global Technology – Active
▪ U.S. Consumer Discretionary
▪ U.S. Materials</td><td>▪ Reflects shorter term model (value and momentum)
▪ Sectors and themes have growth potential and attractive valuations relative to broad market
▪ Seeking participation in select segments without undue risk expansion</td></tr>
<tr><td>Alternative
Anticipated Risk Mitigation with Alpha Opportunities</td><td>▪ Global Macro
▪ Hedged Equity
▪ Long/Short Credit
▪ Managed Futures
▪ Merger Arbitrage</td><td>▪ Given elevated risks to traditional, long-only exposures, favor significant allocations to non-correlated alternative strategies
▪ Favor transparency, low cost, and daily liquidity
▪ Favor global macro, long/short credit, and managed futures strategies for low correlation and diversification potential
▪ Favor hedged equity for volatility targeting</td></tr>
</table>

All investments are subject to risk, including the loss of principal. For additional information, please refer to the Disclosures at the end of this report.

Important Disclosures

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Genesis and Palladiem have discretion to change allocations to styles and vehicles at any time.

Index definitions:

“U.S. Large Cap” represented by the S&P 500 Index.
“U.S. Small Cap” represented by the Russell 2000 Index.
“International” represented by the MSCI Europe, Australasia, Far East (EAFE) Net Return Index.
“Emerging” represented by the MSCI Emerging Markets Net Return Index.
“U.S. Aggregate” represented by the Barclays U.S. Aggregate Bond Index.
“U.S. Government” represented by the Barclays U.S. Government Bond Index.
“U.S. Corporate” represented by the Barclays U.S. Credit Bond Index.
“U.S. High Yield” represented by the Barclays U.S. Corporate High Yield Index.
“Non-U.S. Developed” represented by the S&P International Treasury ex U.S. Index.
“Emg Market Debt” represented by the JP Morgan GBI-EM Global Core Index
“REITs” represented by the FTSE North American Real Estate Investment Trust (REIT) Equity REITs Index.
“Commodities” represented by the S&P Goldman Sachs Commodities Index (GSCI).
“Managed Futures” represented by the Credit Suisse Managed Futures Index.
“Global Macro” represented by the Credit Suisse Global Macro Index

Direct investment in an index is not possible.

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