Genesis Wealth Advisors

A Wealth of Possibilities

Quarterly Update October 2017

Key Takeaways

- ***Continued strong market returns with improved earnings and economic growth; sustainability remains a question***
- ***Limited progress thus far on potential acceleration catalysts (health care, tax reform, and infrastructure)***
- ***The world remains a dangerous place; the Fed remains committed to rate hikes – risks abound***

Overview

- Market results for Q3-2017 powered forward again, with developed non-U.S. equities and U.S. equities rising, and emerging markets outpacing both.
- Growth again outstripped value handily in the U.S. during the quarter, while overseas equities were again led by Europe and Asia ex-Japan.
- Commodities rebounded for the quarter but are still slightly negative year-to-date; the U.S. dollar weakened further and has given up all of its post-election appreciation.
- Strategies that are designed to hedge, or be lower-correlated to, traditional investments continued to post modest returns, as low levels of volatility persisted; returns have been slightly better than investment grade bonds, albeit with slightly higher volatility.

Areas of Opportunity & Concern

- While volatility had largely been absent from markets, it has been prevalent in political and geopolitical spheres: North Korea, health care, and now tax reform.
- Valuations are stretched, but not to extreme levels, and earnings have recovered from a negative run over multiple quarters. The sustainability of earnings growth, requiring rising revenues and at least maintained profit margins, is an open question.
- We believe opportunities exist overseas in both developed and emerging markets that have attractive valuations and perhaps better near-term growth prospects. Therefore, we have moved to a more balanced domestic/international posture.
- We have implemented exposures in some portfolios to a “basket of innovation” seeking to capture some of those opportunities.
- We believe the unnatural calm many markets have experienced recently will change, perhaps suddenly. Investors should be prepared by structuring diversified portfolios with tail risk protection.

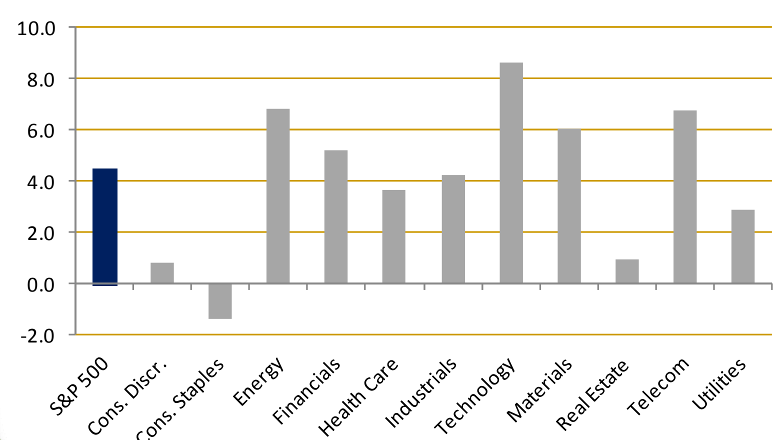
Key Market & Economic Indicators

Bullish	Favorable	Neutral	Cautious	Bearish

Equities	Sep 2017	Trailing 3 Months	Trailing 1 Year	Current View
U.S. Large & Mid Cap	2.06%	4.48%	18.61%	Cautious
U.S. Small Cap	6.24%	5.67%	20.74%	Cautious
International	2.49%	5.40%	19.10%	Neutral
Emerging Markets	-0.40%	7.89%	22.46%	Neutral
Fixed Income				
U.S. Aggregate	-0.48%	0.85%	0.07%	Neutral
U.S. Government	-0.84%	0.38%	-1.56%	Cautious
U.S. Corporate	-0.22%	1.35%	1.96%	Favorable
U.S. High Yield	0.90%	1.98%	8.88%	Neutral
Non-U.S. Developed	-1.31%	3.05%	-1.20%	Cautious
Emg Market Debt	-0.28%	3.29%	7.18%	Bearish
Alternatives				
REITs	-0.03%	0.94%	0.67%	Neutral
Commodities	0.66%	4.90%	2.95%	Bearish
Managed Futures	-2.89%	1.83%	-5.28%	Cautious
Hedge Fund	0.60%	1.83%	5.63%	Favorable

Source: Morningstar *Data as of 09/30/2017*

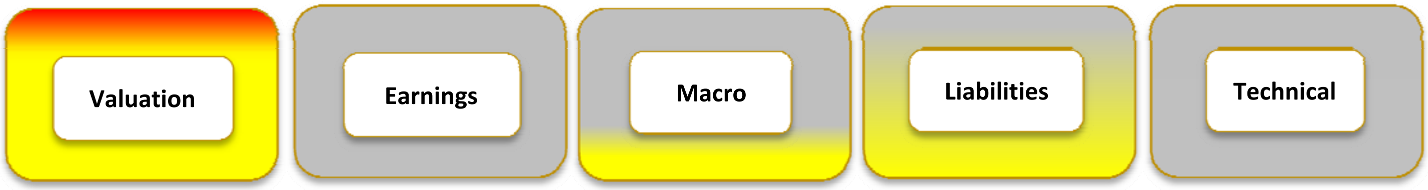
S&P 500 Sector Returns (%)
Third Quarter 2017



Source: Morningstar

Risk Examination

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



Key: Bullish | Favorable | Neutral | Cautious | Bearish

Valuation

- Equity valuations by most measures are rich, especially in the U.S., although they have not approached the extreme levels of 2000. We continue to incrementally shift portfolio exposures overseas to capitalize on lower valuations in select Asian markets and Europe. Bond valuations are arguably more elevated than equities, and investors should carefully evaluate their duration and credit exposures.

Earnings

- Earnings have rebounded and bottom-up estimates expect continued moderate growth in revenues and earnings. What company-focused analysts often miss, however, are the macro driven changes that impact sectors or economies broadly, like recessions and interest rate hikes.
- Looking ahead for the next 12 months or so, consensus expectations are for high single digit earnings growth on the back of roughly 5% revenue growth.

Macroeconomic

- Market expectations for another Fed rate hike in December have risen. A number of market observers and participants are puzzled by the Fed's apparent intent to continue to hike interest rates, despite only modestly accelerating economic growth and quiescent inflation.
- Despite the devastation wrought by three major hurricanes making landfall on U.S. territory, rebuilding efforts should provide a positive impetus to growth measures in coming quarters.

Liabilities

- Global debt levels are higher than ever and rising. Consumer balance sheets did improve due to improved asset levels (housing and equity markets), but rapidly growing auto and student loans are rising to concerning levels, and a recession will squeeze consumers further.
- Corporate balance sheets are largely in decent shape, but debt-to-equity ratios have risen as corporate management has taken advantage of low interest rates. Governments remain the worst balance sheet offender, as they struggle to cope with vastly overpromised benefits and woefully underfunded retirement and health care programs.

Technical

- Record retail flows into passive ETFs and index funds continue. While historical performance appears to favor passive approaches over traditional active security selection, corrections may be sharper and more sudden with fewer active buyers to step in.
- Stock margin debt levels are elevated and growing, while volatility measures are near all-time lows. Mean reversion may be swift and painful.

2017 Scenarios

Our assessment of potential macro scenarios

	Black Swan	Ordinary Correction	Slow and Choppy	Upside Surprise
Economy / Geopolitical	▪N. Korea or Iran conflict leads to military intervention ▪Syria / Russia crisis ▪Terrorist/ cyber attack	▪Valuation contraction ▪Economic recession ▪Central bank policy error ▪Trade policy error	▪Continued slow slog ▪Below trend real economic growth ▪Low inflation ▪Limited or no fiscal response	▪Productivity gains ▪Earnings & growth increases ▪Political cooperation on tax cuts, infrastructure
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 ▪Interest rates only modestly higher	▪Stocks & most risk assets head higher ▪Bond returns challenged by higher rates
Focus	▪Flight to quality: U.S. Treasuries, U.S. Dollar, 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	< 15%	35%	40%	10%

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

Risks

Downside:
- Diverging central bank policies; mishandled rate normalization; Spain split with Catalan
- Terrorism, income inequality, and trade wars
- Recession or sharp global slowdown
- High geopolitical risk leads to major conflict

Upside:
- 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

PORTFOLIO SEGMENT / SEGMENT OBJECTIVE	SEGMENT CONSTITUENTS	SEGMENT COMMENTS
Equity *Low-Cost, Systematic, and Factor Exposure*	▪ Global Systematic Equity ▪ Diversified factor exposure with emphasis on multi-factor and a slight tilt toward quality	▪ 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
Fixed Income *Seeks to Preserve Capital and Generate Income*	▪ Broad, Core Plus Exposure ▪ Active, Multi-Sector Fixed Income ▪ Actively-managed Mortgage Backed Securities ▪ Intermediate High Quality Credit ▪ Shorter duration high yield	▪ Favor intermediate duration or less ▪ Favor quality credit over rates ▪ Selective, short duration high yield ▪ Issuer selection critical
Opportunistic *Reflecting Ideas Based on 12-24 Month Proprietary Forecasts*	▪ Active Beta Emerging Mkt Equity ▪ Regional Developed Mkt non-U.S. Equity ▪ Global Technology ▪ Basket of Innovation	▪ Reflects shorter term model (value and momentum) ▪ Sectors and themes have growth potential and attractive valuations relative to broad market ▪ Seeking participation in select themes with attractive return potential
Alternative *Anticipated Risk Mitigation with Alpha Opportunities*	▪ Global Macro ▪ Hedged Equity ▪ Long/Short Credit ▪ Managed Futures ▪ Merger Arbitrage	▪ Given elevated risks to traditional, long-only exposures, favor moderate allocations to non-correlated alternative strategies ▪ Favor transparency, low cost, and daily liquidity ▪ Favor global macro, long/short equity, and managed futures strategies for lower correlation and diversification potential ▪ Favor hedged equity for volatility targeting

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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