Quarterly Update July 2018

Technology Drives the Market – But it's not 2000 All Over Again

- ***Four of the largest traded technology stocks on the market accounted for 86% of the overall market return this year***
- ***Amazon has contributed nearly 36% of the S&P 500's total return this year (Amazon is up 45% YTD)***
- ***The concentrated effect is reminiscent of the peak of the tech bubble of 2000, with difference being today's leaders are profitable***

Overview

- Domestic markets moved higher during the quarter with strong results in the energy, technology and small cap sectors.
- US equity market performance continued to be dominated by four technology stocks: Amazon, Microsoft, Apple and Netflix.
- Growth stocks continued their strong dominance over value stocks during the quarter, extending the performance gap to record levels.
- Non-US equity markets continued to sell off during the quarter impacted by lower than expected economic results and capital flows out of the emerging markets.
- Bonds held steady during the quarter despite talk of higher interest rates and concerns of deteriorating quality of credit outstanding.
- Alternative investments were mixed during the quarter with the lead results in the multi-strategy and global macro strategy areas. Long /short managed futures and commodity strategies continued to be laggards.

Areas of Opportunity & Concern

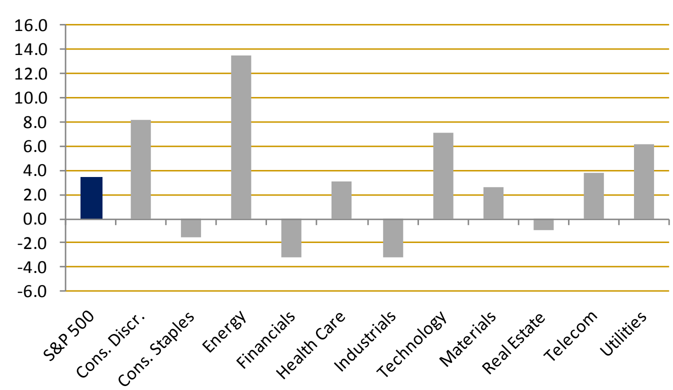
- We do believe there are several opportunities still available for long term investors where fundamentals remain attractive and where there has been neglect (out of favor). Some of these areas include value equity, emerging market equities, shorter term high quality bonds and real estate.
- Despite high valuations in the technology sector, the growth and level of fixed investment in this area are long term positives. We continue to advocate more directed investment in leading innovative technologies across several economic sectors (innovation theme).
- The biggest risk to our forecasts are: a fiscal and/or monetary miss-step, fall-out from trade tariffs and run away global debt growth.

Key Market & Economic Indicators

Bullish | Favorable | Neutral | Cautious | Bearish

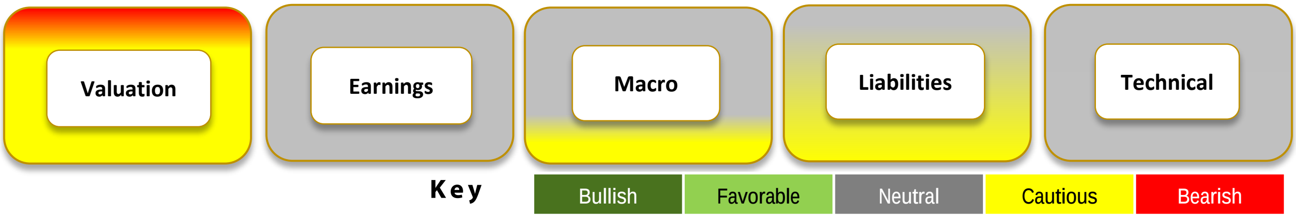
Equities	June 2018	Trailing 3 Months	Trailing 1 Year	Current View
U.S. Large & Mid Cap	0.62%	3.43%	14.37%	Cautious
U.S. Small Cap	0.72%	7.75%	17.57%	Cautious
International	-1.22%	-1.24%	6.84%	Neutral
Emerging Markets	-4.15%	-7.96%	8.20%	Neutral
Fixed Income				
U.S. Aggregate	-0.12%	-0.16%	-0.40%	Neutral
U.S. Government	0.02%	0.10%	-0.63%	Cautious
U.S. Corporate	-0.47%	-0.88%	-0.65%	Favorable
U.S. High Yield	0.40%	1.03%	2.62%	Neutral
Non-U.S. Developed	-0.30%	-4.55%	3.44%	Cautious
Emg Market Debt	-3.08%	-10.89%	-3.61%	Bearish
Alternatives				
REITs	4.36%	10.04%	3.50%	Neutral
Commodities	-3.01%	1.06%	12.29%	Bearish
Managed Futures	1.23%	-2.93%	-3.12%	Cautious
Hedge Fund	-0.19%	0.16%	2.47%	Favorable

S&P 500 Sector Returns (%)
Second Quarter 2018



Risk Examination

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



Valuation

- We continue to believe equities and long-dated bonds are over valued, more so with equities.
- Our view on equity valuation is based on actual and expected revenue growth and not exclusively earnings growth.
- Short term Treasury Bills and Note yields now surpass the yield on the stock market, also a signal that could trigger a reversal by risk averse investors out of equities into cash or cash equivalents.

Earnings

- We continue to believe earnings forecasts are over-optimistic due to the strong momentum bias built into consensus forecasts and that now there is higher likelihood of earnings disappointment as we move into the third quarter.
- We place more importance on actual revenues and forecasted revenue growth rather than earnings growth, that can be measured several ways all of which can disguise true profitability measures.

Macroeconomic

- The consensus view is that the odds of the next US economic recession will arrive during 2020.
- Based on the current path of real economic output, productivity and the behavior of the yield curve we are at odds with consensus and believe that recession risk could arrive much sooner than 2020.
- Interest rate risk and inflation risk should remain tame unless central banks make the policy mistake of raising rates to quickly and too far.

Liabilities

- We believe the household sector cannot sustain its current rate of consumption due to stagnant wage growth, lower rates of savings and higher levels of indebtedness.
- Debt growth in the corporate sector has mushroomed over the last several years due to the low cost of capital. Higher rates and an economic slowdown could result in higher rates of credit default.
- Debt growth in the public sector has accelerated with no offset to pay for that growth. Infrastructure is still broken and real economic growth still remains below the long term average.

Technical

- Just recently investors have become more risk averse evidenced by the recent sell off in equities and increase in market volatility.
- Higher correlations and record low dispersion continues to make it difficult for actively managed investment strategies. The record flow into passive and/or systematically managed low cost ETFs has also created the potential for a liquidity crisis down the road when market sentiment does shift toward the bearish side.

2018 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 ▪Populist movement accelerates ▪Major 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 and 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 and most risk assets head higher ▪Bond returns challenged by higher rates
Focus	▪Flight to quality: U.S. Treasuries, U.S. Dollar, Crypto Currencies & 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%**	**40%**	**35%**	**10%**

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

Risks

Downside:
- Diverging central bank policies; mishandled rate normalization; Social inequality leads to social unrest
- Lone wolf terrorism, cyber hacks, 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 Beta exposure; both market cap and factor weighted ▪ 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 and have dominated
Fixed Income *Seeks to Preserve Capital and Generate Income*	▪ Broad, Core Plus Exposure ▪ Active, Multi-Sector Fixed Income ▪ Actively-managed Mortgage Backed Securities ▪ Short-to-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 ▪ BBB segment is crowded
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 Palladiem's 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 (especially equities), favor moderate allocations to non-correlated alternative strategies ▪ Favor transparency, low cost, and daily liquidity ▪ Favor global macro, long/short equity, and long/short credit strategies for lower correlation and diversification potential (look to de-risk long equity exposure)

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

Important Disclosures

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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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