

QUARTERLY HIGHLIGHTS

- *The Defensive Endowment Model Strategy rose nicely for the quarter, a period marked by strong returns for equities and more modest returns for most bonds and alternative strategies*
- *The strategy model slightly lagged its benchmark, a weighted average combination of the Barclays Aggregate Bond, MSCI ACWI, and HFRX Global Hedge Fund indices, primarily due to its overweight to U.S. equities and its short duration bond allocations*
- *Backed by strong market conditions, all strategy model allocations were in positive territory, but alternative and fixed income allocations were lesser contributors*

MARKET CONTEXT | OUTLOOK

Market results for Q2-2017 were once again strong, with non-U.S. equities and emerging markets outpacing U.S. equities, while bonds moved higher led by credit and high yield. Growth outpaced value handily in the U.S. during the quarter, and overseas equities were led by Europe and Asia ex-Japan. Commodities continued to struggle and declined for the quarter; the U.S. dollar weakened further and has given up all of its post-election appreciation. Hedging and lower correlation strategies continued to post modest returns, as a lack of trends and low levels of volatility persisted through much of the quarter, although technology-related stocks ended the quarter with some volatility pickup.

The Trump administration continues to struggle to find its sea legs, whether looking at the pace of executive branch appointments, the advance of significant legislation, or the ability to stay on message. Meanwhile, the Republican controlled Congress drifts rather aimlessly. Valuations are stretched, but not to extreme levels, and earnings have recovered from a multi-quarter negative run. We believe opportunities exist overseas in both developed and emerging markets that have attractive valuations and perhaps better near-term growth prospects. We believe the unnatural calm many markets have experienced recently will be succeeded by more customary levels of volatility. Investors should be prepared by structuring diversified portfolios with an eye toward significant risks that may manifest suddenly.

STRATEGY KEY CONTRIBUTORS | DETRACTORS

- The systematic equity and quality factor allocations, as well as a global macro strategy and total bond market allocations, were the main catalysts of positive performance during the quarter.
- The alternative and fixed income allocations, while still positive, were smaller contributors.
- The strategy is actively managed with a long-term perspective, so it is reasonable to expect there will be periods when the strategy's results differ from the benchmark in pursuit of objectives over time. Given the defensive nature of its objectives, we have sought to position the portfolio conservatively. Before fees, the strategy model has modestly lagged its weighted average benchmark since inception, albeit with lower risk.

PORTFOLIO CHANGES

- Equity valuations by most measures are rich, especially in the U.S., although they have not approached the extreme levels of 2000. Interest rates and inflation remain at low levels despite central banks' efforts to raise them.
- Earnings have rebounded, led largely by energy companies. In the eighth year of a mediocre economic expansion, and after years of corporate expense management, share buybacks and other manipulations, the question becomes: how sustainable is the earnings picture?
- A number of market observers and participants are puzzled by the Fed's apparent intent to continue to hike interest rates, despite lackluster economic growth and quiescent inflation.
- We remain comfortable with the portfolio's positioning, and therefore made no changes during the quarter.

Strategy Summary

The Defensive Endowment Model Strategy, on a long-term basis, seeks:

- To balance capital preservation with long-term growth and low-moderate volatility
- Moderate beta relative to global equities (~ 0.4)
- Superior risk-adjusted return: (Sharpe ratio > 1.0)
- To diversify the portfolio's long-only equity and other sources of risk
- Exposure to different sources of return than just traditional stocks and bonds

The Defensive Endowment Model Strategy is:

- Actively managed by an experienced team of investment professionals, with daily liquidity
- Implemented at lower cost than many multi-asset class portfolios
- Invested in ETFs and mutual funds focused on multiple asset classes, including alternative strategies
- Typically appropriate as a conservative investor's total portfolio, with at least a short-to-intermediate investment time horizon, and a low-to-moderate tolerance for risk.

ABOUT OUR FIRM

Palladium LLC is an independent, employee owned asset management firm that manages global, multi-asset class investment strategies, with an emphasis on alternative investments and active risk management. Palladium's investment team has 30+ years experience working with high profile institutional clients in the public and corporate pension fund markets, as well as high-net-worth individuals.

The cornerstone of Palladium's investment process was developed nearly 30 years ago. Refined and revised over time, this process has been implemented at both a major wire-house and managed account provider.

PORTFOLIO MANAGEMENT TEAM

Donald Robinson
CEO & Co-CIO

33 years industry experience

David Feldman
President & Co-CIO

32 years industry experience

Joseph J. Scavetti, Jr.
Chief Operating Officer

24 years industry experience

Jacqueline Dewey
Director Managed Account Services

23 years industry experience

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For more information contact us:

Palladium, LLC | 7 Great Valley Parkway, Suite 295 | Malvern, PA 19355

888-886-4122 | info@palladium.com | www.palladium.com