

QUARTERLY HIGHLIGHTS

- *The Absolute Return Strategy model rose modestly for the quarter, as most equity and fixed income strategies were positive*
- *The strategy model lagged its benchmark, the HFRX Absolute Return Fund Index, primarily due to several fixed income strategies, an interest rate hedging strategy, and a managed futures allocation*
- *Exposure to hedged equity, real estate, and a global macro strategy were strong contributors to performance*

MARKET CONTEXT | OUTLOOK

As expected, Jerome Powell, an existing Fed Governor under Chair Janet Yellen, has been highlighted as the White House administration's choice for the new Chair. The expected outcome of this change should be minimal relative to Yellen's current approach to dealing with labor markets and inflation. However, we would expect more favorable deregulation proposals in the bank and finance area. The Phillips Curve looks to be dead (the relationship between full employment and wage inflation), with the U.S. labor market at nearly full employment without a commensurate rise in inflation. As we have stated previously, a shifting labor market from manufacturing to services, coupled with a rapid pace of technological innovation and unfavorable demographics (deflationary), should keep a lid on real wage growth.

Our concerns range from elevated financial asset prices to market complacency. The last several years have been marked by a lack of "productive" capital formation. Equity prices have been driven by the search for yield and non-productive use of capital, such as share buybacks and dividend distributions, rather than capital investment. Opportunities exist longer term in those areas of the global economy where productive capital investment is being made in transforming old business models and funding new R&D. These areas include biotech, machine learning ("AI"), cloud computing, e-commerce and clean tech. Much of that will be predicated on the market's view of future growth, inflation and debt burdens.

STRATEGY KEY CONTRIBUTORS | DETRACTORS

- Allocations to hedged equity, multi-strategy alternative, and an intermediate-term bond strategy were the largest contributors to the quarterly results.
- Exposure to managed futures and long/short equity strategies detracted from performance.
- 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. Since its inception two years ago, the strategy model has outperformed its benchmark (after fees).

PORTFOLIO CHANGES

- Equity valuations by most measures are rich, especially in the U.S. Interest rates and inflation remain at low levels despite central banks' efforts to raise them.
- Bonds and other income producing assets are quite possibly more overvalued than stocks, and we observe some signs of frothiness in certain sectors, such as bank loans and real estate.
- During the quarter, we reconfigured the portfolio to reflect current and anticipated risks and opportunities, while also streamlining the number of holdings and modestly reducing internal expenses.
- We reduced or eliminated exposure to bank loans, municipal securities, an intermediate bond strategy, and real estate, while increasing exposure to an alternative credit focus fund, a hedged equity strategy, and global multi-factor equities.

Strategy Summary

The Absolute Return Strategy, on a long-term basis, seeks:

- To provide returns independent of traditional equity and fixed income indices, with a focus on low volatility and minimal downside risk.
- Moderate correlation with stocks (< 0.4)
- Superior risk-adjusted return: (Sharpe ratio > 1.0)
- To diversify your total portfolio's long-only equity and other sources of risk
- Exposure to different sources of return than traditional stocks and bonds

The Absolute Return Strategy is:

- Actively managed by an experienced team of investment professionals, with daily liquidity
- Implemented at lower cost than most alternative mutual funds and illiquid hedge funds
- Invested in mutual funds and ETFs, seeking to provide positive returns in flat or declining markets.
- Typically appropriate as part of a total portfolio, for an investor with a short-to-intermediate investment time horizon, and a low tolerance for risk.

ABOUT OUR FIRM

Palladiem 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. Palladiem'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 Palladiem'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

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