

QUARTERLY HIGHLIGHTS

- *The Balanced Endowment Model Strategy performed strongly during the quarter, as most equities and fixed income strategies rose*
- *The strategy model slightly lagged its benchmark, a weighted average combination of the Barclays Aggregate Bond, MSCI ACWI, and HFRX Global Hedge Fund indices, mainly due to hedged equity, value equity, and managed futures allocations*
- *The strategy's systematic, technology, and quality equity allocations were positive 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 Philips 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 the total world and broad U.S. stock markets, technology stocks, and exposure to the quality factor were the largest contributors to the portfolio's performance.
- Allocations to managed futures and the broad bond market were the only detractors from overall portfolio 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. Given its objectives and moderate risk tolerance, we believe the portfolio has been conservatively positioned. The strategy model has outperformed its weighted average benchmark over the past three years (before fees), although it has lagged since inception, albeit with lower risk.

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 a U.S. equity overweight, bank loans, municipal securities, technology, and value equities, while increasing exposure to non-U.S. equities, global macro, long/short equities, and non-U.S. multi-factor equity strategies.

Strategy Summary

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

- To grow invested capital over the long-term, with moderate level of volatility
- Moderate beta relative to global equities (~ 0.6)
- 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 Balanced 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 moderate investor's total portfolio, with at least a intermediate-to-long term investment time horizon, and a 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

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