

QUARTERLY HIGHLIGHTS

- *The Focused Income Strategy model rose modestly for the quarter, as most fixed income and dividend-paying equities appreciated*
- *During the quarter, the strategy model slightly underperformed its benchmark, a weighted average combination of the Barclays Aggregate, High Yield, and MSCI ACWI indices, primarily due to its underweight in high yield relative to the benchmark*
- *Backed by strong market conditions, most strategy model allocations were in positive territory, but an interest rate hedging strategy declined modestly during the quarter*

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 in fallen angel bonds, closed end funds, mortgage REITs, and global dividends were the strongest contributors to the strategy's quarterly results.
- Relative to the fixed income benchmark, the strategy was underweight high yield, which was one of the best performing fixed income sectors this quarter.
- Although still positive, mortgage-backed and bank loan allocations were smaller contributors, while an interest rate hedging strategy detracted modestly 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 its objectives over time. Since its inception two years ago, the strategy model (before fees) has outperformed its benchmark since inception.

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.
- We reduced or eliminated exposure to high yield and bank loans, while increasing exposure to an alternative credit focus fund and a multi-asset income strategy.

Strategy Summary

The Focused Income Strategy, on a long-term basis, seeks to provide:

- Maximum yield while sustaining principal
- Some protection of capital and diversification of traditional interest rate risks
- An alternative to typical benchmark sensitive, long-only bond funds
- A somewhat concentrated portfolio of assets including a range of investment grade and high yield bonds, as well as dividend-paying equities
- A strategy that can supplement or replace a traditional fixed income allocation

The Focused Income Strategy is:

- Actively managed by an experienced team of investment professionals, with daily liquidity
- Implemented at lower cost than many strategic income and unconstrained bond funds
- Invested in ETFs and mutual funds focused on income generation, with a keen eye towards risk
- This strategy is typically appropriate for an investor seeking to fulfill or supplement need for current income with 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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