3EDGE Asset Management

Quarterly Letter June 30, 2016

Both the **3EDGE Total Return Strategy** and the **3EDGE Conservative Strategy** earned positive returns in the second quarter of 2016. Gains from our investments in gold, U.S. equities, emerging market equities, India equities, U.S. Treasuries, U.S. TIPS (Treasury Inflation Protected Securities), U.S. corporate high yield bonds and international real estate more than offset losses from ex-U.S. developed market equities during the quarter.

The world's major central banks and governments continued to influence the global capital markets in material ways during the quarter. After several hints that the Fed might hike interest rates in the near term, they chose to refrain based on uncertainty about the U.S. labor market (despite an unemployment rate below 5%), U.S. inflation (despite core inflation rising above 2% year-over-year) and potential international instability (in particular, the possibility of Brexit – the U.K. voting to leave the European Union). Contrary to market expectations, the Brexit vote in favor of leaving the European Union prevailed, resulting in additional uncertainty about Europe's economic prospects and stability, thereby placing more pressure on the European Central Bank and European governments to provide more monetary and fiscal support.

Immediately following the Brexit vote, investors flocked to safe-haven investments such as gold, government bonds and the Japanese Yen. The rising Yen placed renewed pressure on the Bank of Japan and the Japanese government to provide yet more monetary and fiscal stimulus to stem the Yen's rise and reflate Japan's economy. As the second quarter came to a close, the yields on many of the world's major government bonds reached all-time lows, with over 35% of the world's government bonds now yielding negative interest rates.[1] With all the world's major central banks continuing to promote extremely stimulative monetary policies, global equity markets responded favorably, rebounding from the short-term negative reaction to the Brexit vote.

As we enter into the third quarter, our research indicates that economic, fundamental and behavioral factors are generally supportive of higher equity values in the near term. Our strategy is to hold long positions in equity indices we deem to be relatively undervalued and poised to appreciate. We are also continuing to hold gold-related investments as a hedge against potential currency devaluation, central bank policy errors and geopolitical instability. We hold long positions in emerging market equities, including a separate investment in India equities. With the Fed likely to continue to defer rate hikes, the U.S. Dollar is no longer rapidly appreciating relative to many emerging market currencies, thereby supporting the rebound in emerging markets that began early this year. Over the last seven years, U.S. large cap equities outperformed small cap equities while growth has outperformed value. Therefore, we remain invested in U.S. small cap value equities, which we believe have the potential to outperform.

Core Investment Theme

As we have stated previously, we believe that for the foreseeable future the global capital markets will continue to be materially influenced by extraordinary monetary stimulus produced by the world's central banks since the financial crisis of 2008. This was done in an attempt to lift global economic growth indirectly by first raising asset prices, hoping renewed "animal spirits" and an accompanying wealth effect would result. While central banks were successful in raising asset prices by printing money, corresponding economic growth remains elusive. With asset prices climbing more quickly than underlying economic growth, central banks in effect may have robbed from future investment returns by pulling gains into the present. As a result, a simple buy and hold strategy of owning stocks and bonds may not produce returns in the future in line historical norms, thereby creating the potential for a relatively lower return world going forward.

However, the markets don't tend to move in a straight line. Even if we experience returns in the future that are below historic norms, it doesn't mean markets will consistently earn the same low returns year after year. A cornerstone of our investment philosophy is that markets tend to move in cycles, particularly at the asset class level, because they are part of a complex system of interrelated factors, much like systems found in science and nature. Complex systems tend to fluctuate from one extreme to another and are rarely in a state of equilibrium. In market terms, this means that equity, bond, currency and real asset markets also move in cycles and also tend to fluctuate between overvalued and undervalued. Our investment approach seeks to identify those undervalued asset classes that may be poised to enter a period of outperformance by analyzing the economic, fundamental and behavioral factors (including the actions of the world's central banks) that could drive market cycles in the future, particularly at the asset class level.

Risk Management

Importantly, given that the world's major central banks have taken the global capital markets into uncharted territory, we believe that investors may be facing a myriad of potential risks unlike those experienced in recent history. Given a global environment of unusually low interest rates, excessive government debt, a possible devaluation of China's currency, weak Chinese and European bank balance sheets, extraordinarily weak monetary policies, low global economic growth rates and rising geopolitical tensions, among others, we believe that investment portfolios need protection from a variety of "fat tail" or "black swan" events, including vigilance against deflation as well as inflation. The 3EDGE approach to portfolio management prioritizes risk management, and seeks to limit potential drawdowns. Our research extends as far back as 1874 in order to capture and study market dynamics that included periods of deflation, rapid inflation, currency wars, depressions and world wars in an effort to manage portfolio risk more comprehensively, while still seeking to deliver attractive returns.

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1. Source: Bloomberg