



Investor Letter

Quarter ended September 30, 2017

For the quarterly period ended 09/30/2017 (Q3-2017), both the **3EDGE Total Return Strategy** and **3EDGE Conservative Strategy** earned positive rates of return. Both strategies experienced gains from holdings in U.S. equities, global equities, Japan equities-currency hedged (Total Return Strategy), India equities (Total Return Strategy), emerging market equities (Total Return and Conservative Strategies), frontier market equities (Total Return Strategy), gold and fixed income.

During the third quarter of 2017, both strategies remained at or close to their maximum equity weightings with a tilt towards emerging market equities in the Total Return Strategy. The Conservative Strategy also maintained a somewhat smaller exposure to emerging markets during the quarter. While U.S. equity markets continued to reach new all-time highs, non-U.S. equities including emerging markets provided higher returns. The case for further appreciation in the equity markets could be supported by a continuation of the following conditions: positively-sloped yield curves; benign global inflation; narrow credit spreads (signaling that the market believes there is no recession in sight); low real (inflation-adjusted) cost of capital (which contributes to higher valuations of future earnings streams) and signs that the global economy continues to grow faster than expected.

Entering the fourth quarter of 2017, while both the Total Return Strategy and Conservative Strategy continue to remain close to their maximum equity weightings, we remain vigilant and cautious in our outlook for equities in general. Based on our research analysis, we have chosen to reduce our holdings in emerging and frontier markets in the Total Return Strategy such that our current equity holdings are more evenly distributed across the U.S., Europe, Japan, emerging and frontier markets. One potential scenario that may possibly trigger a correction in equity markets could arise from the uncertainty surrounding the future direction of central bank policies around the world and at the U.S. Federal Reserve in particular. In September, the Fed made an initial announcement about its plans to begin to unwind its quantitative easing program that has been providing liquidity to the markets and the economy since the Financial Crisis of 2008. Further, the accompanying language from Fed Chair Janet Yellen was considered by many market participants to be more hawkish than expected. There is additional uncertainty around who will be nominated by President Trump to be the next Fed Chair. The appointment of one particular candidate, former Fed Governor Kevin Warsh for example, could signal an important sea change in philosophy at the Fed. He was quoted recently as saying that the Fed has become a servant to the stock market after years of quantitative easing and loose monetary policy and that the current policy isn't working. In response to just the possibility of upcoming changes in Fed policy, both U.S. bond yields and the U.S. Dollar began to move higher. In addition to a potential new Fed chair, four new Fed Governorships will also need to be appointed relatively soon. These developments may create uncertainty around the Fed's future role in the markets and the economy, and there is a risk that at some point market participants may interpret the Fed's intentions or change in leadership to be counter to higher equity prices going forward. Given the strong sustained market momentum currently driving equity markets to new highs, a correction at this time could be further exaggerated to the downside as the momentum trade could then begin to work in reverse. Central bank tightening always needs to be taken seriously as a potential headwind for the capital markets. Among the world's other major central banks, the Bank of Japan is now the only remaining central bank with the stated intention of continuing its

extraordinarily accommodative monetary policy for the foreseeable future. The potential for monetary policy divergence could contribute to a further weakening of the Japanese yen, which could help Japan's export-driven companies and in turn its economy to grow. Japan equities-currency hedged are currently held in the Total Return Strategy.

The most recent advances in the U.S. equity markets have been supported by the hope that the Trump administration and Congress will be able to pass tax reform legislation which could provide further fuel for continued equity market price appreciation. However, a failure to enact pro-growth tax reform, coupled with the other previous legislative failures, could have the reverse effect and trigger an equity market correction. Another risk that we continue to monitor is the potential for an equity market "melt-up". This occurs when the remaining market skeptics holding on to cash capitulate as the fear of missing out on additional appreciation in the equity markets becomes overwhelming, and the remainder of the cash on the sidelines pours into the equity markets causing a parabolic rise in equity prices. This situation often presages the onset of one final push upward followed by a sudden reversal and major market correction.

There is a great deal of debate presently among investors as to the future rate of inflation. In this regard, we are keeping a close eye on money velocity. The velocity of money is the rate at which money is exchanged from one transaction to another and is usually measured as a ratio of GDP to a country's money supply. Money velocity helps to gauge an economy's robustness or level of "animal spirits". Since 2008, central banks around the world have been printing money and pursuing aggressive monetary policies in order to spark global economic growth and a more satisfactory level of inflation. However, the velocity of money has dropped dramatically since 2008 reflecting a decline in animal spirits (i.e. the reluctance to invest, hire and spend). As a result, while the extraordinary monetary stimulus has inflated asset (equity and bond) prices, the real economy and inflation have not enjoyed a robust rebound. We are watching money velocity very closely for clues as to when economic growth and inflation may rise faster than expected.

We are continuing to watch a myriad of potential risks to investors including the geopolitical tensions between North Korea and the U.S., and we are keeping an eye on the situation in Spain and the Catalonia referendum which could have a negative impact on Southern Europe and possibly spread into Italy, Greece, etc. We will also be closely monitoring how any additional rate hikes and the potential for the unwinding of quantitative easing may affect real (inflation-adjusted) interest rates to gauge whether the U.S. Dollar is likely to strengthen in a sustained fashion or whether real assets may have an opportunity to appreciate.

The 3EDGE approach to portfolio management prioritizes risk management and seeks to limit potential portfolio drawdowns. We believe that investment portfolios need protection from a variety of possible "fat-tail" or "black swan" events. However, we also believe that, going forward, it will still be possible to generate attractive, risk-adjusted returns by continuing to follow our investment discipline of seeking to identify undervalued asset classes across the globe that may be poised to enter a period of market outperformance.



As always, please feel free to reach out to us if you have any questions, and thank you for the confidence that you have placed in our firm.

Stephen Cucchiaro
President & Chief Investment Officer
3EDGE Asset Management, LP

DeFred G. Folts III
Chief Investment Strategist
3EDGE Asset Management, LP

DISCLAIMER: This Quarterly Letter is provided to current and prospective clients of 3EDGE Asset Management ("3EDGE") and is for informational purposes only. It does not constitute an offer to buy or sell any security. The opinions expressed in this Quarterly Letter are those of 3EDGE and are subject to change without notice in reaction to shifting market conditions. 3EDGE's opinions are not intended to provide personal investment advice and do not consider the investment objectives and financial resources of the reader. Information provided in this Quarterly Letter includes information from sources 3EDGE believes to be reliable, but the accuracy of such information cannot be guaranteed. Investments in securities, including common stocks, fixed income, commodities and ETFs, involve the risk of loss that investors should be prepared to bear. Past performance may not be indicative of future results.