3EDGE ASSET MANAGEMENT

Investor Letter Quarter ended December 31, 2017

December 31, 2017 marked the two-year anniversary of 3EDGE Asset Management. Firm-wide assets under management have grown to over $750 million, and we truly appreciate the confidence that each of you has placed in our 3EDGE team.

For the quarterly period ended 12/31/2017 (Q4-2017), both the **3EDGE Total Return Strategy** and the **3EDGE Conservative Strategy** earned positive rates of return. Gains from our global equity holdings as well as our holdings in commodities, gold, corporate bonds and TIPS more than offset slight declines from our holdings in U.S. Treasuries. Given our attention to downside risk management and our goal of protecting our clients against potential "black swan" or exogenous events, we are pleased with our level of investment returns in 2017. We believe that the key to investment success over the long term is to participate during significant equity rallies while protecting capital during downturns, thereby generating not only favorable risk-adjusted returns but also attractive absolute returns over time.

The U.S. stock market, as measured by the S&P 500 Index, earned a positive return in all twelve months of the calendar year, the first time in history that has ever happened. Factors contributing to the strong performance by equities include a globally-synchronized economic recovery, rising corporate earnings, fiscal stimulus / tax reform, low real (inflation-adjusted) cost of capital (which contributes to higher valuations of future earnings streams), narrow credit spreads (signaling that the market believes there is no recession in sight) and sufficiently positively-sloped yield curves (indicating sufficient liquidity to fuel gains). In addition to these economic and financial factors, investor behavior in the form of market momentum has contributed to the rally in equities.

During the year, the stock market also showed unusual resilience, brushing off rising geopolitical tensions with North Korea and within the Middle East, contentious elections in Europe, the Fed's announcement and subsequent actions to begin normalizing monetary policy and controversy in Washington D.C. 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.

George Soros once wrote that a bull market will pass a series of successive tests until investors believe the market is invulnerable, at which point it is ripe for a fall. With stock market volatility near historically low levels, an equity market "melt-up" cannot be ruled out. Historically, the final phase of an extended stock market rally can feature an accelerated surge in prices (e.g. tech stocks in early 2000; Japanese stocks in late 1989; U.S. stocks in 1929). Historical precedent suggests that the sharper the final market rise, the more pronounced the following correction. As the Grateful Dead once sang, "When life looks like easy street, there is danger at your door." We have studied the economic, fundamental and behavioral factors contributing to every market correction since the

1870s. Our goal is to use our global capital market model (supported by our research team and investment committee) to determine when best to reduce our overall net equity allocation in an attempt to further protect clients' capital during the next major correction.

Entering 2018, both the Total Return and Conservative strategies are holding overall equity allocations at or close to their maximum weightings. In the Total Return strategy, equities are tilted a bit more towards Japan and emerging / frontier markets while in the Conservative strategy equity holdings are just about evenly divided between U.S. and ex-U.S. equities. However, we also remain vigilant and cautious in our outlook for equities in general and are prepared to reduce equity exposure should our research model analysis deem it appropriate to do so. Based upon the potential for interest rates to increase and inflation to pick up in 2018, our fixed income holdings in both the Total Return and Conservative strategies are focused on maintaining low duration (the approximate measure of a bond's price sensitivity to changes in interest rates), and holding Treasury Inflation Protected Securities - TIPS (U.S. Treasury securities that are indexed to inflation in order to protect investors from the negative effects of inflation). We are also near our minimum weightings in both real assets and cash in both our Total Return and Conservative strategies.

Money Velocity and the Mystery of Inflation

Even the Federal Reserve Board admits to being confused about why inflation remains below its target despite the extraordinary monetary policy unleashed by the Fed and other major central banks since the financial crisis of 2008. The inflation conundrum may best be explained by examining changes in money velocity. Money velocity, which is the rate at which money is exchanged from one party to another within the economy, has steadily declined since the financial crisis of 2008, reaching a level far below the norms experienced since the 1960s. Measured as the ratio of nominal GDP to money supply, a drop-in money velocity by definition restrains economic growth and inflation despite a rise in money supply, helping to explain why the extraordinary monetary stimulus has not yet led to a rise in inflation. Money velocity can also serve as a quantitative measure of an economy's robustness or "animal spirits" (i.e. how aggressively employers hire, consumers spend and investors invest, driving economic growth). Should animal spirits rise in 2018 due to the globally synchronized recovery, tax reform, fiscal stimulus, deregulation and rising markets, then a recovery in money velocity would by definition result in a rise in nominal GDP. If debt, demographics and full employment restrain real (inflation-adjusted) GDP, then inflation would most likely increase in a manner not expected by the markets. For comparison, it is interesting to examine the period of the late 1940s, early 1950s - a time when inflation had been dormant for an extended period, financial repression existed in the form of regulatory interest rate caps instead of quantitative easing and money velocity was low and declining - all similar to the current situation. Yet inflation did unexpectedly rise during that time from under 2% to over 9% in a matter of several months as money velocity rebounded. An inflation spike today would put central banks in a quandary: raise short rates higher than expected - risking an inverted yield curve and a market and economic downturn; or let inflation "run hot" - risking a 1970s-style scenario with negative real yields, sharply rising gold and commodities prices and a bear market in bonds as long-term interest rates rise. A potential risk to the equity markets in 2018 could emanate from an unexpected rise in inflation, first causing a correction in the bond market, which in turn could lead to a correction in the stock market as rising bond yields expose the stock market's elevated valuation metrics. A measure of inflation known as the Underlying Inflation Gauge has just reached an 11-year high, now approaching 3%. Given how long it has been since the stock market experienced a correction greater than 5%, the next correction could be further exaggerated to the downside as the momentum trade could then begin to work in reverse.

We continue to watch a myriad of potential geopolitical risks to investors related to North Korea, Iran, Saudi Arabia, Russia as well as the controversy surrounding developments in Washington D.C. We conduct our research and run our models daily to analyze any changes in key economic, fundamental and behavioral factors that may provide early warning signals of adverse market conditions. 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 targets alpha, or attractive risk-adjusted returns, by following our investment discipline of seeking to identify undervalued asset classes across the globe that may be poised to enter a period of market outperformance. At the same time, we prioritize risk management and seek to limit potential portfolio drawdowns as we believe that investment portfolios need protection from a variety of possible "fat-tail" or "black swan" events.

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 3EDGE.

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