MAI STRATEGIES

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Investment Outlook & Asset Allocation

Q2 Investment Outlook

We have been gradually raising our caution level for over a year. *Despite general market optimism presently, we feel a profound sense of urgency to raise our caution level even further this quarter to an investment posture that anticipates a substantial decline in broad equity markets, credit and real estate*.

Our rationale is based on weakening near-term factors overlaid onto a secular economic and investment environment that cannot support even incremental, temporary adversity. Factors include:

Near Term Factors

- Declining US and global real output growth
- Stalling corporate revenue and earnings growth
- The onset of the evanescence of the political honeymoon period in the US related to proposed Trump fiscal, tax and regulatory initiatives
- Central bank communications that portray a narrative of strengthening economies, but which is unsupported by economic data
- The onset of rising US dollar FX volatility, which hinders global trade volume
- The expected tapering of ECB liquidity infusion and transition to interest rate normalization
- Spring seasonality that tends to decrease liquidity and enthusiasm for equities
- Low cash and market volatility levels that imply fully or near-fully invested portfolios

Secular Factors

- Aging populations in the world's largest economies
- Declining overall birth rates among the world's wealth holders
- Record sovereign and household balance sheet leverage
- The continued economic emphasis of finance over production
- The reliance on over-accommodating central banks
- Historically high equity, credit and real estate prices and record low real asset and liability values
- The well-established shift from risk-adjusted investing to passive and mechanical asset allocation

As a result of these factors we expect markets to begin sniffing out a very asymmetric risk/return profile and the potential for significantly lower prices. If/when investors begin entertaining the idea that exogenous support from monetary and fiscal authorities is insufficient, a meaningful, unexpected decline in popular asset prices could begin. It could occur anytime, perhaps as soon as the second quarter.

Q2 Asset Allocation

MAI model portfolios reflect our heightened state of caution. We believe MAI Tactical is positioned to demonstrate substantial gains and MAI MACAW is positioned to demonstrate substantial alpha within such an environment. A discussion of asset allocation for each model portfolio is below.

MAI Multi Asset Class All-Weather (MACAW)

Cash & Equivalents: We are raising MACAW's cash weighting from 12.5% to 15% as of April 1, reflecting our cautious outlook. We envision major structural monetary reform to occur eventually. US dollars (and then gold) should become pre-eminent among major currencies as this occurs, and so we hold all cash in US dollars.

Fixed Income: We raised MACAW's overall allocation to fixed income as of April 1 from 20% to 25%. Although income from fixed income instruments at current yields is generally very poor, we believe there will be a significant capital appreciation in long duration Treasuries, and we are raising our allocation from 10% to 15%. Weaker global output growth, lower developed market sovereign yields abroad, a stronger US dollar, tight credit spreads among increasingly dubious credits, continued demand for long-duration liability matching, zero-percent risk weighting for banks, and continued central bank buying should collectively act as a ceiling on yields and provide impetus for increasing absolute and relative demand.

We are maintaining MACAW's allocation to inflation protected Treasuries at 8% because we feel significant inflation will eventually accompany central bank pressure to re-introduce quantitative easing. We also maintaining MACAW's exposure to high grade corporates at 2%. We do not like holding these positions at current yield and spread levels, but are willing to hold a small amount of high grade bonds for their incremental yield and expected inflow from high yield credits.

Equity & Resources: We are reducing MACAW's exposure to equities and resources from 67.50% to 60.00% due to historically full valuations and our cautious outlook for global growth.

Below, we summarize our Equity sector weightings as of April 1.

Consumer Cyclicals: We retain only 1.50% allocation to consumer cyclicals as of as of April 1. It is our least favorite sector. High valuations and our outlook for an economic slowdown overwhelms our incentive to bet on relative winners in this sector.

Consumer Staples: We are reducing MACAW's allocation to the consumer staples sector from 10.00% to 8.00%, after capturing its very strong performance in 2016 and Q1 2017. This sector should still outperform other sectors due to the demand-inelastic nature of the businesses, but their beta exposure to equities suggests a reduction.

Energy: We are reducing our already low 3.25% allocation to energy to 2.00 as of April 1. We are doing this given the geopolitical influence over global energy prices and the long-term movement towards a more balanced energy complex, in terms of production and product mix. Specifically, we are reducing MACAW's weighting in Gazprom from 0.50% to 0.25% and eliminating 0.25% allocations to service and equipment companies, Enterprise Products, Halliburton, Kinder Morgan and Schlumberger.

Financials: We are reducing MACAW's allocation to financials for the second time in as many quarters, from 5.25% to 3.50% as of April 1 (down from 8.25% on October 1, 2016). Strength in the financial sector throughout 2016 began to fade in Q1 2017, and for good reason. Valuations are unwarranted given our cautious view of the global economy and our expectations of a flatter yield curve. We are eliminating MACAW's 0.25% allocations to Banco Santander and Blackstone, after their very strong Q1 performance, as well as 0.25% allocations each to Société Générale, Wells Fargo, UBS, AIG and Travelers.

Health Care: We are reducing MACAW's exposure to the health care sector from 6% to 5% following a bounce higher in Q1 (+7.64%). The sector had negative returns in 2016 following years of growth, we believe in large part due to potential political intervention that would get in the way of revenues. Our sense last quarter was that such fears were overdone, especially given Donald Trump's victory. We still envision increasing pricing pressure over time. Specifically, we are reducing allocations to Johnson and Johnson and Merck from 0.75% to 0.50% each, and eliminating MACAW's 0.50% allocation to Biogen.

Industrials: We are reducing slightly MACAW's industrial sector weighting from 4.75% to 4.50%. We think declining economic activity in 2017 will generally lead to top line pressure on these businesses. We are eliminating the 0.25% allocation to Southwest Airlines. The portfolio's remaining industrial sector is composed of defense contractors and railroad companies, two industries we feel would be relatively inelastic to declining output in the service sector.

Materials: We are leaving MACAW's material section unchanged at a 7.50% weighting as of April 1. The sector had a strong first quarter (+7.53%), helped in large part by our additional allocation to an agricultural ETF, which rose 9.34% in Q1. As we noted then, there is an already embedded global supply shortage building in corn, wheat and soybeans meant for human consumption. Against this, demand should remain constant. We generally like natural resources explored, produced and sold by basic materials manufacturers and see the industry as a beneficiary of global inflation, which we see as inevitable over time.

Technology: The technology sector was the star of the first quarter for MACAW's equity portfolio, rising 11.99%. Nevertheless, indeed due in large part to excessive valuations brought about by past strength, we are reducing the portfolio's allocation to technology from 5.75% to 4.00%. Specifically, we are reducing allocations in Cisco, Qualcom, Samsung, Alphabet, Alibaba, Oracle and SAP from 0.50% to 0.25%. MACAW's tech allocations are spread across 16 established businesses. We recognize the portfolio's low exposure to technology relative to most other portfolios, however we have no special insight or visibility when it comes to which innovations and technologies will be able to maintain market share and pricing power over the long run, which is the portfolio's investment horizon.

Telecommunications: We are reducing MACAW's exposure to the telecom sector from 5.25% to 4.00%. Specifically, we are reducing allocations in Deutsche Telecom, Nippon Tel, Verizon, AT&T, and NTT DoCoMo from 0.75% to 0.50%. Although the businesses we have allocated to are infrastructure companies, and we see them as defensive plays when global growth declines, their high debt levels are giving us pause.

Utilities: Utilities had a strong Q1 and we are using that strength to reduce our already low sector allocation from 2.25% to 1.45%. Specifically, we are eliminating multi-line businesses National Grid and Sempra Energy, and electric company NextEra Energy. As with Telecom, the sector's debt load makes it negatively convex. Utility shares should drop much more than rise given an equal move up or down in underlying interest rates. And even if interest rates fall, we think it will be due to fallen output – an environment in which debt service would become challenging and in which regulators would be hesitant to pass rate hikes along to consumers.

Other: We are raising MACAW's allocation to gold from 12.50% to 15.00% as of April 1. Given our secular outlook, the potential magnitude of gold appreciation is substantial and gold's multi-year price basing suggests a significant move higher.

(A complete accounting of performance as well as all holdings, weightings and contribution reports may be viewed online or upon request.)

MAI Tactical is a highly concentrated long/short model portfolio that expresses macro-oriented views (mostly through exchange-traded products) in equity, fixed income, commodity, and foreign exchange markets, as well as in various sectors and geographies. The hypothetical portfolio is aggressive and highly concentrated (15 to 25 positions), and uses leverage to position assets. It has a six to eighteen month investment horizon. MAI Tactical holds positions that, on balance, tend to take advantage of unexpected market changes, and therefore tends to be uncorrelated to stock and bond market indexes.

Consistent with our strong market view towards the weaker asset markets, we reduced Tactical's long exposure (by 5%) and increased its short exposure (by 10%). As of April 1, 2017, MAI Tactical holds aggregate positions (long and short) amounting to 185% of its theoretical NAV, up from 180% in the first quarter. Total long positions are 100% (down from 105% in Q1) and total shorts are 85% (up from 75% in Q1) for a net long position of 15% (down from 30%).

The components of MAI Tactical remained largely in place, with the exception of a 5% allocation to generic US small and mid-cap (SMID) equity, which was eliminated. Tactical maintained its 10% long exposure to SMID value stocks and its 10% short exposure to SMID growth stocks.

We maintained the portfolio's aggressive exposure to long-duration U.S. Treasuries at 20%, and hope to profit from a bull flattening along the curve. We expect the Fed to follow through with overnight rate hikes at least once in 2017, which would stifle credit and threaten output growth. Even if the Fed does not hike as generally expected, we think long-duration Treasury yields will fall significantly in light of global economic weakness, sovereign interest rate differentials, a stable-to-stronger dollar, 0% risk-weighting of Treasuries for banks, global central bank capital flows and generally negative sentiment among levered investors. Given bearish sentiment and current under-weighting, owning long-duration Treasuries seems positively convex to macroeconomic outcomes, and therefore worthy of an aggressive weighting.

We further think a long Treasury position can offset our long gold position (20%) in certain environments, specifically one in which surprisingly weak *global output* elicits gold selling by holders concerned (incorrectly) that a weak economy will lead to lower inflation. As we have written, at this late stage of the global leverage cycle, general economic weakness will threaten debt coverage (return of capital) more than alpha generation (return on capital). There should be a swift, unified, and inflationary monetary policy response to any economic weakness, especially if it is accompanied by equity market weakness. Long duration Treasuries will be a destination for risk capital seeking sanctuary in the dollar. We expect Treasuries and gold to become correlated in a rally and think Treasury yields will hit new lows.

We also maintained our aggressive short position in high yield credit (-20%). Junk bond yields remain quite low historically in spite of weakening global growth and a Fed rate hike regime now in play. Our view that global growth is falling and will soon be acknowledged by the equity markets should give bond investors incentive to roll up the credit curve. We furthered maintained Tactical's 10% long position in investment grade corporates. The carry from investment grade bonds partially offsets negative carry associated with the portfolio's high yield short.

MAI Tactical is very aggressively short US and global equities (-35%) as of April 1. Total long positions (30%) are more than offset by total shorts (-65%). Further, our long positions are quite timid: 10% to aforementioned SMID value, 10% to US Preferreds, and 10% to currency hedged Japanese large caps. We continue to think the Bank of Japan will take measures to weaken the yen, which would drive equity prices higher. The position has worked well and we continue to hold it.

Tactical's short equity book includes -10% to aforementioned SMID growth stocks; -12.5% to the Consumer Discretionary Sector (up from -10%); -12.5% to the Financial Sector (up from -10%); -15% to REITS (up from -12.5%); and -15% to the US Home Construction Industry (up from -12.5%).

Last quarter we wrote that we were "super bearish on US consumers and the aggregate of consumer discretionary businesses due to overall consumer debt levels, increased competition among online retailers, deflationary pricing, the plan to hike interest rates and aging demographics. The sector's stocks are up 108% over the last five years, and do not reflect these shifting macro dynamics, in our view." Our timing was pretty good on that one; the sector fell over 8% even while the market rose about 5%. We think this consumer trend will continue for a long time to come.

We established the short in financials last quarter after being long them in 2016. We believe their past appreciation (+19% in 2016 and +120% over the last 5 years) was the result of central bank subsidies that will be running off (IOER spreads) and assumes best-case macroeconomic and domestic economic policy scenarios, which we do not think will pan out.

Real estate and mortgage rates cannot go much lower (and are now trending higher). The economics of debt-funded real estate consumption is increasingly dicey. If this is further combined with a global economic slowing, which we anticipate, then the negative impact could be significant. US real estate is very over-sponsored domestically, and any influx of global capital to the dollar and dollar-denominated assets should go to major urban areas and trophy properties. REITS and homebuilders would not benefit meaningfully, if at all.

As for resources, we maintained our long position in agriculture at 10%. As noted, there is an already-embedded global supply shortage building in corn, wheat and soybeans meant for human consumption. Meanwhile, global demand should remain constant even if the global economy slows. Shares in agricultural businesses have lagged and are at very compelling valuations.

We also maintained the portfolio's emerging market equity exposure from at 10%. EM performed nicely in 2016 and especially well in Q1. We expect further gains should the dollar weaken. EM exposure also provides the portfolio with an offset to other expressions that imply a strong dollar.

As noted above, we maintained our aggressive long exposure to gold from at 20% as of April 1. We like the secular outlook for gold. It is the ultimate potential money form in a global environment in which established political, social, economic, financial and trade understandings come into question. Its year-long price basing suggests a significant move higher may come in 2017. This is a very aggressive position and we acknowledge that there may be another down leg in the USD gold price before its price shifts higher. The potential magnitude of gold appreciation is so great, however, that we feel the high weighting is worth the risk – especially given other Fund exposures that could offset severe gold weakness.

(A complete accounting of performance as well as all holdings, weightings and contribution reports may be viewed online or upon request.)

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