Premise Capital 2nd Quarter Investment Commentary

	Q2 2017 Return	Q2 2017 Std Dev	YTD 2017 Return	YTD 2017 Std Dev
BBgBarc US Agg Bond TR USD	1.45	3.31	2.27	3.76
BBgBarc US Treasury US TIPS TR USD	-0.40	4.08	0.85	4.44
BBgBarc US Treasury 20+ Yr TR USD	4.18	10.86	5.66	11.81
BBgBarcrclays US Corporate High Yield TR I	2.17	1.71	4.93	2.61
S&P 500 TR USD	3.09	8.83	9.34	8.46
S&P MidCap 400 TR	1.97	12.58	5.99	12.82
S&P SmallCap 600 TR USD	1.71	15.84	2.79	16.58
MSCI EAFE NR USD	6.12	10.65	13.81	10.39
S&P Developed Small NR USD	4.54	9.77	10.32	9.80
MSCI EM NR USD	6.27	11.01	18.43	11.08
FTSE NAREIT All Equity REITs TR	2.27	10.26	4.88	11.79

Premise Investors,

2017 2nd Quarter

The second quarter has ended with a continuation of the outperformance of the international equities relative to their domestic counterparts. As both the quarter and year to date numbers show on the return table, international large cap, international small cap, and emerging markets have continued to outpace U.S. Markets. The moves we made in early January to increase all non-domestic equity classes have continued to pay off as we reach the halfway point of 2017.

It is interesting to note that this outperformance came just as investors were voicing concerns after seeing the S&P 500 outperform the equivalent diversified basket at comparable fixed income to equity ratios. It is useful to remember that the S&P 500 has the lowest long term expected return of all the equity classes we use in our portfolios. The inclusion of small cap, international, emerging markets and others in a diversified portfolio is not only based on the correlation benefit and thus risk reduction of holding different classes, but also because over the longer term, these other classes have higher expected returns.

More risk usually accompanies higher expected return, but these expected returns are over the long term. A class like emerging markets has a higher standard deviation and a greater *expected* return than the S&P 500, but that doesn't mean that in any given year, it will have a higher *actual* return. There are always small or intermediate term moves that cause the classes to move in different directions and amounts. Rather than attempting to pick which class will win the horse race every period, the goal of diversification is to spread the risk into a diversified optimal portfolio that has the best return for a given level of risk.

How is this relevant to the Premise philosophy and reflected in our models? We position our models in what we feel is the most optimal allocation looking forward for each risk tolerance knowing that actual results in a short time frame will always differ from the expected. So what happens when the S&P 500 beats a group of equity classes that have higher expected returns? You see portfolios that seem to "underperform", as every other equity classes drags the performance of the whole below the return of just the S&P.

Is holding 100% of the lowest expected return equity class a good long term policy?
If every equity asset class is good, is it good investment policy to try to pick which is better in the short term ?

We would suggest the answer to both of these questions is

Premise Capital 2nd Quarter Continued

no. If you only choose the class that has the lowest expected return, you give up the opportunity to increase performance. For example, think about staying in cash long term because it had a recent period of outperformance to the stock market – not exactly good long term policy. We don't like the other option of placing a bet on which class might be the best either, as it increases risk by being dependent on always being right on concentrating a position.

In 2017, we have seen a difference in the returns of international vs domestic and now you see the benefit of increased return along with diversification and risk reduction. With the strength in international markets and their returns beating the S&P 500 (as would be our long term expectation), we see the portfolios as a whole getting not only the risk reduction benefit, but the return benefit as well. This would be even more pronounced if the small and midcap US equities and their higher expected returns played out the same way as non-US classes . If you look at them vs. the S&P, they dragged return performance, but as with international, they aren't in there because they return more than the S&P 500 in any given year, but because over the long term they have higher expected returns.

If all you looked at was return, you would just buy 100% of the class that expected the greatest return but would then be exposed completely to the higher risk class, and deviation of actual return from expected could be quite painful. This becomes the game that is played by other tactical managers. While we believe in tilting the portfolio into and away from classes depending on our future expectations, our methodology lends itself to a more measured response to these decisions as we acknowledge that the future is unknown.

Premise portfolios are created with the goal of taking advantage of overall long term efficiency through the benefits of diversification. So while our portfolios are "tactical", our approach does not play the same game as other managers that try to bet on the best class at any time.
Most tactical investing relies too much on manager "calls" as well as an increased risk from concentration in a small number of classes. Investors are delighted when these "bets" pay off, but this risky type of investing is no way to position portfolios for the long term.

Our "premise" is that creating portfolios with the combined benefits of Modern Portfolio Theory (i.e. balancing risk and return) and Tactical investing (i.e. limiting the portfolio's exposure to inadequately compensated risk) may be a more effective long term solution. As a result, we look to minimize risk for each unit of return, or looking at it the other way, maximizing return for each unit of risk.

Going forward, we are in a rare time when all classes are positive, and portfolios are positioned as they would be in a buy and hold world. Hence, there are no tactical tilts and each model looks as it would in a traditional core portfolio. We will continue to monitor each class and make adjustments as necessary. Thank you again for your continued confidence in Premise.

Jason Rolence
Partner