

Premise Capital 3rd Quarter Investment Commentary

Premise Investors,

The third quarter ended with continued weakness in the international markets. As the following table shows, our continued underweight of the **Developed International and Emerging Market** equity classes, and subsequent overweight of domestic equities, have provided outperformance for the bulk of the quarter. While the price action at the beginning of the 4th quarter has exposed weakness in domestic markets, they are still stronger than their international counterparts, and our portfolios are positioned as such.

We also start the 4th quarter with no exposure to fixed income except for the more equity-like **High Yield** class and our default 1-3 year **Treasury** position. Fixed income has been flat to down since the middle of 2016 and has been a drag on returns. This is seen more sharp-

	Q3 2018		YTD	
	Return	Std Dev	Return	Std Dev
BBgBarc US Agg Bond TR USD	0.02	2.84	-1.60	3.40
BBgBarc US Treasury US TIPS TR USD	-0.82	3.27	-0.84	3.63
BBgBarc US Treasury 20+ Yr TR USD	-3.00	9.68	-5.92	11.31
BBgBarcclays US Corporate High Yield TR I	2.40	1.39	2.57	2.64
S&P 500 TR USD	7.71	8.70	10.56	16.91
S&P MidCap 400 TR	3.86	9.90	7.49	15.83
S&P SmallCap 600 TR USD	4.71	12.39	14.54	17.13
MSCI EAFE NR USD	1.35	12.25	-1.43	13.02
S&P Developed Small NR USD	2.40	8.83	4.81	12.14
MSCI EM NR USD	-1.09	16.46	-7.68	17.25
FTSE NAREIT All Equity REITs TR	0.50	14.00	1.78	16.92

ly the more conservative the model, as the required allocation to fixed income is much higher. As interest rates have held their bottom and have possibly started their long-anticipated trek higher, the money we currently have allocated to short term treasuries will be substantial dry powder for reinvestment at higher interest rates than we have had available for years. As the S&P 500 continues its dominance over all other equity classes, the continued questioning of the benefits of portfolio diversification linger. Many advisors

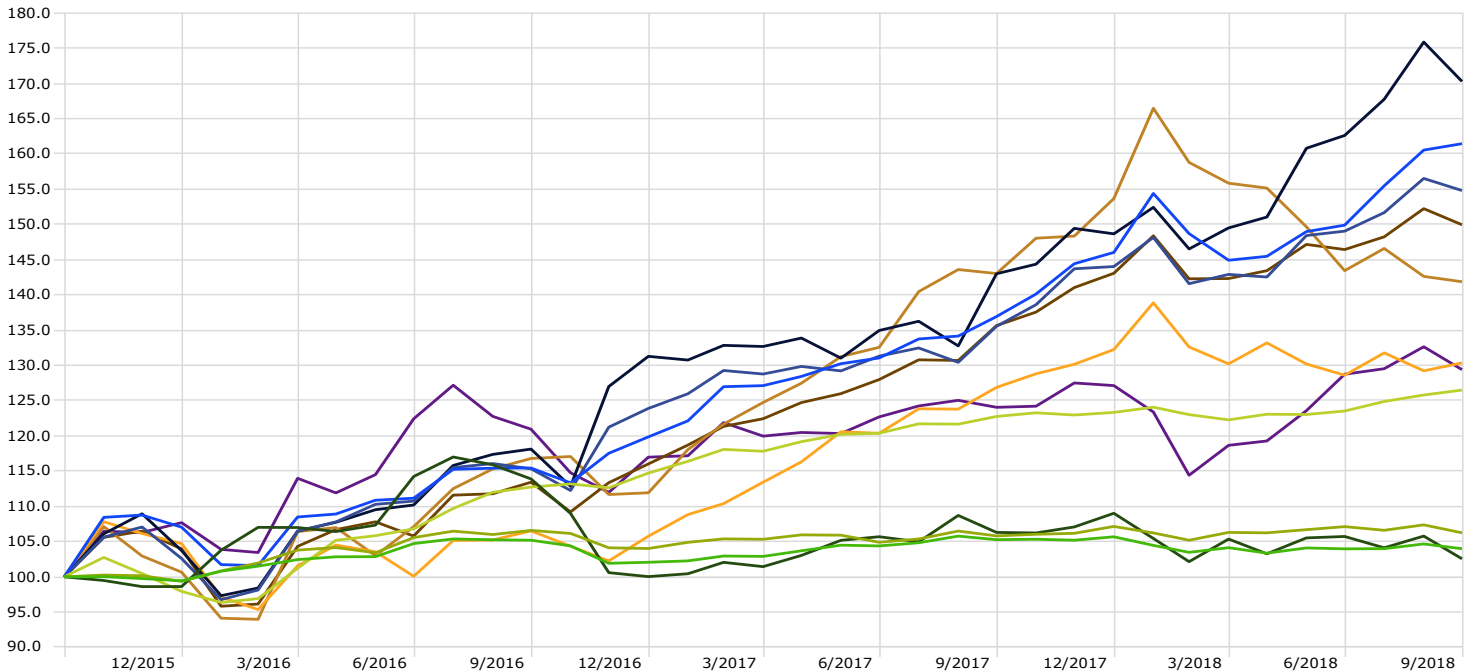
are being asked why their diversified portfolios are not keeping up with the S&P 500, and I would like to provide the following explanation. While we, and others, have been over the benefits of diversification many times, maybe this will provide another view. Most times, diversification benefits are seen by looking at return for risk taken. Here, let's just look at the return component without acknowledging risk, which is the way investors sometimes judge performance. Look at the following chart:



Premise Capital 3rd Quarter Continued

Investment Growth

Time Period: 10/1/2015 to 9/30/2018



BBgBarc US Agg Bond TR USD	104.0	BBgBarc US Treasury US TIPS TR USD	106.2	BBgBarc US Treasury 20+ Yr TR USD	102.6
BBgBarc US Corporate High Yield TR USD	126.5	S&P 500 TR USD	161.4	S&P MidCap 400 TR	154.8
S&P SmallCap 600 TR USD	170.3	MSCI EAFE NR USD	130.3	MSCI EM NR USD	141.9
S&P Developed Small TR USD	149.9	FTSE Nareit All Equity REITs TR USD	129.4		

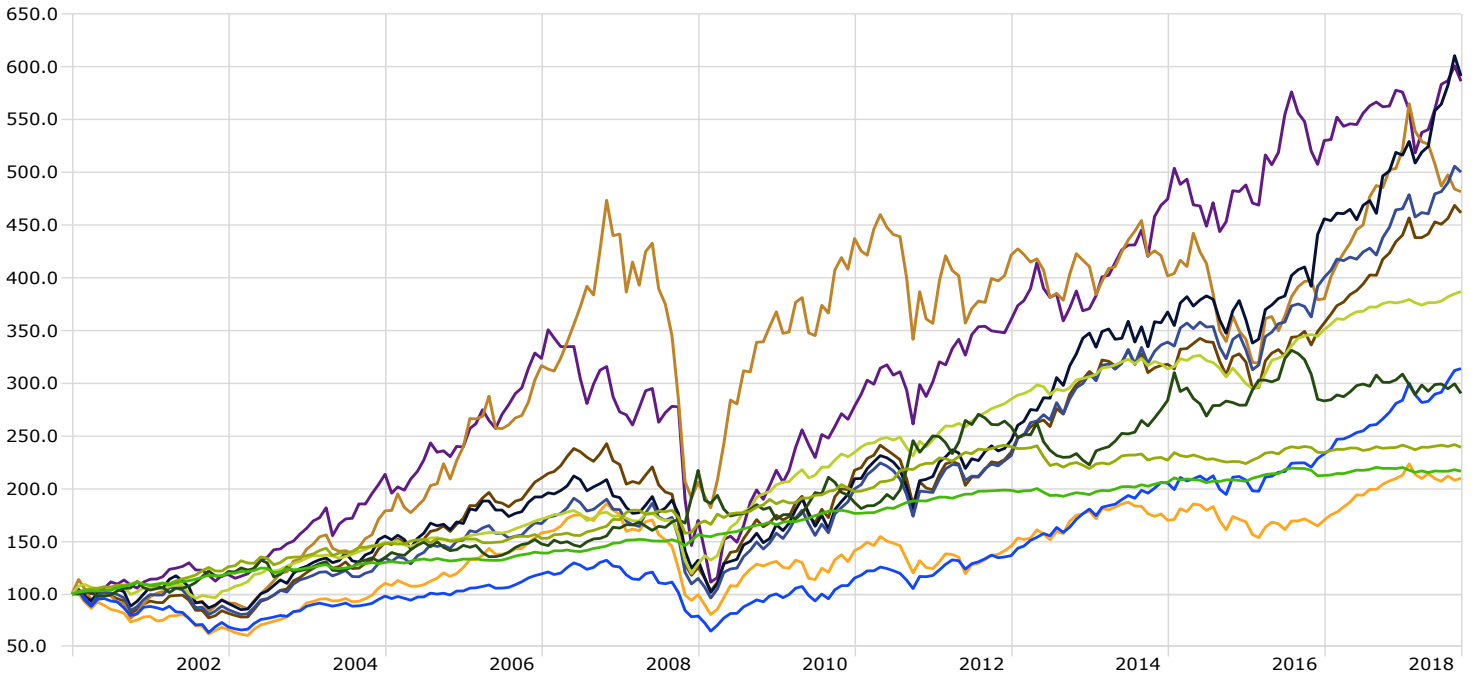
Over the last three years, you can see that the S&P 500 outperforms every other class we use in our diversified portfolios, except US Small Cap. In general, the more conservative the model, the more you will have of the green classes (fixed income) over the others (equity), but you either have a diversified basket that holds some of each of these classes or you have a manager that is merely picking which of these classes will “win.” Because the S&P 500 performed so well compared to the other classes, any amount you have in any of the other classes would cause you to “underperform” the S&P 500. *But is this return difference underperformance?* - Only if you were in the business of picking which class will be the best and concentrating all your money into that single bet. Now, look at the same graph with a longer time frame. When you go back to 2001, you can see that the S&P 500 was one of the worst performing equi-



Premise Capital 3rd Quarter Continued

Investment Growth

Time Period: 1/1/2001 to 9/30/2018



BBgBarc US Agg Bond TR USD	216.4	BBgBarc US Treasury US TIPS TR USD	239.1	BBgBarc US Treasury 20+ Yr TR USD	290.2
BBgBarc US Corporate High Yield TR USD	386.8	S&P 500 TR USD	313.7	S&P MidCap 400 TR	500.1
S&P SmallCap 600 TR USD	591.1	MSCI EAFE NR USD	209.6	MSCI EM NR USD	481.4
S&P Developed Small TR USD	461.4	FTSE Nareit All Equity REITs TR USD	586.2		

ty classes. The only equity class it beats is Developed International.

As the time frame increases, so does the probability that returns will come back to the averages/expectations. Every equity class we use in addition to the S&P 500 has a higher long term expected return than the S&P 500 itself. Over the long term, they are expected to add to return, not detract as they have done over the last few years. Over the long term, the portfolio must be able to take advantage of the return that would be left on the table if you only invested in large cap domestic. Look back at the above graph and notice some of the numbers in the legend. Creating a risk-tolerance-based portfolio meant to address an individual's long-term goals must account for the probability that there will be an increased return (*even before considering the*



Premise Capital 3rd Quarter Continued

decreased risk) by using these other classes, regardless of how they perform relative to the S&P in shorter time frames. That is one reason why **we create a strategic base-line - a long-term strategic portfolio comprised of our 12 core asset classes - at each risk tolerance**, and not a “go wherever you want” policy. That means our “fallback” or “home base” position is the diversified portfolio at your risk tolerance, instead of just cash or arbitrary positioning. Therefore, the tactical movement remains relative to the positioning of the classes from the traditional diversified portfolio. This will be reflected in model returns that are closer to diversified benchmarks at each risk tolerance and not returns that hover near the return of the S&P 500. While in the short term, it may be easy to think you would get the return of Domestic Large Cap, almost all would agree that over the long term, a diversified basket provides the best risk adjusted returns.

The lack of longer term return drag of the diversified basket can be seen in the following tables. It shows the same time frames as above, but with the diversified risk tolerance indices from both Morningstar and Dow Jones. You can see that over the last three years, the S&P has outperformed the moderately aggressive indices, albeit with more risk. The longer-term table shows the S&P return outperformance does not persist, yet the diversified portfolio risk reduction remains.

Aggressive: Equity<90%						
Time Period: 10/1/2015 to 9/30/2018		Calculation Benchmark: S&P 500 TR USD				
	Return	Std Dev	Sharpe Ratio	Sortino Ratio	Max Drawdown	
DJ Moderately Aggressive	11.95	10.14	1.53	1.80	-12.03	
Morningstar Mod Agg	11.76	9.85	1.55	1.82	-11.39	
S&P 500	17.30	14.21	1.61	1.89	-12.71	

Aggressive: Equity<90%						
Time Period: 1/1/2001 to 9/30/2018		Calculation Benchmark: S&P 500 TR USD				
	Return	Std Dev	Sharpe Ratio	Sortino Ratio	Max Drawdown	
DJ Moderately Aggressive	7.06	15.73	0.58	0.67	-48.87	
Morningstar Mod Agg	6.68	15.55	0.55	0.63	-46.19	
S&P 500	6.65	22.73	0.43	0.51	-55.25	

This year we have had an opportunity to underweight international and emerging markets - classes which have been very weak - and that has allowed us to outperform comparable diversified benchmarks. The equity portion of our portfolios is overweight domestic and that has been a positive, *but remember, that is a shorter term tactical move in a longer term diversified portfolio*. In the longer term, we would expect the other classes to outperform the S&P 500 as they have since 2001.



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It is that increased return, as well as the correlation-risk-reduction benefit, that keeps our strategic baseline a diversified portfolio. In sum, thinking a portfolio should have returned as much, or more, than the S&P 500 over the last few years, is in the long run, trying to win a battle but losing focus on the war.

Thank you again for your continued confidence in Premise.

The Premise Team

