

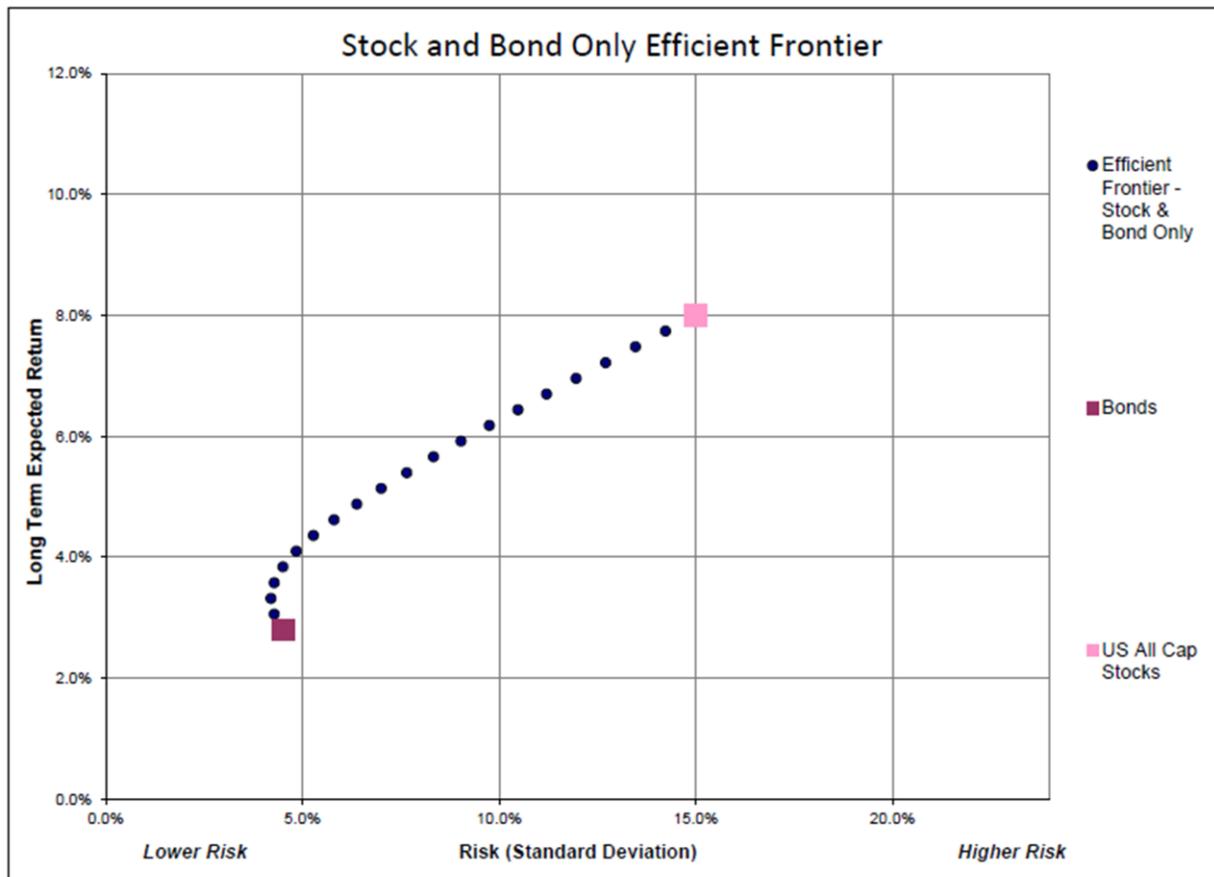


Global Strategy Update

FEBRUARY 2017

Historically, a typical U.S. individual investor has invested in a mix of U.S. stocks and bonds. This strategy was hugely successful in the post-World War Two era as the U.S. established itself as the largest and most dominant economy on the globe. However, after a lengthy post-recession bull market with growing uncertainty and interest rates near all-time lows, a stock and bond only portfolio is unlikely to provide returns approaching its historical levels going forward. For modeling purposes, we expect the broad U.S. stock market to provide returns of approximately 8.0%, modestly below long term historical norms, and investment grade bonds to provide an even lower approximated expected return of only 2.8%. (Please see full disclaimer at the end of this document.)

Diversification across stocks and bonds has been, and continues to be, a method to lower portfolio volatility, also known as risk (*Standard Deviation* is a typical measure of risk). We have plotted a mix of stocks and bonds on the graph below. The vertical axis shows the expected return and the horizontal axis shows the expected standard deviation. The graph below is commonly referred to as the “efficient frontier” for a two asset class world that only has stocks and bonds.



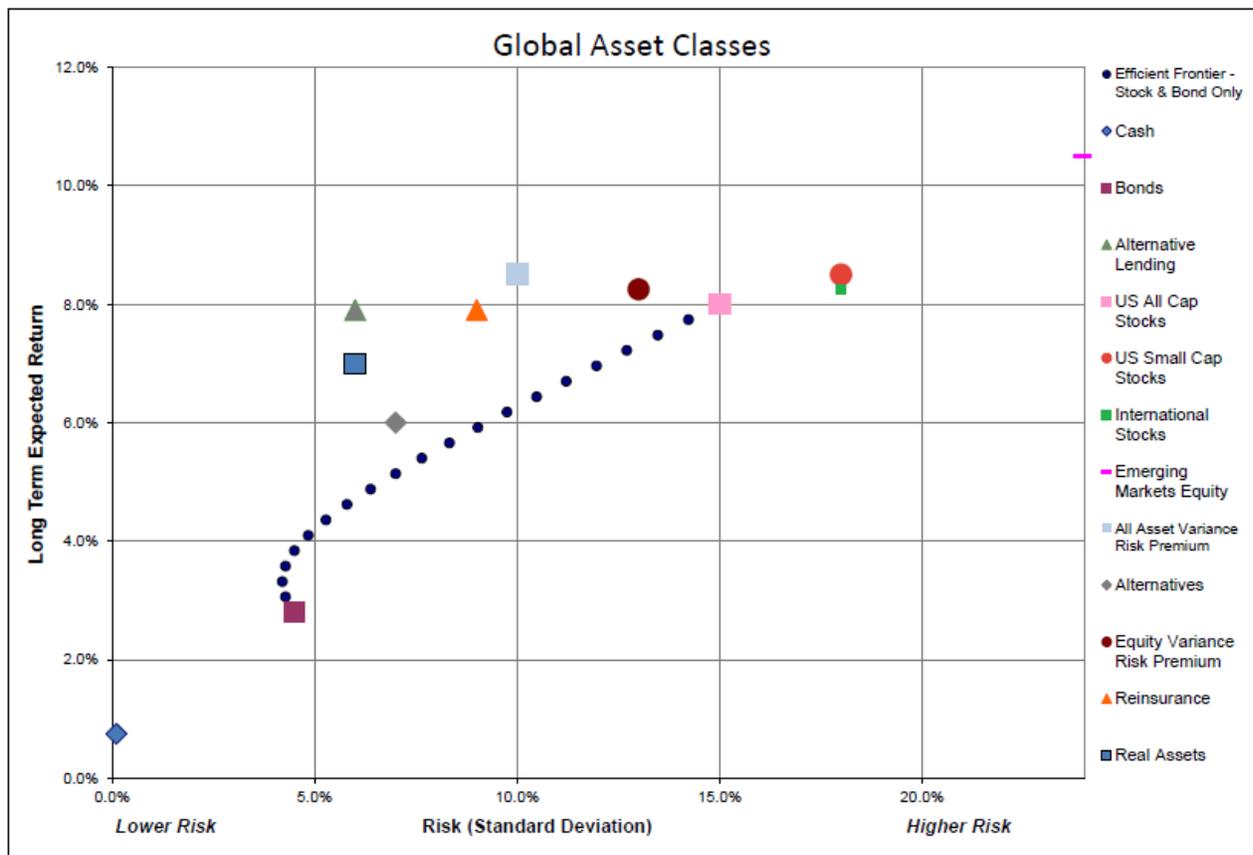
Efficient Frontier Points along the Curve

Stock and Bond Only Efficient Frontier

Asset Class Mix		Long Term Expected Return	Expected Risk
US All Cap	Bonds		
0%	100%	2.80%	4.5%
10%	90%	3.32%	4.2%
20%	80%	3.84%	4.5%
30%	70%	4.36%	5.3%
38%	62%	4.75%	6.1%
45%	55%	5.14%	7.0%
50%	50%	5.40%	7.7%
55%	45%	5.66%	8.3%
65%	35%	6.18%	9.8%
73%	27%	6.57%	10.8%
80%	20%	6.96%	12.0%
90%	10%	7.48%	13.5%
100%	0%	8.00%	15.0%

As depicted in the graph above, the greater the stock allocation, the higher the expected risk and the expected return. As an investor diversifies and adds more bonds into the portfolio, both the expected risk and the expected return move lower, until the allocation approaches almost all bonds; and then the expected returns continue to head down but expected risks actually increase modestly. Specifically, moving to a 100% bond portfolio actually *increases* the portfolio risk while *reducing* expected returns.

The good news is we are not limited to investing exclusively in U.S. stocks and bonds. In a globally diversified portfolio, we have the option of including other asset classes to diversify and improve the expected risk return profile.



The graph above shows these additional asset classes plotted next to the Stock and Bond Only Efficient Frontier. Each asset class has a different correlation with every other asset class. (*Correlation* is a measure of how asset returns move together) The higher the correlation, the more the moves are similar in magnitude and direction. When we diversify across asset classes that have low or moderate correlations with each other, the diversification will lower overall portfolio expected risk. We have built several model strategies comprised of different percentages of these additional asset classes, which take advantage of the benefits of diversification and less than perfect correlation.

Asset Class Returns

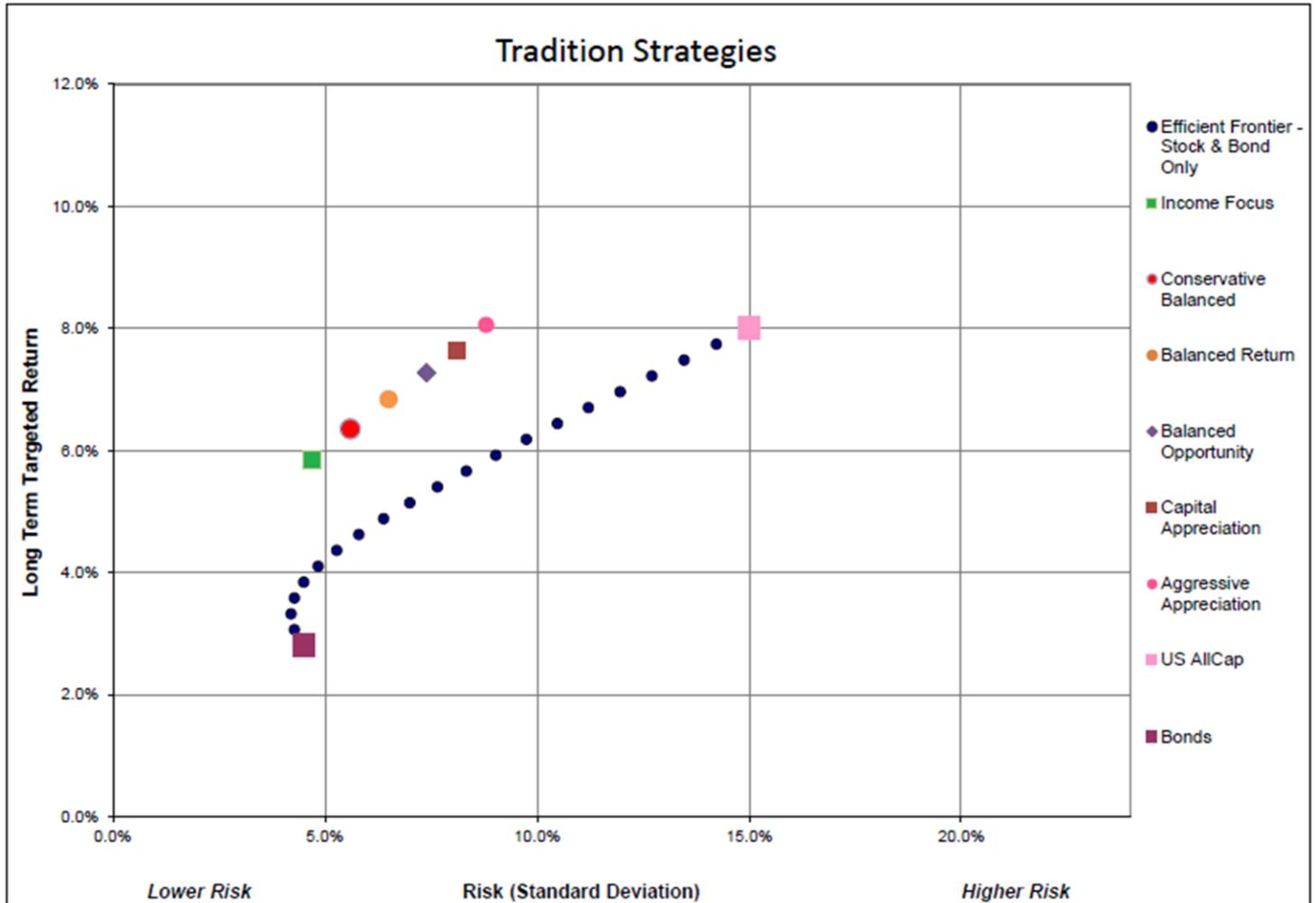
Asset Class	Long Term Expected Return	Expected Risk
Cash	0.75%	0.1%
Bonds	2.80%	4.5%
Alternative Lending	7.90%	6.0%
US All Cap Stocks	8.00%	15.0%
US Small Cap Stocks	8.50%	18.0%
International Stocks	8.25%	18.0%
Emerging Markets Equity	10.50%	24.0%
All Asset Variance Risk Premium	8.50%	10.0%
Alternatives	6.00%	7.0%
Equity Variance Risk Premium	8.25%	13.0%
Reinsurance	7.90%	9.0%
Real Assets	7.00%	6.0%

The table below outlines the expected return and expected risk parameters for these strategies. Please see full disclaimer at the end of this document keeping in mind that these are not projections, but are only used for modeling and long term cash flow analysis.

Model Strategies

Strategy	Long Term Targeted Return	Expected Risk
Income Focus	5.85%	4.7%
Conservative Balanced	6.35%	5.6%
Balanced Return	6.84%	6.5%
Balanced Opportunity	7.27%	7.4%
Capital Appreciation	7.64%	8.1%
Aggressive Appreciation	8.06%	8.8%

The graph below shows how these diversified strategies compare to the original Stock and Bond Only Efficient Frontier. As you can see, diversification improves the expected return at the same level of expected risk compared to the stock and bond only efficient frontier. Thus the diversified global strategies have expected return and expected risk profiles that are better than the typical U.S. investor's portfolio of only stocks and bonds over long investment horizons of ten or more years.



While the future, and specifically returns, are unpredictable, understanding how asset classes relate and work together is a valuable process for building better portfolios. The expected returns and expected risks are not forecasts but are essential tools as we strive to construct portfolios that have strong expected risk/expected return profiles. Please read the full disclosure directly below.

DISCLAIMER

For illustrative and discussion purposes only, to show possible return profiles of various asset classes. This illustration does not reflect historical returns nor is it a projection of future returns. Past performance is not indicative of future results. Investing involves risk and may result in losses. At a given time, any risk asset class or asset may lose value and result in substantial losses. Inflation risk is an additional risk for financial assets. This illustration is not GIPS compliant and is shown only for illustrative purposes. Tradition does not make any assertions, estimates or guarantees about future results. Future results are unpredictable and could result in losses. Expected return and expected risk are not forecasted returns or risks but are only statistical definitions for modeling purposes. The above is not meant to be a full or complete discussion of all the risks involved in investing as that is beyond the scope of the article; many of the risks involved in investing are not specifically named above but nonetheless still exist.