# Macro Allocation Fund

William Blair

Investment Review

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The Fund involves a high level of risk and may not be appropriate for everyone. You could lose money by investing in the Fund. There can be no assurance that the Fund's investment objective will be achieved. The Fund is not a complete investment program and you should only consider the Fund for the alternative portion of your portfolio. Separate accounts managed by the Advisor may invest in the Fund and, therefore, the Advisor at times may have discretionary authority over a significant portion of the assets invested in the Fund. In such instances, the Advisor's decision to make changes to or rebalance its clients' allocations in the separate accounts may substantially impact the Fund's performance. The Fund is designed for long-term investors.

The Fund may use investment techniques and financial instruments that may be considered aggressive—including but not limited to the use of futures contracts, options on futures contracts, securities and indices, forward contracts, swap agreements and similar instruments. Such techniques may also include short sales or other techniques that are intended to provide inverse exposure to a particular market or other asset class, as well as leverage. These techniques may expose the Fund to potentially dramatic changes (losses) in the value of certain of its portfolio holdings. Investments are subject to a number of other different types of risk, including market risk, asset allocation risk, credit risk, commodity risk, counterparty and contractual default risk, currency risk, and derivatives risk. For a more detailed explanation and discussion of these risks, please read the Fund's Prospectus.

**Performance cited represents past performance. Past performance does not guarantee future results and current performance may be lower or higher than the data quoted. Returns shown are average annual total returns, which assume reinvestment of dividends and capital gains. Investment returns and principal will fluctuate and you may have a gain or loss when you sell shares. Most recent month-end performance information for William Blair Funds is available by visiting the William Blair Funds Web site at www.williamblairfunds.com, or by calling the William Blair Funds at 1-800-742-7272.**

***Please carefully consider the Fund's investment objective, risks, charges, and expenses before investing. This and other information is contained in the Fund's prospectus, which you may obtain by calling 1-800-742-7272. Read it carefully before you invest or send money.***



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- **Macro Allocation is positioned cautiously in respect of systematic market risk (beta) and overall strategy risk as compared to the long-term expected averages.**
- **The macro environment still presents risks that mitigate the attractiveness of fundamental opportunities across the opportunity set.**
- **These risks include asset-market vulnerability after a prolonged period of market appreciation with low volatility, heightened geopolitical risks, and escalation of global trade tensions.**

**Performance Summary**

The Macro Allocation Fund completed the quarter with negative performance, with both aggregate market and currency exposures detracting. Within markets, the portfolio benefitted from long exposures to European equities like U.K., France, and Spain. Negative contributors to performance in the market strategy were long exposures to emerging market equities and sector positioning within U.S. equities. Within currencies, short exposures added value, particularly the New Zealand dollar, Thai baht, euro, and Czech koruna while long exposures in the Turkish lira, South African rand, and Great Britain pound detracted.

**Strategy Positioning**

Market strategy remains long of equities, with an effective exposure of +22%, with exposures generally unchanged during the quarter. The strategy's largest exposures remain in developed Europe, U.K., and emerging equities. Market strategy is slightly short of fixed income with a net exposure of -8%, with short exposure primarily in European government bonds.

Within currencies, strategy remains long of emerging currencies such as the Turkish lira, Philippine peso, and Indian rupee with the largest short positions in the Thai baht, Swiss franc, and New Zealand dollar.

**Strategy Review and Outlook**

Global equities made modest gains in the second quarter and did not revisit the year's low point, which coincided with the end of a volatile first quarter of 2018. In currency-hedged terms, the MSCI All Countries World index (hedged into U.S. dollars) rose by 2.9%. Developed country markets were up 3.8%, though hedged emerging equities lagged and returned -3.6%. Bond yields moved higher (again) in the United States and in some European markets (Italy, Spain), but not for the eurozone as a whole and not in Japan. Against a basket of developed currencies, the U.S .dollar strengthened, reversing its fall in the first quarter and some of its decline in 2017. The dollar also climbed relative to emerging market currencies, in some cases (Turkey, Mexico) particularly steeply. Other emerging currencies (India, Indonesia) were more resilient, particularly when their "carry" (nominal interest rate premium) is included.

Growth in the second quarter was mostly slower in advanced economies: both the United States and the eurozone posted weaker real GDP gains than in late 2017. In the United Kingdom, growth fell almost flat (partly attributable to bad weather). The larger developing economies, China and India, continued to expand relatively rapidly but India was not able to repeat its 2017 achievement of exceeding China. Among the slower-growing emerging economies, there was some acceleration in growth (from a low base) in Mexico and Brazil, while South Africa experienced a surprising slump. The International Monetary Fund, in its most recent update of its World Economic Outlook (in April), has become more optimistic about growth in 2018-19, though the IMF warned that risks to this improvement could come from trade tensions, asset market vulnerability, and geopolitical risks.

The Where stage of our investment process, which compares our estimate of fundamental value to current prices, suggests a medium amount of investment risk is currently appropriate in our portfolios. This applies to all of our risk budgets: systematic market (beta), unsystematic market (relative value), and currency. From a systematic market risk perspective, the Where stage informs us that equities in Europe (Italy, Spain, the United Kingdom, Greece) and select equity markets in the developing world are attractive while bonds are generally unattractive. From an unsystematic market risk view, unattractive equity markets in the Canada, Japan, South Africa, and Mexico provide us opportunities to be short. Looking across our currency universe, we see a mix of attractive and unattractive currencies in both developed and developing areas, a marked difference from the opportunity set we saw just a few years ago when we were generally long emerging currencies and short developed ones.

However, all three items mentioned in the IMF update (trade, market vulnerability, and geopolitics) also provide reasons why the risk taken in our strategies is lower than the "untainted" or pure valuation opportunity would warrant. This is not to ignore valuation altogether, but to take into account headwinds in our Why stage that, in most cases, are currently blowing in the opposite direction to the gradual pull of value. These headwinds are more prominent than was the case in 2017. Put simply, a widening opportunity set (price moving away from value) presents a challenging environment for fundamental investors. In such an environment, we do not necessarily avoid risk altogether, but rather we are more deliberate in accumulating active risk. We are then armed with ample dry "risk" powder so that we may appropriately take on more risk after such headwinds have created larger opportunities than were present before. We can take each of the three categories of investment headwind in turn.

Reductions in the volume of global trade, brought on by higher barriers to trade such as tariffs, are generally a growth-hampering impulse. Higher trade barriers have been both implemented and threatened in recent months, mostly led by the U.S. administration's more protectionist stance under President Trump, and involving Canada and Mexico (via the North America Free Trade Agreement or NAFTA), China, and recently Europe. The geopolitical dynamic of trade disputes is best appreciated by analysis of the incentives facing the governments that are involved. "Nobody wants a trade war" is a truism deriving from the assumption that, in aggregate, all parties suffer a negative growth outcome the more free trade is impaired, but at the same time it is well understood that in game-theoretical terms, one player's best reply to another's raised trade barrier is to reciprocate, leading to a pattern known as "tit-for-tat." Therefore, uncertainty and risk is increased by the deliberate actions of the players, even though their encompassing best interests would be better served by not escalating and indeed de-escalating the situation. For these reasons, we are negative on trade-sensitive markets and have reflected this in our portfolios—we are less long of Chinese equities and the Mexican peso than fundamentals suggest, and we are more short of Canadian equities than we would be without this elevated risk. We do not, however, expect a dramatic and negative trade war as a base case, and this is due to the encompassing best interest noted above. In this vein, dialing down of trade threats (U.S.-China) and/or delaying their implementation have also been features of political maneuvers in recent months. But the bottom line is that this aspect of global policy is producing increased uncertainty (a headwind) that was not present in recent years.

We share the IMF's concern about market vulnerability for reasons outlined in our first-quarter letter. The experience of 2017, when we saw little-to-no volatility and high equity returns, still renders market prices fragile, we believe. This is especially the case because of the large growth of passive, or rule-following, strategies, and the corollary of potentially significantly lower discretionary liquidity being available (an evolution also driven by market regulation of recent years) should the market conditions that have rewarded passive strategies end, or reverse. This vulnerability had already become more visible in the first quarter of 2018. But, notwithstanding market events in February and June, this situation (much rules-based trading, less room for liquidity expansion) has not yet been stressed, making its potential impact substantially unknowable. Although we find reason to be concerned about market fragility, it is costly, over time, to protect against adversity by buying options (which for a premium can automatically reduce long exposure to markets that fall). Our approach to the vulnerability concern has been (i) to carry less systematic risk in portfolios than valuation justifies, and (ii) to hold long option protection against a large adverse market move, that would not particularly change portfolio behavior in the case of moderate or normal downside volatility, and which, therefore, does not cost so much in option premium. Our option positions are dispersed across asset classes: protection on small-cap eurozone equity, on three emerging currencies (Chinese yuan, Philippine peso, Indian rupee), and long optionality to the spread of high yield over investment grade fixed income. In each case, our analysis anticipates that "risk-off" market behavior would result in all three effectively reducing portfolio downside beta (sensitivity to falling equities).

Thirdly, geopolitical risk remains pronounced across our investment universe. In particular, politics has added to investor uncertainty in the most recent quarter and contributed to price weakness in both Italy and Turkey. In Italy's case, a general election in June that produced a hung parliament led to almost three months of negotiations before a government comprising Italy's two largest populist parties was finally formed. During this negotiation period, fears were raised both about Italy remaining in the eurozone (to which the new government committed, but not until early June), and likely fiscal expansion by the government breaching the zone's deficit limits and adding to the country's very high public debt load. Italian government bond yields jumped higher, and equities, which had performed well until early May, dropped. We cut our long exposure to Italian equity before the sell-off (having increased it in the prior quarter and benefiting from market strength at the time), such that Italy becomes another market in which we have dampened risk relative to the opportunity, this time owing to geopolitics.

In Turkey, President Erdogan called a snap election in April (one year early), and while campaigning in May stated that he would seek to influence the central bank to lower interest rates despite high inflation caused in part by depreciation of the Turkish lira. This frightened market participants and gave the lira a further sharp fall, with the consequence that the central bank stepped in to increase interest rates, twice, quite probably by more than would have been the case absent Mr. Erdogan's verbal interference. We made two increases to the strategy's long lira exposure through this episode, and at quarter end, it was our largest long exposure. Looking forward, substantial political risk remains in respect of Turkey, but we believe that May's experience with the lira largely reduces the danger of renewed rhetoric that would compromise monetary policy. Put bluntly, Mr. Erdogan "played chicken" with the currency market and lost. Hence we are content to increase our exposure to a now very large divergence between currency value and price.

In the United Kingdom, negotiations with the European Union about the United Kingdom's departure ("Brexit") became dominated by a near-unanimous political imperative to avoid re-establishment of a customs border between Northern Ireland (part of the United Kingdom) and Ireland, which was removed when the EU's "single market" was created in 1993 and would need to be reinstated if the United Kingdom exited the single market, as is official government policy. The reason almost all parties are distinctly unwilling to countenance a new border is that it would echo (in sentiment) a military border that divided the countries during the Northern Ireland "Troubles" (ethno-nationalist conflict involving paramilitary groups), which have been over since a 1998 peace accord was reached. The interest in the objective of no border appears to have greater compulsion across political "players" than the coalition that favors what is known as "Hard Brexit," involving the United Kingdom leaving with nothing similar to the single market, or existing customs union, in place. The political outturn from this has been general delay since a solution is not apparent that reconciles both interests; we also conclude that the likelihood of "Soft Brexit" has risen. The latter is preferable to the former from a market perspective, both as it relates to U.K. equity and the British pound (both of which we regard as attractive relative to fundamental value). We maintain both of our long exposures.

In the larger picture, our longer-term investment objective is to deliver positive investment returns above inflation through a market cycle. We remain grounded in fundamental valuation as our first step—we strive to only take compensated risk and are unwilling to extend exposures unduly in a reach-for-yield that would be dictated not by opportunities and risks but by very low real interest rates. There will be environments in which we conclude that macro markets do not provide returns and risks compatible with portfolio objectives alongside other periods where compensation is abnormally high. During the last decade, the challenge of navigating these evolving environments has remained a significant component in the investment landscape, but we find our investment process, dialogue, and decision-making well-equipped to meet this challenge in an appropriate way. We remain vigilant as we assess new and relevant information to capture future investment opportunities in a timely manner and will continue balancing the relationship between risk taken and compensation expected.

| *Investment Performance for Periods ended 6/30/2018* | 3 Months | YTD | 1 Year | 3 Year | 5 Year | Since Incept.* | Since Incept.** |
|---|---|---|---|---|---|---|---|
| Macro Allocation Fund (WMCJX) Institutional Class | -2.01% | -1.43% | 1.07% | -1.30% | -- | 1.08% | -- |
| Macro Allocation Fund (WMCIX) Class I | -2.01% | -1.52% | 0.97% | -1.40% | 2.29% | -- | 4.87% |
| Macro Allocation Fund (WMCNX) Class N | -2.02% | -1.60% | 0.63% | -1.68% | 2.00% | -- | 4.60% |
| BofA Merrill Lynch 3-Month U.S. Treasury Bill Index | 0.45% | 0.81% | 1.36% | 0.68% | 0.42% | 0.45% | 0.34% |
| HFRI Macro Discretionary Thematic Index | 1.72% | 1.00% | 0.47% | 0.00% | 0.25% | 0.18% | 0.60% |
| U.S. CPI + 5% | | | | | | 6.53% | 6.52% |

* Inception: 10/21/2013
**Inception: 11/29/2011

**Expense Ratios:**

| | Gross | Net |
|---|---|---|
| **Institutional** | **1.08%** | **1.08%** |
| **Class I Shares** | **1.18%** | **1.18%** |
| **Class N Shares** | **1.53%** | **1.47%** |

**Expenses shown are as of the most recent prospectus and include acquired fund fees and expenses. The net expense ratio reflects that the Fund's Adviser has contractually agreed to waive fees and/or reimburse expenses to limit fund expenses until 4/30/2019. The investor will pay the net expense ratio. The Adviser has contractually agreed to limit the Fund's operating expenses (excluding acquired fund fees and expenses, borrowing costs, brokerage commissions, taxes, other investment-related costs and extraordinary expenses) to 1.25% of average daily net assets for Class N shares until 4/30/2019. Please refer to the Fund's Prospectus for more information on the Fund's expenses.**

**Performance cited represents past performance. Past performance does not guarantee future results and current performance may be lower or higher than the data quoted. Returns shown are since inception total returns, which assume reinvestment of dividends and capital gains. Investment returns and principal will fluctuate with market and economic conditions and you may have a gain or loss when you sell shares. For the most current month-end performance information, please call 1-800-742-7272, or visit our Web site at www.williamblairfunds.com. Class N shares are available to the general public without a sales load. Institutional Class and Class I shares are available to certain institutional investors.**

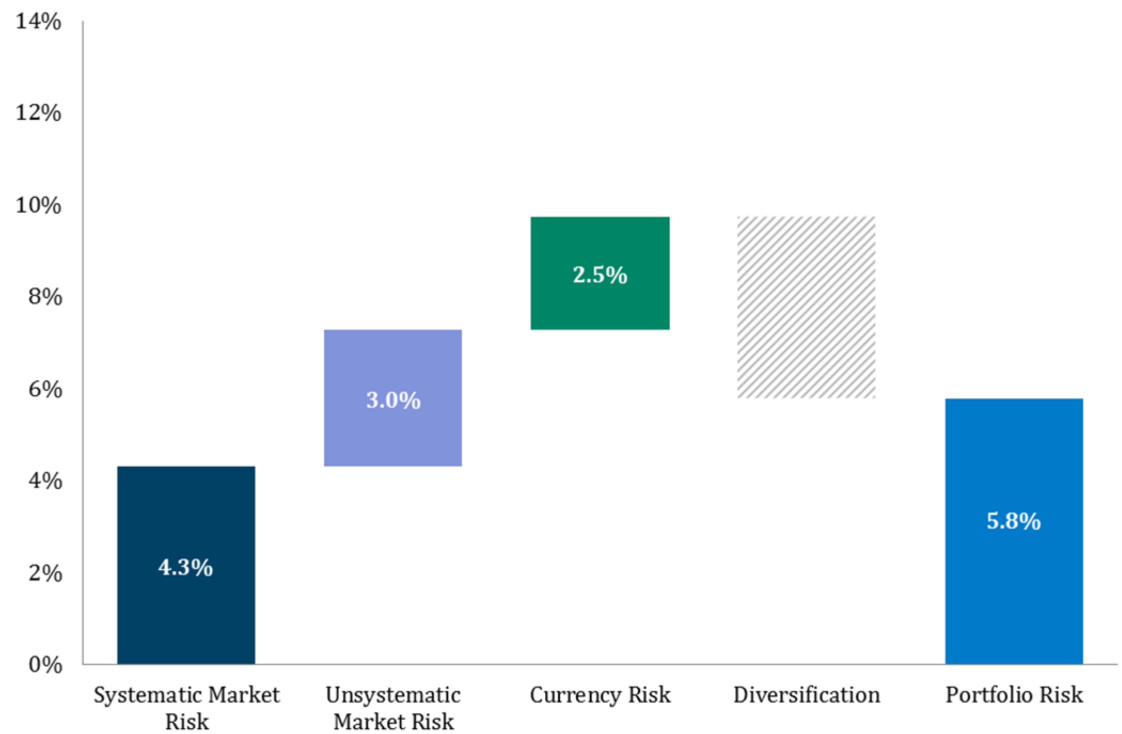
The BofA Merrill Lynch 3-Month U.S. Treasury Bill Index measures total return on cash, including price and interest income, based on short-term government Treasury Bills of about 90-day maturity. The index is unmanaged, does not incur fees or expenses, and cannot be invested in directly. The U.S. CPI + 5% is not a benchmark but is included as supplemental reference as the long-term return objective. The HFRI Macro Discretionary Thematic Index includes hedge fund strategies primarily reliant on the evaluation of market data, relationships and influences, as interpreted by an individual or group of individuals who make decisions on portfolio positions; strategies employ an investment process most heavily influenced by top down analysis of macroeconomic variables. Constituents are equally weighted and returns are reported net of underlying manager fees. The index is unmanaged and cannot be invested in directly.

The below table shows the calculated regional performance attribution of the Macro Allocation Fund by asset segment as of quarter-end.

| **Macro Allocation June 2018** | **Equity** | **Rates** | **Credit** | **Currency** | **Residual / Other** | **Total** |
|---|---|---|---|---|---|---|
| North America | -0.63% | 0.49% | -0.08% | 0.00% | | **-0.21%** |
| Developed Europe | 0.79% | -0.15% | -0.01% | 0.40% | | **1.03%** |
| Developed Asia (ex Japan) | -0.21% | 0.00% | 0.00% | 0.46% | | **0.25%** |
| Japan | -0.14% | 0.00% | 0.00% | -0.27% | | **-0.41%** |
| Emerging Markets | -1.64% | 0.00% | -0.01% | -0.84% | | **-2.49%** |
| Multi-Region | 0.13% | 0.00% | 0.00% | 0.00% | | **0.13%** |
| Residual/Other | | | | | | **-0.33%** |
| **Total** | **-1.69%** | **0.35%** | **-0.09%** | **-0.25%** | **-0.33%** | **-2.02%** |

*Past performance does not guarantee future results. Portfolio exposures and attribution are based on the Macro Allocation Fund (Class N). Performance attribution is sourced from Cloud Attribution Ltd. Using the Karnosky-Singer performance attribution methodology.*

The below chart shows the expected sources of investment risk* for the Macro Allocation Fund.




*Source: William Blair*
*The DAS team's expectation of the portfolio's volatility as viewed through the team's proprietary Equilibrium risk model, in which the team's long-term return and risk assumptions are quantified. Equilibrium can be thought of as "normal" state risk.

The detail below shows selected market and currency strategy exposures of the Macro Allocation Fund as of quarter-end.

| **Equity** | **22.1%** |
|---|---|
| **U.S.** | -0.3% |
| **Canada** | -3.6% |
| **Europe (ex-U.K.)** | 9.4% |
| **UK** | 6.4% |
| **Asia Developed** | -0.2% |
| **Emerging** | 10.4% |

| **Fixed Income** | **-7.9%** |
|---|---|
| **U.S. Treasury & Credit**[1,*] | -0.2% |
| **Non-U.S. Treasury & Credit**[1,*] | -8.5% |
| **Emerging** | 0.7% |

| **Unencumbered Cash** | **26.7%** |
|---|---|

| **Active Currency** | |
|---|---|
| **U.S. Dollar (USD)** | -7.3% |
| **Canada Dollar (CAD)** | 0.0% |
| **Other Americas** | 12.5% |
| **Euro (EUR)** | -8.0% |
| **Switzerland Franc (CHF)** | -7.0% |
| **Great Britain Pound (GBP)** | 7.0% |
| **Other Europe** | -0.5% |
| **Australia Dollar (AUD) and New Zealand Dollar (NZD)** | -13.0% |
| **Japan Yen (JPY)** | 6.0% |
| **China Yuan (CNY)** | -1.7% |
| **Asia (Excluding JPY and CNY)**** | 0.0% |
| **Other** | 12.0% |

[1]Reflected as 10-year exposures

| ***Credit Detail** | |
|---|---|
| *U.S. Investment Grade Spread* | *5.3%* |
| *U.S. High Yield Spread* | *-1.0%* |
| *U.S. MBS Spread* | *0.0%* |
| *European Investment Grade Spread* | *2.2%* |
| *European High Yield Spread* | *0.0%* |

| ****Select Exposures Detail** | |
|---|---|
| *Indian Rupee (INR)* | *7.3%* |
| *Philippine Peso (PHP)* | *10.5%* |
| *Singapore dollar (SGD)* | *6.5%* |

Not intended as investment advice. Allocations are subject to change without notice.

This section provides additional commentary relating to the strategy changes within the Macro Allocation Fund during the quarter.

**4 April 2018: Decreasing U.S. equity via Financials and Information Technology**

From a fundamental valuation perspective, U.S. equity remains modestly unattractive in aggregate; however, we continue to see sectors that are more value-oriented as relatively attractive and growth sectors as relatively unattractive. IT and Financials are good examples of sectors with those style biases with U.S. Financials relatively attractive and U.S. IT more notably unattractive. From a conventional wisdom perspective, U.S. Financials remain sensitive to interest rates, with higher rates tending to lead to higher margins, all else equal. With respect to IT, the conventional wisdom has been fairly homogeneous and persistently positive in its outlook for companies associated with disruption/innovation. Although conventional wisdom is quite supportive towards both IT and Financials, our sense is that support may be ebbing on a forward-looking basis due to an elevation of previously benign regulatory and populist issues in the lead up to the midterm elections. This strategy change reduces systematic market risk.

**9 April 2018: Increasing Indian rupee (INR), Philippine peso (PHP) and decreasing Chinese yuan (CNY) using currency options**

From a fundamental valuation perspective, the relative shift from the Chinese yuan (CNY) to the Indian rupee (INR) and Philippine peso (PHP) is supported by relative movement in value to price discrepancies. Furthermore, this strategy change is also rooted in increasing nonlinear ("convex") protection in an environment of significant emerging currency weakness, which could be linked to generalized equity market falls and higher volatility. This strategy change slightly increases currency risk.

**13 April 2018: Increasing Russian ruble (RUB) and decreasing Chinese yuan (CNY)**

Following recent appreciation to our long exposure in the Chinese yuan (CNY) and recent weakness to Russian ruble (RUB), this change is justified by valuation considerations. From a conventional wisdom standpoint, the CNY has appreciated as market participants have rewarded the environment of leadership stability and incremental growth reforms in China, and have so far shrugged off increased bilateral trade tensions between China and the U.S. The RUB has contrastingly fallen as geopolitical tension between Russia and the U.S. has increased, which has had ramifications in respect of diplomacy and economic sanctions. This strategy change slightly reduces currency risk.

**13 April 2018: Decreasing Russian equity**

From a long-term fundamental valuation perspective, Russian equity remains one of the more attractive equity markets globally. Russia has been through a dramatic cycle during the past few years, primarily as a result of its significant sector exposure to energy. U.S. opposition to Russia with respect to military operation in the conflict in Syria creates an environment of higher geopolitical risks, escalation of military force, sanctions, and/or political exclusion, which may cause further upset on the market. Our sense is that if another round of retaliation comes from the U.S., it will likely be directed at specific corporates, rather than something broader based, which would impact sovereign debt and, thus, the ruble. This strategy change reduces both systematic and unsystematic market risk.

**18 April 2018: Decreasing Mexican equity**

From a fundamental valuation perspective, Mexico equity is one of the more unattractive equity markets. However, most recently, Mexico equity prices have risen on an absolute basis and relative basis versus the rest of the world, and therefore the valuation case has become more compelling. From a conventional wisdom perspective, Mexico equity is typically viewed as a relatively low-risk emerging market. However, conventional wisdom for Mexico has become much less sanguine in the aftermath of the U.S. election in 2016 and in the lead-up to the election in Mexico this July. The shift is a function of both the ongoing NAFTA negotiations and the rise in popularity of Mexico's populist presidential candidate, Andres Manuel Lopez Obrador (AMLO). This strategy change reduces both systematic and unsystematic market risk.

**2 May 2018: Increasing Mexican peso (MXN) and decreasing Chinese yuan (CNY)**

From a fundamental valuation perspective, the Mexican peso (MXN) is sufficiently undervalued to justify larger exposure while the Chinese yuan's (CNY) undervaluation has been reduced to warrant a reduction in exposure. We reduced MXN exposure early in the year due to MXN's sensitivity to domestic political risks like the upcoming presidential election and trade. We conclude that the domestic political risks about which we were concerned are fully anticipated already by conventional wisdom, suggesting that there is not a need to continue to de-risk the valuation opportunity. This strategy change slightly reduces currency risk.

**2 May 2018: Increasing Swedish krona (SEK) and decreasing Israeli shekel (ILS)**

From a long-term fundamental valuation perspective, the Swedish krona (SEK) remains fundamentally undervalued while the Israeli shekel (ILS) is relatively overvalued. Comparing against the euro (EUR), SEK has depreciated with recent falls being attributed to expectation that the European Central Bank (ECB) may remove extraordinary easy monetary conditions at a faster pace than the Swedish Central Bank ("Rijksbank"). However, even without a move from the ECB, SEK still attracts negative carry relative to the EUR. Our conclusion is that this carry prospect is more than compensated for by the SEK's resulting cheapness so as to justify responding to the valuation opportunity. While the Israeli economy has been strong despite continuous geopolitical uncertainties, we find that the increase in ILS overvaluation to have reached a significant level. This strategy change slightly reduces currency risk.

**10 May 2018: Increasing South African equity and decreasing Italian equity**

From a long-term fundamental valuation perspective, Italian equity remains attractive while South African equity remains somewhat unattractive on both an absolute and relative basis. Recently, this relative valuation opportunity has narrowed with Italy outperforming South Africa. In Italy, the populist push to form a government continues to drag out with negotiations now in their third month since the election in early March. However, the market appears a bit sanguine again as we enter a potential inflection point in this negotiation phase that will see either a new election triggered or a populist led coalition between Five Star and the League. In South Africa, Cyril Ramaphosa continues to operate as President of the ANC since he replaced Jacob Zuma when he was forced to resign in mid-February. The market generally presumes many of South Africa's challenges will remain unchanged in the near term—most notably their sliding fiscal situation that has rating agencies split between investment and non-investment grade. This strategy change slightly reduces unsystematic market risk.

**10 May 2018: Increasing U.S. equity via Telecom**

From a long-term fundamental valuation perspective, U.S. equity in aggregate remains modestly unattractive; however, on a sector level, we have seen the U.S. Telecom sector underperform to the point where it has become attractive on a relative basis. From a conventional wisdom perspective, the U.S. Telecom sector represents a more value-style based sector where growth remains largely constrained by regulation and a maturing product cycle. Telecom has been at the crosshairs of U.S. regulation for some time but this risk has been elevated more recently, in particular, with respect to objections and challenges to further M&A, both within the U.S and on a global basis. This strategy change slightly increases systematic market risk.

**15 May 2018: Increasing Mexican equity**

From a fundamental valuation perspective, Mexico equity is one of the more unattractive equity markets. Conventional wisdom typically views Mexican equity as a relatively low-risk emerging market, but since the U.S. election in 2016 and given the upcoming election in Mexico, conventional wisdom has become less sanguine. While Mexico's primary presidential candidate, Andres Manuel Lopez Obrador (AMLO), is a left wing populist whose policies may be negative for the market, we see that his victory has been priced into the equity market for the most part. Additionally, we believe that the upcoming NAFTA negotiations will most likely occur after the Mexican election and before the U.S. mid-term elections, which would likely be positive for Mexican equities as a major uncertainty is removed. This strategy change increases systematic market risk.

**18 May 2018: Decreasing Spanish equity**

From a fundamental valuation perspective, Spain equity remains one of the more attractive equity markets. Conventional wisdom views Spain as a relative bright spot within the EMU in terms of economic growth and financial reform. In addition, after navigating some of the ever-present challenges in Catalonia, Spain remains a low-intensity constituent within the Populism theme and one of the less influential players in the current EU game theater centered on Brexit negotiations. Risk considerations were a large motivation for this change. After taking advantage of opportunities to increase emerging equities in Mexico and South Africa, we are pairing back some exposures within Europe. This strategy change slightly decreases systematic market risk.

**25 May 2018: Increasing Turkish lira (TRY) and decreasing Australian dollar (AUD)**

Concerning fundamental valuation, the Turkish lira (TRY) has weakened significantly against almost all currencies, including the Australian dollar (AUD), which warrants increasing exposure in TRY and decreasing AUD. The lira's significant depreciation was primarily driven by the increasingly authoritarian rule by Turkey's President Erdogan and his influence on Turkey's central bank, which resulted in a failure to raise interest rates amid high inflation. The central bank did finally raise rates, albeit with severe currency depreciation, and we see TRY stabilizing in the short term amid a large valuation opportunity driven by this depreciation. Although emerging market currencies do at times go through periods of correlated movement (up and down) in "risk on" / "risk off" situations, we believe that the current situation in respect of the TRY is overwhelmingly idiosyncratic such that the Turkish lira (TRY) represents a large (valuation) opportunity that has been created for domestic reasons and is largely not correlated with our strategy exposures elsewhere. We believe it is highly appropriate to increase TRY exposure following recent events, and strategy has the capacity to increase this allocation even further, contingent on future developments. This strategy change slightly increases currency risk.

**31 May 2018: Increasing Turkish lira (TRY) and decreasing Chinese yuan (CNY)**

Concerning fundamental valuation, the Turkish lira (TRY) has weakened significantly against almost all currencies, including the Chinese yuan (CNY), which warrants increasing exposure to the TRY and decreasing our exposure to the CNY. Recent pressure by President Erdogan on the Turkish Central Bank to not raise rates triggered a massive depreciation of the lira and caused the Turkish Central Bank to belatedly respond by raising rates even faster and higher than what would have otherwise been the case. Due to President Erdogan's failure to keep interest rates low at the cost of a depreciating lira, we conclude that the threat of renewed rhetoric to undermine the currency is significantly lowered—at least in advance of the June election. Although this does not remove all short-term risks surrounding the TRY, our response is to move further into what is a very large fundamental opportunity. This strategy change slightly increases currency risk.

**6 June 2018: Increasing Brazilian equity and Brazilian real (BRL), decreasing Russian equity and Russian ruble (RUB)**

From a long-term fundamental valuation perspective, all markets and currencies in this strategy change are attractive on an absolute basis. However, Brazil equities and the Brazilian real have underperformed their Russian counterpoints on a relative basis. The primary conventional wisdom backdrop in Brazil has, for some time, been one of high risk aversion brought on by a period of economic recession and a significant inflation spike. We see more turbulence in the coming election; however, we anticipate that the period after the elections will be characterized by market friendly reforms, albeit, as always, in fits and starts. Russia, meanwhile, has no prospects for reform in the foreseeable future. We also see a threat to Russia as a natural-gas power, as increased natural gas supplies worldwide will likely depress gas prices in the years to come. We also see heightened short-term risk in Russia with the probability of the U.S. imposing more company-directed sanctions on the country. This strategy change results in little change to overall portfolio risk.

**15 June 2018: Decreasing Argentine equity**

From a long-term fundamental valuation perspective, Argentina equity remains modestly attractive. We believe that the aggressive pursuit of institutional reforms under President Mauricio Macri remains on track, especially after successful legislative elections last fall. However, the question remains whether Macri will be able to lead beyond one term and make these needed leaps in institutional reform, which tend to happen more slowly. More recently, we have seen the Macri administration coming under pressure, primarily due to a falling peso and subsequent support needed from the IMF. We are increasingly concerned the medium-term polls will show weakened support for Macri, with more resistance to his policies emanating from the Peronist opposition. While elections are still a ways off (October 2019), a fall in the polls in the meantime would likely be a setback to the markets. This strategy change slightly decreases portfolio risk.

**20 June 2018: Increasing Great Britain pound (GBP) and decreasing Thai baht (THB)**

From a fundamental valuation perspective, the Great Britain pound (GBP) is modestly attractive while the Thai baht remains unattractive; however, this change goes beyond the valuation case for GBP. Although the GBP is on balance stronger than at the time of our last purchase after the U.K. referendum in November 2016, and although valuation does not indicate a bigger exposure, we are increasing long GBP because we conclude that political dynamics have increased the likelihood of "Soft Brexit"; meaning the U.K. remains in the customs union, or something very similar, for an extended time and perhaps permanently. This outcome is likely less adverse for U.K. growth, U.K. assets and the GBP. The sale of THB lowers our aggregate Asian (ex JPY) currency exposure from slightly long to approximately flat (excluding the more developed Singapore dollar (SGD), the aggregate Asian emerging currency exposure is net short as a result). We are comfortable with this position in the light of heightened "tit-for-tat" protectionist trade aggression between the U.S. and Chinese governments, which (among other things) may raise the short term downside risk for the Chinese yuan (CNY) and, along with that, other Asian emerging currencies. This strategy change slightly increases currency risk.

**26 June 2018: Increasing U.S. dollar (USD) and decreasing Chinese yuan (CNY)**

From a fundamental valuation perspective, the U.S. dollar (USD) is expensive and the Chinese yuan (CNY) is about fairly valued. We believe that the near-term environment for the CNY is more adverse than previous both due to a potentially more intense impact from our macro theme "China growth" and from increased bilateral protectionist threats and actions between the U.S. and Chinese governments. Although it is not a base case scenario, deliberate CNY depreciation could be considered as a protectionist lever from the Chinese side. Accordingly, we decrease our CNY exposure despite its recent fall. This strategy change keeps portfolio risk unchanged.

**29 June 2018: Increasing Mexican peso (MXN) and decreasing Colombian peso (COP) and Thai baht (THB)**

Relative value-to-price discrepancies justify this strategy change. Additionally, for the MXN, we anticipate that the risks behind our prior attenuation of Mexican peso exposure are essentially priced in. On the eve of the presidential election, victory for Andrés Manuel Lopez Obrador (AMLO), a left-leaning candidate, is highly discounted while trade talks with Mexico's NAFTA partners have been put on hold around the election, but will likely resume shortly after. Mexico's inflation and monetary policy settings are more favorable to investment compensation from Mexican peso exposure than previously. We are decreasing Colombian peso and Thai baht as the counterpart to the purchase of Mexican pesos such that this change does not alter our aggregate exposure to emerging market currencies. This strategy change slightly increases currency risk.

# *Glossary - Terms*

**Beta:** A quantitative measure of the volatility of the portfolio relative to the overall market, represented by a comparable benchmark. A beta greater than 1 is more volatile than the overall market, while a beta less than 1 is less volatile, and could be expected to rise and fall more slowly than the market.

**Risk (Standard Deviation):** A measure of the portfolio's risk. A higher standard deviation represents a greater dispersion of returns, and thus a greater amount of risk. The annualized standard deviation is calculated using monthly returns.

**Sharpe Ratio:** A risk-adjusted measure calculated using standard deviation and excess return (Portfolio return – Risk Free Rate) to determine reward per unit of risk. The higher the Sharpe ratio, the better the portfolio's historic risk-adjusted performance.