Lee Adaptive Strategies Update

Monthly Commentary

June 2019

Non-Random Walks

June was a good month. The S&P 500 gained 7.05% and the MSCI AC World gained 6.59%. Of course, exuberance was dampened by the recollection that May had been a bad month. June more or less neatly made up for it, giving the S&P a two-month gain of 0.26%. Investors can be forgiven for being less than giddy.

In some circles, particularly academic ones, it is popular to think of market returns as being a random walk. That is, that each day/month/year the market randomly goes up or down without reference to what happened the day/month/year before. We are not sure how many investors actually think this is how the market works, but it is the basic assumption that underlies most financial theory and such things as option pricing and risk models.

In contrast, most investors believe that the market has some kind of memory, that the recent history of the market (or of an individual stock) has an impact of some kind on near-term returns. Just how the past affects the future is a bit controversial. Momentum investors believe stocks that have been going up tend to continue going up, while contrarian investors think that price movements tend to revert back to a mean, that what goes up must come down. But few agree with the nihilism of the random walk.

Our view is nuanced, if somewhat contradictory. We think both momentum and contrarian philosophies have merit, depending on time frame. We believe in reversion in the short term, that a stock that goes up sharply over a day or two is more likely to go down immediately after, and in momentum in the medium term, that a stock that has done well over the past three or four months is more likely to continue to rise than not.

More broadly, we believe that humans have a nearly irresistible urge to invent narratives for past price movements. The first thing that every investor does when considering a stock, ETF, or index is to look at a chart of prices over the past six to twelve months. They may not be able to articulate what they are looking for, but consciously or not the squiggly line assumes some kind of meaning.

One of the factors that we use to evaluate the near term prospects for the market is something we call Behavioral Momentum. It is similar in spirit to typical momentum measures, where positive (or negative) recent price movements imply positive (or negative) outlooks. But there is a twist. Price movements are considered in the context of market history. Simplifying considerably, an upward movement in prices that creates a new high for the year is a more positive signal than the same upward movement that merely recovers from a low and leaves prices in the middle of their range.

The S&P 500 was down -6.35% in May. That is quite similar to October of 2018, when it lost -6.83%. But the psychological results of the two months were significantly different. October was a rude awakening. The market, which had before then gone up calmly for six months in a row, suddenly had its worst month in eight years. It was followed by an anemic gain in November and then a frighteningly bad December. This May, on the other hand, was disappointing but not alarming, and was followed by a nice bounce back in June.

The simple momentum or contrarian viewpoint would have similar months such as October and May producing the same forecast, whatever that might be. The more subtle approach considers context. The aftermath of May was less severe than last fall partly because it closely followed last fall. Not only did May not seem so bad when compared to other recent bad months, but the market rebounded strongly from those recent bad months. For better or worse, the simplistic lesson from Q4 2018 was not to worry and stay invested.

Our models had us reduce market exposure in November 2018, partly in response to the market experience in October. For a few weeks, that seemed to be a prescient move, until the market rebounded so convincingly in January. This month, following a similarly poor May 2019, our models told us to do nothing. So far, that seems prescient.

The Market Sentiment Framework

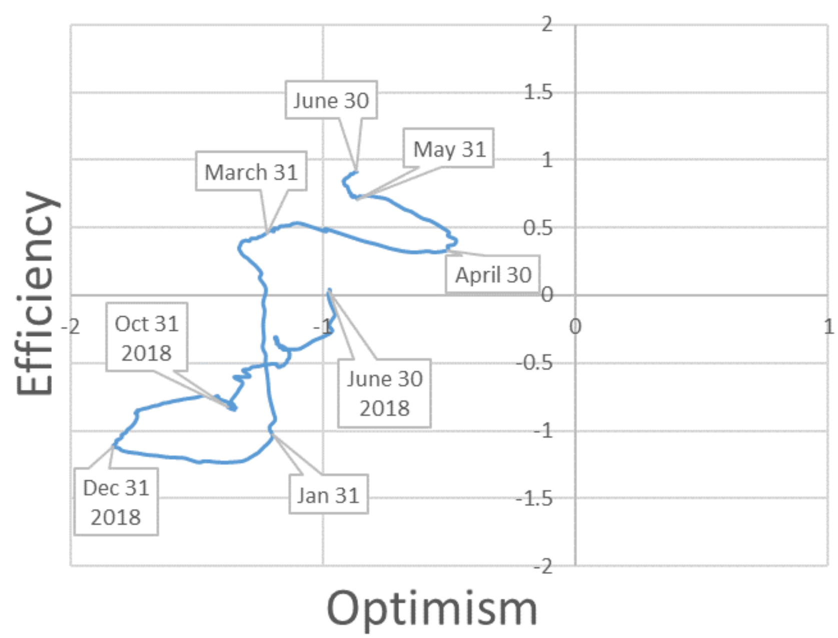
We use our Market Sentiment Framework to adapt the mechanics and weightings of our full quantitative models to changing market conditions. The Sentiment Framework gauges the current state of market psychology on two dimensions. Efficiency measures the crowdedness of the market, the volume of participants seeking investment opportunities. Lower levels of efficiency imply more market mispricing. Optimism measures the willingness of investors to take on risk in exchange for distant and uncertain rewards. Higher levels of optimism imply a better outlook for risky asset classes.

During June the level of both Optimism and Efficiency were largely steady.

After a May in which markets fell and Optimism retreated from -0.51 to -0.86, June saw strong markets but Optimism was essentially unchanged at -0.87.

Although still negative in absolute terms, implying a somewhat lower than average outlook, Optimism is still far above its levels of late 2018.

Efficiency rose modestly from 0.71 to 0.91 during June. Over a longer time horizon, Efficiency has improved quite considerably from the levels seen in January, which suggested a market under meaningful stress.



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Middling levels of Efficiency, as we currently have, are neither good nor bad news for value and momentum investors, suggesting that some opportunities exist for both.

The current positioning of the Sentiment Framework implies a market that is functioning well but is still less efficient than it could be, with moderate opportunities for relative gains from stock picking as well as from momentum. Optimism holds at a level that would suggest courage in market exposure.

Performance

Lee Adaptive Large Cap Sector (LALCS)

For the month of June 2019, the LALCS composite, on a net of fee basis, was up an estimated +6.88%, modestly behind the S&P 500, which was up +7.05% on a total return basis.

The strategy began and ended June holding all sectors. There was no trading during the month.

Lee Adaptive Broad Market Sector (LABMS)

For the month of June 2019, the LABMS composite, on a net of fee basis, was up an estimated +6.88%, modestly behind the S&P 500, which was up 7.05% on a total return basis.

The strategy began and ended June holding all sectors and the small cap ETF. There was no trading during the month.

Lee Adaptive Global Equity (LAGES)

For the month of June 2019, the LAGES composite gained an estimated +6.58%. This was in line with the MSCI All Country World Index, which gained +6.59% on a total return basis.

The portfolio began and ended the month invested in all equity geographies with no cash in the portfolio. Ending positions were approximately 55% US equity, 3% Japan, 9% Emerging Markets, 22% Europe, and 11% Asia ex-Japan.

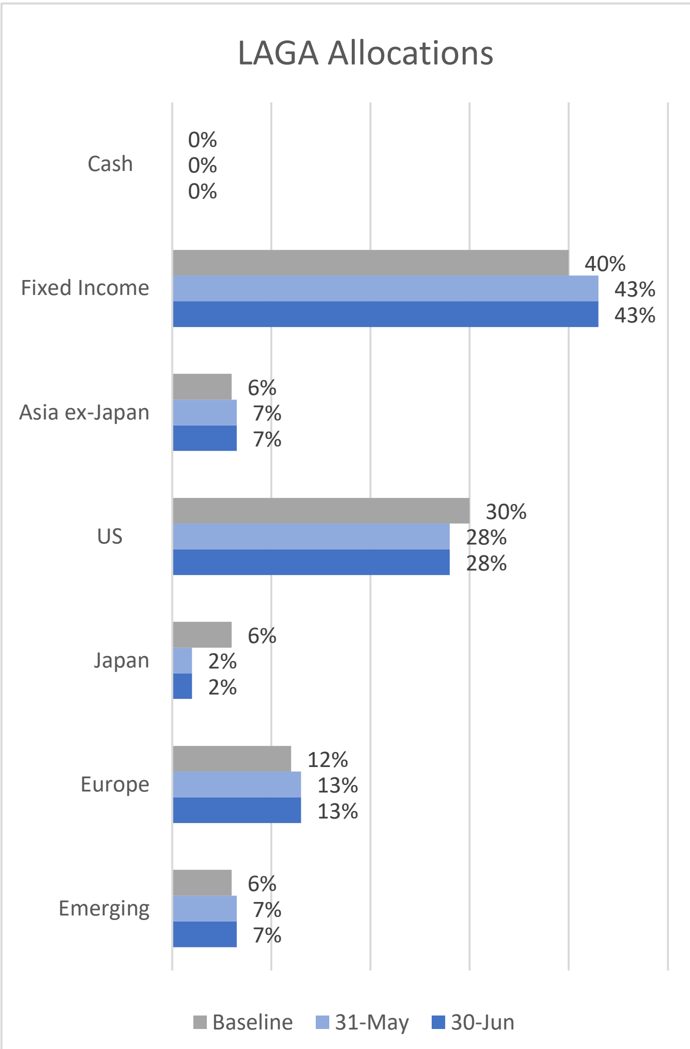
Lee Adaptive China (LACS)

For the month of June 2019, the LACS composite gained an estimated +2.37%. This was behind the MSCI China Index, which was up +8.03% on a total return US Dollar basis.

The portfolio began the month entirely in cash and stayed that way until the 19th, when it reduced cash to 75%, investing 12.5% in KBA, the broad market A Shares ETF, and 6.25% in each of KURE, the healthcare ETF, and PGJ, the US-listed (or N Share) ETF. A week later, on the 24th, the strategy became fully invested in equity, increasing its positions in KBA, KURE, and PGJ to 50%, 25% and 25% respectively.

Lee Adaptive Global Allocation (LAGA)

For the month of June 2019, the LAGA composite, on a net of fee basis, was up an estimated +4.08%, just behind our blended benchmark, which was up+ 4.46% on a total return basis.



The strategy remained fully invested during June at levels near its baseline weights. Fixed income was slightly overweighted, at 43%, and both US and Japanese equity were slightly underweighted.

Overall, the portfolio is maintaining a cautiously optimistic stance, which is a meaningful shift away from the defensive positioning it had a few months ago.

PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS OR PROFITABILITY

Definitions:

Lee Adaptive Large Cap Sector Composite ("LALCS Composite"). A capital weighted performance composite of an investment strategy known as the Lee Adaptive Large Cap Sector strategy (the "LALCS Strategy") that holds some combination of the U.S. large cap sector ETFs and/or cash, as determined by a proprietary quantitative model. The LALCS Composite performance is based on actual trading profits/losses/expenses net of a management fee of 0.55%. Actual expenses of operating the LALCS Strategy may vary, depending on the investment structure in which the Strategy is used, which could result in lower returns than those stated for the LALCS Composite. Such expenses may detract materially from the performance of the LALCS Strategy and, consequently, the results shown above may not be fully indicative of the actual performance results of the LALCS Strategy.

The LALCS Composite is being shown for illustration purposes only and should not be relied upon. No representations or assurance is made that any investor will or is likely to achieve results comparable to those shown above or will make any profit or will be able to avoid incurring substantial losses.
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Lee Adaptive Broad Market Composite ("LABMS Composite"). A capital weighted performance composite of an investment strategy known as the Lee Adaptive Broad Market Strategy (the "LABMS Strategy") that holds some combination of the U.S. large cap sector ETFs, a small cap ETF and/or cash, as determined by a proprietary quantitative model. The LABMS Composite performance is based on actual trading profits/losses/expenses net of a management fee of 0.55%. Actual expenses of operating the LABMS Strategy may vary, depending on the investment structure in which the Strategy is used, which could result in lower returns than those stated for the LAUSE Composite. Such expenses may detract materially from the performance of the LABMS Strategy and, consequently, the results shown above may not be fully indicative of the actual performance results of the LABMS Strategy.

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Lee Adaptive Global Equity Composite ("LAGE Composite") Performance. A capital weighted performance composite of the of an investment strategy known as the Lee Adaptive Global Equity strategy (the "LAGE Strategy"). The LAGE Strategy is currently offered by LCM to certain qualified investors through certain accounts managed by LCM on a discretionary basis ("LAGE Managed Accounts"). The LAGE Managed Accounts use the same investment program as the LAGE Strategy. The LAGE Composite performance is based on actual trading profits/losses/expenses net of a management fee of 0.50%. Actual expenses of operating the LAGE Strategy may vary, depending on the investment structure in which the LAGE Strategy is used, which could result in lower returns than those stated for the LAGE Composite. Such expenses may detract materially from the performance of the LAGE Strategy and, consequently, the results shown above may not be fully indicative of the actual performance results of the LAGE Strategy.

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Lee Adaptive Global Allocation ("LAGA Composite"). A capital weighted performance composite of the of an investment strategy known as the Lee Adaptive Global Equity strategy (the "LAGA Strategy"). The LAGA Strategy is currently offered by LCM to certain qualified investors through certain accounts managed by LCM on a discretionary basis ("LAGA Managed Accounts"). The LAGA Managed Accounts use the same investment program as the LAGA Strategy. The LAGA Composite performance is based on actual trading profits/losses/expenses net of a management fee of 0.50%. Actual expenses of operating the LAGA Strategy may vary, depending on the investment structure in which the LAGA Strategy is used, which could result in lower returns than those stated for the LAGA Composite. Such expenses may detract materially from the performance of the LAGA Strategy and, consequently, the results shown above may not be fully indicative of the actual performance results of the LAGA Strategy.

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S&P 500 Total Returns Index. The returns for the S&P 500 index on a total return basis, that is, with dividends included and does not reflect the deduction of fees and expenses. You cannot invest directly in this index. The returns for the S&P 500 Index are provided for comparison purposes only to show how the LALCS Composite compares to a broad-based index of securities. The S&P 500 is comprised of a representative sample of 500 large-cap companies. The index is an unmanaged, float-weighted index with each stock's weight in the index in proportion to its float, as determined by Standard & Poors. The index is one of the most widely used benchmarks of U.S. equity performance. The index is not subject to any of the fees or expenses to which the LALCS Composite is subject. It is not possible to invest in this index. The index is used for comparison purposes only. It should not be assumed that the LALCS Strategy will invest in any specific securities that comprise the index or that the investment program of the LALCS Strategy will track the index. Consequently, the returns of the LALCS Composite may or may not be highly correlated with those of the index.

MSCI All Country World Index. The returns for the MSCI All Country World Index ("ACWI") on a total return basis, that is, with dividends included and does not reflect the deduction of fees and expenses. The returns for the index are provided for comparison purposes only to show how the above composite returns compare to a broad-based index of securities. The MSCI AC World Index is composed of large and mid-capitalization developed and emerging market equities. The index is one of the most widely used benchmarks for global equity performance. You cannot invest directly in this index. It should not be assumed that the strategies above will invest in any specific securities that comprise the index or that the investment program of the strategies above will track the index. Consequently, the returns of the composites above may or may not be highly correlated with those of the index.

MSCI China Index. The returns for the MSCI China Index ("ACWI") on a total return basis, that is, with dividends included and does not reflect the deduction of fees and expenses. The returns for the index are provided for comparison purposes only to show how the above composite returns compare to a broad-based index of securities. The MSCI China Index represents large and mid-capitalization across H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). With 495 constituents, the index covers about 85% of this China equity universe. Currently, the index also includes Large Cap A shares represented at 5% of their free float adjusted market capitalization**.** It should not be assumed that the LACS strategy will invest in any specific securities that comprise the index or that the investment program of the LACS strategy will track the index. Consequently, the returns of the composite above may or may not be highly correlated with those of the index.

Bloomberg Barclays US Aggregate Bond Index. The returns for the Bloomberg Barclays US Aggregate Bond Index ("US Agg") on a total return basis, that is, with dividends included and does not reflect the deduction of fees and expenses. The returns for the index are provided for comparison purposes only to show how the above composite returns compare to a broad-based index of securities. The US Agg is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The US Agg index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency). The index is one of the most widely used benchmarks for fixed income performance. You cannot invest directly in this index. It should not be assumed that the strategies above will invest in any specific securities that comprise the index or that the investment program of the strategies above will track the index. Consequently, the returns of the composites above may or may not be highly correlated with those of the index.

Blended Benchmark. Is a hypothetical index comprised of 60% MSCI AC World Index and 40% the Bloomberg BarCap US Aggregate Bond Index. You cannot invest directly in this index.

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