NEW FRONTIER

Market Perspectives: 2nd Quarter 2016

Enhanced Return ▪ Effective Diversification ▪ Managed Risk

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After Boris

Markets

Psychologically, the second quarter of 2016 was mired in uncertainty due to the coming British referendum on remaining in the European Union (EU). In spite of the global shock of UK's decision to leave the EU, the quarter ended with global markets retracing much of their declines. Domestic equities ended mostly positive for both the quarter and the year. The S&P 500 gained 1.9% for the quarter and 2.7% for the year, the Dow Jones 1.4% for the quarter and 2.9% year-to-date, though the tech heavy NASDAQ lost 0.6% for the quarter and 3.3% for the year. In general, domestic small stocks did well with the Russell 2000 index gaining 3.4% for the quarter and 1.4% for the year. Domestic bond markets were also good performers with the Barclay's Aggregate Bond Index gaining 1.6% in the quarter and up 5.3% for the year. The dollar was up 2.5% to the euro for the quarter, but down 2.2% for the year. Relative to the Japanese yen, the dollar was down 8.4% for the quarter, and down 14.4% for the year. However, the dollar was up 7.8% to the pound sterling for the quarter, and up 10.6% for the year. Brent Crude oil is trading at $49 per barrel, up 28.9% for the quarter. Gold posted an impressive gain of 8.8% for the quarter. The VIX is below normal levels at 15.

Developed international markets were mostly negative, while emerging markets posted mixed results for the quarter and the year. The EURO STOXX 50 lost 4.7% for the quarter and is down 12.9% for the year. The Japanese Nikkei 225 lost 7.1% for the quarter, and is down 18.2% for the year. MSCI Emerging Markets Investable Market Index lost 0.3% for the quarter, but is still up 4.4% for the year. The Chinese SSE Composite Index lost 2.5% for the quarter and lost 17.2% for the year. On the other hand, the offshore Hang Seng index is up 0.1% for the quarter, but is down 5.05% for the year. Latin America continues to recover; MSCI Latin America IMI is up 4.7% for the quarter and is up 23.5% for the year. It is worth noting the decline of interest rates in developed economies including US, Switzerland, Sweden, Germany, and Japan. There is a very strong demand for safe-haven assets, and it is reflected in current interest rates. In dollar terms, virtually all ETF investments for our strategies are up for the quarter and for the year. All of our ETF-based portfolios are up for both the quarter and the year, and above benchmarks. Performance reflected New Frontier patented investment technologies and global and asset class diversification.

Perspectives

The quarter was dominated by the uncertainty due to the British referendum in late June on whether to stay or leave the European Union (EU). The vote to leave was a complete shock to much of the global political and financial community. Global capital markets were instantly pummeled. The pound slipped to levels not seen for

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About New Frontier

New Frontier is a Boston-based institutional research and investment advisory firm specializing in the development and application of state-of-the-art investment technology. Founded in 1998 by the inventors of the world's first broad spectrum, patented, provably effective portfolio optimization process, the firm continues to pioneer new developments in asset allocation and portfolio selection. Based on practical investment theory, New Frontier's services help institutional investors across the globe to select and maintain more effective portfolios.

More information is available at www.newfrontieradvisors.com.

three decades. The political chaos in Britain included the resignation of the Prime Minister David Cameron. The problem of EU immigration policy highlighted by Brexit threatened to destabilize the political spectrum across Europe raising the question of the long-term viability of the European experiment.

For the UK, the impact of Brexit is both political and financial. All the major political parties are in disarray. There is widespread sentiment in Britain that the electorate was duped. Boris Johnson, who led the Leave effort in the Tory party, and was the presumptive heir to David Cameron as Prime Minister, decided he was not "up to the job" and withdrew. He has been the focus of much anger. Often posing as a charming witty buffoon, he has a long history of little concern with the facts or the consequences of outrageous statements for which he later takes no responsibility. In one instance, when making the case of onerous regulations on Britain, he asserted that the EU had a law saying that balloons cannot be blown up by children under 8. Having led the country to its greatest constitutional crisis in peacetime, he no longer wished to be involved.

Scotland and Northern Ireland made it plain they want no part of a UK that is not part of the EU. Millions signed up for a revote on the internet. As a matter of law, the referendum was advisory and does not legally commit the UK to invoking article 50 which leads to formal exit. Though he will not be part of the negotiation, Cameron has said that he considers the decision irreversible. By the end of the month it was clear that to the majority, sentiment against EU immigration policies was unacceptable and that the decision to leave was no fluke.

From an economic perspective, the UK has its own currency and the Bank of England (BOE) can function independently of EU restrictions. In the short-term, Brexit devalued the UK economy with respect to trade and its financial role in the global economy. The devalued currency pushes up prices while the contraction in investment and hiring slows the economy. However, as the master of its own economy, it may be able to use the freedom from the EU to reposition itself relative to non-EU economies.

For the American economy, Brexit is likely to be just another unanticipatable event that the economy has weathered since the Great Recession. Unemployment is low, interest rates are low, consumer confidence is up, wage growth accelerating, higher retail sales, oil below $50, and a well-functioning Federal Reserve has made U.S. capital markets largely resilient and a global safe harbor for investors. Prospects remain for slow growth with a wary Fed looking over their shoulder to Europe, Asia, and Emerging Markets.

The more serious case may be Europe without the UK. The EU is saddled with the economic limitations of a single currency with member economies in wide variation

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New Frontier Portfolios

New Frontier develops and manages a broad range of ETF asset allocation portfolios for advisors and their clients, and currently oversees nearly $2 billion in global ETF asset allocation portfolios.

of economic health, a fractured banking system, and millions of new migrants. ECB's corporate bond purchasing program and overall stimulus policies have had positive effects in invigorating economic growth. But Brexit supports a nagging sense that the European experiment and EU ideals simply do not work in practice. Hopes for better performing EU capital markets are unlikely to be satisfied anytime soon.

For Japan, Brexit resulted in a strengthening yen that reduces exports and makes the goal of reviving the economy and defeating deflation even more difficult. Japan's industrial output is falling while inventories are rising. The concern is that many of the principles of modern monetary macroeconomics simply do not work in an economy with high cultural rigidity and too high a savings rate with little consumer incentive to spend in an aging demographic.

Brexit has also disrupted Chinese monetary policy with its focus on using the yuan as a tool for managing economic growth. At 6.65 to the dollar, the yuan is at 2010 lows. A strengthening dollar relative to the yuan encourages capital flight and limits policy decisions. The decision by MSCI not to include local currency equities in its benchmark emerging markets index reflected a lack of financial maturity persisting in Chinese capital markets.

Emerging capital markets have performed better recently. Oil prices have stabilized and a sense of a new order has taken hold. Corruption and political dysfunction is the focus of efforts in a number of economies. Current economic pain may lead to sustainable reforms in important cases.

Look Ahead

The next four months will be dominated by the Presidential and Congressional elections. We will be subject to a full court press of media saturation and talking-head pundit speculation. Sanity may be well served by extended summer vacations far from a bizarre election cycle that has more than superficial resemblance to recent Brexit politics. The Federal Reserve governors are in a wait-and-see mode relative to global risks. Economists are now forecasting no rate increase for the rest of 2016. The U.S. economy is in a slow but steady growth path. Until domestic political uncertainty resolves, investors are likely to see the impact of steady growth not in robust capital asset returns but in enhanced purchasing power relative to a strong dollar, low interest rates, and cheap oil.

For Britain, some venting of animal spirits directed towards a disconnected political class may have been necessary. But it is presumptuous to anticipate a greatly diminished role for the UK in the global economy. A dramatically cheap British pound will spur exports and may revive some dormant industries. Britain survived very well without the EU. Britain remains a uniquely innovative and dynamic economy with

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strong trading ties well beyond Europe. Capital markets are likely to experience significant volatility near term during the political uncertainty unleashed by the referendum, and London is unlikely to maintain its place as one of the two globally dominant centers of finance; nevertheless the UK will remain a dominant participant in the global economy in the long-term.

In many respects, the economic storm unleashed by Brexit seems more ominous for the European experiment than for the UK. While the euro may have encouraged a benign sense of common good in the European community as well as facilitating cross border commercial facility, it remains a serious economic straightjacket limiting the beneficial effects of a floating currency for major economic units. Implementation of macroeconomic monetary policy is extremely difficult and may not be possible without a unified banking system and coordinated political will currently lacking in the eurozone. The heroic efforts of the European Central Bank to overcome major economic hurdles well beyond received macroeconomic monetary theory remain a work in progress. The pernicious impact of negative interest rates in many eurozone economies, high persistent unemployment, ineffective political leadership, and deflationary pressures also includes the impact of millions of migrants with little in common with European culture. It will be hard to ignore the example of the rise of anti-immigrant sentiment existing in many parts of the EU that has already resulted in political chaos in one of the more stable European societies. But whatever happens in the short- and medium-term, Europe is very rich and productive and will remain an important entity driving global economic growth.

Political risk is the single most important risk facing capital markets. The uncertainty created by Brexit for the UK, EU, and indeed for the global economy as well is not predictable over any definitive timetable. Brexit surfaced deep resentment of EU immigration policy, the loss of national identity and values, and of the European elites who remain above the economic fray of those left behind by technological innovation and education. Class resentment can be ignored only at the peril of those who do. EU austerity policies have had little success while creating hardship and unemployment for many. It will be a while before the competing political issues in greater Europe sort themselves out.

The good news is that global capital markets, with some exceptions, have returned to near Brexit levels. But many social, political, and economic issues yet to be resolved are not confined to Europe. We appear to be on the knife-edge of a shift in thinking about the benefits of globalization and of social values in the developed world. Religious, political, and social terrorism no longer confined solely to the Middle East are related examples of social discontent relative to globalization and technology that limits the social welfare benefits of an efficient global economy.

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DISCLOSURES: Past performance does not guarantee future results. As market conditions fluctuate, the investment return and principal value of any investment will change. Diversification may not protect against market risk. There are risks involved with investing, including possible loss of principal.