SWAN GLOBAL INVESTMENTS

Issue 29 - Q2, 2018

The Good, the Bad, and the Ugly

Quarterly Update of the Swan Defined Risk Strategy

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We are hosting a series of regional due diligence events and inviting advisors from across the nation to discuss solutions to the unique and pressing investment challenges facing investors today and beyond.

A look at the world of managed finance from Durango, CO and elsewhere...
From the Desk of Randy Swan

The Good

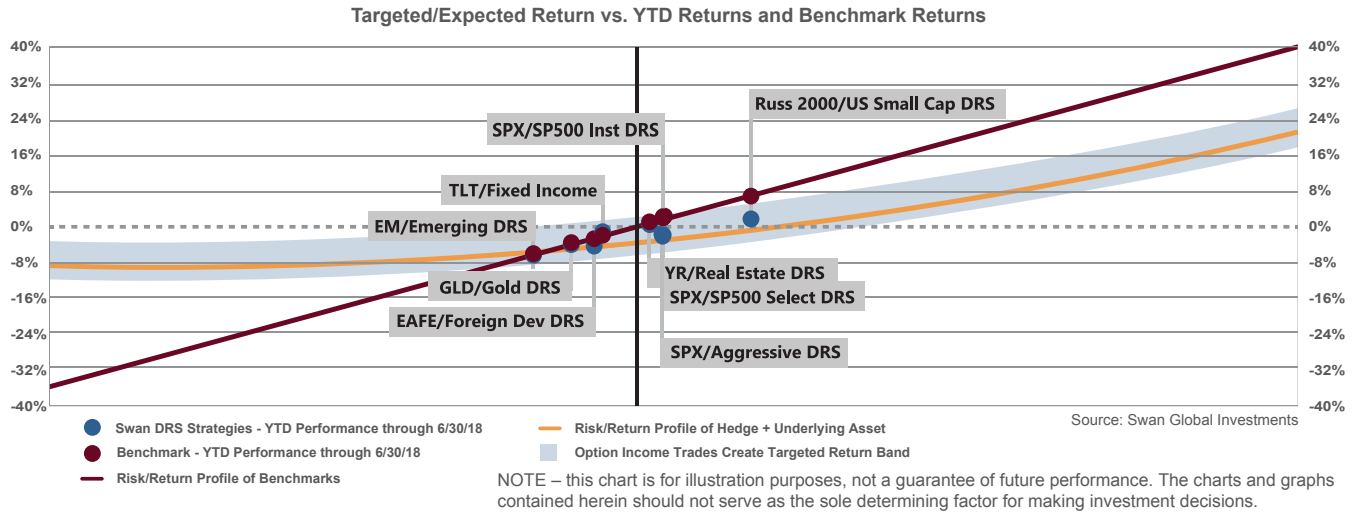
The performance of the Defined Risk Strategy (DRS) across all assets was good during the second quarter. The U.S. based solutions captured between half and three-quarters of the upward movement in the underlying assets. The hedge helped offset some of the downward moves in the international assets. Across the board, all DRS solutions benefitted from the drop off in volatility from its rise in the first quarter. As I discussed last quarter, the premium available when writing options tends to be much richer, and thus potentially profitable, as markets recover from a volatility spike. What we saw transpire in the second quarter was true to form, albeit faster than in the past (see page 5 for more on this).

However, year to date performance is at the lower end of expectations. The year thus far has been unusual, with an extreme move up and down in the first six weeks of the year followed by the market remaining in a relatively tight trading range since then. There are two reasons why the YTD DRS performance has been at the lower end of expectations. One, the extreme volatility coupled with the sharp whipsawing moves in Q1 resulted in our equity asset classes showing negative income of -2.15% across our four equity assets (non-equity DRS assets had positive income in Q1). While the anticipated "clawback" in income did occur during the second quarter, the losses incurred during the first quarter are not yet fully recovered.

Two, the value-tilting equally-weighted sector approach (EQW) has continued to underperform the cap-weighted market, reducing upside capture. While EQW and cap-weight were roughly equal in the second quarter, EQW has underperformed by -1.4% vs the S&P 500 through the first half of the year. I could put these two performance factors in the "bad" section but I wanted to save that section this issue to focus on what I believe could be the signs of a market top.

It is too early to know which direction the market is moving but rest assured the DRS has a high likelihood of performing as expected. Using history as evidence, 98% of the time our annual performance has placed in or above the targeted return band across all DRS assets since inception.

With respect to global equity performance, most of the foreign equity markets are down on the year whereas U.S. equities are up slightly. Although it is too early to tell, it looks like the



NOTE – this chart is for illustration purposes, not a guarantee of future performance. The charts and graphs contained herein should not serve as the sole determining factor for making investment decisions.

long-awaited topping process has started. I say process because market tops are a process, not an event.

Ominously, the yield curve is close to inverting. Traditionally, an inverted yield curve has led to a recession and market weakness. In addition, short-term cash now yields about the same as the S&P 500 dividend for the first time since 2008. The spread between the 2-year and the 10-year yield is also at its tightest since 2007.

Some might be asking why we would want to spend time discussing the possibility of a bear market in the good section. The answer is simple: the DRS needs regular bear markets to thrive. We believe that experiencing a bear market can actually help to increase our long-term returns. Even though the bear has obviously been in hibernation since 2009 and this current bull market has the potential to be the longest bull market in history, many signs point to a bear market soon, and we will review some of these signs in the "bad" and "ugly" sections.

Also, we will include a special section later in this issue of the GB&U to review how the DRS should act during a bear market. In addition, we will compare various option-based categories and how they could perform in a bear market.

Mutual Funds vs Hedge Funds/SMAs

The claim that mutual funds are dying might be premature if the new tax laws are taken into consideration. The tax laws starting in 2018 creates a new benefit due to the netting of the expenses for mutual funds against the yield of the underlying investments. As the new tax law disallows the itemized deduction of investment expenses, this gives a slight advantage to 1940 Act funds relative to hedge funds or separately managed accounts.

The Bad

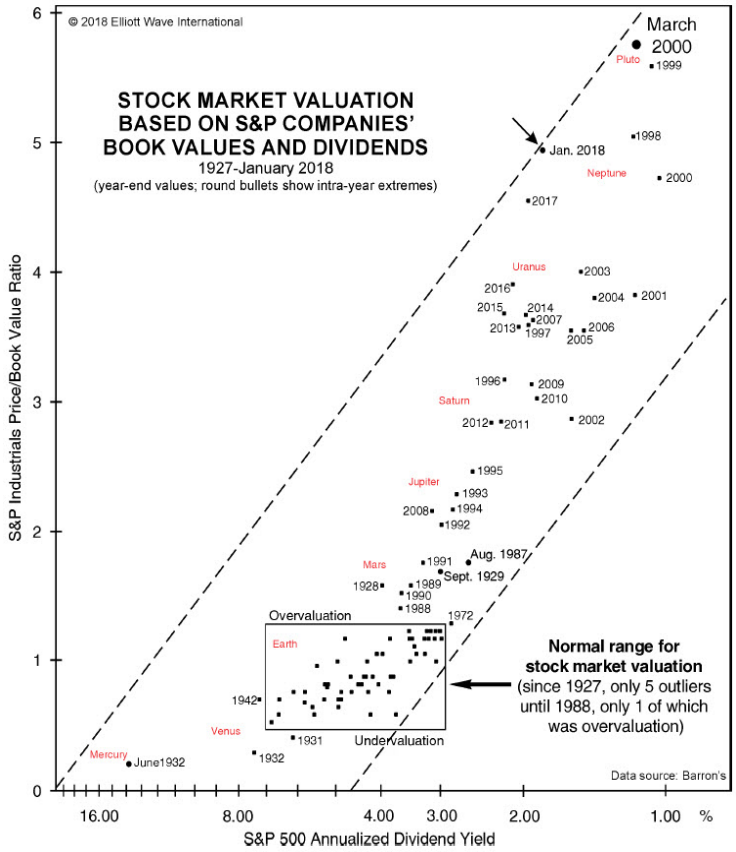
The "bad" is going to be devoted almost exclusively to valuations and some warning signs of a market top.

Valuations: The big question of the day is whether or not equities are overvalued. Based upon numerous commonly used valuation metrics, the answer is emphatically "yes." For many years I've been making the argument that the central banks around the globe have coordinated their efforts to keep the proverbial party going by keeping interest rates artificially low to goose the market into higher growth and taking more and more risk.

I recently encountered a visual that supports the old adage: "a picture is worth a thousand words." It presents equity valuations in a new and innovative way, using the distances between the planets as a scale. The chart is from Elliott Wave Theorist (EWT) June 15, 2018 issue and uses the S&P Industrials' price-to-book value ratio as the vertical axis while the horizontal-axis represents the Composite's annualized dividend yield.

I believe this chart is very illustrative of the market's current overvaluation because it encompasses over 91 years from 1927 to 2018. It not only shows what normal historical valuations have been over many bull and bear market cycles but also how the last 30 years since 1988 is unprecedented. The planets in our solar system are used as points of reference, with Mercury being the closest to Earth (most undervalued) and Pluto being the furthest (most overvalued).

Looking at the chart, every year since 1988 has been either somewhat overvalued or extremely overvalued relative to the period from 1927 to 1988. This includes the recession/bear market bottom years in 2003 and 2009. Amazingly, nothing since 1999/2000 did anything to substantially alleviate the overvalued conditions, it merely brought valuations from Pluto back to Neptune.



Source: Elliott Wave International

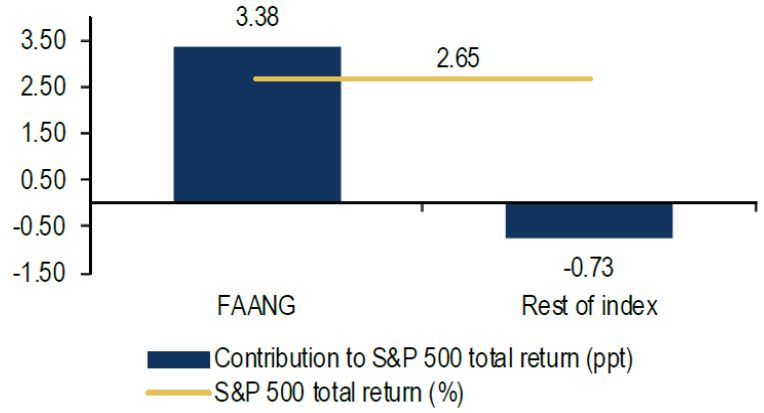
To understand this chart further and how crazy market valuations have gotten, let's look at how the EWT describes the chart:

> "The box near the bottom of the chart denotes the normal range of year-end valuations from 1927-1987. As noted on the chart, there were only 5 outliers during that time, and four of them were lower valuations, while only one was higher. This period is limited by the data to 60 years, but the range of year-end values through 1987 probably applies just as well to the preceding century or two of U.S. and British stock prices. From the 1987 crash emerged the Great Asset Mania. Valuations at every year's end since then have been beyond the normal-range box. Even 2008's figure, recorded ten weeks before the end of the biggest stock market plunge since the Great Depression, did not bring valuations back to the normal range. Many economists think that the 2007-2009 bear market was a once-in-a century affair that means we won't see its like for another hundred years. They are wrong. That setback was a pause in an ongoing mania, not a cleansing washout." (Elliott Wave Theorist (EWT) June 15, 2018)

Breadth: Another topping warning sign is the return of the mega tech stocks driving the return of the S&P 500, showing narrow market breadth and participation weakness. The top 15 companies in the S&P 500 now make up 26.37% of the index and have an average P/E ratio of 52.69, compared to the average of 17 for the overall S&P 500. The well-known FAANG acronym (Facebook, Apple, Amazon, Netflix, Google), now accounts for 15.1% of the entire S&P 500 index. These five stocks now impact the S&P 500 index more than the combined weight of the energy sector (6.3%), the basic material sector (2.8%), as well as every utility (2.8%) and real estate company (2.7%) within the S&P 500. In other words, five Tech companies have the same impact on the market as all of its energy, basic materials, utilities, and real estate companies combined. And in the first half of the year, without those stocks, the S&P 500 would have been negative. The year 2015 was a similar year where the mega cap stocks held the market up.

Chart 5: Excluding FAANG stocks, index returns would have been negative

FAANG stocks' contribution to the S&P 500 1H18 total return



Note: FAANG = FB, AAPL, AMZN, NFLX, GOOG/GOOGL

Source: S&P, BofA Merrill

It is difficult to rationalize the performance and valuation of some of these Tech companies. For example, the streaming content provider/producer Netflix was up 98% year-to-date and 700% from January 2015. Recently, the company achieved a notable milestone when its market capitalization surpassed that of iconic media giant Walt Disney. The more one digs into the topic, the more difficult it becomes to justify:

> "A comparison of the two company's financial metrics raises at least an eyebrow. Fast-growing Netflix generated revenue of $11.7 billion and earned $597 million in net income for the period ending in December 2017. In contrast, Walt Disney generated revenue of $56.9 billion and produced a profit of $9.8 billion. The true difference between these two companies resides at the free cash flow level, or the company's cash flow from operations minus the amount needed to reinvest in the company's ongoing operations: Netflix generated negative $1.9 billion while Walt Disney produced $10.7 billion in free cash flow for the company's shareholders." (St. James Investment Company, July 2018, Investment Adviser's Letter)

So Disney generates five times the revenue and sixteen times the profit, but is the same size in today's stock market.

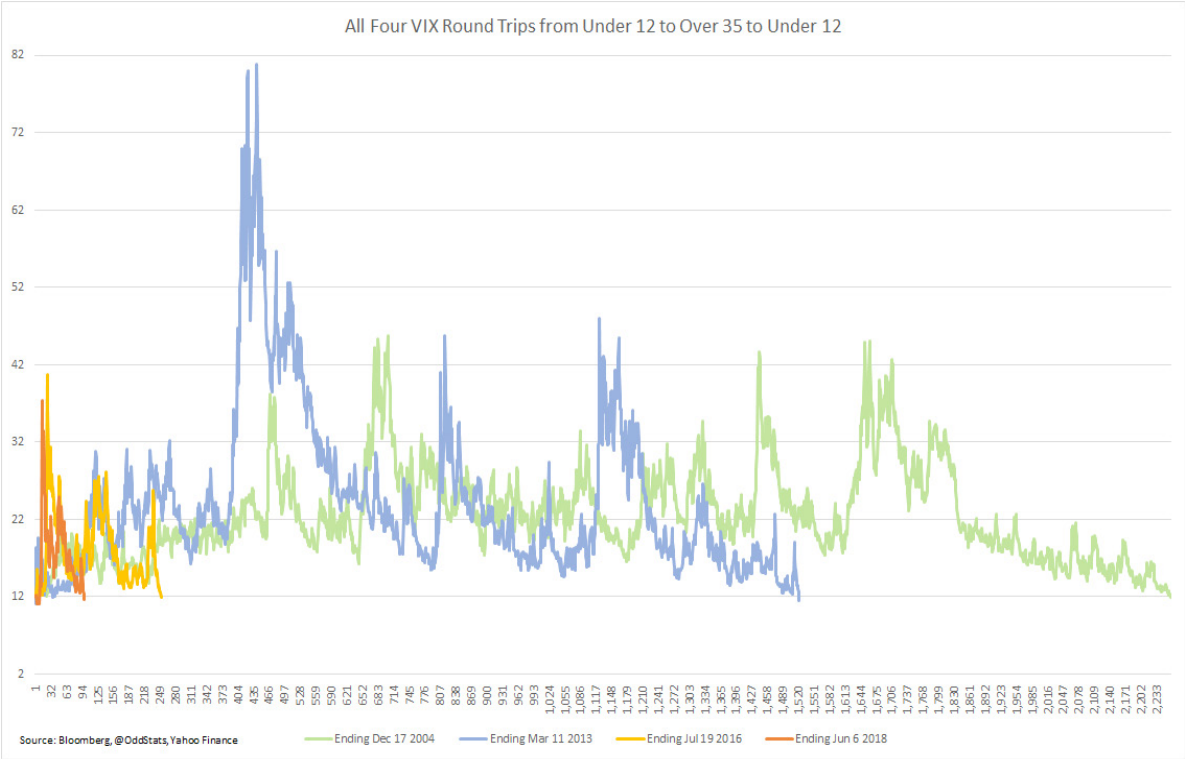
Yields: Not that we need another example of a world gone topsy-turvy, but there is still over $8 trillion of negative yielding debt. It increased by over $1 trillion in June alone. These bonds continue to offer evidence that there is a concerted effort across the globe to force investors into riskier assets. The goal of course is to stimulate the economy's low growth rates but this artificial stimulation creates imbalances since it violates natural law.

As indicated in the last issue, the bottom line is that expectations for stock market returns are fairly poor and of course bonds are probably an even worse risk/reward trade off.

The Ugly

John Mauldin has a great series of articles called the "Train Wreck series" that you can find on his site at http://www.mauldineconomics.com/economic-analysis. I believe everyone who shares my concerns about equity overvaluations, unsustainable debt and spending, and overly accommodative monetary policy should review his findings. I believe some option-based strategies should perform during the "Reset" that John writes about when he believes global debt will be restructured. The positive side is that John believes that those who get to the other side will enjoy a new world with massive improvements to our quality of life and longevity. The bottom line is that you want to get to the other side with lots of cash, otherwise it could be very ugly.

Another ugly from the second quarter was how quickly volatility retreated following the spike in the first quarter, relative to other past volatility events. This chart shows the four times the VIX has ever gone from under 12 to over 35. Notice how two are tied to the big bear markets of the 2000's; they took years with numerous other volatility events interspersed before a retreat back to lower volatility levels. But then the next VIX spike in August 2015 was worked off in less than a year. And this year, only the fourth occurrence, took only four months.



What is the significance of this chart and why do we view it as ugly? This chart is another way to illustrate how the current market environment is unnatural and how market risk has been artificially squelched by governments and central banks. While we at Swan like it when realized volatility is less than implied volatility, we believe the speed of the decline in volatility is unhealthy and unnatural.

This kind of interference doesn't allow the markets to sort themselves out properly. Long periods of intervention will likely lead to bigger problems later. One could argue that the two big bear markets of the 21st century, those illustrated on this chart, were either created by or made worse by not letting things play out naturally.

At Swan, we make necessary adjustments to our income trades to take into consideration differing risk/reward environments. We seek to reduce our risk during periods of extremely low volatility since these types of quick volatility events and recoveries can hamper the returns of our income component. The income component is a vital part of the strategy, even if the current environment leads to lower returns in the short-term. Nevertheless, lower absolute volatility does not imply a poor risk premium harvesting environment, just one that requires "nimbleness" with respect to position management.

Expectations for the DRS and other Option-Based Strategies in a Bear Market

With all of this talk about the topping of the bull market, we are often asked how to properly set expectations for performance during bear markets. Marc Odo, Client Portfolio Manager at Swan, recently discussed this in his white paper "Managing Expectations: Drawdown Scenarios and Swan DRS Performance Analysis." I encourage everyone to read this document.

In a forthcoming white paper, we will expand our analysis to the entire Morningstar "Options-Based" category. Morningstar's release of an Options-Based category was a welcome one, but we believe this is only the first step. Options can be used in many different ways to accomplish a wide variety of goals.

We believe the Options-Based category can be further subdivided into three subcategories, each with very different objectives and risk/return characteristics. They are 1) hedged equity, 2) option income, and 3) alpha trading strategies. Our next white paper will dive deeper into each of these sub-categories. We will explore how different funds try to achieve various objectives through options, how combinations of options and other holdings can "synthetically" replicate other strategies, and what the pros and cons are of each. For now, we will just focus on how each of these broad subcategories might perform in a bear market.

Only the first category, hedged equity, has the explicit goal of

protecting on the downside. The objective of the hedged equity strategies is precisely that—to hedge against downside risk in the market. Usually, this means holding a core equity position and hedging it through the purchase of put options. There are additional ways one can implement a hedged strategy, which we will explore in our forthcoming paper, such as utilizing VIX futures, VIX options, or short ETFs. Suffice to say, we believe hedged equity strategies are the most effective for bear markets.

The second subcategory is what we call option income. These typically have a core holding while options provide "income" via writing puts and/or calls. Buy writes and put writes fall into this subcategory. While there are many variations to this theme, it is important to remember the primary objective is to provide income as opposed to just capital appreciation. Explicitly hedging against downside risk is not part of the value proposition. This subcategory tends to do best during a flat to gently rising market.

The final subcategory, alpha trading strategies, are the riskiest. They usually employ a wide variety of buying or writing of options, often without a core holding other than cash as part of the strategy. These strategies will succeed or fail on the outcome of their option trades. Often these types of strategies employ leverage to "juice" their returns. It is very difficult to anticipate how an alpha trading strategy might perform in a bear market. They could do spectacularly well, they could blow up, or they could fall somewhere in-between. That said, the Achilles Heel of many alpha trading strategies are volatility spikes, leverage risks, and liquidity risks. Those risks tend to increase in a market sell-off. Many alpha trading strategies are better suited for benign markets rather than choppy markets. These types of strategies can be good as a small part of other strategies, but on their own can be unpredictable or too susceptible to tail risk.

If recent history is any indication due to the failure of several option-based strategies and products, mostly from the third subcategory, it is very important to perform proper due-diligence and understand the various types of option-based strategies. The bottom line is that it is very important to "know what you own" to avoid surprises.

This is certainly a rich topic, one deserving a much more thorough treatment than possible here. In the coming quarter, look for another insightful, thought-provoking piece from Swan Global Investments that advances your understanding of the world of options.

To return to the original question, however, Swan has always maintained that over a full market cycle, our hedging pays for itself. In other words, the "drag" during a bull market is more than recovered when the hedge protects during a bear market. During the DRS's first two bull-bear cycles this proved true. What happens when the current bull market turns to bear is yet to be seen. This bull market is the second-longest in U.S. history, so its been a while since we've seen that hedge pay off. That said, given the many problems and the unsustainable government policies I've often talked about in this space, I believe future bear markets will be significant, perhaps even surpassing the Global Financial Crisis of 2007-09. Should that happen, I'm confident the DRS's hedge will prove its worth yet again, especially in comparison to option income or alpha trading strategies.

Next, we dive into the changes in the equal weighting of the DRS.

Equal-Weight Change in Q3

A sector change is about to happen that will lead to some changes in our equal-weight sector approach. The S&P Dow Jones and MSCI, which control the GICS or sector classification of stocks, recently decided to create a new sector called Communication Services. This sector will be made up of stocks currently in the Technology, Consumer Discretionary, and Telecom sectors. After the re-organization, this new Communication Services sector will be about 10% of the market. Some of the well-known names moving into this sector include Facebook, Netflix, Google, Walt Disney, Verizon, and AT&T.

The ETF for this sector has already been created and launched, but the reorganization and movement of these stocks from one sector to another will not happen until mid-September. How will Swan be handling this sector change in its flagship S&P 500 DRS? After analyzing the changes and how it would impact the portfolio to either adopt or not adopt this new sector, Swan has decided that it will add the Communication Services sector to its core holdings in order to remain true to the principal of an equally-weighted sector approach. The new sector/ETF will contain some very significant names, which simply can't be excluded from the DRS's core holdings.

What will this mean for Swan's EQW? Previously there were nine sectors, each with an 11.1% weight. Now each sector will have a 10% weighting. For the sectors where Swan has been heavily overweight, such as Utilities, Basic Materials, and Energy, the overweight will be slightly reduced. This will also mean the portfolio will be a little more underweight some of its most underweighted sectors such as Financials and Healthcare.

Due to the fact that many of the names in the newly created Communications Services sector were previously in the Technology sector, it will mean the overall portfolio will move a little closer to cap-weighted. Technology will still be underweight, but not to the degree it has been since 2012.

The portfolio will remain value-tilted but will be a little less so owning a little bit more than it does now of some of the Tech and Consumer Discretionary names. For more detail, please contact us and we will be happy to share some of the resources available that explain the sector change.

S&P Sector Name	Cap-weight Now	EQW Now	Estimated Cap-weight Mid-Sept	EQW Core in Mid-Sept
Materials	2.8%	11.1%	2.8%	10.0%
Energy	6.2%	11.1%	6.2%	10.0%
Financials	14.3%	9.4%	14.3%	8.4%
Industrials	9.6%	11.1%	9.6%	10.0%
Information Technology/Telecom	26.4%	11.1%	**19.4%**	10.0%
Consumer Staples	7.2%	11.1%	7.2%	10.0%
Real Estate	2.9%	1.7%	2.9%	1.6%
Utilities	3.0%	11.1%	3.0%	10.0%
Health Care	14.3%	11.1%	14.3%	10.0%
Consumer Discretionary	13.3%	11.1%	**10.3%**	10.0%
Communication Services	0.0%	0.0%	10.0%	10.0%
Total	100.0%	100.0%	100.0%	100.0%

Source: Bloomberg

Swan DRS Product Performance Summary

As of: June-30-2018

	DRS Products				Benchmark		
	Core Equity	Hedge	Income	Total Portfolio (Net)	Benchmark	Return	Over/Under Performance
YTD 2018							
S&P 500 DRS Select Composite (1)	0.90%	-1.37%	-1.28%	-1.98%	S&P 500	2.65%	-4.63%
S&P 500 DRS Institutional Composite (2)	0.98%	-1.25%	-1.19%	-1.92%	S&P 500	2.91%	-4.83%
DRS Emerging Markets Composite (3)	-7.26%	2.06%	-0.99%	-6.75%	MSCI EM Index (Gross)	-6.51%	-0.25%
DRS Developed Markets Composite (4)	-3.14%	-0.04%	-1.13%	-4.77%	MSCI EAFE Index (Gross)	-2.37%	-2.41%
DRS U.S. Small Cap Composite (5)	6.49%	-3.05%	-0.45%	2.27%	Russell 2000 Index (Gross)	7.66%	-5.39%
DRS Gold (6)	-3.81%	-0.34%	0.17%	-4.46%	SPDR Gold Shares (GLD)	-4.05%	-0.41%
DRS Real Estate (6)	1.14%	-0.82%	0.54%	0.46%	iShares US Real Estate (IYR)	1.26%	-0.81%
DRS Fixed Income (6)	-2.83%	1.38%	1.09%	-0.92%	iShares 20+ Yr Treasury Bond (TLT)	-3.01%	2.10%
DRS Aggressive (6)	0.82%	-1.15%	-1.16%	-1.98%	S&P 500	2.65%	-4.63%

Source: Swan Global Investments and Morningstar

Performance is net-of-fees; total portfolio return includes all expenses. The core equity, hedge, and income components do not sum to the Total Portfolio (Net) return due to fees and differences resulting from geometrically smoothing component returns.

1. The Defined Risk Strategy Select Composite demonstrates the performance of non-qualified assets managed by Swan Global Investments, LLC since inception. It includes discretionary individual accounts whose account holders seek the upside potential of owning stock, and the desire to eliminate most of the risk associated with owning stock. The Composite relies on LEAPS and other options to manage this risk. Individual accounts own S&P 500 exchange traded funds and LEAPS associated with the exchange traded funds as well as multiple other option spreads that represent other indices that are widely traded. The Defined Risk Strategy was designed to protect investors from substantial market declines, provide income in flat or choppy markets, and to benefit from market appreciation. ETFs and options are the primary components of the strategy.
2. DRS Institutional Composite includes high net-worth, non-qualified accounts that utilize cash-settled, index-based options held at custodians that allow participation in Clearing Member Trade Agreement (CMTA) trades. The Composite relies on LEAPS and other options to manage risk. This composite owns S&P 500 exchange traded funds (ETF) and LEAPS associated with the ETFs as well as multiple other option spreads that represent other indices that are widely traded. The DRS was designed to protect investors from substantial market declines, provide income in flat or choppy markets, and to benefit from market appreciation. ETFs and options are the primary components of the strategy.
3. Emerging Markets DRS Composite demonstrates the performance of mutual fund accounts invested in the DRS Emerging Markets strategy. DRS emerging markets accounts seek the upside potential of owning stock and the desire to eliminate most of the risk associated with owning stock. The Composite relies on LEAPS and other options to manage this risk. The Funds invest in exchange traded fund(s) (ETF) that own emerging markets equities and LEAPS associated with the ETFs as well as multiple other option spreads that represent other indices that are widely traded. The DRS was designed to protect investors from substantial market declines, provide income in flat or choppy markets, and to benefit from market appreciation. ETFs and options are the primary components of the strategy.
4. Foreign Developed Markets DRS Composite demonstrates the performance of research and development account(s) and mutual fund accounts invested in the DRS Foreign Developed Markets strategy. DRS Foreign Developed Markets accounts seek the upside potential of owning stock and the desire to eliminate most of the risk associated with owning stock. The Composite relies on LEAPS and other options to manage this risk. The Funds invest in exchange traded funds (ETF) that own foreign developed markets equities and LEAPS associated with the ETF as well as multiple other option spreads that represent other indices that are widely traded. The DRS was designed to protect investors from substantial market declines, provide income in flat or choppy markets, and to benefit from market appreciation. ETFs and options are the primary components of the strategy.
5. U.S. Small Cap DRS Composite demonstrates the performance of research and development account(s) and mutual fund accounts invested in the DRS U.S. Small Cap strategy. DRS U.S. Small Cap accounts seek the upside potential of owning stock and the desire to eliminate most of the risk associated with owning stock. The Composite relies on LEAPS and other options to manage this risk. The Funds invest in exchange traded funds (ETF) that own U.S. small cap equities and LEAPS associated with the ETF as well as multiple other option spreads that represent other indices that are widely traded. The DRS was designed to protect investors from substantial market declines, provide income in flat or choppy markets, and to benefit from market appreciation. ETFs and options are the primary components of the strategy.
6. Research and Development account. No fees are being charged in the R&D accounts but performance reflects a 1% management fee being charged monthly in arrears for illustrative purposes.

Annualized Returns as of June 30, 2018

Composite	One Year	Three Year	Five Year	Ten Year	Since Inception
DRS Select Composite	5.41%	4.88%	6.00%	6.40%	8.32%
S&P 500	14.37%	11.93%	13.42%	10.17%	7.49%
DRS Institutional Composite	5.06%	3.65%	5.80%	6.34%	8.29%
S&P 500	14.37%	11.93%	13.42%	10.17%	7.49%
DRS Emerging Markets Composite	2.85%	1.75%	N/A	N/A	1.78%
MSCI EM (Emerging Markets)	8.59%	5.98%	N/A	N/A	5.95%
DRS Foreign Developed Markets Composite	1.39%	0.86%	N/A	N/A	1.35%
MSCI EAFE	7.37%	5.41%	N/A	N/A	7.76%
DRS U.S. Small Cap Composite	7.45%	4.77%	N/A	N/A	5.61%
Russell 2000	17.57%	10.96%	N/A	N/A	11.62%

Source: Morningstar Direct

Disclosures:

Performance results are presented in U.S. dollars, net of management fees, and include reinvestment of dividends and capital gains. Fees may vary based on account size, custodial relationship and other factors. No current or prospective client should assume future performance of any specific investment strategy will be profitable or equal to past performance. All investment strategies have the potential for profit or loss. Changes in investment strategies, contributions or withdrawals may cause client portfolio performance results to differ from the composite. Different types of investments involve different degrees of risk; we make no assurance that a specific investment will be suitable or profitable for a client's portfolio.

Historical performance results for market indices and categories do not reflect the deduction of transaction fees, custodial charges, or management fees, the incurrence of which would have the effect of diminishing historical performance. All Swan products utilize the Defined Risk Strategy ("DRS"), but may vary by asset class, regulatory offering type, etc. Accordingly, all Swan DRS product offerings will have different performance results, and comparing results among the Swan products and composites may be of limited use. Economic factors, market conditions, and investment strategies will affect the performance of any portfolio and there are no assurances that it will match or outperform any particular benchmark. Swan Global Investments, LLC ("Swan") is an independent Investment Advisor headquartered in Durango, Colorado registered with the U.S. Securities and Exchange Commission under the Investment Advisers Act or 1940. Being an SEC-registered advisor implies no special qualification or training. Swan Global Investments, LLC is affiliated with Swan Capital Management, LLC, Swan Global Management, LLC, Swan Wealth Advisors, LLC, and Swan Wealth Management, LLC.

There are eight DRS Composites offered: 1) The DRS Select Composite which includes non-qualified accounts; 2) The DRS IRA Composite which includes qualified accounts; 3) The DRS Composite which combines the DRS Select and DRS IRA Composites; 4) The DRS Institutional Composite which includes high net-worth, non-qualified accounts that utilize cash-settled, index-based options held at custodians that allow participation in Clearing Member Trade Agreement (CMTA) trades; 5) The Defined Risk Fund Composite which includes mutual fund accounts invested in the S&P 500; 6) The DRS Emerging Markets Composite which includes mutual fund accounts invested in emerging markets; 7) The DRS Foreign Developed Composite which includes all research and development account(s), and mutual fund accounts invested in foreign developed markets; 8) The DRS U.S. Small Cap Composite which includes all research and development account(s), and mutual fund accounts invested in U.S. small cap issues.

Additional information regarding Swan's policies and procedures for calculating and reporting performance returns is available upon request. Swan claims compliance with the Global Investment Performance Standards (GIPS) and has prepared and presented this report in compliance with GIPS standard. Swan investment performance has been independently verified from its inception on July 1, 1997 through December 31, 2017. A copy of the verification report is available upon request by calling 970.382.8901 or emailing operations@swanglobalinvestments.com. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate performance in compliance with GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

The Defined Risk Strategy Select Composite demonstrates the performance of all non-qualified assets managed by Swan Global Investments, LLC since inception. It includes discretionary individual accounts whose account holders seek the upside potential of owing stock, and the desire to eliminate most of the risk associated with owning stock. The composite relies on LEAPS and other options to manage this risk. Individual accounts own S&P 500 exchange-traded funds, LEAPS associated with the ETFs, as well as option strategies based on other widely traded indices. The Defined Risk Strategy Select Composite includes all nonqualified discretionary accounts which are solely invested in the Defined Risk Strategy. The Defined Risk Strategy was designed to protect investors from substantial market declines, provide income in flat or choppy markets, and to benefit from market appreciation. Stock and options are the primary components of the strategy.

The performance benchmark used for the Defined Risk Strategy is the S&P 500 Index comprised of 500 large-capitalization stocks, and which does not charge fees.

The performance benchmark for the DRS Institutional Composite is the S&P 500.

The performance benchmark for the DRS Emerging Markets Composite is the MSCI (Morgan Stanley Capital International) Emerging Markets Index, which is designed to measure equity market performance in global emerging markets.

The performance benchmark for the DRS Foreign Developed Markets Composite is the MSCI (Morgan Stanley Capital International) EAFE index, which comprises the MSCI country indexes capturing large and mid-cap equities across developed markets, excluding the U.S. and Canada.

The performance benchmark for the DRS U.S. Small Cap Composite is the Russell 2000 Index, which is designed to measure the equity market performance of U.S. small-cap to mid-cap companies.

One cannot invest directly in an index.

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