WEEKLY MARKET REVIEW

APRIL 25, 2017

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- *ETFs continue their explosive asset growth.*
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Market Performance

Equities	LAST WEEK	QTD	YTD '17
Total U.S. Market[1]	+1.07%	-0.42%	+5.29%
Domestic Large-Cap Equity[2]	+0.87%	-0.49%	+5.54%
Domestic Small-Cap Equity[3]	+2.58%	-0.40%	+2.06%
International Equity[4]	+0.12%	-0.32%	+7.51%
Developed International Equity[5]	+0.22%	-0.53%	+6.68%
Emerging Market Equity[6]	+0.17%	+0.45%	+11.95%
Fixed Income	**LAST WEEK**	**QTD**	**YTD '17**
U.S. Investment Grade Bonds[7]	+0.00%	+0.93%	+1.75%
Cash Equivalent[8]	+0.02%	+0.04%	+0.15%
Commodities	**LAST WEEK**	**QTD**	**YTD '17**
Commodity[9]	-2.76%	-1.65%	-3.94%

[1]Russell 3000 [2]S&P 500 Index [3]Russell 2000 Index [4]MSCI ACWI ex-U.S. Index [5]MSCI EAFE Index [6]MSCI Emerging Markets Index [7]Bloomberg Barclays Capital U.S. Aggregate Bond Index [8]Bloomberg Barclays Capital 1-3 Month U.S. Treasury Bill Index[9]Bloomberg Commodity

As of 4/21/2017

Week in Review

It was a strong week for the markets. Small-cap stocks led the way in the U.S. with the Russell 2000 up more than 2.5%, while large-cap stocks ended 0.8% higher. Internationally, equities were little changed with developed markets up 0.2% and emerging markets up almost 0.2%. Bonds ended flat, while commodities were down nearly 3.0% on a selloff in energy.

Entering the weekend, all eyes were on Sunday's French presidential election. Polls correctly predicted Emmanuel Macron, a centrist political newcomer, and Marine Le Pen, the far-right candidate, would move on to the next round. Early polls show Macron will defeat Le Pen by more than 20.0% in the May election and, as a result, risk assets are poised for a strong start to the next week.

Entering 2017, there was a tremendous amount of optimism in the air. Readings on various business and consumer surveys hit their highest levels since the 2008 financial crisis, and risk assets reflected that optimism. In fact, the S&P 500 just experienced its best first-quarter performance in four years.

More recently, it seems economic data has not kept up with those lofty expectations. For example, the Citi Group Economic Surprise Index, which measures how economic data compares to market expectations, has plunged this month. Additionally, the Federal Reserve Bank of Atlanta's GDPNow model is forecasting just 0.5% real GDP growth for the first quarter (as of April 18, 2017). It appears real growth rates moving above the post-financial-crisis average of 2% may not be a foregone conclusion.

It's generally unwise for long-term investors to make investment decisions based on short-term economic expectations. Absent a crystal ball, developments are extremely hard to predict on a consistent basis. Clouding the picture further, financial markets don't always exhibit the expected response to changes in the real economy.

Citi Enconomic Surprise (U.S.) Index

Source: Citigroup Global Markets Inc., Bloomberg. As of 4/21/2017.

CLS believes a balanced approach gives investors the best chance for long-term success. Rather than getting caught up in the noise of the daily news flow, we maintain a long-term perspective, and we make investment decisions based on portfolio risk, asset valuations, and fundamentals.

A critical component of any balanced portfolio is the bond allocation. While stocks may stand to benefit from improving growth prospects, bonds can benefit if that outcome does not materialize. Since longer-term interest rates are typically thought to be based on inflation and growth expectations, staying in "slow and steady" growth mode could offer a nice tailwind. The beauty of a balanced portfolio is not having to play the guessing game. Investors are exposed to the upside and cushioned on the downside.

Bonds Leading the Way in ETF Asset Growth

Bonds are thriving within the ETF wrapper. By year-end 2016, ETF bond assets reached nearly $450 billion. While that may seem like a small slice of the overall pie, bond ETFs haven't been around as long as their equity counterparts. The first U.S.-listed equity ETF was issued in January 1993; it wasn't until July 2002 that bonds entered the ETF scene.

Nearly 15 years later, bond ETFs are driving growth for the industry. Over the last five years, bond assets have increased by roughly 19.7%, compared to 13.3% growth in other categories. In 2016, the pace of bond ETF growth was more than double the rest of the industry.

So what has contributed to the success of bond ETFs? The answer can be separated into two components:

1. The benefits of bond funds, and
2. The benefits of ETFs versus mutual funds.

Bond funds offer investors significant advantages over a portfolio of individual securities. They allow investors to dramatically increase their levels of diversification. The advantages go beyond enabling investors to diversify credit risk across a few issuers; bond funds allow them to allocate across multiple bond sectors. There is huge disparity between a laddered portfolio of 10 investment-grade corporate bonds and a portfolio diversified across Treasuries, municipals, mortgages, investment-grade credit, high-yield credit, international sovereigns, and emerging market bonds.

Liquidity is also an important factor. Bond funds allow investors to access the aforementioned exposures much more cheaply than by buying individual issues from a broker. Even in the relatively liquid U.S. investment-grade bond market, an investor could easily spend more than a year's worth of interest income crossing the bid-ask spread.

Another benefit of bond funds is targeted interest-rate exposure. With a laddered bond portfolio, the exposure to interest rates is falling until a new bond is purchased for the portfolio. With a bond fund, the portfolio of hundreds, or even thousands, of names can be easily adjusted to maintain a targeted exposure. Some investors believe a laddered portfolio of individual bonds can protect them against rising rates. The thinking goes: If rates rise (and the value of the bond falls), the bond can simply be held to maturity and the par value can still be received. While that is technically accurate, this fails to consider all of the lost income from choosing to retain a portfolio of lower-yielding bonds. Regardless of the time to maturity, or the scale of the interest rate move, the result is the same.

While ETFs and mutual funds share in the advantages above, the ETF is simply the superior product wrapper. CLS discusses the benefits of ETFs frequently, including in the

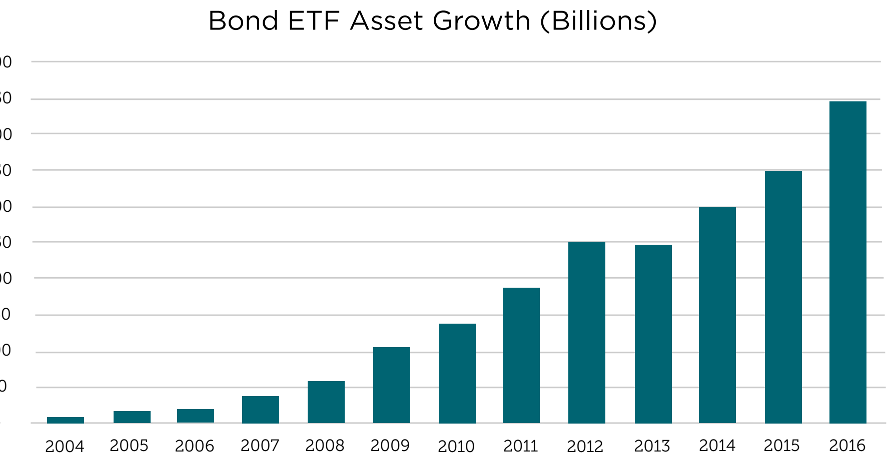
Annual Growth Rate	Bond ETFs	ETF Market (Ex. Bonds)
5 Year	19.7%	13.3%
3 Year	22.9%	11.6%
1 Year	26.4%	11.0%

Source: Morningstar, as of 12/31/2016

	U.S. Equity	Intl. Equity	Sector Equity	Taxable and Municipal Bond	Commodities	Alternative	Allocation	Total Assets
Total AUM	$1,191	$457	$346	$447	$61	$43	$10	$2,555
% of Total	46.6%	17.9%	13.6%	17.5%	2.4%	1.7%	0.4%	100.0%

Source: Morningstar, as of 12/31/2016

Quarterly Reference Guide. The benefits include:



Source: Morningstar, as of 12/31/2016

1. **Lower Cost:** Because ETFs do not have minimums, front-end loads, or redemption fees, they can offer significant cost saving.
2. **Diversification:** ETFs are designed to track market indices that may contain hundreds or thousands of securities.
3. **Transparency:** Most ETFs report exact holdings daily, so investors can verify the ETF is closely tracking its benchmark.
4. **Tax Efficiency:** ETFs typically distribute fewer capital gains to shareholders than traditional mutual funds.
5. **Stable Market and Risk Exposure:** ETFs can provide much more stable market exposure than mutual funds, allowing investors to minimize style drift.
6. **Intra-Day Liquidity:** Like stocks, ETFs trade throughout the day, so their price fluctuates with market supply and demand.

Bond ETFs are excellent tools for investors and make up an integral part of a balanced portfolio. For all of the reasons mentioned, CLS thinks bond ETFs will continue this steep growth trajectory.

Josh Jenkins, CFA
Portfolio Manager

Joshua Jenkins joined CLS in March 2013 as a Research Analyst, and accepted the role of Portfolio Manager in 2015. Mr. Jenkins currently serves as a manager on CLS's moderate- to low-risk mutual funds. In addition, he is a manager on income-focused separate account strategies. Prior to joining CLS, Mr. Jenkins was an Analyst for Auriga, USA, LLC.

Mr. Jenkins received his Bachelor's degree in Finance from the University of Nebraska-Lincoln, and holds the Chartered Financial Analyst® designation.

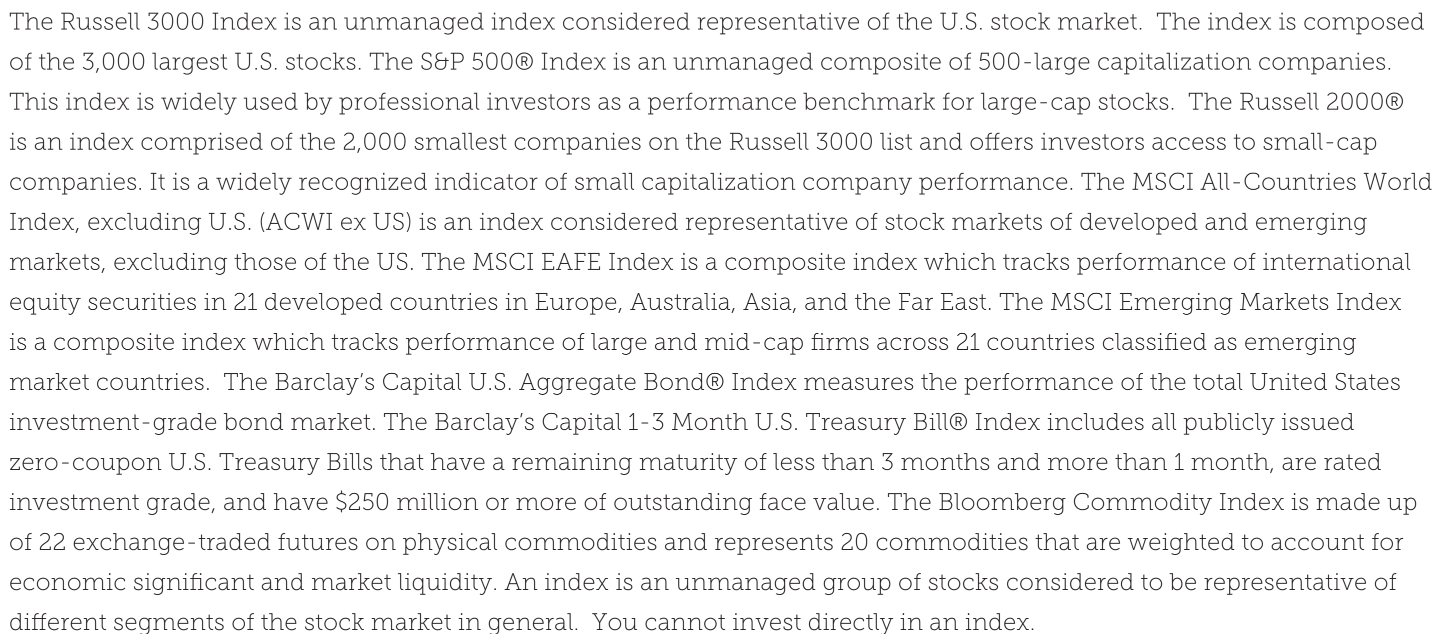
Fixed Income Year-To-Date Review

After a rough finish to 2016, the bond market has done relatively well the first four months of the new year. As illustrated in the "Market Performance" chart on the first page, the U.S. bond market (proxied by the Bloomberg Barclays Aggregate Index) is up close to 2.0% year-to-date. Helping overall performance was a 20 basis point decline in the 10-year Treasury yield and the tightening of credit spreads.

CLS portfolios have benefited from high exposure to emerging market bonds, which have been the strongest performer in the bond market thus far. Adding preferred stock and high-yield municipal bonds has also benefited performance.

Detracting from performance so far has been high exposure to inflation-protected bonds and mortgage-backed securities. We have also generally positioned portfolios to carry less sensitivity to interest rate fluctuations than the broad market. Since interest rates have fallen year-to-date, this had a negative impact.

Recently, CLS has increased its use of actively managed bond ETFs further. In the absence of obvious bargains across fixed income sectors, our aim is to leverage the bottom-up individual security selection the funds offer. As attractive opportunities again appear, we can then shift our emphasis.



The Russell 3000 Index is an unmanaged index considered representative of the U.S. stock market. The index is composed of the 3,000 largest U.S. stocks. The S&P 500® Index is an unmanaged composite of 500-large capitalization companies. This index is widely used by professional investors as a performance benchmark for large-cap stocks. The Russell 2000® is an index comprised of the 2,000 smallest companies on the Russell 3000 list and offers investors access to small-cap companies. It is a widely recognized indicator of small capitalization company performance. The MSCI All-Countries World Index, excluding U.S. (ACWI ex US) is an index considered representative of stock markets of developed and emerging markets, excluding those of the US. The MSCI EAFE Index is a composite index which tracks performance of international equity securities in 21 developed countries in Europe, Australia, Asia, and the Far East. The MSCI Emerging Markets Index is a composite index which tracks performance of large and mid-cap firms across 21 countries classified as emerging market countries. The Barclay's Capital U.S. Aggregate Bond® Index measures the performance of the total United States investment-grade bond market. The Barclay's Capital 1-3 Month U.S. Treasury Bill® Index includes all publicly issued zero-coupon U.S. Treasury Bills that have a remaining maturity of less than 3 months and more than 1 month, are rated investment grade, and have $250 million or more of outstanding face value. The Bloomberg Commodity Index is made up of 22 exchange-traded futures on physical commodities and represents 20 commodities that are weighted to account for economic significant and market liquidity. An index is an unmanaged group of stocks considered to be representative of different segments of the stock market in general. You cannot invest directly in an index.

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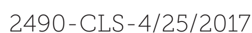

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