WEEKLY MARKET REVIEW

MAY 31, 2017

In This Edition

- *Importance of international investing - why now, why always?*
- *Benefits of professional money management - through simple brilliance.*
- *ETFs are the future - a technological evolution.*

CLS INVESTMENTS

Market Performance

Equities	LAST WEEK	QTD	YTD '17
Total U.S. Market[1]	+1.41%	+2.30%	+8.17%
Domestic Large-Cap Equity[2]	+1.47%	+2.59%	+8.81%
Domestic Small-Cap Equity[3]	+1.11%	-0.12%	+2.35%
International Equity[4]	+0.68%	+5.58%	+13.88%
Developed International Equity[5]	+0.20%	+6.00%	+13.68%
Emerging Market Equity[6]	+2.17%	+6.41%	+18.59%
Fixed Income	**LAST WEEK**	**QTD**	**YTD '17**
U.S. Investment Grade Bonds[7]	+0.03%	+1.25%	+2.08%
Cash Equivalent[8]	+0.01%	+0.11%	+0.22%
Commodities	**LAST WEEK**	**QTD**	**YTD '17**
Commodity[9]	-0.82%	-1.45%	-3.74%

[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 Index

As of 5/26/2017

Week in Review

Global markets had another great week, led by emerging markets (which remain winners so far this year) despite Moody's decision to downgrade China's credit due to perceived fading financial strength. Here in the U.S., we saw a five-for-five win as the S&P 500 went up each day, marking record highs for three of those days. Forgetting about the Trump administration's troubles, the market focused on favorable Federal Reserve (Fed) statement meeting minutes showing confidence in a strong economy and some surprising earnings results primarily from retail and technology companies. A June rate hike remains a high probability event.

The bond market was relatively flat, and the only thing in the red was commodities. Energy tumbled late in the week as the Organization of Petroleum Exporting Countries (OPEC) members met and agreed to extend current production limits, but did not increase supply cuts.

The Importance of International Investing

The latest version of the CLS Reference Guide has a slew of amazing new charts! Many of them fall into categories that we at believe are crucial for investors to grasp. The first is the importance of international investing.

The information begins on page 22 with "The Benefits of a Globally Diversified Portfolio." This page includes a chart that illustrates the optimal allocation to international, from a risk-reduction standpoint, which is between 30% and 40%. Interestingly, risk is still lower than an all-U.S. portfolio until it reaches a 70% allocation to international.

Page 23 includes our 15-year Callan chart, which shows that a global, balanced portfolio (with U.S. and international stocks and bonds) cuts through the volatility of individual asset classes over time. While cumulative returns fall in the middle of the pack, risk is at the lower end (far right column).

Page 24 shows five-year returns for the U.S. versus international developed and emerging markets since 1989. The winner in each five-year period alternates from U.S. to international, with the U.S. winning the last period. In addition, an all-world allocation is also shown, and it lies consistently in the middle, providing a smoother return stream over the five-year periods.

An Overvalued Dollar

The relative valuation of the U.S. dollar, as measured by Purchasing Power Parity (PPP), is highlighted on page 25. PPP refers to the theory that a product should cost the same in all countries — a Big Mac from McDonald's should cost the same in the U.S. as it does in Japan. Based on PPP, the dollar is currently overvalued by almost 17%, meaning there is a higher probability of dollar weakness going forward (the dollar currently buys too many Big Macs).

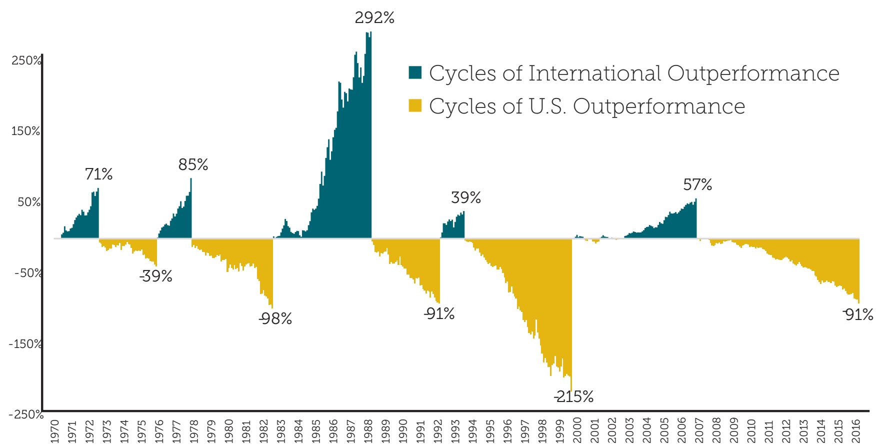
How have various markets performed based on trends with the U.S. dollar? Turn to page 26. When the dollar strengthens, like it did in the late 1990s and post-crisis 2000s, U.S. stocks do great. When it weakens, as it did in the mid-2000s, international (and particularly emerging markets) outperform. So, if the expectation is that the dollar will weaken going forward, where do you want to be invested now?

Reversion to the Mean

My favorite new chart, on page 27 and the left chart below, illustrates reversion to the mean. This is the theory that what goes up must come down; and the higher it goes up, the higher the probability that it will come down. This page shows the performance of international relative to the U.S. since 1970 over a 0% line. Above the line means international outperformance and below means U.S. outperformance. It shows there is a cyclical pattern over time, and the winner goes back and forth.

The right table below shows aggregated data on the length and outperformance during each cycle period. The current period of U.S. outperformance has lasted 112 months, while the average is only 66. This outstretched period leads us to believe there is a higher probability of a reversal going forward, i.e., a higher likelihood of international outperforming the U.S. as the line reverts to 0%.

Cumulative Relative Performance of the MSCI EAFE Index Relative to the S&P 500 Index



Source: Morningstar Direct data from 01/01/1970 to 02/28/2017

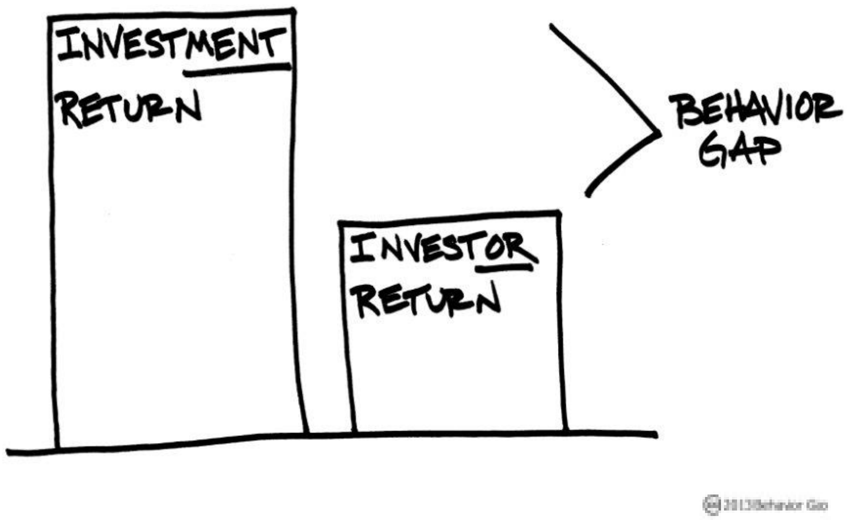
Cycles of International Outperformance			
Start Date	End Date	# of Months	Performance
1971	1973	31	71%
1976	1978	24	85%
1983	1989	68	292%
1993	1994	17	39%
2000	2007	86	57%
	Average	45.2	109%
Cycles of U.S. Outperformance			
Start Date	End Date	# of Months	Performance
1973	1976	40	39%
1978	1983	57	98%
1989	1993	47	91%
1994	2000	74	215%
2007	Current	112	91%
	Average	66.0	107%

You may not have noticed, but many of the Oscar-nominated movies over the last couple years have been based on true stories. There is just something about the simple brilliance of a true story that pulls viewers in. When creating the [CLS Reference Guide,](#) we try to incorporate that same idea: presenting simple, easy-to-understand charts that all clients can relate to.

One of these charts is perhaps the best example of simple brilliance (in the financial world at least): the behavior gap graphic created by Carl Richards. This chart, found on page 9 of the Reference Guide and on the previous page of this Weekly Market Review, succinctly illustrates the negative impact of human emotion and subsequent irrational behavior on portfolio returns: for example, chasing performance and buying stocks when they have had a great run — just in time for them to peak and drop. It also presents another idea that's essential for investors to understand: the benefits of professional money management.

On page 10, we delve further into that idea by quantifying those benefits. Utilizing data from Vanguard, we show how an advisor can potentially add 3% to an investor's returns. The largest portion of that potential value-add comes from helping investors stay disciplined — avoiding the behavior gap.

On page 11, we further illustrate the behavior gap with real numbers from a Dalbar study, showing



that the average fund investor earns less than a broad market index. Additionally, on page 11, a bonus chart shows how investor emotions change over a market cycle in a somewhat comical manner: an investor says "Wow, I am smart!" in excitement right before a market peak, and then that emotion fades into denial, fear, and desperation as the market drops.

The S&P 500's annual returns dated all the way back to the 1940s, shown on page 12, clearly illustrate the importance of staying disciplined and invested.

The Time to Invest is Now

Page 13 shows the percentage of active funds beating the S&P 500 on a five-year basis is cyclical in nature, just like most other things in investing. We are currently at the lower end of the range of historical cycles, meaning active management has underperformed in recent years (since the 2008 financial crisis). This puts active management in a position of higher probability to outperform going forward as that cycle starts to turn.

Another new page (page 14) shows qualities of good active managers and explains how each is represented at CLS: emphasis on low costs, "eating our own cooking," stewardship, and low portfolio turnover.

We finish with a relatively new page (page 15) showing the best time to invest is now. Even if an investor is the worst market timer in history, investing in the S&P 500 on the worst possible day each year (at the peak) since the year 2000, it would still be better than keeping money in the bank as it outperforms cash.

So, the next time someone asks why use an advisor or professional money manager like CLS, or why stay invested when a market is falling, the CLS Reference Guide offers plenty of answers.

ETFs are the Future

We live in a great age of technological evolution. Or is it revolution? Whether we are tech-savvy or tech-dependent, we have all embraced this change with open arms. We have a supercomputer, formerly known as a cell phone, within arm's reach at all times. The same type of innovation is happening in the financial industry through the creation of exchange traded funds (ETFs). These funds utilize the top qualities of other types of instruments (including mutual funds and stocks) to create a well-balanced investment structure.

So, what makes ETFs so great? You need only look at the CLS Reference Guide.

The information starts on page 30 with the classic "Best of Both Worlds" diagram. The graphic shows that ETFs take the most beneficial features of stocks (more options to get targeted exposures, intra-day trading, etc.) and the most beneficial features of mutual funds (well-diversified, tracks a theme/index, etc.) to come up with a financial innovation of massive proportions.

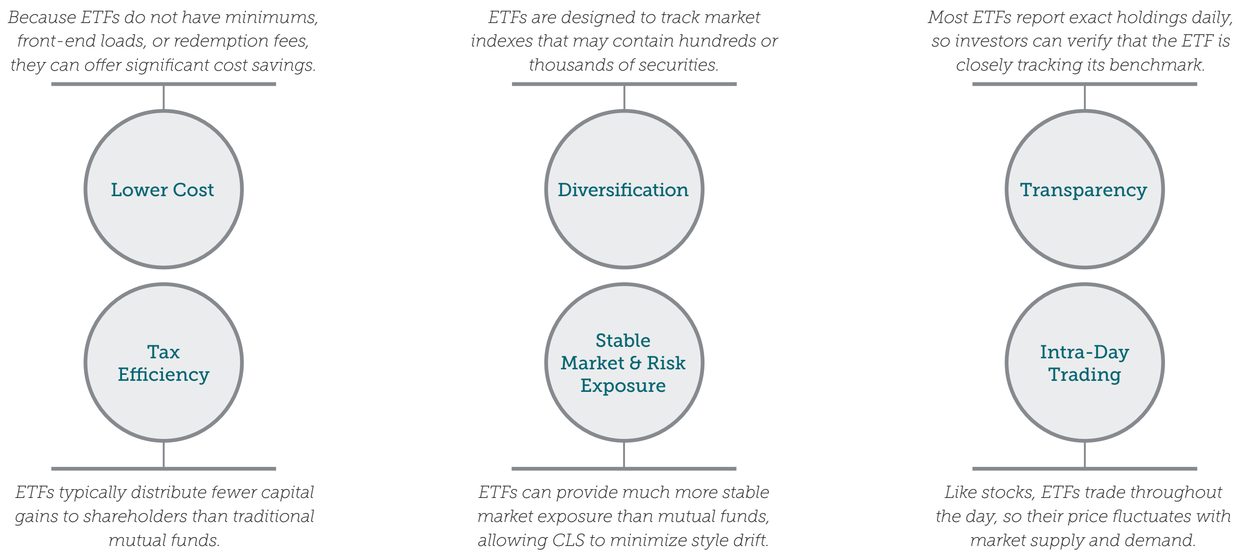
Next, on page 31, we dive deeper into the benefits of ETFs. We list the main six benefits: lower cost, tax efficiency, diversification, stable exposure, transparency, and intra-day trading; but there are actually many more reasons that just didn't fit on the page. There is also a brief explanation of each benefit on the page.

Page 32 shows the growth in the ETF market. A huge milestone is just around the corner with total assets nearing $3 trillion (currently at $2.92 trillion) and more than 2,000 listed in the U.S. Most of this growth has taken place over the last decade and is happening very quickly, but the size is nowhere near that of the $17 trillion mutual fund market, so there is plenty of room to run. This type of growth is consistent with other new and superior technologies, which take some time to get everyone on board.

Finally, on page 33, we show a timeline of key ETF milestones and CLS's history of using ETFs. We were an early adopter. We utilized ETFs in the late 1990s, and we have grown into one of the largest active money manager that uses ETFs — thus our classification as an ETF strategist.

If you would like to learn more about ETFs, don't forget about the ETF Education Center on our website, which includes great documentation and videos from some of our partners on the benefits of ETFs.

ETF Benefits



Kostya Etus, CFA
Portfolio Manager

Konstantin "Kostya" Etus began his career at CLS in 2011 as a Trading Specialist and became Research/Portfolio Analyst in early 2013. Later, he was promoted to Portfolio Manager. Mr. Etus is currently a co-manager on two mutual funds and lead manager on various separate account strategies.

Prior to working at CLS, Mr. Etus worked as an Associate Financial Analyst at ConAgra Foods, Inc., managing the company's global cash network. He graduated from the University of Nebraska at Omaha with a Bachelor of Science in Business Administration, and obtained Master's degrees from Creighton University in Investment Management and Financial Analysis, as well as Business Administration. He holds the Series 65 securities registration and the Chartered Financial Analyst (CFA) designation.

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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