WEEKLY MARKET REVIEW

JUNE 13, 2017

In This Edition

- *Value should remain a focal point of investors' portfolios.*
- *Keep an eye on the fundamentals.*
- *Tax time is all the time for non-qualified investors.*

Market Performance

Equities	LAST WEEK	QTD	YTD '17
Total U.S. Market[1]	-0.20%	+3.22%	+9.15%
Domestic Large-Cap Equity[2]	-0.27%	+3.34%	+9.61%
Domestic Small-Cap Equity[3]	+1.18%	+2.79%	+5.33%
International Equity[4]	-0.68%	+6.08%	+14.42%
Developed International Equity[5]	-1.17%	+6.57%	+14.29%
Emerging Market Equity[6]	+0.36%	+6.65%	+18.86%
Fixed Income	**LAST WEEK**	**QTD**	**YTD '17**
U.S. Investment Grade Bonds[7]	-0.15%	+1.59%	+2.42%
Cash Equivalent[8]	+0.02%	+0.14%	+0.24%
Commodities	**LAST WEEK**	**QTD**	**YTD '17**
Commodity[9]	+0.13%	-3.27%	-5.52%

[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 6/9/2017

Week in Review

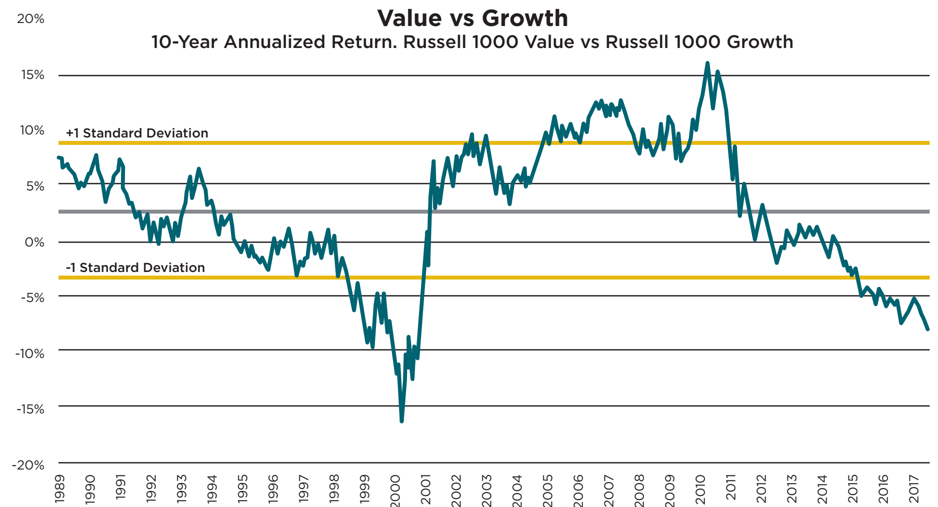
Global markets closed last week slightly lower, with the global benchmark (MSCI All Country World Index) down 0.50%. Thursday was dubbed "Super Thursday" (likely by the media searching for news flow) as the day started with the European Central Bank meeting, ex-FBI director James Comey testifying before Congress, and the British election. But at the end of it all, the only asset class that saw major movement was the British pound.

Large-cap domestic stocks closed slightly lower as technology shares lagged late Friday. Smaller companies rebounded, and emerging markets continued their impressive streak. Financial firms also rebounded, contributing to value-oriented companies outperforming growth last week by the most in 2017 (more on value shortly).

Economic data was light last week. Yields moved higher in fixed income, with the yield on the closely followed 10-year Treasury closing at 2.20%. Higher-than-forecast oil inventory and production data weighed on energy prices, but rebounds in other commodities managed to push the asset class higher on the week.

Sticking with Value

One of our investment themes for 2017 is Global Value. It is more than just an investment theme; it is how we gauge investment opportunities around the world (as described in our latest Monthly Market Review). The theme emphasizes relative value opportunities around the world, but it also emphasizes value-oriented stocks here and abroad. Overseas, this value orientation has been helpful. However, domestic value stocks haven't performed nearly as well as they did last year, which has scared some investors away.



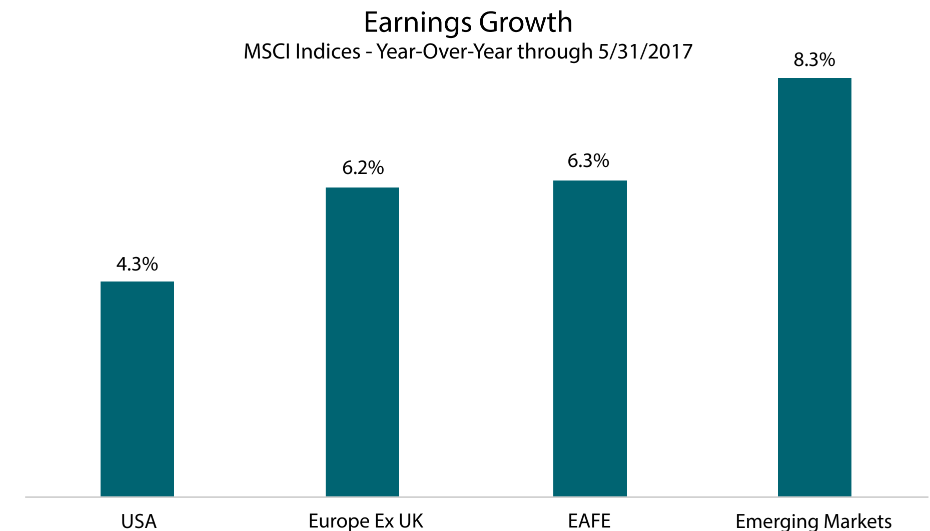
Value can come in many shapes and sizes. Classic measures of value, such as book-to-market or price-to-earnings, generally find their way into the construction of many ETFs and indices we use, but other more exotic measures can find their way into the index construction also. More recently, products have come to market that allocate to value in a *sector-neutral* fashion, meaning they hold sector weights at roughly the same level as the parent index. For instance, technology normally is not considered a value sector, but given its weight in the index, a sector-neutral value ETF needs to hold a lot in tech. We have utilized these sector-neutral value ETFs in addition to more "pure" value exposures, which has been helpful to allocations as sector-neutral names have outperformed others by nearly 5% in 2017. Just another example of why it's a good idea to pay attention to how your ETF is constructed.

If we look at the long-term performance trend, value has underperformed growth since the 2008 financial crisis. Comparing annualized 10-year returns (as another measure of valuation), value stocks are approaching two standard deviations of underperformance – levels not seen since the tech bubble in the late 1990s. There are reasons beyond underperformance and undervaluation that explain why it makes sense to stick with value. Moves higher in interest rates and inflation are generally positive for value stocks, in particular financial and cyclical companies, which make up large portions of value indices.

Earnings season is all but over for most of the domestic market, and we've seen some of the strongest growth in earnings and revenues from financials, materials, and the energy sector – all major value components (more on earnings shortly). As the FAANNG* stocks continue their rapid pace higher. It makes it much easier to ignore value stocks. However, we are sticking with value.

**FAANNG includes: Facebook, Amazon, Apple, Netflix, Nvidia, and Google. These stocks are up an average of 31% in 2016.*

Investors have enjoyed a great run this year, and over the last several years. It's always worth harkening back to the basic fundamentals of stock price movements to uncover if market moves are justified. By its very nature, a stock is a claim on future earnings of a company, so it should be no coincidence that stock price movements are driven over the long-term by earnings growth.



*Sources: MSCI, Ned Davis Research, FactSet. *Developed international is represented by the MSCI EAFE Index.*

Following the drop in oil prices in late 2014 and the subsequent surge in the dollar shortly thereafter, earnings and economic activity took a hit globally, and some countries even went into recession. As we've dug our way out of the hole those forces created, we've seen earnings rebound around the world – and stock prices move higher.

The nice rebound in stock prices, particularly overseas, has been met with growth in earnings, which is good to see. Emerging markets have enjoyed a rebound in stock prices and earnings. What's important to keep in mind is overseas markets have been undervalued relative to their histories. So, it's not unhealthy to see multiple expansions as those regions move back toward their historical averages. We continue to see strong earnings growth in the U.S., but as prices fly higher, strong future earnings growth is being priced in for years into the future. International markets are rebounding after years of underperformance and have the fundamentals to support a repricing.

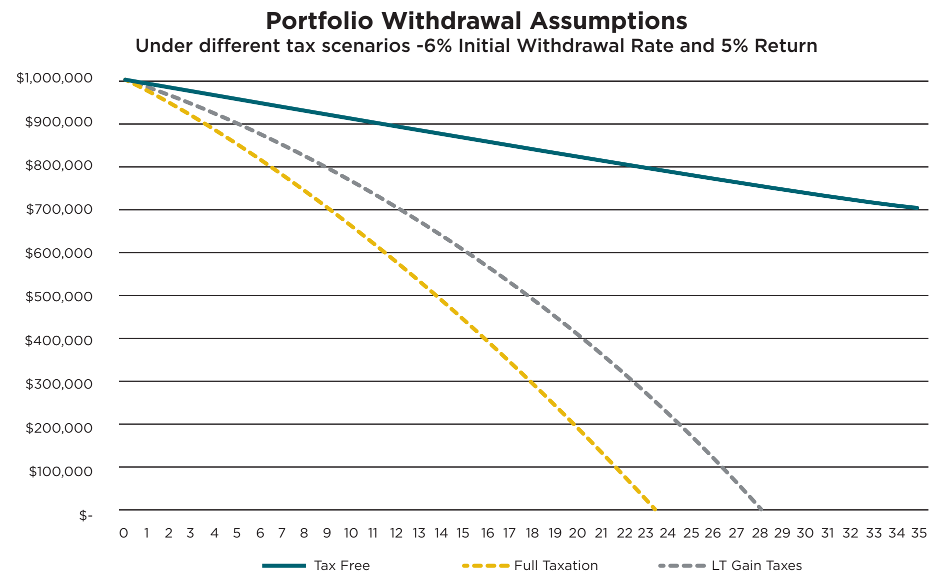
Grant Engelbart, CFA, CAIA
Portfolio Manager

Grant Engelbart joined CLS in 2009, and after several roles in operations and investment research, accepted the role of Portfolio Manager in 2013. Mr. Engelbart currently serves as a manager on CLS's aggressive mutual funds in addition to several ETF and mutual fund separate account strategies. Prior to joining CLS, Mr. Engelbart held positions at TD Ameritrade and State Street Corporation.

Mr. Engelbart received his Bachelor's degree in Finance from the University of Nebraska-Lincoln. He holds the Chartered Financial Analyst (CFA) designation, Chartered Alternative Investment Analyst (CAIA) designation, and FINRA Series 65 license. He is a member of the CFA Society of Nebraska and the CAIA Chicago Chapter.

It's Always Tax Time

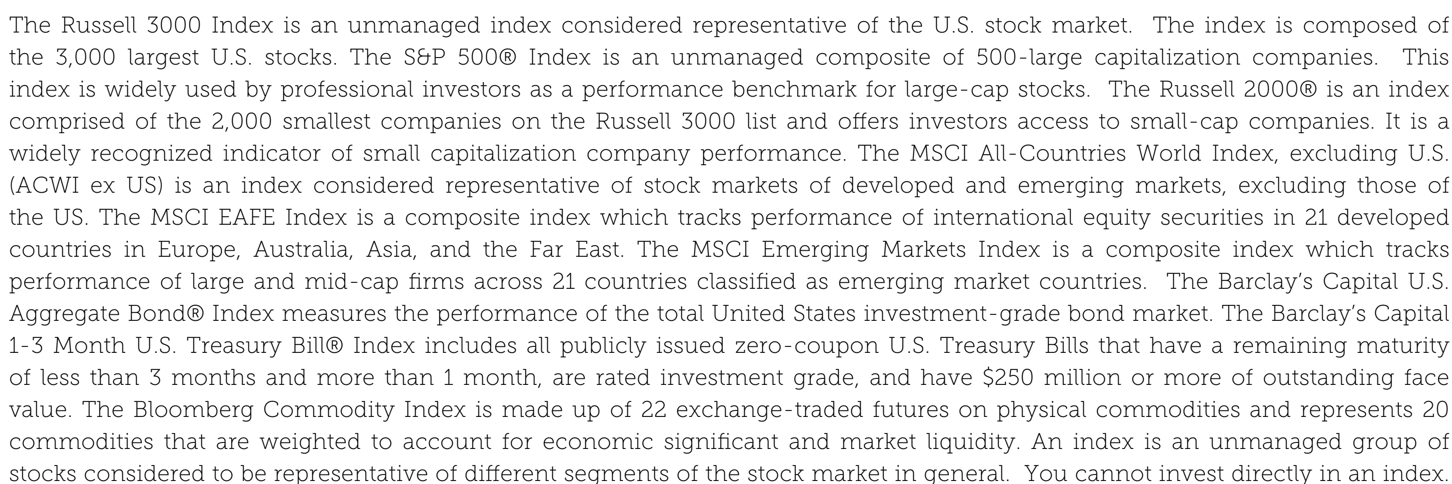
Accountants have been celebrating the end of tax season for a couple of months now, and many investors are probably still recovering from their hefty tax bills after years of market strength. There are a lot of positives, of course, to a growing portfolio, but it also can be painful when Uncle Sam comes to collect. With many investors transitioning to the drawdown phase of their lives, stretching wealth as long as possible is increasingly important.



Yet, investors tend to ignore or downplay the effects of taxes on their non-qualified assets (another huge benefit of having a financial advisor). Running a simple scenario on a $1 million portfolio, we can see this effect in full force. Under a $5,000/month withdrawal (6% of initial value), a tax-free portfolio would maintain its value through time fairly well assuming a 5% annual return. Obviously, there will be some degradation since we are withdrawing more than we are earning, but only a limited amount. Unfortunately, not too many people have $1 million in their Roth IRAs (since legislation was enacted in the late 90s), so most folks will have to pay some degree of taxes on their earnings or withdrawals.

Here is where tax management – or at least tax awareness - can become exceptionally valuable. If earnings were taxed each year at the highest income rate (40% in this scenario), the original $1 million would run out after 23 years. However, if that were taxed at the highest capital gains tax rate (20% in this scenario), that money would last five additional years – which could make all the difference. Tax managing a portfolio can help close that gap, as can embracing a total-return approach for non-qualified accounts (income is taxed higher than cap gains).

Taxes can be complicated, troublesome, and, frankly, boring – but they aren't going away. Being smart about taxes can make a difference in the lives of our clients.



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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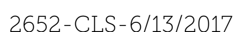

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