WEEKLY MARKET REVIEW

JUNE 27, 2017

In This Edition

- *The market is calling the Fed's rate hike bluff.*
- *Bond ETF demand poised to jump - who will be buying?*
- *CLS shares its insight at a Smart Beta Industry Gathering.*

CLS INVESTMENTS

Market Performance

Equities	LAST WEEK	QTD	YTD '17
Total U.S. Market[1]	+0.27%	+3.53%	+9.47%
Domestic Large-Cap Equity[2]	+0.22%	+3.69%	+9.98%
Domestic Small-Cap Equity[3]	+0.58%	+2.36%	+4.88%
International Equity[4]	+0.14%	+5.86%	+14.18%
Developed International Equity[5]	-0.18%	+6.40%	+14.11%
Emerging Market Equity[6]	+0.97%	+6.17%	+18.32%
Fixed Income	**LAST WEEK**	**QTD**	**YTD '17**
U.S. Investment Grade Bonds[7]	+0.17%	+2.03%	+2.86%
Cash Equivalent[8]	+0.03%	+0.18%	+0.29%
Commodities	**LAST WEEK**	**QTD**	**YTD '17**
Commodity[9]	-1.99%	-6.50%	-8.67%

[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 6/23/2017

Week in Review

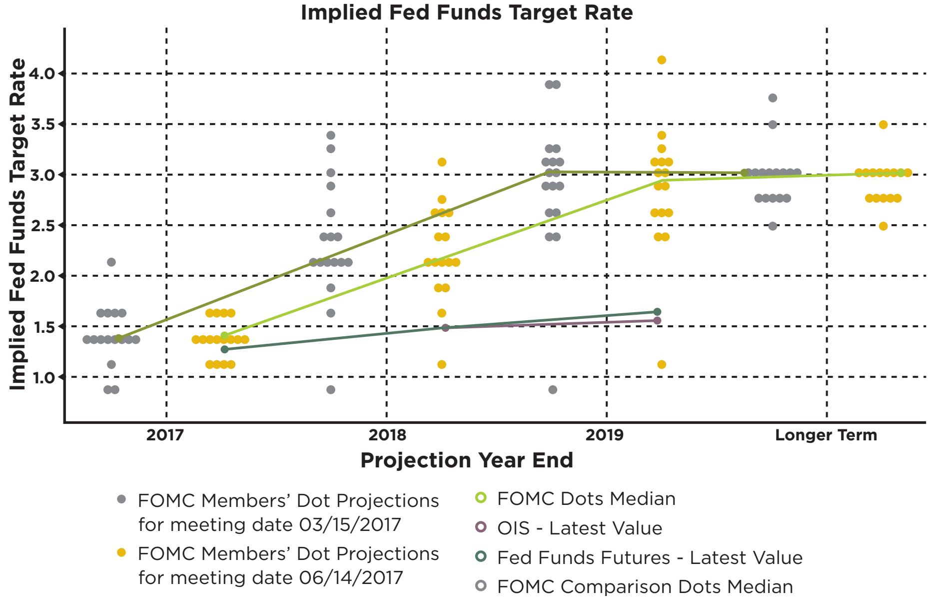
Last week was generally positive for the markets. U.S. stocks finished in the green up 0.27% with small-caps outperforming large-caps. International markets also posted gains, ending the week up 0.14%. Developed international companies were down slightly, but a strong week for emerging markets kept the group positive. The bond market continues to have a solid year, ending the week up 0.17% as the 10-year Treasury yield fell approximately four basis points. Commodities continued their weakness, ending the week down 1.99%. Oil entered a bear market last week, falling more than 20% year-to-date. Falling energy prices have been attributed to expanding production in the U.S. and Libya offsetting the effects of recent production cuts by the Organization of Petroleum Exporting Countries (OPEC).

It was a fairly quiet week for economic data. Highlights included weaker-than-expected Purchasing Managers' Index (PMI) data, an increase in existing home sales, and higher-than-expected jobless claims. In the upcoming week, we will see the third revision of U.S. GDP, inflation data, and durable goods orders.

As expected, the Federal Reserve (Fed) raised the benchmark interest rate at its most recent Federal Open Market Committee (FOMC) meeting earlier this month. This marks the fourth time in the current cycle that interest rates have been increased. In addition, the FOMC published its projection, known as the "Dot Plot," for the level of future rates. Consistent with the previous publication, the FOMC anticipates it will increase rates one more time this year. The market, however, isn't buying it. Currently, Fed fund futures are pricing in less than a 50% probability that there will be another hike in 2017.

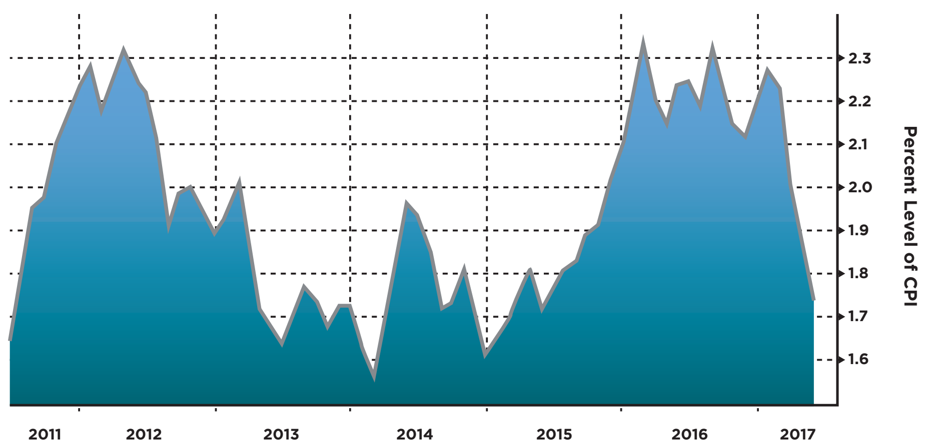
What is causing the mismatch in expectations between the Fed and the market? Much of it likely stems from the softening of recent economic data. Readings related to the Fed's dual mandate of 2% inflation and low unemployment have been disappointing as of late. For instance, the U.S. Department of Labor's jobs report has come in below the surveyed estimate for three consecutive months,

Implied Fed Funds Target Rate



Source: Bloomberg. As of 6/14/2017
**The FOMC Members' Dot Projections indicate the value (rounded to the nearest 1/8 percentage point) of an individual participant's judgment of the midpoint of the appropriate target range for the federal funds rate or the appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run.*

U.S. CPI Urban Consumers Less Food and Energy (YoY)



Source: Bloomberg. As of 5/31/2017

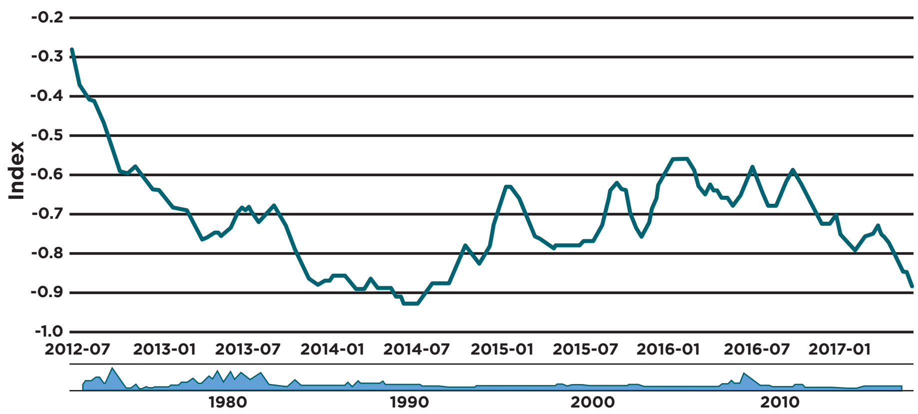
Joshua Jenkins, CFA
Portfolio Manager

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.

The Market is Calling the Fed's Bluff (Continued)

Chicago Fed National Financial Conditions Index



Source: Federal Reserve Bank of Chicago; fred.stlouisfed.org
Shaded areas indicate U.S. recessions. As of 6/23/2017

and core Consumer Price Index (CPI) has fallen dramatically so far this year. In light of this, the market has positioned itself for some tightening.

Interestingly, despite having four hikes since December 2015, financial conditions have actually eased. The Federal Reserve Bank of Chicago's National Financial Conditions Index measures risk, liquidity, and leverage in the money, bond, and equity markets. A positive reading on the index indicates conditions are tighter than average, while a negative level indicates conditions are looser than average. As of last Friday, the index was at -0.89, its most accommodative level since 2014. If financial conditions remain this accommodative, it could provide cover for the Fed to continue tightening despite the softer economic data.

Bond ETF Demand Poised to Jump

Regulations on insurance companies may soon change allowing as much as $300 billion of additional assets to flow into fixed income ETFs, per a recent BlackRock estimate. The National Association of Insurance Commissioners (NAIC) appears primed to relax rules on the accounting for ETFs within insurance portfolios.

Previously, fixed income ETFs have been treated the same as equity funds. Utilizing a new method called "systematic value," which was partially developed by BlackRock, insurers will be able to measure certain ETFs based on the underlying cash flows of the securities. The result is the ability to compare ETFs to traditional bonds, which typically dominate insurer portfolios.

This development is a strong positive for the ETF industry, signifying another nod to the potential benefits of the ETF wrapper and demonstrating ever-increasing levels of acceptance.

Earlier this month, I had the opportunity to represent CLS by speaking on a panel at the Inside Smart Beta conference held in New York City. It was an excellent event packed full of great speakers, including some household names, such as Kevin O'Leary from "Shark Tank" and the father of smart beta himself, Rob Arnott. My panel looked at the case for applying smart beta to the bond market, why growth in that area has lagged, and where there is opportunity going forward.

The case for smart beta within the fixed income market is arguably stronger than it is for equities. Traditional equity indices weigh holdings based on the market value of the firm's equity, while bond indices weigh holdings based on the market value of debt. In both cases, investors are tilting toward securities that have increased in price (perhaps above intrinsic value) and tilting away from securities that have decreased in price (perhaps below intrinsic value). In this situation, investors are engaging in some degree of performance chasing by always purchasing high and selling low. Clearly not what they ought to be doing. What makes the situation worse for bonds is investors are allocating the most money to the firms with the most debt. Generally speaking, as the debt load increases, so does risk due to deterioration in the creditworthiness of the borrower. For equities, however, companies with larger capitalizations are generally less volatile, not more.

Total assets in fixed income smart beta are substantially lower than what equity products have gathered. Even using the broadest of definitions, there is only about $12.3 billion invested. So, why has smart beta lagged on the bond side? Well, there are a few reasons. The first equity ETF came to market in 1993, nearly 10 years before the first bond ETFs. So, fixed income product development and adoption have generally always lagged equities, not just with smart beta. The one exception to this is actively managed ETFs, which have been dominated by the fixed income side. These products offer an additional alternative to investors seeking to deviate from traditional cap-weighting.

Another cause of slow growth has been a general lag in research and development. For decades, academics and practitioners have studied the efficacy of factors in the stock market, but only recently has this work been applied to the bond market in a meaningful way. This work has started to translate into new product development. Approximately a third of smart beta bond ETFs have come to market since the beginning of last year. Asset growth is also starting to improve; more than a quarter of the assets have flowed into the space over the last year.

Opportunities for smart beta development seem to fall into one of two categories. The first category of products tries to improve upon the broad market indices, such as the Bloomberg Barclays Aggregate Bond Index. To do this, issuers have used some combination of expanding the opportunity set to sectors not currently represented in the index, reweighting or rotating between sectors, or reweighting or applying factors within specific sectors. Another category focuses on a specific sector, such as high yield or emerging market bonds, and applies an alternative weighting scheme or factor tilt.

At the end of the day, the case for smart beta within fixed income is strong. More recently, the level of research and product development has accelerated in this area. This is unquestionably a positive trend for investors.

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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