CLS's WEEKLY 3

What You Need To Know About the Markets

DECEMBER 12, 2017

1. Keeping up with millennials may be daunting – here are some suggestions on where to start.
2. Don't let taxes ruin your holidays – we present some best practices as we near year-end.
3. Stock markets continue to hit all-time highs – is this really a good time to invest?

CLS INVESTMENTS

Market Performance

Equities	LAST WEEK	QTD	YTD '17
Total U.S. Market[1]	+0.26%	+5.33%	+19.99%
Domestic Large-Cap Equity[2]	+0.39%	+5.67%	+20.72%
Domestic Small-Cap Equity[3]	-0.97%	+2.28%	+13.47%
International Equity[4]	-0.08%	+2.01%	+23.57%
Developed International Equity[5]	+0.09%	+1.84%	+22.17%
Emerging Market Equity[6]	-0.45%	+2.80%	+31.36%
Fixed Income	**LAST WEEK**	**QTD**	**YTD '17**
U.S. Investment Grade Bonds[7]	-0.02%	+0.20%	+3.34%
Cash Equivalent[8]	+0.02%	+0.19%	+0.74%
Commodities	**LAST WEEK**	**QTD**	**YTD '17**
Commodity[9]	-2.83%	-0.31%	-3.17%

[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 12/8/2017

Week in Review

Within equities, the U.S. market was up slightly for the week. Domestic small-caps stood out as underperformers, down almost 1%. U.S. large-caps were top performers with international stocks about flat. Emerging markets trailed developed markets.

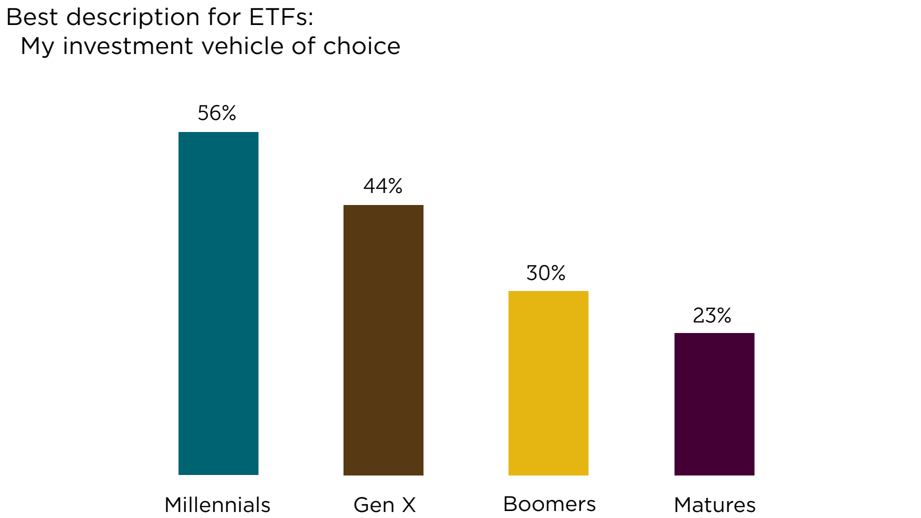
Treasury yields were little changed, and thus so were bond returns, with the 10-year Treasury note ending the week at 2.38%. Most commodity sectors got hit with the aggregate commodity index down almost 3%, while the U.S. dollar rose against most major currencies.

On the economic front, we finally received "clean" numbers (those not affected by hurricanes), although they were not overly exciting – which is not a bad thing. November non-farm payrolls increased by 228,000, beating expectations. The unemployment rate held steady at 4.1%, the lowest in 17-years. Lastly, average hourly earnings rose 2.5% annualized, slightly below forecast.

"The key to this business is personal relationships." – Dickie Fox, Jerry Maguire

Financial advisors and investment managers are trying to crack the code on what millennial investors are looking for and how to help them save for retirement. Here are a few insights from a millennial point of view on dealing with this *evolutionary* generation.

More than any other generation, Millennials say ETFs are their investment vehicle of choice



Source: Schwab, as of Septebmer 30, 2017

Keeping Up With Technological Evolution

Millennials are always busy. They're often tired and often working. They're typically starting their families, and they don't have much time to visit with financial advisors. Millennials also want everything at their fingertips, which is, of course, very possible with the evolution of the mobile phone. We all have a supercomputer in our pocket.

But, financial advisors don't always make it easy to manage investment accounts from a mobile device. While they may prefer their clients to call if they're concerned or have questions, many millennials simply don't have the time. They would rather send a text message or get text message notifications. This preference is leading to growth in automated account oppening tools, which enables users to sign on to a website and create accounts in a matter of minutes, while making everything easily available through an online interaction.

Advisors need to think about interactions with their clients and how they can evolve their technology offerings to keep up with this trend and adapt to the future. At CLS and our sister company, Orion, we continue to evolve our back office support with video statements, text notifications for account information, and the launch of an automated account opening platform called Autopilot. We are consistently trying to find ways to help advisors with technological evolution.

Keeping Up With Investment Evolution

As far as product evolution, all signs point to ETFs. Flows have continued to move to ETFs over the past decade, growing as much as 20-30% per year. There has been intense competition in the investment fund space, and the focus has shifted toward low-cost. Millennials are very cost-centric, and they are also very skeptical. After experiencing two major bear markets — the tech bubble in 2000 and the global financial crisis in 2008 — younger investors have little reason to trust the markets. As a result, they demand products that are easy to understand and offer transparency.

Additionally, I like to call millennials the know-it-all generation because we perceive ourselves as experts on everything. No matter the question, we simply "Google it" and find the answer instantly. The ability to look things up quickly creates a great benefit to ETFs, which are highly transparent and simple. They're very easy to understand; they're index-based and transparent. Anyone can look up the underlying holdings every day and know exactly what companies are being held. Millennials can really grasp and appreciate that. If you told me I could have a simple, diversified investment at a low cost, it's a no brainer.

To read more on keeping up with millennials, keep an eye on the CLS blog for a new post coming soon.

The chart above is from an investor study by Charles Schwab highlighting millennials' preference for ETFs.

"Will you look at those morons. I paid my taxes over a year ago." – Homer Simpson, The Simpsons

Financial markets have seen another marvelous year of performance. So, is it time to rejoice and enjoy the holidays? Well, don't get too celebratory because you may be getting a tax bill even if you didn't sell any investments.

Mutual funds distribute capital gains generated within the funds to shareholders. Distributions are typically paid out in mid-to-late December. Luckily, these distributions are considered long-term capital gains and thus are subject to a lower rate than short-term gains (typically 15% depending on income). Nonetheless, they are often a surprise to investors who did not sell any of the investments for a gain.

Many fund companies have sent out initial estimates for capital gains this year, and they are staggering — some of the highest in years. Some estimates exceed 30% of the net asset values, according to CapGainsValet (see graphic to the right). It would be wise to scan through your taxable accounts and look up the expected distributions, which can usually be found on each fund company's website.

Current Capital Gain Stats - 2017

304	31	9
Estimated Distributions Over 10% (10% to 19%)	Estimated Distributions Over 20% (20% to 29%)	Estimated Distributions Over 30%!

Source: CapGainsValet as of December 5, 2017

But it is not the end of the world, and there are a couple things you can do for potential tax savings.

1. Harvest Losses

A general best practice in investment management is harvesting losses (selling securities at a loss to help offset gains generated elsewhere).

Unfortunately, one of the most unique things about this year is there are few asset classes experiencing losses. The energy sector, including master limited partnerships, stands out as one of the only places with negative returns. Some agricultural commodities have seen losses, too.

Tax-loss harvesting does require purchasing a replacement, and investors generally should not change investment strategies simply to achieve a tax advantage. The use of ETFs makes these decisions much easier because there are typically multiple ETFs tracking a similar index, and these can be swapped for tax purposes.

2. Avoid Capital Gains

Perhaps the easiest way not to get the unexpected tax bill is to avoid a capital gain altogether by not owning the mutual fund when it pays out. One way to achieve this is to sell before the distribution and buy the fund back afterwards. But, that requires time out of the market. A wise solution may be to sell the mutual funds and buy tax-efficient ETFs.

ETFs utilize a creation and redemption process for asset flows with their underlying holdings, which typically allows them to avoid capital gains. This tax efficiency, and ability to avoid capital gains in a year like we have had, is one of the major benefits of ETFs over mutual funds.

** This publication does not, and is not intended to, provide legal, tax or accounting advice, and readers should consult their tax advisors concerning the application of tax laws to their particular situations.*

"Nobody is going to hit as hard as life, but it ain't how hard you can hit. It's how hard you can get hit and keep moving forward. That's how winning is done." – Rocky Balboa, Rocky

We are currently in the midst of one of the strongest bull markets in history. And to top it off, we have had a historic up-year with continuous all-time highs and record low volatility. So, is this really a good time to invest?

History would suggest it's *always* a good time to invest.

Does the day you invest matter?

On Black Monday, October 19, 1987, stock markets around the world crashed unexpectedly, and the U.S. market fell more than 20% in one day. So, if an investor invested $100,000 on October 16 (peak) versus October 19 (bottom), how would his or her portfolio look today? That investor would have $0.9 million if he invested on October 16 and $1.2 million if he invested on October 19. Now $300,000 is a lot of money, but the point is, he made a lot of money either way (see top chart to the right).

So, the answer is somewhat contingent on the next question—after all, a portfolio's value depends more on long-term returns than the single day chosen to begin investing.

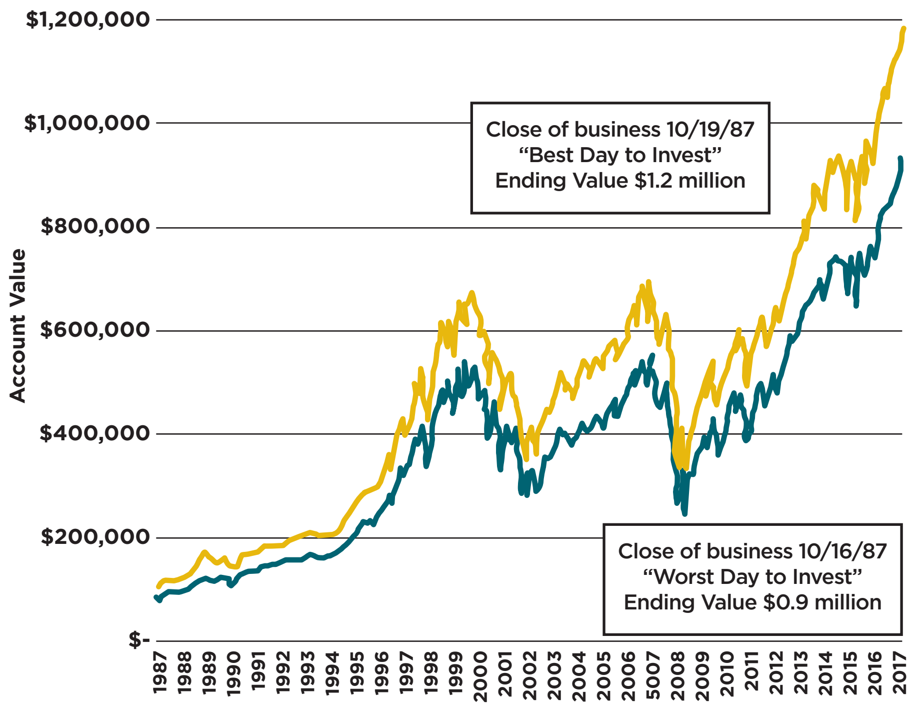
Does the holding period matter?

For this question, let us evaluate the historic chances of winning at markets. If an investor invests for only one year, the historical probability of making a profit would be about 68% — certainly better than a coin flip. But, when the holding period is increased to 5, 10, and 20 years that probability increases significantly. Ultimately, a holding period of 30 years or more has historically resulted in positive returns 100% of the time (see bottom chart above).

The answer to this question is yes. While we may very well be in the final phase of the decade-long bull market, historical probabilities for profit suggest it's always a good time to be invested.

$100,000 Invested in Stock Market on 10/16/87 vs. 10/19/87

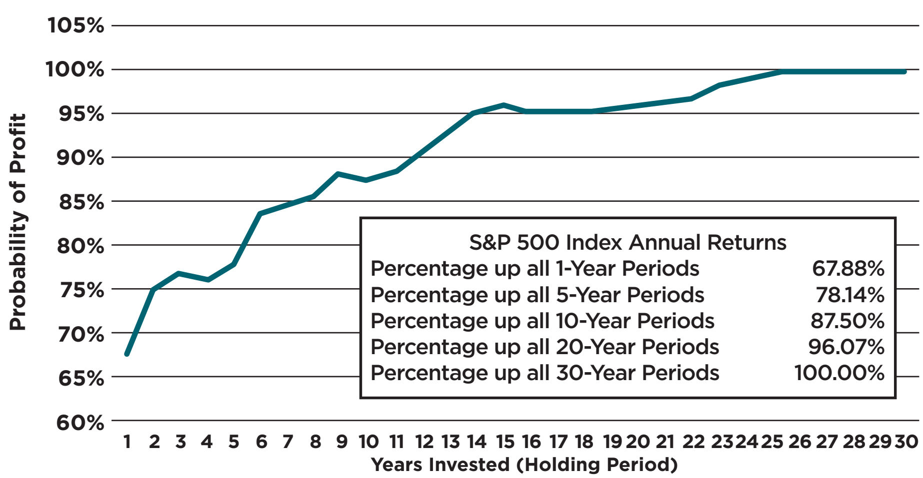
S&P 500 Index Price Return Daily 10/16/87 - 12/8/17



Source: Bloomberg

Probability of Positive Return

S&P 500 Index Price Return Monthly Data 12/30/1927 - 11/30/2017



Source: Bloomberg

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 Bloomberg Barclay's Capital U.S. Aggregate Bond® Index measures the performance of the total United States investment-grade bond market. The Bloomberg 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 exchange-traded futures on physical commodities and represents 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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Kostya Etus, CFA

Portfolio Manager

Konstantin "Kostya" Etus specializes in international investments. He is a co-manager on two mutual funds (aggressive allocation and international) and manager on various separate account strategies, including Core Plus ETF and SRI/ESG. In addition, he manages 529 plans.

Mr. Etus has eight years of investment experience, including six at CLS. He began his career at CLS in 2011 as a trading specialist and became a research/portfolio analyst in early 2013. In 2016, he was promoted to Portfolio Manager. 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 degree in business administration and obtained Master of Investment Management and Financial Analysis and Master of Business Administration degrees from Creighton University. He holds the Series 65 securities registration and the Chartered Financial Analyst® (CFA) designation.

Did you know? Kostya grew up in Soviet Russia.