CLS's WEEKLY 3

What You Need To Know About the Markets

JUNE 12, 2018

1. Where (and how) CLS finds value today.
2. Taxes don't have to be a burden if managed properly.
3. Is artificial intelligence going to take over investing?

CLS INVESTMENTS

Market Performance

Equities	LAST WEEK	QTD	YTD '18
Total U.S. Market[1]	+1.71	+6.08	+5.40
Domestic Large-Cap Equity[2]	+1.66	+5.65	+4.85
Domestic Small-Cap Equity[3]	+1.51	+9.56	+9.47
International Equity[4]	+0.85	+0.53	-0.66
Developed International Equity[5]	+0.96	+1.26	-0.29
Emerging Market Equity[6]	+0.54	-2.62	-1.24
Fixed Income	**LAST WEEK**	**QTD**	**YTD '18**
U.S. Investment Grade Bonds[7]	-0.22	-0.62	-2.07
Cash Equivalent[8]	+0.04	+0.32	+0.66
Commodities	**LAST WEEK**	**QTD**	**YTD '18**
Commodity[9]	-0.49	+3.23	+2.82

[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 6/8/2018

Week in Review

Global stocks closed modestly higher last week as equities attempted to move out of their multi-month sideways trading pattern. Generally strong economic data, a weakening U.S. dollar, and a slowing in the pace of interest rate moves all seem to have contributed to stronger sentiment. Overseas, worries about the new Italian government eased, and the euro strengthened. Offshore Chinese stocks led emerging markets higher on the week despite currency troubles in Brazil, Turkey, Mexico, and Argentina.

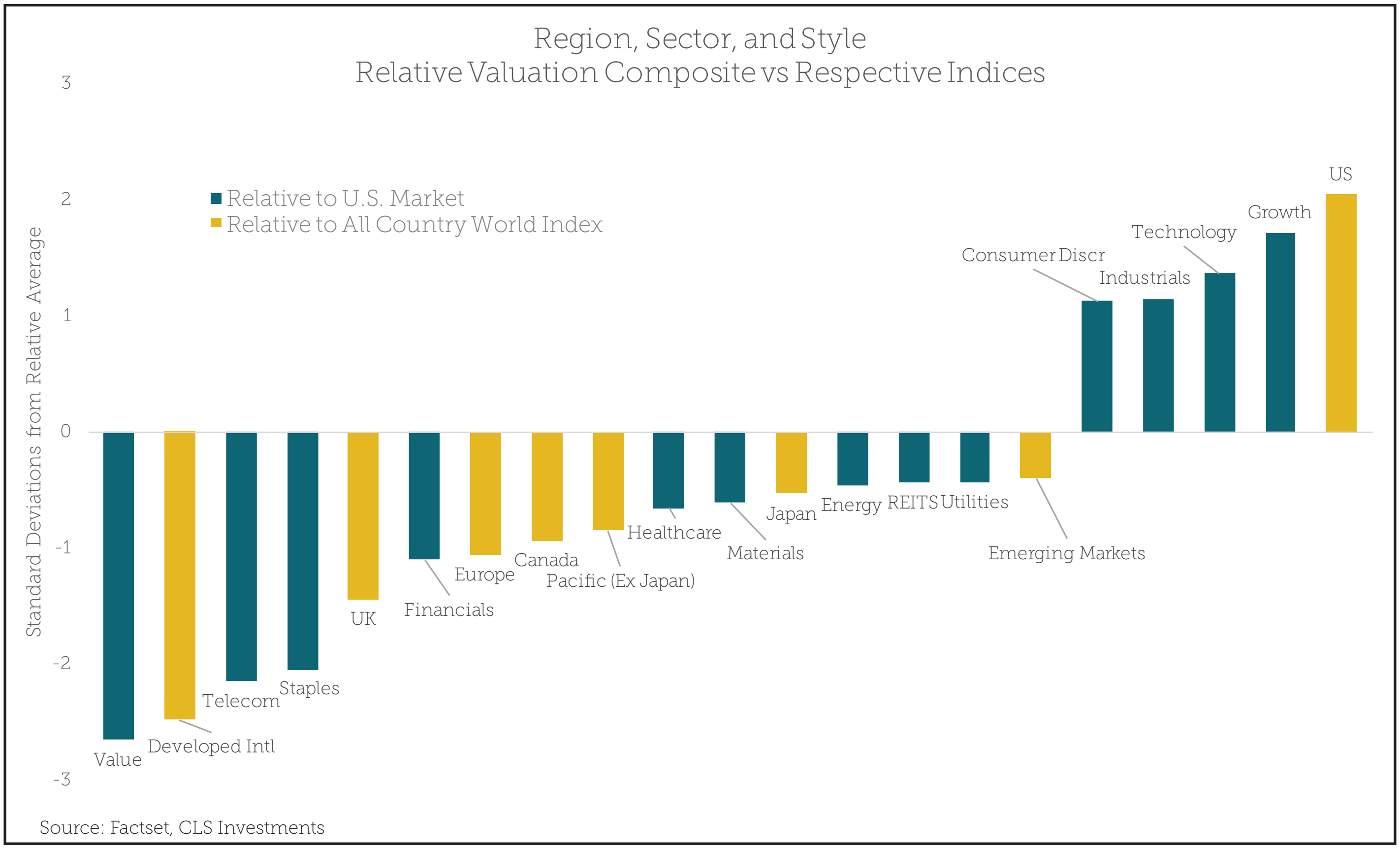
Bonds finished slightly lower on the week. The closely followed 10-year U.S. Treasury bond closed lower with the yield at 2.95%. Despite the U.S. dollar losing strength, commodities also gave back some of their recent strong performance.

Where is the Value?

A common narrative nowadays is the valuation of the U.S. stock market. On a variety of metrics, the U.S. market is fairly valued or anywhere from slightly to very overvalued. Valuation is a very important determinant of future returns, especially over long periods of time. When we look at valuations of various asset classes at CLS, we typically examine the value of securities on a *relative* basis, rather than absolute. We believe being out of the market for any period of time can be detrimental to returns, which is why we take on a consistent amount of risk based on each client's Risk Budget. If we look at valuations relative to one another, we find there are plenty of opportunities available for investors with multi-year time horizons.

The below image is a graphical representation of the CLS Chart Pack (available to advisors) in which we create composites of four different trailing valuation metrics and compare them to a broad market or region over time. This helps us determine where certain asset classes are trading relative to the broader market and can act as a starting point for decision making.

So, where is the value now? Value! Value stocks are trading more than two standard deviations from their long-term average, and many value-oriented sectors are trading at similar levels. Developed international stocks are also quite attractive on this metric. Emerging markets broadly are less expensive than their relative average; however, some parts of emerging markets, such as value (not shown here), are trading at extremely attractive levels. As we search the globe for favorable opportunities, we expand on the attractively valued areas by looking at momentum and trend, sentiment, fundamentals, economics, and risks (both qualitative and quantitative) and build out an investment case. This defined and systematic process allows us to prudently invest for the long-term benefit of our clients.



Tax Alpha

Despite changes in the tax code, taxes are inevitable and can be a burden on those who don't prepare their finances properly. It is also an area where we at CLS interact and share an important role with our financial advisors. When managed properly, taxes don't have to be a burden, and it's even possible to add some "tax alpha" to increase after-tax returns. Here are some of the main areas where tax management can improve results:

Tax-Loss Harvesting

This strategy is probably most apparent to us on the investment side of the relationship. Harvesting tax losses is a core principle of the Master Manager Tax Managed strategies in order to limit overall taxable gains clients incur. We also take into account the types of gains and losses available. Taking short-term gains in portfolios is not helpful (taxed at the investor's income tax rate) unless there are short-term losses to offset those gains. If we are taking gains, we prefer them to be long-term (taxed at 15% or 20% capital gains rates), and we still try to offset them if possible. Other strategies (particularly tax-aware strategies) are sensitive to taking short-term gains, too. Most often, a buy and sell within a year's time doesn't really fit our investment philosophy anyway.

Asset Location

We have many clients with both qualified and non-qualified accounts in the same household. In many cases, experts recommend placing high-income assets (or accounts), such as corporate bonds, into qualified accounts to avoid paying taxes on that income. Dividends and long-term capital gains are taxed at lower rates for most people (15%) and those could be placed in a non-qualified account as one example of an asset location strategy (although it does depend on each client's situation).

Withdrawal Strategies

There can be significant benefits to withdrawing money from portfolios in specific ways. Waiting to withdraw from qualified accounts until clients are of the right age is a must to avoid a tax penalty. But even when clients are old enough to spend down those accounts, it may make more sense to use up taxable (non-qualified) assets first while allowing qualified money to continue growing tax-free or tax-deferred.

Strategies and ideas in this area can get complicated fast, which is a significant reason our relationship with advisors is so important. It is hard enough managing client expectations and emotions. The additional complexities of taxes and investments make for partnerships in our industry all the more important.

Grant Engelbart, CFA, CAIA

Portfolio Manager

Grant Engelbart manages CLS's aggressive mutual funds and several ETF and mutual fund separate account strategies, including CLS's American Funds portfolios. He also leads the alternative broad asset class team and serves on several committees across CLS's parent company, NorthStar Financial Services Group, LLC.

Mr. Engelbart first joined CLS as an intern in 2007. He returned in 2009 and held several roles in trading and investment research prior to accepting the role of Portfolio Manager in 2013. He previously held positions at TD Ameritrade and State Street Corporation.

Mr. Engelbart received his Bachelor of Science degree in Finance from the University of Nebraska at 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.

Mr. Engelbart was named one of the Top Ten Money Managers to Watch by Money Management Executive in 2018.

Did you know? Grant invested in his first fund at age 13.

Artificial Intelligence and Investing

One of the more popular buzzwords of late is "artificial intelligence" or "A.I." Dictionary.com defines artificial intelligence as *"the theory and development of computer systems able to perform tasks that normally require human intelligence, such as visual perception, speech recognition, decision-making, and translation between languages."*

The concept of artificial intelligence has been around for decades, if not longer; however, given the exponential growth of computing power, applications for A.I. are sprouting up everywhere. One of the industries beginning to see A.I. creeping in is our very own field of finance. Quantitative, computer-driven investment strategies have been around as long as it has been possible for them to exist, but this is a bit different. As the definition suggests, A.I. can *learn* rather than just take human-programmed inputs and implement them (like a quant strategy would). Two ETFs have been launched in the last year that utilize A.I. to parse through masses of news stories, company filings, and other sources of information every day that would be nearly impossible for a human to do in such a short time frame. There is even at least one artificial intelligence financial advisor that has popped up! It would be foolish for me to make predictions or try to discredit any of these developments, but it does raise some questions:

- A computer can analyze more information than we ever could, but is more information *always* better?
- If A.I. can learn, how much history does it need to learn from?
- Would A.I. help me make a personal financial decision that is suboptimal financially but might have some strong psychological benefits (like dollar-cost averaging or paying off my smallest debt first in order to gain enthusiasm to pay off more)?
- Do A.I. investment systems have their own investment styles (value, growth, etc.)? Are they programmed or learned? Can they change? Are they all of the styles at once?!
- Is that insurance commercial with the robot agent going to happen soon?
- The removal of certain psychological biases we all have could be powerful for A.I. investing, but can A.I. be contrarian? Defensive? Aggressive? Comforting?
- How many false signals will A.I. detect and trade on if there is so much information available?
- Will my A.I. advisor send me a birthday card? Will it golf with me?

There are a million more questions to be asked, and the answers are still works in process. One thing is for sure, A.I. is a trend that has serious implications for many areas of our lives. If embraced properly, like most technology, it could make our lives easier, more efficient, more enjoyable, and maybe even longer.

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 index of 500-large capitalization companies. This index is widely used by professional investors as a performance benchmark for large-cap stocks. The Russell 2000 Index is an index comprised of the 2,000 smallest companies on the Russell 3000 Index and offers investors a benchmark for small-cap stocks. The MSCI ACWI ex U.S. Index (MSCI All-Countries World Index, excluding U.S.) is an index considered representative of stock markets of developed and emerging markets, excluding those of the U.S. The MSCI EAFE Index is an index which tracks performance of international equity securities in developed countries in Europe, Australia, Asia, and the Far East, excluding the U.S. and Canada. The MSCI Emerging Markets Index is an index which tracks performance of large and mid-cap firms across countries classified as emerging market countries. The Bloomberg Barclays Capital U.S. Aggregate Bond Index measures performance of the U.S. investment-grade bond market. The Bloomberg Barclays 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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CLS Investment, LLC ("CLS") Portfolio Manager, Grant Engelbart, CFA, CAIA, was selected as a "Top 10 Fund Managers to Watch" in 2018 by Money Management Executive. Money Management Executive is an unbiased, third-party publication covering the asset management industry. Money Management Executive chose the list of managers to watch by screening Morningstar data from funds with a single manager, ranked as having the best three-year annualized returns in their respective categories. The list of managers was published March 12, 2018. Money Management Executive is not affiliated with CLS. Ratings and awards may not be representative of any one client's experience and are not indicative of CLS's future performance. 1596-CLS-6/11/2018