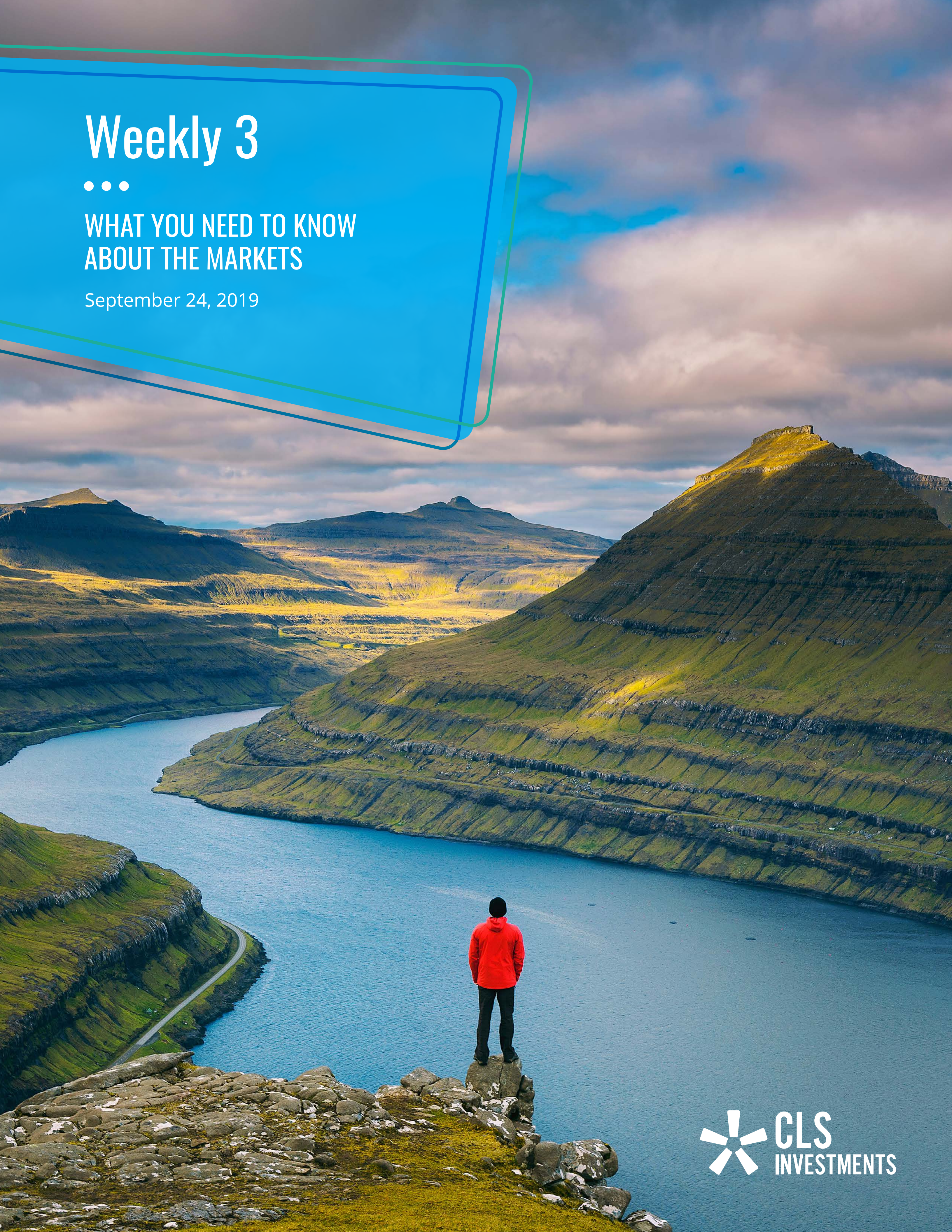
Weekly 3

WHAT YOU NEED TO KNOW ABOUT THE MARKETS

September 24, 2019



CLS INVESTMENTS

Week in Review

Global stocks fell slightly in what was a busy week from start to finish. Monday opened with a bang as oil prices surged the most since 2009 after Saudi Arabian oil fields were taken offline by a drone attack. On Wednesday, the Federal Reserve cut interest rates for the second month in a row. Throughout the week there was a constant news flow trying to explain double-digit overnight repurchase agreement (repo) rates. Oil prices and repo rates calmed down by Friday, with oil ending the week up just over 5% (compared to a 14% gain on Monday). The prior week's large trend reversal from momentum and low-volatility securities to value stocks paused as choppier market conditions led to lower-volatility securities outperforming. (Momentum looks a lot like low-volatility right now!)

Emerging markets gave back some gains after a strong prior week. This was despite a surge in the Indian stock market on Friday following a surprise corporate tax cut. Developed international stocks performed in line with the U.S. market, while small-cap stocks also paused their recent outperformance, falling just over 1%. Bonds had another strong week, with the yield on the 10-year Treasury falling to 1.75%.

1 *Despite a massive number of bonds with negative interest rates, investing in bonds still makes sense*

2 *Three underrated tools that can help your clients save more money*

3 *What has changed and what has stayed the same at CLS over the past 10 years*

Market Performance

as of 9/20/2019

FIXED INCOME	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	LAST WEEK
Cash Equivalent[1]	+0.50%	+0.94%	+1.49%	+2.30%	+1.67%	+0.46%	+0.04%
U.S. Investment Grade Bonds[2]	+3.77%	+3.34%	+2.95%	+10.11%	+8.07%	+1.84%	+0.88%
EQUITIES	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**LAST WEEK**
Global Equity Market[3]	+8.53%	+6.35%	+10.50%	+1.92%	+17.11%	+0.87%	-0.32%
Total U.S. Market[4]	+13.15%	+10.25%	+13.82%	+3.47%	+21.17%	+1.93%	-0.46%
Domestic Large-Cap Equity[5]	+13.17%	+10.77%	+14.57%	+4.36%	+20.89%	+2.38%	-0.47%
Domestic Small-Cap Equity[6]	+11.65%	+7.25%	+9.22%	-6.47%	+17.88%	-0.15%	-1.20%
International Equity[7]	+4.84%	+2.76%	+7.31%	+0.07%	+12.98%	-0.34%	+0.20%
Developed International Equity[8]	+5.06%	+2.87%	+7.39%	-0.52%	+14.66%	+0.26%	-0.16%
Emerging Market Equity[9]	+4.19%	+2.36%	+7.19%	+2.53%	+8.10%	-2.11%	-0.32%
DIVERSIFIERS	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**LAST WEEK**
Diversified Alternatives[10]	+2.92%	+0.46%	+1.79%	+0.38%	+4.95%	+1.10%	+0.15%
Commodity[11]	-4.14%	-6.97%	-0.51%	-3.38%	+4.95%	-0.10%	+0.67%

[1]Morningstar Cash Index [2]Bloomberg Barclay's Capital U.S. Aggregate Bond Index [3]Morningstar Global Market Large-Mid Index [4]Morningstar U.S. Market Index [5]Morningstar U.S. Large Cap Index [6]Morningstar U.S. Small Cap Index [7]Morningstar Gbl xU.S. Large-Mid Index [8]Morningstar DM xUS Large-Mid Index [9]Morningstar EM Large-Mid Index [10]Morningstar Diversified Alternatives Index [11]Bloomberg Commodity Index.

GRANT ENGELBART, CFA, CAIA
Director of Research & Senior 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, Orion Advisor Solutions, 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 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.]

What in the World is Up with Bonds?

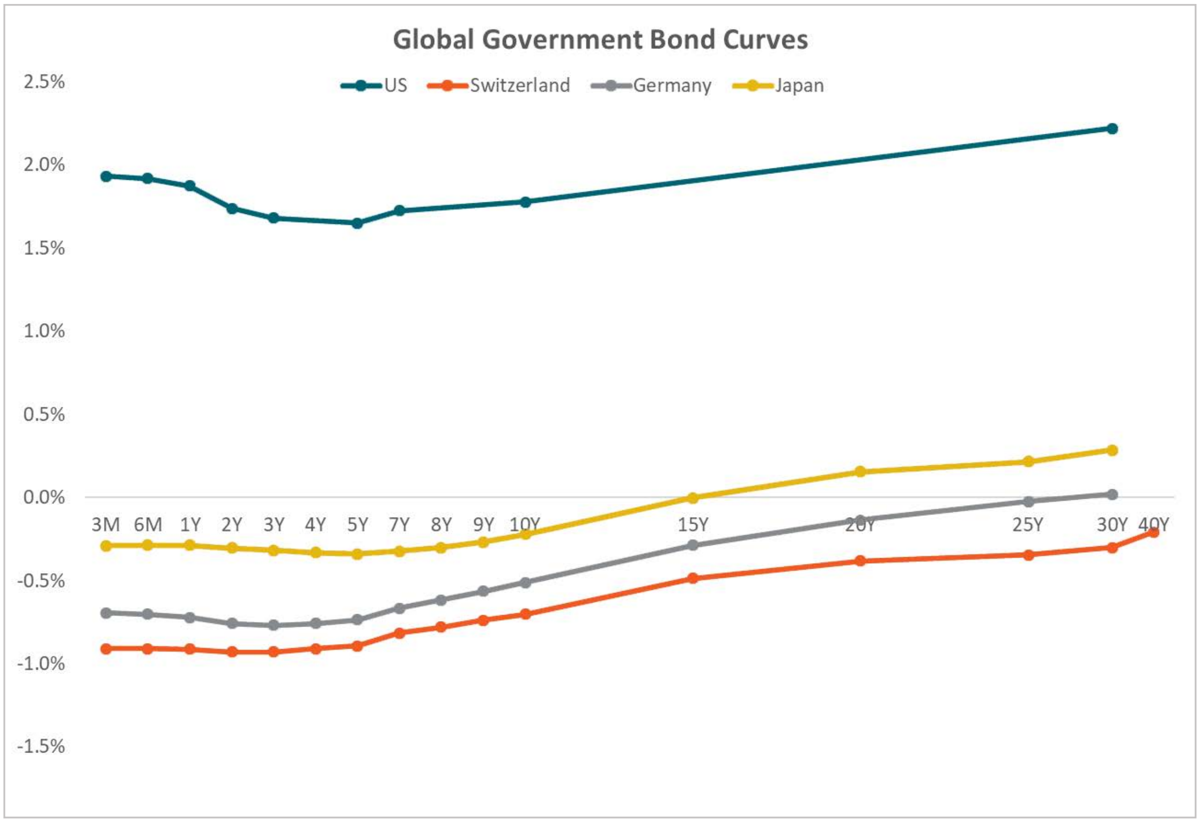
1

We have an inverted yield curve here in the U.S. The entire yield curve of Switzerland (and Germany except for its 30-year) is negative. Yet, in Argentina, the short-term interest rate is… 85.99%! What in the world is going on?

Lower interest rates encourage spending by consumers, investing by businesses, and lending by banks (assuming they can lend at a higher rate than they pay depositors). And as monetary theory would state, lower interest rates should support economic growth and inflation. So, a negative interest rate should be even better, right? Consumers and businesses have little reason to leave cash at the bank if they are being charged for it, so they should go out there and spend money. In theory, yes. In practice, the jury is still out.

Our yield curve is inverted, meaning some long-term interest rates are lower than short-term rates (the normal shape is for longer-term rates to be higher than short), but our bond market may look fairly normal compared to the rest of the world. As the Swiss and European Central Bank (among others) have cut rates below zero, it has affected their entire bond markets. There is some $17 trillion in negative-yielding bonds worldwide (about 15% of the global bond market), and it can be a real head scratcher. Here are some potential explanations (and remember, not even central bankers know the answer):

- **Quantitative easing:** Many of these central banks have been buying their own bonds, driving up demand and therefore driving down yield.
- **Demographics:** In developed economies worldwide, the population is getting older but living longer – making the case for more savings and more demand for savings tools, such as bonds.



Source: Bloomberg as of 9/19/2019.

What in the World is Up with Bonds? (cont.)

1

- **Growth and inflation:** In many economies, the U.S. included, economic growth and inflation aren't totally anemic but are nowhere near the levels we've seen in the past. Historically, economic growth plus inflation equals the math behind a government bond yield.
- **Structural effects:** Many large institutions (pensions, endowments) globally are required by law to buy their own government bonds. This creates demand that otherwise could probably be allocated elsewhere.
- **Currency:** This could be the biggest head scratcher – why don't these European investors just buy U.S. bonds? Well, it would cost them more than 2% to keep on a consistent currency hedge in order to do so. Take a look at the U.S. bond curve above – 2% in hedge costs erodes all the yield pickup! (It should also be *nerdily* noted that the Swiss National Bank has cut rates to negative levels in large part to weaken Switzerland's safe-haven currency and support export-oriented parts of its economy).
- **Safety:** There is a ton of irony in this one. Because of places in the world like Argentina, which is struggling with out-of-control inflation, there is demand for "safe-haven" assets, such as Swiss and German bonds. This safety is important enough to some investors that they are willing to pay interest for it. These safety trades ebb and flow with the rest of the market, but we believe they have likely still had an impact on the price (up) and yield (down) of bonds.

Interest rates, like investors and daily stock price movements, are very difficult to predict, even with a more mathematical investment, such as a bond. The negative interest rate phenomenon has confused just about everyone. It should be noted that lower interest rates support higher economic growth and higher inflation, which ultimately leads to higher yields. Remember, regardless of what interest rates do, we believe fixed income is very important to portfolio construction. Balancing risk, providing income (hopefully more than zero), and helping to provide downside protection are a few of the most important aspects of bonds. (Long-term Treasury bonds are up 20% this year!) If rates rise, investors may benefit from the reinvestment of cash flows at higher interest rates (amongst other positives), and if they fall, investors may benefit from capital appreciation.

The Most Underrated Savings Tools

2

It's no secret that one of the best ways to overcome the potential for lower future returns from stocks and bonds is to simply save more money. As important as that may be, savings can manifest themselves in a number of different ways that can potentially prove useful to diversifying a client's wealth. Here are a few tools that could be helpful (some well-known and some not so much):

Health Savings Account (HSA)

HSAs are different (and better, in my honest opinion) than Health Reimbursement Accounts (HRA) and Flexible Spending Accounts (FSA). Pre-tax money is put into an HSA that can be used to pay for health-related expenses. Pretty straight forward, but that money can also be invested when it exceeds a certain limit. It can grow tax-free, and it can be withdrawn at any time for medical expenses (tax-free) or for any reason penalty-free, but it is subject to taxes when the account holder is 65+. There is also a lot of flexibility on contributions and withdrawals. In the long-run, nearly everyone has or will have a need for coverage on health care costs, and the HSA gives you the ability to grow and control those assets. For example, with a solid base of assets in your HSA, individuals could repurpose some of their health-related emergency savings. In my view, the main drawback of HSAs is that they aren't available to everyone – only those with an eligible, high-deductible health insurance plan.

Roth 401(k)

This may not seem very uncommon to a lot of people, but I don't think Roth 401(k)s are as widely understood as many might think. The Roth IRA is an important and commonly used tool, with annual maximum after-tax contributions of $6,000 for individuals under 50 and $7,000 for those over 50. Conversely, in a Roth 401(k) the maximum contribution is $19,000 for those under 50 and $25,000 for those 50 and older! That is a lot of money that can then grow tax-free. Roth IRAs are only eligible for individuals with earned income less than a certain amount (phase-outs begin at $137K for individuals and $203K for couples). In higher-earning areas, these can be prohibitive. With a Roth 401(k), however, there are no income limits! Of course, like an HSA, Roth 401(k)s aren't available in everyone's retirement plan. Also, generally, employer matches are still pre-tax, so if you contribute 3% to a Roth 401(k) and get a 3% free-money match, you would have half your assets in after-tax funds and half in pre-tax funds. In my opinion, not a bad deal — nice tax diversification. When you withdraw or roll out, however, those two pools of money will have to be treated separately (unless you want to pay taxes).

I Bonds

You may be scratching your head at this point. I bonds? Like, savings bonds? Sort of. I bonds are a bit different. These are savings bonds that earn both a fixed rate of return and a variable semi-annual inflation rate. They are similar to a Treasury Inflation-Protected Security (TIPS) but without the market fluctuation and generally with a better interest rate. Currently, I bonds are yielding 1.9%. Not life-altering, but certainly better than a 10-year TIPS yield of 0.15% and better than just about every yield in the chart from the previous section. All that without the market fluctuation – another nice savings diversifier. There are also tax advantages as you can defer taxes on interest payments (which are exempt from state taxes) until redemption or maturity. There are, of course, some drawbacks. Individuals can only purchase up to $10,000 worth of I bonds per calendar year – so start saving up now!

Hopefully, these ideas can encourage clients to give their savings a boost and save some money on taxes, too. I'm sure there are many other savings tools out there, but these are three that I think get overlooked and three that I use myself.

Wright Street

3

"In some places, it's easy to lose perspective. But I think it's very easy to keep perspective in a place like Omaha."

—Warren Buffett

My 10-year anniversary at CLS is right around the corner. I know – it's not really that long in the grand scheme of things. But in a fast-growing and ever-changing company, a decade is a long time. Just a few things have changed in 10 years: two new buildings, a few new strategies, eight different business cards, and a sea of new faces (I see someone new literally every day!). Through all that change and growth, one thing has remained the same – an unwavering willingness to do right by our advisors and their clients.

On Wall Street, the motive is engineering a profit. On Wright Street, where CLS's headquarters are located, our motive is fulfilling the needs of advisors and investors. We've helped countless advisors develop strategies and solutions to better serve their clients. What kind of firm creates free (0% strategist fee) model portfolios**? What kind of organization sponsors a 5K to support mentoring in our community? A firm that takes being a fiduciary very seriously.

I never thought that a firm right down the street in Omaha would have the influence on our various industries that we have. CLS has become a huge name in the fast-growing ETF industry, and Orion is taking fintech by storm. It's rare that an outside investment firm would come to Omaha and not visit our offices. I could brag for days about how many big names have visited CLS, but I think it's more important that we use our influence to continue to change the industry for the better.

The investment industry has been plagued for too long with scandal, corruption, and controversy. But things are changing. Commission-only business is declining rapidly (fiduciary rule or not), independent firms are growing, and money is moving. Just look at the massive number of top-notch independent RIAs that are using Orion technology.

I don't believe the name of the street we are located on was intentional, but it is so fitting.

The Morningstar Global Market Large-Mid Index is an index that measures the performance of the global market's equity markets targeting the top 90% of stocks by market capitalization. The Morningstar U.S. Market Index is an index that measures the performance of U.S. securities and targets 97% market capitalization coverage of the investable universe. It is a diversified broad market index. The Morningstar U.S. Large Cap Index is an index that measures the performance of U.S. large-cap stocks. These stocks represent the largest 70% capitalization of the investable universe. The Morningstar U.S. Small Cap Index is an index that measures the performance of U.S. small-cap stocks. These stocks fall between the 90th and 97th percentile in market capitalization of the investable universe. In aggregate, the Small Cap Index represents 7% of the investable universe. Morningstar Global ex U.S. Large-Mid Index is an index that measures the performance of Global Markets (ex-U.S.) equity markets targeting the top 90% of stocks by market capitalization. The Morningstar DM ex U.S. Large-Mid Index is an index that measures the performance of developed markets ex-U.S. equity markets targeting the top 90% of stocks by market capitalization. The Morningstar EM Large-Mid Index is an index that measures the performance of emerging markets targeting the top 90% of stocks by market capitalization. The Barclay's Capital U.S. Aggregate Bond® Index measures the performance of the total United States investment-grade bond market. The Morningstar Cash Index is an index that measures the performance of a Treasury Bill with six to eight weeks until maturity in the U.S. market. 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. This index provides investors with a means of understanding the performance of commodity futures markets and serves as a benchmark for investment performance of commodities as an asset class. The volatility of the indexes may be materially different from the individual performance attained by a specific investor. In addition, portfolio holdings of investors may differ significantly from the securities that comprise the indexes. You cannot invest directly in an index.

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*CLS Investment, LLC ("CLS") Senior Portfolio Manager & Co-Director of Research, 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.

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