DIRECTIONS
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Helping Investors Succeed

Why we (still) love global, balanced portfolios

CLS's number one goal is to help investors succeed. We believe in accomplishing investment success through portfolio management, education, and communication. This issue of Directions *will discuss this philosophy in more detail.*

Konstantin "Kostya" Etus began his career at CLS in 2011 as a Trading Specialist and became Research/Portfolio Analyst in early 2013. Later, he was promoted to Associate Portfolio Manager. Mr. Etus is currently a co-manager on one mutual fund and lead analyst on two mutual funds advised by CLS. In addition, he is the lead manager on various separate account strategies.

Mr. Etus is currently working toward both a Master of Business Administration and Master of Securities Analysis & Portfolio Management from Creighton University, as well as his Chartered Financial Analyst (CFA) designation.

Global, Balanced, Risk-Budgeted, ETF Portfolios to Help Investors Succeed

At CLS, we pride ourselves on our people, process, and philosophy. This all filters through to effective money management, but what specifically does CLS do? If I had to sum it up in a few words: we build global, balanced, risk-budgeted ETF portfolios to help investors succeed. Let's break that sentence down to better understand what it means.

Global

We are global investors. We stand by our global tag now more than ever. Why? Global portfolios break out of domestic borders and invest in asset classes across various global regions to take advantage of favorable economic and market conditions abroad.

Historically, globally diversified portfolios have earned superior risk-adjusted returns over the long run compared to portfolios composed of only domestic stocks. In recent years, underperformance in international investments has made investors wary. But it is important to realize that the inherent benefits of international diversification have not changed. Overall, we believe investing globally should result in a better investor experience over time.

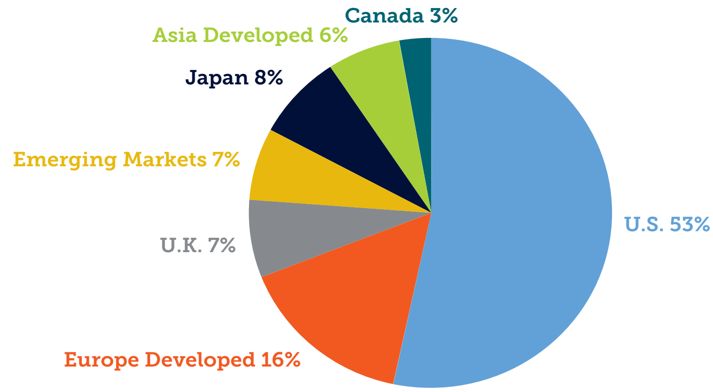
While the U.S. still makes up the majority of the global market, international markets have grown over time and now account for nearly 47% of it.

CLS INVESTMENTS

Economic conditions in various countries allow investors to take advantage of growth opportunities. The second chart on the right shows that the U.S. is responsible for less than a quarter of the world's gross domestic product (GDP), which is the total value of all goods and services produced. Investors must reach out internationally to capture world growth. In addition, many countries are growing faster than the U.S., making them attractive places for investment allocation.

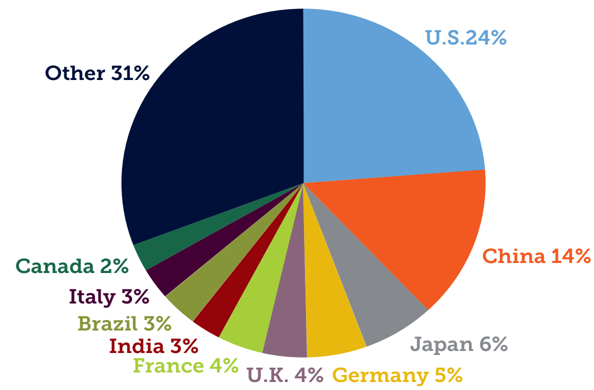
Technological advances and structural reforms have opened up new investable markets and driven progress in many developing countries. For example, China opened its mainland stock market in 2014 to foreign investors and allowed its people to invest in the offshore Hong Kong market. In 2015, it un-pegged its currency (keeping it at a fixed rate) so it could be recognized by the International Monetary Fund (IMF) as a reserve currency. Both moves helped China grow as an economic power. These types of activities narrow the gap between more developed countries, such as the U.S., and are viewed favorably by financial markets.

WEIGHTS IN MSCI ALL COUNTRY WORLD INDEX (ACWI)



As of 11/30/15

COUNTRY SHARE OF WORLD GDP



As of 12/31/14

Balanced

We are asset allocators, balancing risk and return requirements through balanced portfolios. Our asset allocation and risk-management research continues to improve. A balanced portfolio is typically associated with asset allocation and has exposure to multiple asset classes seeking to achieve more stable, risk-adjusted returns in the long term.

Diversification is the main benefit of balanced portfolios. Combining asset classes with low correlations (correlation is a statistical measure of how two securities move in relation to each other) tends to produce portfolios with lower volatilities. Portfolios with lower volatility (risk) typically lead to steady returns and help eliminate short-term market noise. This can help investors meet their expectations for rate of return given a specific investment strategy. Potential benefits of diversification include:

Risk Reduction:
Investing in balanced portfolios can be appropriate for risk-averse investors looking at a longer-term horizon.

Decreased "Single Stock Risk":
Investing only in financial stocks during the financial crisis would have resulted in heavy losses; investors can benefit from a less concentrated approach.

Differing Exposures:
Different asset classes (stocks, bonds, international, commodities, etc.) perform differently in various market environments; having exposure to a wide variety can limit the liability of a significant drop in any one asset.

Save You From Yourself:
The natural human tendency is to

buy winners and sell losers. This typically leads to buying at peaks and selling at troughs. Sticking to a balanced portfolio avoids some of these dangerous human nature behaviors.

Beyond diversification, balanced portfolios provide an opportunity to fine tune investment objectives, including income generation, capital appreciation, capital preservation, or some combination thereof.

Risk Budgeting

Risk budgeting is what CLS is known for. More than 90% of our assets are risk-budgeted. Even portfolios that are not formally risk-budgeted are still risk-managed. Risk management is essential to successful portfolio construction; and identifying and managing portfolios according to our investors' risk profiles helps them stay the course.

ETFs

We are one of the largest ETF strategists and our ability to analyze ETFs is the best it's ever been. Why ETFs? Because ETFs can provide benefits for investors in terms of lower costs, tax efficiency, and investment precision.

Helping Investors Succeed

Our number one goal is investor success through portfolio management, education, and communication.

Our education, communication, and client service resources are better than ever, and we continue to believe that global, balanced, risk-budgeted ETF portfolios are key to successful portfolio management.

The first two words that describe what we do may raise the most questions – at least this year. Our focus on global markets and balanced portfolios has hurt returns in 2015. In this edition of *Directions*, I'd like to explain why we are committed to global, balanced portfolios at CLS and why we believe this focus will benefit investors in the long term.

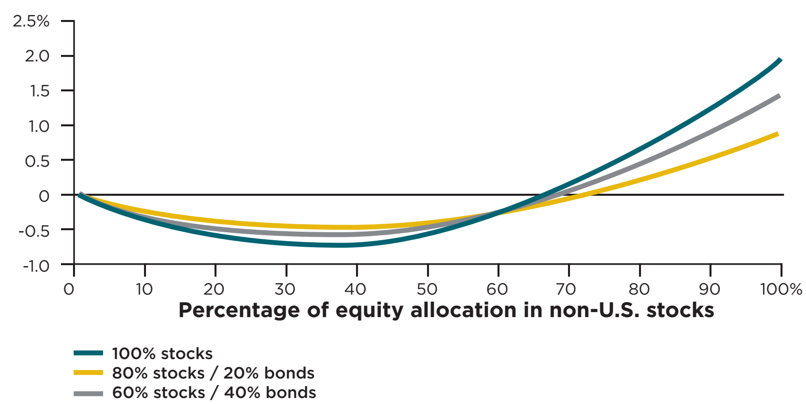
How to Allocate Global, Balanced Portfolios

The right balance in a portfolio depends on an investor's ability and willingness to take on risk. The traditional, moderate allocation of 60% stocks and 40% bonds can be used as a baseline. Therefore, 80% stocks and 20% bonds would correspond to higher levels of volatility and be more appropriate for an investor with an appetite for more risk. Likewise, an allocation to 40% stocks and 60% bonds would be geared toward a more conservative investor.

From a global perspective, since one of the main reasons to invest internationally is to increase diversification, it may make sense to focus on allocations that minimize volatility. In Vanguard's study "Global Equities: Balancing Home Bias and Diversification," researchers found diversification benefits strengthen as more international is added. This is true until the portfolio reaches a 30-40% allocation to international range, which is a good allocation target to achieve optimal volatility levels.

In conclusion, global, balanced portfolios can reduce risk and help earn long-term returns consistent with investor expectations. Despite a rough year, we remain firmly committed to our investment philosophy at CLS. Our consistent money management process allows us stay true to our core mission of help investors succeed.

AVERAGE ANNUALIZED CHANGE IN PORTFOLIO VOLATILITY WHEN ADDING NON-U.S. STOCKS TO A U.S. PORTFOLIO



Source: Vanguard: "Global Equities: Balancing Home Bias and Diversification"

2016 Investment Themes

from CLS Chief Investment Officer, Rusty Vanneman, CFA

X-FACTOR

We expect lower U.S. stock market returns in the year(s) ahead and will therefore be emphasizing factor-based ETFs, otherwise known as "smart beta" ETFs. These ETFs have a rules-based approach to building a portfolio, which emphasizes a factor, such as value, growth, or high quality. Factor-based ETFs capture the essence of active management but at a fraction of the cost. We believe this emphasis will enhance returns in the year(s) ahead. CLS Investments is already an industry leader in the usage of smart beta ETFs, and this emphasis is likely to grow.

In addition, we expect market volatility will increase in the year(s) ahead. Market volatility has been at historically low levels in recent years, and this usually sets the stage for increased volatility. If that is the case, additional risk management, via factor-based risk management, should fortify our risk budgeting approach.

INTERNATIONAL OPPORTUNITIES

In a low-growth world, valuations, yields, monetary policies, and reforms play greater roles, and international markets are more likely to benefit from these factors than U.S. markets going forward. Currently in international markets, valuations are lower, dividend yields are higher, reforms are taking hold, and central banks are providing greater support.

While these benefits are powerful, some international markets are facing certain headwinds. For example, some emerging market economies aren't growing as once expected. A diversified approach to international investing may be complemented by targeted allocations in particular countries, regions, and sectors. We expect wider performance dispersion between countries when reforms and policies have an outsized effect.

CREATIVE DIVERSIFICATION

Given the low level of interest rates, we continue to be creative in how we diversify our equity-dominated portfolios. We can do this in two ways. First, we can be tactical in our fixed-income exposures, which we have been. We have actively managed our duration (i.e., interest rate sensitivity), credit, and sector exposures. Currently, our portfolios are less interest-rate sensitive than the overall bond market, and our overall credit quality is higher than in years past. Second, we can use alternative asset class segments and strategies, which can include managed futures, hedge fund strategies, and currencies. This could also mean increased exposure to commodities, which have been beaten down over the last several years (many commodities are at multi-year price lows). Commodities are a diverse and broad asset class, and we can utilize the broad array of ETF offerings to tailor our exposure.

What Do ETF Strategists Stand For?

from CLS Senior Market Strategist, Joe Smith, CFA

Joe Smith, CFA
CLS Senior Market Strategiest

Over the last 20+ years, exchange traded funds (ETFs) have captured the hearts and minds of investors. These investment vehicles have empowered everyday investors to build portfolios that help them reach their financial goals – with greater transparency, lower costs, and more precision. ETFs have taken the power from active money managers and placed it in the hands of individual investors. As these tools have proliferated, investors are turning to firms that specialize in ETFs to help them sort through their options and apply their expertise in finding the best fit.

As usage has increased, so has the level of scrutiny on these boutique investment managers, known as ETF strategists, and some recent blunders have called their value into question.

So who are ETF strategists, and why do we need them?

ETFs: A Response to Mediocrity

Before ETFs, individuals placed their investments in the hands of active managers via pooled accounts or mutual funds. It was the only mechanism for investors to gain access to the markets, and they just had to hope their fund managers outperformed. But selecting the right manager can be a long and tedious process, and fees charged by mutual fund providers can often leave investors worse off than where they started. As documented in numerous studies, active managers weren't delivering on their most important promise: a positive experience for clients that brings them closer to their long-term financial goals.

The first ETF issuers, such as State Street, iShares, and PowerShares, wanted to ensure ETFs could change that paradigm. They worked tirelessly to build ETFs to serve as a lighthouse – a beacon of hope for investors desperately looking for another way to meet their goals.

Bottom Line – ETF Strategists Are On the Side of Investors

ETFs have provided hope to investors, and ETF strategists are increasingly becoming the embodiment of that hope. The days of simply selecting traditional active managers by whole is most likely to outperform are long over. Even when under pressure from traditional active managers, ETF strategists are on the side of the investor. They believe in ETFs because their innovation, lower costs, accessibility, and effective risk management help build portfolios engineered for long-term success.

Despite some recent stumbles, CLS believes the role of ETF strategists is still in its infancy and will continue to evolve. Building ETF portfolios is not about searching for some mysterious return called "alpha"; it's about adding consistent value through active management of beta. ETF strategists will continue to push the envelope on behalf of all investors for one simple reason: investors deserve a better experience, even if some are not willing to provide it.

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An ETF is a type of investment company whose investment objective is to achieve the same return as a particular index, sector, or basket. To achieve this, an ETF will primarily invest in all of the securities, or a representative sample of the securities, that are included in the selected index, sector, or basket. ETFs are subject to the same risks as an individual stock, as well as additional risks based on the sector the ETF invests in. 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. 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.

A client's risk budget is derived from the client's specific answers to CLS's Confidential Client Profile questionnaire, which establishes the client's financial goals, ability to handle risk, and overall investment time horizon. The individual client risk budget is expressed as a percentage of the risk of a well-diversified equity portfolio.

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