WEEKLY MARKET REVIEW

DECEMBER 6, 2016

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- *History shows us that bond returns are postive over time*

CLS INVESTMENTS

Market Performance

Stock Market	LAST WEEK	QTD	YTD '16
Total U.S. Market[1]	-1.08%	+1.85%	+10.18%
Domestic Large-Cap Equity[2]	-0.91%	+1.50%	+9.45%
Domestic Small-Cap Equity[3]	-2.40%	+5.23%	+17.29%
International Equity[4]	-0.14%	-3.87%	+1.73%
Developed International Equity[5]	-0.22%	-3.94%	-2.28%
Emerging Market Equity[6]	-0.30%	-5.45%	+9.69%
Fixed Income	**LAST WEEK**	**QTD**	**YTD '16**
U.S. Bonds[7]	+0.08%	-3.20%	+2.41%
Commodity[8]	+2.37%	+2.06%	+11.12%
Cash Equivalent[9]	+0.01%	+0.04%	+0.25%

[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]Barclays Capital U.S. Aggregate Bond Index [8]Bloomberg Commodity [9]Barclays Capital 1-3 Month U.S. Treasury Bill Index

Week in Review

Last week was negative for global markets. After recently hitting all-time highs, the U.S. stock market gave some back. Large-cap stocks fell 0.91%, while small-caps, which have done especially well this year, were down 2.40%. Equity markets fared a little better internationally but were also down, with developed markets slightly edging out their emerging counterparts. The bond market managed a small gain after a painful month, and commodities had a strong week thanks in part to The Organization of the Petroleum Exporting Countries (OPEC) finalizing its production-cut agreement.

Highlights from last week's economic data releases include an upward revision on third quarter GDP to 3.2%, mixed payroll data, and manufacturing data from the Purchasing Managers' Index (PMI) that beat expectations.

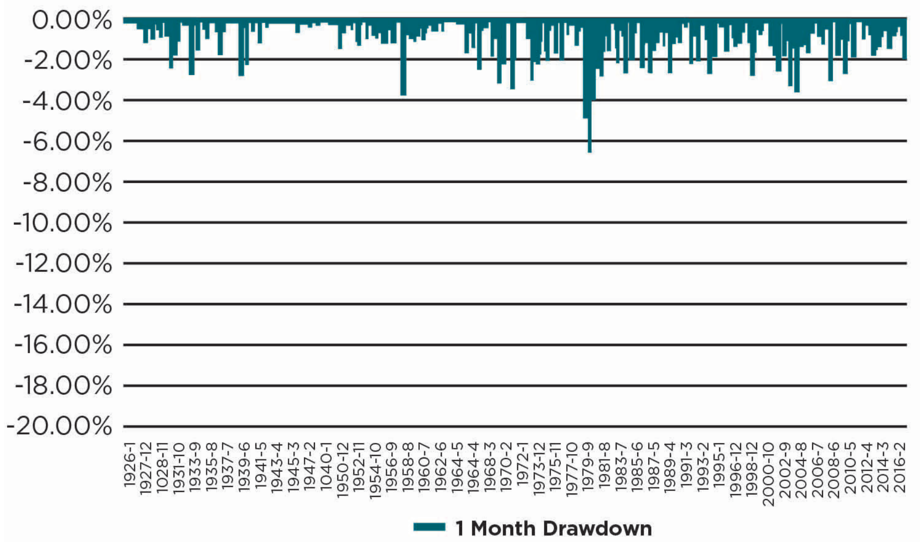
The slow grind up in interest rates that began in July has accelerated in the aftermath of the presidential election. The yield on the 10-year Treasury bond is up more than 100 basis points over the period, closing the month at 2.37%. More than half of the move came in November alone. Considering bond prices move inversely with interest rates, it goes without saying that the fixed income market has had a rough go recently. Investor fears related to bonds appear to be as high as they've been since the Taper Tantrum in 2013. Just how bad was bond performance in November?

To provide a historical perspective for last month's bond losses, let's take a look at the Ibbotson and Associates SBBI Intermediate-Term Treasury Index, which has data going all the way back to the 1920s. Based on this index, intermediate-term Treasury bonds returned -1.89%. Over the past 90 years, the index has only been down more than that in a single month just 3% of the time!

So, November was one of the scariest months ever for bond investors, and there is "blood in the streets". How does this historic bond market drawdown compare to stock market drawdowns? The truth is that it's not much of a comparison. Large drawdowns in the stock market are much more frequent and severe. Going back to the 1920s, U.S. stocks have experienced a one-month loss of -1.89% or more, 23% of the time (255 months). The single worst month for bonds was February 1980 when the 10-year yield increased 2.44%. Yes, that's a 2.44% increase in a single month! Well, the stock market has experienced a larger single month drawdown 7% of the time (72 months).

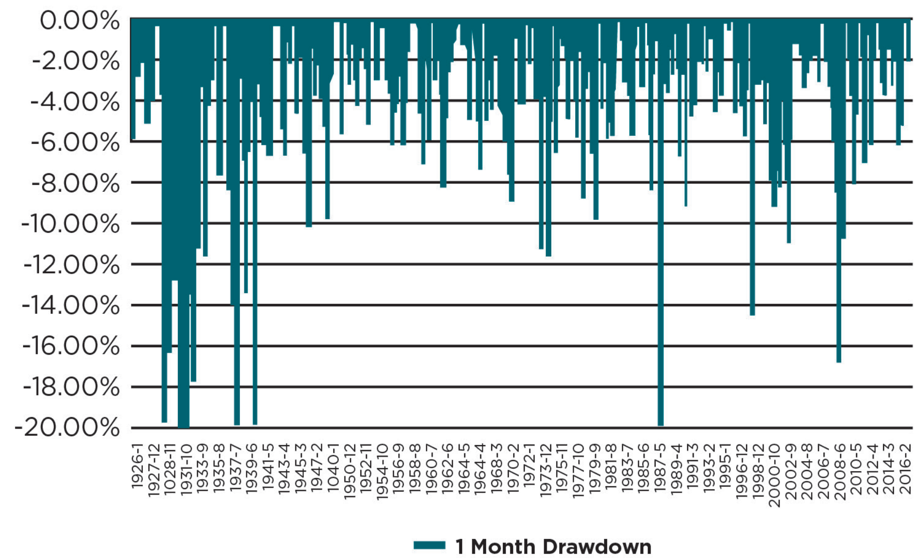
Ultimately, over time, the bond market has generated a little more than half the return of the stock market with less than a quarter of the volatility. Even after this large drawdown, the bond market is still positive year-to-date. Perhaps blood in the streets is too aggressive. This seems more like a bloody nose for the market.

Intermediate-Term Treasury Bond Drawdowns



Source: Ibbotson and Associate SBBI Intermediate-Term Treasury Index

U.S. Stock Market Drawdowns



Source: Ibbotson and Associate SBBI US Large Stock Index

A Bullish Case for Bonds

Sentiment in the bond market is decidedly bearish, and the financial media has been filling the airwaves with yet another round of calls for the end of the bond bull market. Should investors heed their warning? Is it time to sell out of bonds? Or, could the argument be made that bonds are actually attractive in the wake of such a selloff? To answer this question, we will again look to history for guidance.

We established that in the last 90 years, bonds have experienced a similar or worse selloff approximately 3% of the time. That means out of 1,091 months, 33 experienced a larger loss. How has the bond market performed after these past drawdowns? Would investors have been well served to sell out of bonds to prevent further losses?

The answer may be surprising. If an investor had sold out of bonds after each of the 33 months, he or she would have avoided further losses over the next 12 months just twice. The average loss avoided would have been -1.83%. In the other 31 instances, he or she would have sold just as the market was again turning positive and missed out on an average return of more than 8%. History shows that November's experience has actually presented some very attractive buying opportunities. As Baron Rothschild famously said: Buy when the market's nose is bloodied... or something like that.

Josh Jenkns, CFA
Portfolio Manager

Joshua Jenkins joined CLS in March 2013, and serves as a Portfolio Manager. He is the lead manager of an income-focused separately-managed account strategy and also functions as the lead analyst for the CLS Growth and Income Fund, CLS Flexible Income Fund, and the Milestone Treasury Obligations Fund. In these roles, Mr. Jenkins utilizes fundamental and technical analysis to assist portfolio managers in asset allocation decisions. In addition, due to his extensive knowledge of Exchange Traded Products, he drives CLS's implementation process and is integral in selecting the appropriate ETPs to gain desired exposure within CLS portfolios.

Prior to joining CLS, Mr. Jenkins worked as an Analyst on the private equity desk at Auriga USA, LLC, a small broker-dealer headquartered in New York City.

Let History Be Your Guide

It is natural for investors to get jittery when markets become volatile. Fortunately, many will have a financial advisor to turn to for counsel. A historic perspective will illustrate that fears are overblown and bonds remain an integral part of a balanced portfolio. CLS's own outlook is cautiously optimistic.

Intermediate-Term Treasury Bonds: Monthly Rolling Annualized Returns

	3 Year	5 Year
Percentage of Periods with a Negative Return	0.4%	0.0%
Average Loss	-0.7%	0.0%
Percentage of Periods with a Positive Return	99.6%	100.0%
Average Gain	5.3%	5.3%

Source: Ibbotson-Associates

Academic research suggests that investors feel the sting of losses twice as much as the enjoyment of gains. This asymmetric response may be amplified when investors experience the loss in their bond allocations, which are generally considered to be safety nets. The emotional urge to free oneself from this pain is indeed very powerful. This urge contributes to the findings of the Dalbar study, which shows investors drastically underperform the funds in which they invest, a result of panicked selling at the lows and euphoric buying at the highs. It is here that services of a financial advisor are invaluable: putting clients in balanced portfolios, educating them, and keeping them from acting on knee-jerk reactions. As I have written about in the past, returns in the bond market are overwhelmingly positive over time. Since 1926, the bond market has had a positive return on a rolling three-year basis more than 99% of the time and has had no instances of a negative return over any five-year window! That is an impressive 90-year track record, especially considering that over this period we saw multiple wars, countless other geopolitical shocks, bouts of inflation, and several rate-hiking cycles.

CLS believes that the Federal Open Market Committee (FOMC) will likely raise the policy rate at its next meeting later this month. The policy of slowly reducing monetary stimulus will probably continue in 2017, though the outlook for longer-term interest rates is a bit cloudier. The 10-year Treasury yield just increased dramatically without material changes in economic data, but there does not appear to be much reason for it to rise materially more in the near term. Anchored by the historical record, CLS's outlook translates to an expectation for positive, but below average, returns moving forward.

While there is a lot of fear and negativity about the bond market filling the airwaves, past experience can offer guidance in charting the path forward. History shows us that bond returns are positive over time and maintaining or increasing bond allocations after large drawdowns can be rewarding.

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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