WEEKLY MARKET REVIEW

MARCH 21, 2017

In This Edition

- *How will the rising rates impact CLS portfolios?*
- *Why investors should consider probabilities over possibilities.*
- *Ways to stay ahead of behavioral investing.*

CLS INVESTMENTS

Market Performance

Equities	LAST WEEK	QTD	YTD '17
Total U.S. Market[1]	+0.50%	+6.36%	+6.36%
Domestic Large-Cap Equity[2]	+0.28%	+6.72%	+6.72%
Domestic Small-Cap Equity[3]	+1.97%	+2.79%	+2.79%
International Equity[4]	+2.48%	+8.02%	+8.02%
Developed International Equity[5]	+2.07%	+7.29%	+7.29%
Emerging Market Equity[6]	+4.29%	+12.18%	+12.18%
Fixed Income	**LAST WEEK**	**QTD**	**YTD '17**
U.S. Investment Grade Bonds[7]	+0.50%	+0.15%	+0.15%
Cash Equivalent[8]	+0.01%	+0.08%	+0.08%
Commodities	**LAST WEEK**	**QTD**	**YTD '17**
Commodity[9]	+1.06%	-2.59%	-2.59%

[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

As of 3/17/2017

Week in Review

It's officially spring time! We had great weather over the weekend here in Omaha, but the week ahead shows weather back to normal with lower temps and rain almost every day. Markets last week were all higher. International stocks led the way, up about 250 basis points (bps), with the U.S. market (Russell 3000) eeking out 50bps. Year to date, international stocks are outpacing domestic, as the U.S. dollar takes a breather from its recent strong returns, down about 2% this year.

As you are reading this weekly review, it has been over 100 trading days since we have had a negative one percent or more move in the S&P 500. In fact, if today's close is above 2,350 in the S&P 500, we will have matched the record of 110 days, last seen about 20 years ago.

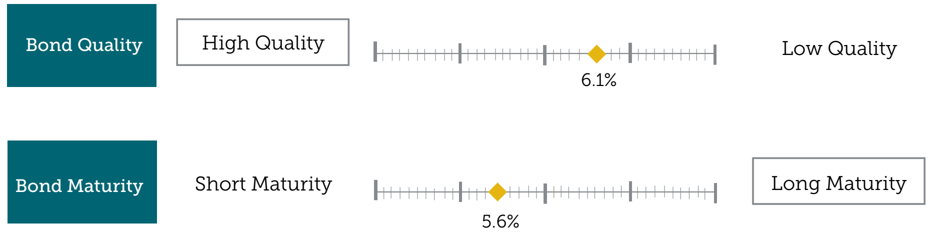
Major news for the week was surrounding the Federal Reserve's (Fed's) interest rate hike from a range of 50-75bps up to 75-100bps. This came as literally no surprise, as the federal funds futures market pointed to a near 100% chance of the increase. At the press conference, the statement by Fed Chair Yellen was a little less hawkish than market participants expected, with the Fed staying firm on guidance of two more hikes this year. Stock and bond markets rallied on the news for the day. More on this in the following pages

Recent: Fed Raises Rates

Frequency of Historical Rolling 12-Month Annualized U.S. Bond Market Returns

12-Month Rolling Returns	According to CLS: Probability of Returns over Next 12 Months	According to Historical Averages: Frequency of Returns Since 1871*
Returns > 20%	1%	3%
Returns between 10 and 20%	4%	16%
Returns between 5 and 10%	14%	26%
Returns between 0 and 5%	44%	40%
Returns between 0 and -5%	27%	13%
Returns between -5 and -10%	11%	2%
Returns <-10%	2%	0%

Numbers as of 11/30/16
Past performance is not a guide to future performance. Individual client accounts may vary. Probabilities are based on calculations from CLS portfolio managers and research analysts. The CLS outlook is comprised of equal-weighted portfolio manager forecasts in five different return categories. The analyst team is equal weighted to count as a single portfolio manager vote. Historical probabilities for the five categories are also researched. Overall views which are presented have been adjusted based on perceived value by each portfolio manager and analyst.
*Source: Ibbotson Index Data



as of 11/30/16 - for our most recent continuums, download our Monthly Perspectives piece at CLSinvest.com/monthlyperspectives
*The active weights shown are versus a blended index comprised of 60% domestic equity and 40% international equity

Market headlines last week focused on central bank policy and short-term interest rates. For only the third time in the past decade (yes, decade) the U.S. raised short-term interest rates 0.25% to a range between 0.75% and 1.00%. Overseas, China raised interest rates in lock step with the Fed. Japan and England voted to keep rates as is.

The Fed also released its latest dot plot, which lays out what to expect regarding rates in the near future. While hardly set in stone, the Fed expects two more hikes this year as it moves to normalize interest rates. Bond markets rallied as yields fell during the day, but for the week and the year, the broad bond index (Bloomberg Barclays U.S. Aggregate Bond Index) is little changed to slightly positive. Historically, bonds have a very high skew to return positive for investors (see far right column in chart on the top right). CLS is not particularly surprised that bonds have not moved much this year or last. The starting yield for bonds gives the best indication of their returns going forward; and with rates still low and potentially set to rise, we see a higher probability for returns to decrease or turn negative (see middle column in chart above). This table can be found in the CLS Reference Guide.

So, if rates are likely to move higher and there is a greater chance for low to negative returns from bonds moving forward, how is CLS adjusting in fixed income? Below is our positioning pulled

Case Eichenberger, CIMA®

Client Portfolio Manager

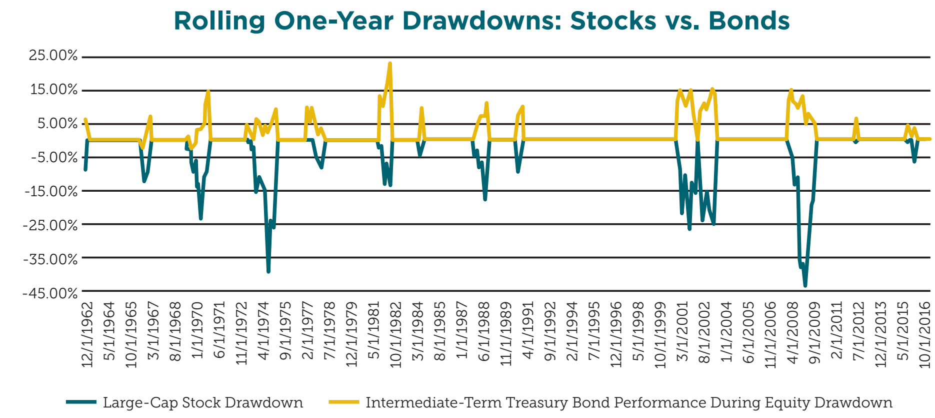
Case Eichenberger has been with CLS since 2007. Mr. Eichenberger has held various roles while at the company, including Relationship Representative and Internal Wholesaler. In 2015, he accepted the role of Client Portfolio Manager. In his current role, Mr. Eichenberger co-manages CLS's American Funds strategies, works closely with CLS's separate account strategies (Master Manager), and communicates very closely with advisors and their clients both remotely and in-person.

Mr. Eichenberger holds the Series 6, 63, and 65 licenses. He also holds his Certified Investment Management Analyst (CIMA®) designation. During the accreditation process, Mr. Eichenberger attended the Wharton School of Business at the University of Pennsylvania.

Recent: Fed Raises Rates (Continued)

from the most recent [CLS Monthly Perspectives.] In a rising-yield and rising-rate environment, it is our view that an active manager should hold shorter duration (a measure for interest-rate risk) than the bond index. As rates and yields rise, longer duration (and maturity) will lead to lower prices. Since rates started to move higher in July 2016, long-term bonds have been down about 6.5% compared to the index at negative 2.5%, and short-term bonds have been flat. CLS has been short duration, and we are comfortable with our duration. In fact, we may look to lengthen our investments a little.

The other side of this is credit bonds, or bonds that take on credit risk, which mainly include high-yield bonds and senior bank loans. Like the Fed, CLS sees the economy improving slowly and steadily and believes the chance of a recession is low. Therefore, default rates for these credit bonds should be low as well. We currently have a tilt towards low-quality credit bonds, but with credit spreads tight (a form of valuation for bonds, meaning expensive) we have lowered positioning to favor higher-quality bonds.



CLS is actively managing and diversifying risk in all markets, specifically bonds. This does not mean bonds should be sold and stocks purchased. If an investor has a Risk Budget Score lower than 100, bonds will always be a part of his or her allocation, no matter the outlook.

Above is a chart from our most recent white paper: ["Bonds in a Rising-Rate Environment."] Bonds are important diversifiers for stocks (and vice versa). Typically, in times of stress for the stock market, a flight to quality, i.e., bonds, occurs. Just think back to the beginning of 2016 when global markets started down 10% or more, while bonds were positive about 2%. They are important diversifiers, for sure!

Some Worthwhile Reads From the Past Week:

"Markets Defy Finance Theory on Fed Hikes"
https://www.bloomberg.com/view/articles/2017-03-10/markets-defy-finance-theory-on-fed-hikes

"A Contrarian View: Favor International in the Face of Isolationism"
http://www.fa-mag.com/news/a-contrarian-view--favor-international-in-the-face-of-isolationism-31827.html?section=68

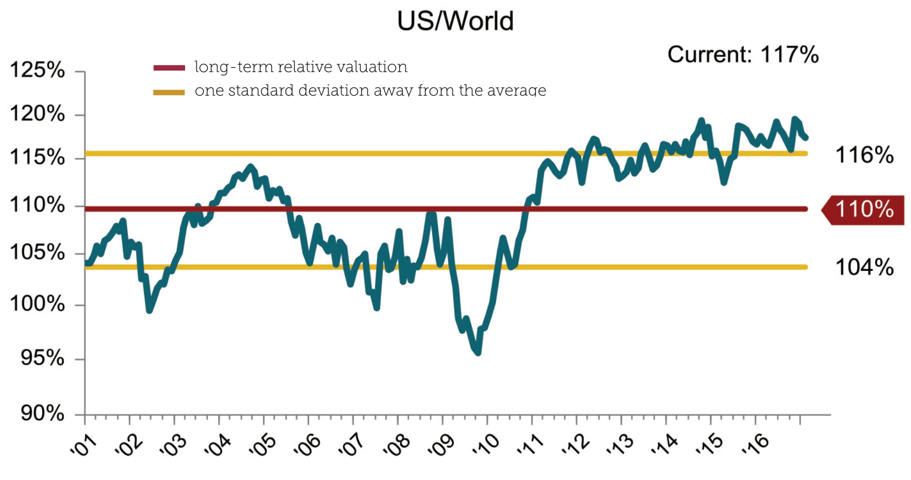
"Happy Birthday Bull – March 9, 2009 to March 8, 2017"
http://www.wsj.com/graphics/bulls-birthday-march-9-2017/

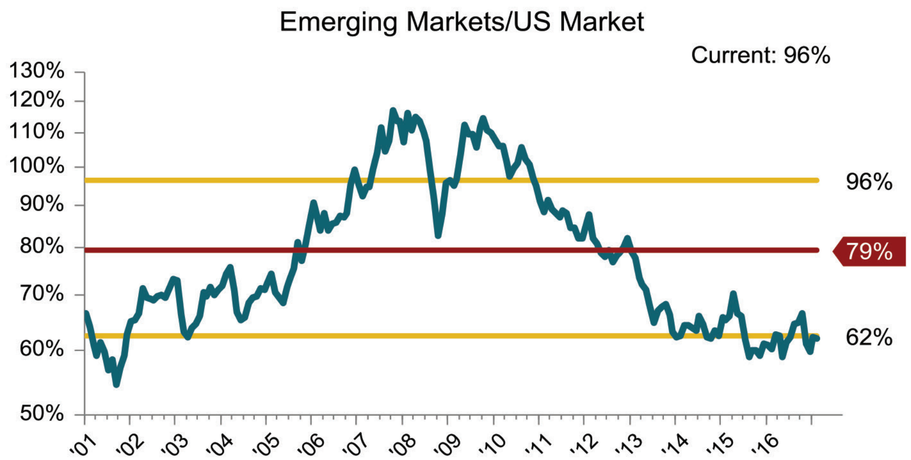
"Seven Psychological Quirks That Destroy Investment Returns"
http://monevator.com/psychology-and-investment-returns/

"Return Expectations Going Forward"
http://awealthofcommonsense.com/2017/03/return-expectations-going-forward/

Why Market Reporters Lean Towards Negative News:
https://www.ft.com/content/c884defa-054a-11e7-ace0-1ce02ef0def9

Everything we do on the portfolio management team at CLS ties into numbers and statistics in some way or another. It even shapes our free time. Lately, we've been optimizing our meeting schedules and, more importantly, fine tuning our NCAA basketball brackets. We know past performance does not equal future results, but it is important to study the past and put it in terms of statistics and probabilities. By looking at the global markets this way, we believe it gives us an edge over other market participants who do not have clearly defined philosophies and disciplines. Our job as a team is to put the odds in investors' favor. Sometimes these odds won't play out the next day, next week, or even next year, but we believe patience will be rewarded.



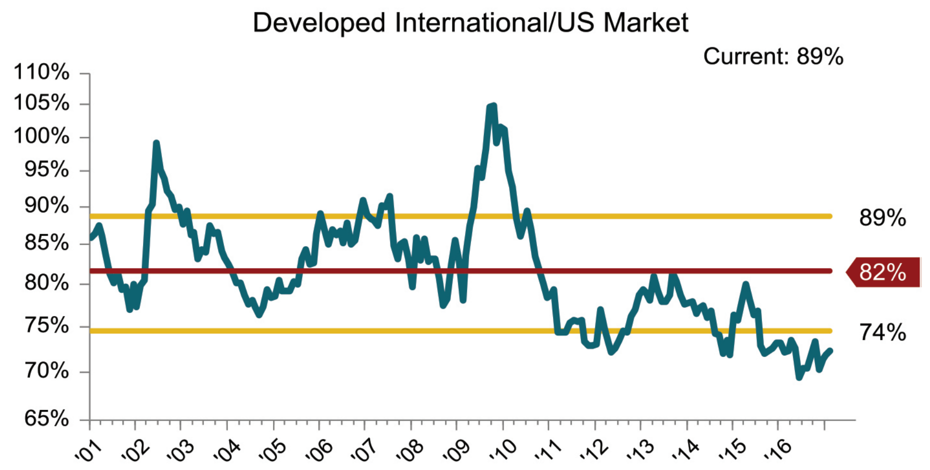


With that being said, let's talk about valuations and positioning at CLS. There have been numerous articles, blog posts, and research studies recently about the U.S. stock market being overvalued and expensive to own. CLS agrees. But, this does not mean a crash is coming. The economy appears to be improving, and rich valuations can always get richer (remember the late '90s?). We believe the U.S. stock market has the probability of earning a lower return going forward than other markets that are less expensive by historical standards.

Consider the two charts above and the one at the top of the next page. These show the U.S. stock market in relation to the rest of the world. Investing above the top gold line means investing in a market that is expensive, which U.S. stocks are by many measures. Probabilities tell us when the market is above the top line (one standard deviation above the average) it has a higher chance of going down than up.

Now consider international stocks. The bottom chart on the previous page and chart on the top the the right show both emerging markets (Brazil, China, etc.) and developed international markets (Europe, Japan, etc.) in relation to the U.S. stock market. They both appear cheap, and they are. CLS's philosophy of Risk Budgeting makes sure we take the appropriate amount of risk, but also look to buy less expensive markets.

To sum up our market expectations, based on the probabilities and statistics we use to help make our decisions, see the chart on the bottom to the right, which is found in the CLS Reference Guide. This tells us that stocks outside the U.S. are expected to have higher returns in the near term.



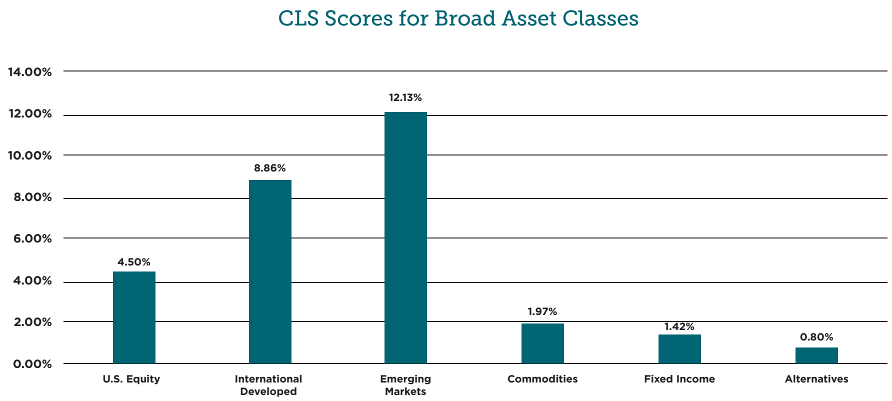


Chart Source: Morningstar, Bloomberg, Ned Davis Research, Research Affiliates, and MSCI, as of 11/30/2016CLS Scores for Broad Asset Classes
*For a complete explanation of the "CLS Score," please see page 59 of this Reference Guide

Valuations and probabilities are not the only areas we look at when deciding where to target, but they do have some of the biggest impacts. In the end, we want to put probabilities in investors' favor to offer a better chance of earning higher returns in the not-so-distant future. After all, is it possible the U.S. stock market can keep climbing?

Yes, anything is possible. But, as portfolio managers, we are forced to think in a more disciplined way in terms of *probabilities*, not *possibilities*.

This week, I read an interesting, but not all that surprising, article in the Financial Times titled: "Why Market Reporters Lean Towards Negative News." We have all heard it before: negative and scary headlines sell newspapers. Financial media is no different from the local news, which often opens broadcasts with crime reports. While the latter may prompt you to lock your doors at night, the former may drive you to make a costly decision about your retirement.

The Cycle of Investor Emotions

Reporters are skeptical about everything, including money. It is their job to be the first line of defense for the public against industries trying to oversell or take advantage of people. Being a reporter is a noble calling, but it is possible the media sometimes does more harm than good. By sensationalizing negative news, newspapers and television news can create an oversized reaction. That is why having a well-defined financial plan is so important, and that can only come with the help of a qualified financial fiduciary and advisor.

At CLS, we want to be accessible as we realize investors' emotions are likely the single largest detractor of future gains. In fact, it is one of our biggest concerns right now. Our joint effort is perhaps more important than ever. Constant news and a stream of hot products and funds created with strong "back tests" tempt investors to change their plans. New technology is also making it easier for investors to check their daily performance, text their money managers, or hire robo-advisors to get automated investment help. We know through various studies that human beings have a propensity to hate losses twice as much as they like gains. On any given day, the market has about a 50% chance of seeing a negative return. The more notifications and texts investors receive on a daily basis, the better chance they have to make irrational decisions.

I believe technology is a great tool, but it could have some unintended consequences in the retirement world. Tech gives people more and more; but most of the time, as a fiduciary, less is more. Less trading is better than more, watching accounts less frequently is better than daily, and watching less financial news is better than consuming it constantly. Carl Richards, the creator of the "Behavior Gap," put it best: "As a **REAL** financial advisor, the single most important thing that sets you apart from the so-called robo-advisors is your ability to communicate. Your ability to listen, to empathize, to care...that is something that no robo-advisor can do." In the upcoming year, expect CLS to dive deeper into behavioral finance and work to deliver tools to help investors avoid these missteps.

All of the charts used in this week's review can be found in various CLS resources.

Thank you for reading.

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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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