DIRECTIONS
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Benefits of Professional Money Management:
Plus, The Importance of International Investing
And Bonus, A Comparison of SRI and ESG Investing

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 Portfolio Manager. Mr. Etus is currently a co-manager on two mutual funds and lead manager on various separate account strategies.Prior to working at CLS, Mr. Etus worked as an Associate Financial Analyst at ConAgra Foods, Inc., managing the company's global cash network. He graduated from the University of Nebraska at Omaha with a Bachelor of Science in Business Administration, and obtained Master's degrees from Creighton University in Investment Management and Financial Analysis, as well as Business Administration. He holds the Series 65 securities registration and the Chartered Financial Analyst (CFA) designation.

CLS INVESTMENTS

In this quarter's Directions, *CLS's Portfolio Manager, Kostya Etus, CFA, explains the benefits of professional money management, along with why it's importatnt to invest internationally. Mr. Etus begins by explaining the behavioral investment gap, followed by qualities that describe a good active manager. He then will discuss why investors should diversify their portfolios. Lastly, he explains the differences between SRI and ESG investing."*

Many Oscar-nominated movies over the last couple of years have been based on true stories. There is just something about the simple brilliance of a true story that pulls viewers in. When coming up with material for presentations, including the CLS Reference Guide, we try to incorporate that same idea: presenting simple, easy-to-understand charts that all investors can relate to.

One of these charts is perhaps the best example of simple brilliance (in the financial world at least): the behavior gap graphic created by Carl Richards. This chart, shown on the top of the next page, succinctly illustrates the negative impact of human emotion and subsequent irrational behavior on portfolio returns. For example, chasing performance and buying stocks when they have had a great run — just in time for them to peak and drop. It also presents an idea that's essential for investors to understand: the benefits of professional money management.

Vanguard has conducted research quantifying those benefits and found that a financial advisor can potentially add 3% to an investor's returns. The largest portion of that potential value-add comes from helping investors stay disciplined — avoiding the behavior gap.*

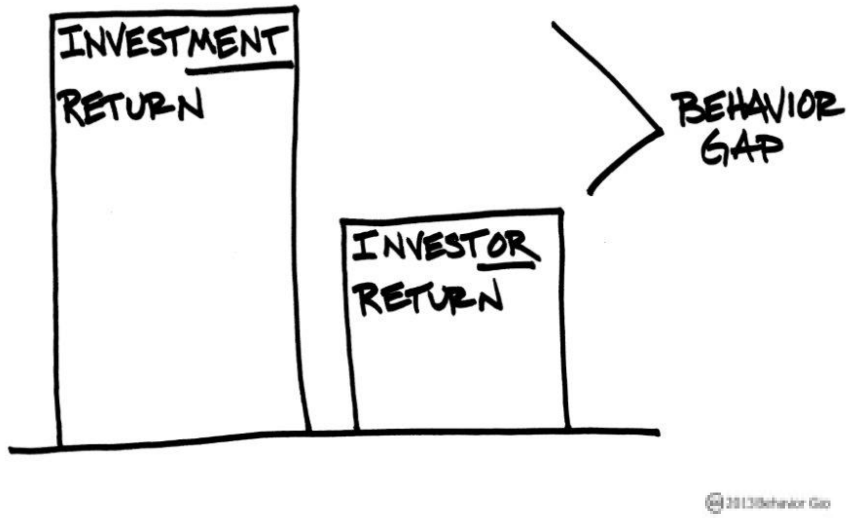
Another study, from Dalbar Inc., calculates the behavior gap with real numbers. It shows that between 1986 and 2016, average fund investors earned an average return of only 3.98%, significantly less than a broad market index (i.e., S&P 500 Index) at 10.16%.** What is the cause of this underperformance? The answer is investor emotions, which change dramatically over a market cycle. An investor says, "Wow, I am smart!" as his or her stock pick climbs right before a market peak, and then that emotion fades into denial, fear, and desperation as the market drops and the investor wonders, "How could I have been so wrong?" right at the market bottom.

The S&P 500's annual returns dating back to the 1940s clearly show the importance of staying disciplined and invested, particularly when compared to the largest market declines each year. If an investor sold out at the market bottoms, he or she could miss out on potential gains in any given year.

Another thing to keep in mind is that active management is cyclical, just like most aspects of investing. Thus, it can be important for investors to stick with active managers they trust as opposed to chasing performance or the next hot stock idea. The percentage of active funds beating the S&P 500 on a 5-year basis is currently at the lower end of the range of historical cycles, meaning active management has underperformed in recent years (since the 2008 financial crisis). This puts active management in a position of a higher probability to outperform going forward as that cycle starts to turn.

What are some qualities of good active managers? CLS believes the following qualities are most important:

- *Emphasis on low costs* - We emphasize low-cost ETFs.
- *"Eating our own cooking"* - Our portfolio managers own shares in every fund they manage.
- *Stewardship* - This has been ingrained in our culture since the company's founding.



- *Low portfolio turnover* - Our typical holding period is two to three years.

For more information on how active managers help close the behavior gap, we encourage you to check out the recently published book by CLS's very own Chief Investment Officer, Rusty Vanneman, CFA, CMT. In the book, Rusty shares his insights on the client-advisor relationship and how helping clients reach their long-term investment goals is truly a "Higher Calling."

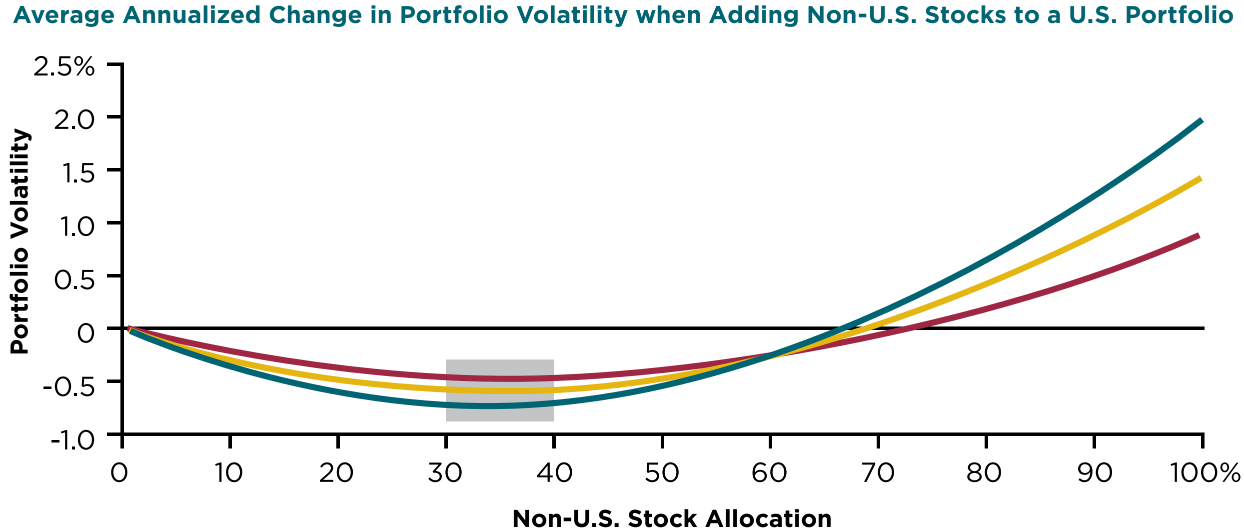
The Importance of International Investing

CLS builds Risk-Budgeted, global, balanced ETF portfolios to help investors succeed. I would like to focus on the "global" part of that key sentence and explain why investing in companies across the world is so important, both now and always.

The most important point to understand is the diversification benefit. International markets are less correlated with the U.S. market, so adding them together can lead to lower risk over time. The chart at the top of the next page, from Vanguard, illustrates that the optimal allocation to international, from a risk-reduction standpoint, is between 30% and 40%. Interestingly, risk is still lower than an all-U.S. portfolio all the way to a 70% allocation to international.

The annual return of various asset classes over the last 15 years (including U.S., international, emerging markets, bonds, commodities, etc.) shows there is no clear winner that continues to outperform each year. But a global, balanced portfolio (with U.S. and international stocks and bonds) cuts through the volatility of individual asset classes over time. While cumulative returns may fall in the middle of the pack, risk ends up at the lower end — leading to higher risk-adjusted returns over the long run.

While the diversification benefits make international a must-have in any asset allocation, it is particularly attractive right now. One reason is the concept of reversion to the mean. This is the theory that what goes up must come down; and the higher it goes up, the higher



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

Notes: U.S. equities represented by MSCI USA Index; non-U.S. equities represented by MSCI World Index ex USA from 1970 through 1987 and MSCI All Country World Index ex USA thereafter. Bond data represented by Salomon High Grade Index from 1970 through 1972, Lehman Long-Term AA Corporate Index from 1973 through 1975, and Barclays U.S. Aggregate Bond Index thereafter. Data through December 31, 2013.

the probability it will come down. Performance of international relative to the U.S. since 1970 shows a clear cyclical pattern over time, as the winner goes back and forth.

We evaluated each cycle period and aggregated the data. The current period of U.S. outperformance has lasted 112 months (since 2007), but the average U.S. outperformance cycle is only 66 months. In addition, the cumulative outperformance has been 91% versus an average of 107%. While there may be a bit more U.S. outperformance to be had to reach the average, the outstretched length of the cycle leads us to believe there is a higher probability of a reversal going forward (i.e., a higher likelihood of international outperforming the U.S. as the cycle begins to turn).

For more information on this topic, please reference some of CLS's published white papers highlighting the benefits and importance of a global-investing approach, including our "Why International: The Case for International Investing" and "Global & Balanced" white papers.

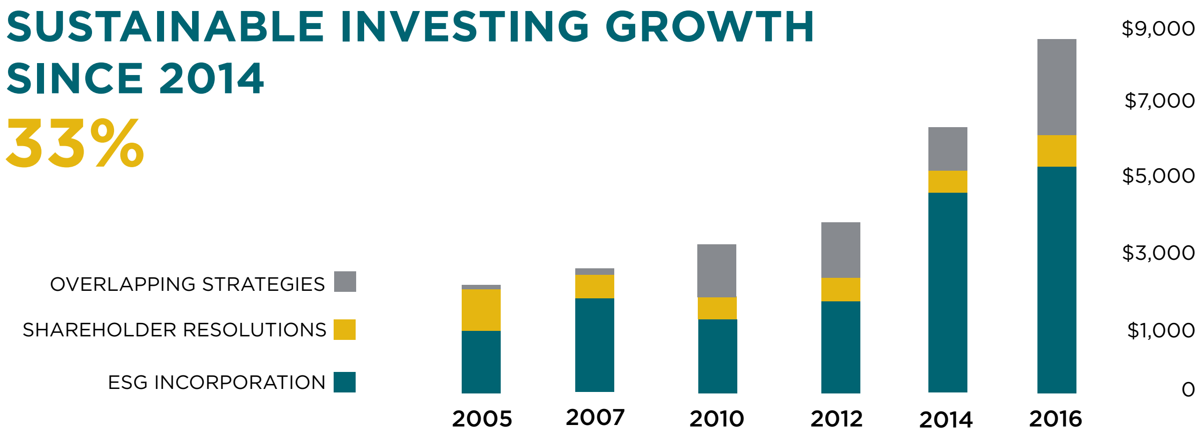
The Battle of the Acronyms: SRI Versus ESG

To wrap up this quarter's *"Directions,"* I would like to give a brief overview of a topic that has been making headlines and growing a lot of assets: values-based investing. There are many definitions of values-based investing, and it can mean something different to everyone. But, I believe the following are some unifying classifications:

- Socially Responsible Investing (SRI) is the "old school" or "traditional" values-based investing strategy. It is referred to as "exclusionary" screening, as the methodology is to exclude stocks from an index. These are typically "sin stocks," such as those in the tobacco, alcohol, and firearms industries. The strategy dates back decades and really became popular in the 1980s as investors wanted to divest from the South African economy to pressure the government to end apartheid.
- Environmental, Social, and Governance (ESG) is the "new school" values-based investing strategy. It is referred to as "inclusionary" screening, as the methodology is to include companies that exhibit favorable traits, including:
  1. *Environmental* — reducing fossil footprint, managing resources wisely, etc.
  2. *Social* — respecting human rights, culture, workplace equality, product safety, etc.
  3. *Governance* — stewardship for shareholders, transparent, accountable, etc.

- Impact investing is the "future school." It is the investment in companies that specifically benefit the world, environment, communities, etc. For example, working towards the United Nations Sustainable Development Goals. These

SUSTAINABLE INVESTING GROWTH IN THE UNITED STATES (BILLIONS) 2005-2016



Source: ussif.org - The Forum of Sustainable and Responsible Investment
**In ESG incorporation, investment institutions complement traditional, quantitative techniques of analyzing financial risk and return with qualitative and quantitative analyses of ESG policies, performance, practices and impacts.*
**Shareholder resolutions are a meaningful way for shareholders to encourage corporate responsibility and discourage company practices that are unsustainable or unethical.*

goals include eradicating poverty and hunger, and promoting good health, quality educations, gender equality, clean water, and clean energy.

Since impact investing is a relatively new concept, and there are not many publicly traded investment options, my comparison will be between SRI and ESG.

SRI has received a bad reputation over the years. One negative connotation is that investors pay a higher expense for a screen that still leaves them with market-like exposure, and thus, consistent underperformance versus the broad market. The second issue is that SRI investments tend to be negatively correlated with the energy sector (since many oil companies are screened out). So, much of the performance can be explained by moves in oil prices.

ESG looks to address these issues through its inclusionary process. The thesis is that ESG is a risk factor, which can be attributable to historic returns. This factor is a component of quality within companies. More stable and profitable companies:

1. Have money to spend on bettering the environment,
2. Care about their employees,
3. And, have diversified boards of directors that keep their shareholders in mind.

Therefore, these companies should perform better over time. Specifically, they should have more confident management that could be able to weather market downturns and potentially avoid lawsuits from financial and environmental wrongdoing.

As you can see in the chart above, sustainable investing has shown strong growth of 33% since 2014. We believe this growth may continue as more values-conscious millennials begin saving for retirement. And, we believe ESG will be increasingly important to financial advisors and asset managers. Please stay tuned as CLS is currently working on a new white paper on ESG investing that will summarize current published research and include our own research showing the benefits and evolution of ESG.

2017 Investment Themes

from CLS Chief Investment Officer, Rusty Vanneman, CFA

GLOBAL VALUE

This theme refers to an emphasis on value stocks around the globe that have lower valuations than the overall market. In other words, they might have a lower stock price to some fundamental unit of value ratio, such as sales or earnings. Not only do relative valuations support increasing positions in value stocks, but an improving economy also supports this theme. We are currently overweight value stocks, and will likely to increase that positioning even more in 2017.

Value stocks sectors CLS will be emphasizing: financials, natural resources, and emerging markets.

SMART BETA

This theme is essentially a re- branding of our previous theme, X-Factor. Smart Beta ETFs are rules-based ETFs whose holdings aim to intentionally diverge from a broad, market-cap-weighted index. At CLS, we emphasize five equity factors and two fixed income factors when we analyze portfolios and select ETFs. Over the past year, this investment theme has positively contributed to our performance. Moving forward, while recognizing that all investment styles are cyclical, we believe this theme will provide a durable edge over the long haul.

Equity Factors: Value, Quality, Size, Minimum Volatility, and Momentum
Fixed Income Factors: Credit and Duration

CREATIVE DIVERSIFICATION

This theme remains the same as last year. With interest rates at low levels compared to historical averages, this theme refers to the need to continue diversifying equity volatility to manage overall portfolio risk. CLS achieves this by being creative in the ways we actively manage our fixed income exposures, our continued use of alternative asset class segments and strategies, and through buying commodity-based ETFs.

Q&A: With CLS Portfolio Manager, Paula Wieck, CFA

Recent Money Manager Executive "Top 10 Women in Asset Management: award winner, CLS Portfolio Manager, Paula Wieck, CFA, shares her journey to success in the financial services industry.

Q: What influenced you to seek a career in the financial industry?

A: It's a funny story actually, it all began in the field of nutrition. My primary focus in life was to help people learn how to manage their health. Over time, I kept hearing my clients talk about their finances and retirement and it swayed me to begin my journey in the financial industry. Financial health is just as important as physical health, and it's something that people have trouble facing head on.

Q: What do your responsibilities at CLS include?

A: I manage the Investment Research Team whose main focus is to provide in-depth data for CLS's decision making. I also co-manage three AdvisorOne multi-asset mutual funds which currently amounts to $1.2B in assets.

Q: How have you helped improve CLS's marketing, technology, and/or operations?

A: In 2012, I created CLS's Investment Research Team by creating analyst job positions, interviewing for the positions, and hiring the team. I have developed the procedures, daily workflow, and tracking measures for this team that are still implemented today. I also assist the marketing team by providing performance reports and overseeing marketing collateral regarding the funds I manage.

Q: How has creating the Investment Research Team help CLS?

A: Since developing the team and applying new tracking procedures, we have doubled the number of projects and reports while meeting our set deadlines. The current system allows us to deliver analytics in a way that boosts CLS's reputation and credibility in the asset management industry.

Q: Recently, you have published various commentary regarding women in the finance industry and show such passion with the topic. How do you intend to empower younger women to seek careers in the financial industry?

A: This is something I am extremely passionate about and think it's important to continue building women up in the finance industry. I support a number of local women's networking groups within my community. I am also a member of Women in ETFs, and have attended a couple large women's conferences: the Institute for Career Advancement (ICAN) and the Women's Fund of Omaha Conference. My goal is to take time to educate and motivate younger generations of eager women who are interested in the finance industry pursue their desired careers.

It is also very important to me that we begin encouraging younger children to take interest in the financial industry. The University of Nebraska Omaha Mavericks Investment Camp is an event that is very dear to me. It allows me to be able use my knowledge and experiences to educate teenagers about important financial topics such as the stock market and ETFs. This camp at my alma mater helps prospective students learn more about investing and gain an understanding of savings.

Q: Throughout your years in the finance industry, who would you say has been a mentor for you?

A: I am proud to say that my supervisor and CLS's Chief Investment Officer Rusty Vanneman, has served has a mentor to me. Since day one, Rusty has taken time to work with me on finding my niche within the finance industry. He also continues to support me in my efforts to promote gender equality in the industry and he also speaks about the importance of women in the financial industry. Having him in my corner and his constant support allows me to pursue two of my passions: investing and empowering women.

In part, these responses helped Paula earn the "Women in Asset Management Award" from Money Management Executive.

To view the complete article regarding the Women in Asset Management Award, click here. This information is not complete without the following disclosures.

CLS Investments, LLC ("CLS") Portfolio Manager, Paula Wieck, CFA, was included in a "Top Women in Asset Management" in 2017 selected by Money Management Executive. Money Management Executive is an unbiased, third-party publication covering the asset management industry. Money Management Executive editors chose the list of women from nominations that discussed their roles at their asset management company, as well as any community service programs in which they may be involved. The list of managers was published May 1, 2017. 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.

* Source: Vanguard - Putting a Value on your Value: Quantifying Vanguard Advisor's Alpha"

** Source: "Quantitative Analysis of Investor Behavior, 2016," DALBAR, Inc. www.dalbar.com Equity performance is represented by the Standard & Poor's 500 Composite Index, an unmanaged index of 500 common stocks generally representative of the U.S. stock market. The average investor refers to the universe of all mutual fund investors whose actions and financial results are restated to represent a single investor. This approach allows the entire universe of mutual fund investors to be used as the statistical sample, ensuring ultimate reliability. QAIB calculates investor return as the change in assets, after excluding sales, redemptions and exchanges. This method of calculation captures realized and unrealized capital gains, dividends, interest, trading costs, sales charges, fees, expenses and any other costs. You cannot invest directly in an index. Past Performance is not necessarily indicative of future results.

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