

CLS's WEEKLY 3

What You Need To Know About the Markets

AUGUST 8, 2017

In This Edition

1. It appears the U.S. and Eurozone's monetary policies have been successful.
2. Try not to rely too much on forecasts; they are often wrong.
3. Yes, another benefit of ETFs: the ability to own high-price-per-share stocks.



Market Performance

Equities	LAST WEEK	QTD	YTD '17
Total U.S. Market ¹	+0.09%	+2.07%	+11.19%
Domestic Large-Cap Equity ²	+0.23%	+2.37%	+11.93%
Domestic Small-Cap Equity ³	-1.17%	-0.15%	+4.84%
International Equity ⁴	+0.66%	+4.14%	+18.82%
Developed International Equity ⁵	+0.87%	+3.50%	+17.80%
Emerging Market Equity ⁶	+0.44%	+6.10%	+25.66%
Fixed Income	LAST WEEK	QTD	YTD '17
U.S. Investment Grade Bonds ⁷	+0.16%	+0.60%	+2.88%
Cash Equivalent ⁸	+0.02%	+0.09%	+0.39%
Commodities	LAST WEEK	QTD	YTD '17
Commodity ⁹	-1.40%	0.92%	-4.38%

¹Russell 3000²S&P 500 Index³Russell 2000 Index⁴MSCI ACWI ex-U.S. Index⁵MSCI EAFE Index⁶MSCI Emerging Markets Index⁷Bloomberg Barclays Capital U.S. Aggregate Bond Index⁸Bloomberg Barclays Capital 1-3 Month U.S. Treasury Bill Index⁹Bloomberg Commodity Index

As of 8/4/2017

Week in Review

It was a generally positive week for the markets with the exception of U.S. small-caps and commodities. While the S&P 500 did not make a new high for the week, the Dow passed 22,000 for the first time ever. The strong U.S. performance is attributable to economic strength and positive earnings reports. On the economic front, non-farm payrolls (number of jobs added in the U.S.) came in at 209,000 for July, more than the 180,000 estimate, and unemployment dropped from 4.4% to 4.3%, matching a 16-year low. For earnings, about 75% of S&P 500 companies have reported second quarter results with strong 10% year-over-year earnings growth, beating estimates of just more than 6%. Nonetheless, international markets outperformed domestic as has been the trend this year.

But, perhaps our most important update is that CLS Portfolio Manager Josh Jenkins, CFA, got married over the weekend. The venue was the beautiful and historic Orpheum theatre in downtown Omaha. The majority of the team was able to help Josh celebrate the big day. Now the newlyweds are on their way to Europe to tour Italy. Congratulations to Mr. & Mrs. Jenkins and best wishes for a lifetime of happiness.

Beyond Green Shoots: A Global Growth Story

"The flower that blooms in adversity is the most rare and beautiful of all."
— The Emperor of China, Mulan

Green shoots are the early signs of life in a plant as it first breaks through the soil. In financial terms, green shoots are signs of an economic recovery after a downturn. It has now been about 10 years since developed markets started aggressively loosening monetary policies in an attempt to recover from the financial crisis of 2008. Now the question becomes: Have these policies succeeded?

Specifically evaluating the U.S. Federal Reserve (Fed) and Eurozone's European Central Bank (ECB), a brief timeline shows the ECB was quite a bit slower than the Fed to reach 0% interest rates and initiate quantitative easing.

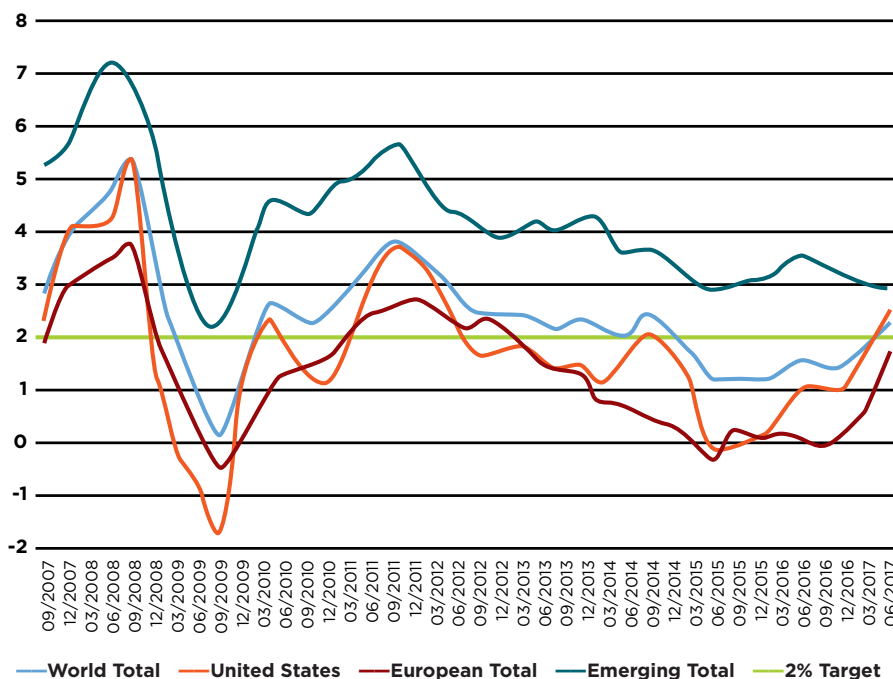
The success of either's monetary policies can be defined by a few measures, including inflation, unemployment, and real GDP growth (we will review this through the end of the first quarter for data

completeness). The Fed's monetary policy has a long-run inflation target of 2% and an unemployment target of about 5%. The ECB has a medium-term inflation target of just less than 2%, and no specific unemployment target. Ultimately, a sign of economic recovery is a

boost in real GDP growth for which the Fed has set a central tendency of about 2%.

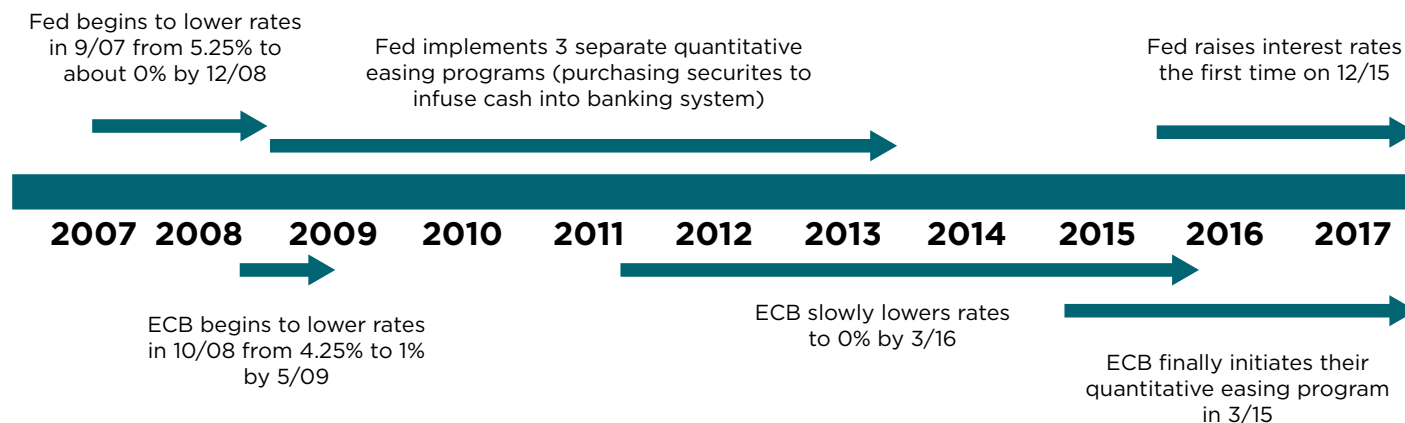
First, let's look at inflation as measured by the Consumer Price Index (CPI). Inflation had a healthy rebound through 2012, but then

Consumer Price Index



Source: Factset. As of 6/30/2017

U.S. Federal Reserve & Eurozone's European Central Bank Timeline (September 2007 - June 2017)



Sources: The Telegraph, 3/10/2015; European Central Bank, As of 6/30/2017; Board of Governors of the Federal Reserve System (Open Market Operations-As of 6/14/2017 & Federal Open Market Committee, As of 3/15/2017); Bankrate, As of 9/17/2015

Beyond Green Shoots: A Global Growth Story (Continued)

began to sink down, particularly for the Eurozone. Nothing a bit of quantitative easing can't fix. It rebounded in 2016, and now the U.S. is above its target and the Eurozone is not too far behind. More than just green shoots here.

Unemployment has moved steadily downward in the U.S., crossing the Fed's target in 2016 and now starting to level off. The Eurozone had some issues half way through, but its zero interest-rate policy (ZIRP) helped it recover. While there may be another couple percentage points to go to reach pre-crisis levels, we are now seeing some leaves form.

In real GDP growth, the U.S. has been hovering around its target since the start of easing, and the Eurozone finally turned it around after becoming more aggressive in its policies post-2013. With both currently close to 2%, flowers are starting to bloom.

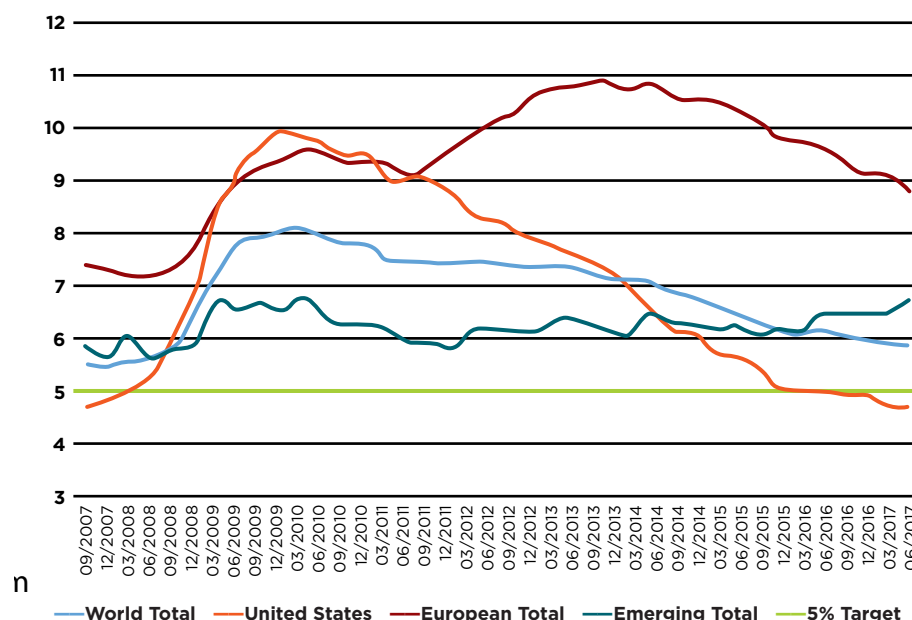
With post-crisis improvement on all three charts for the U.S. and more recently the Eurozone, I would say the policies have worked. But, has that success translated into market returns? The U.S. market has returned about 100% since it started to lower rates, while the Eurozone has been flat. Seems like there is some catchup to be done since both economies are aligned.

Readers may note, I snuck two additional lines in these three charts. One is for emerging markets (EM), which have had decreasing CPI (best to have positive, but low inflation), stable unemployment, and real GDP growth, well above developed markets despite a soft decrease that

has recently rebounded. The kicker is that EM has accomplished all this without much central bank support as interest rates in these countries are still quite high. The other line

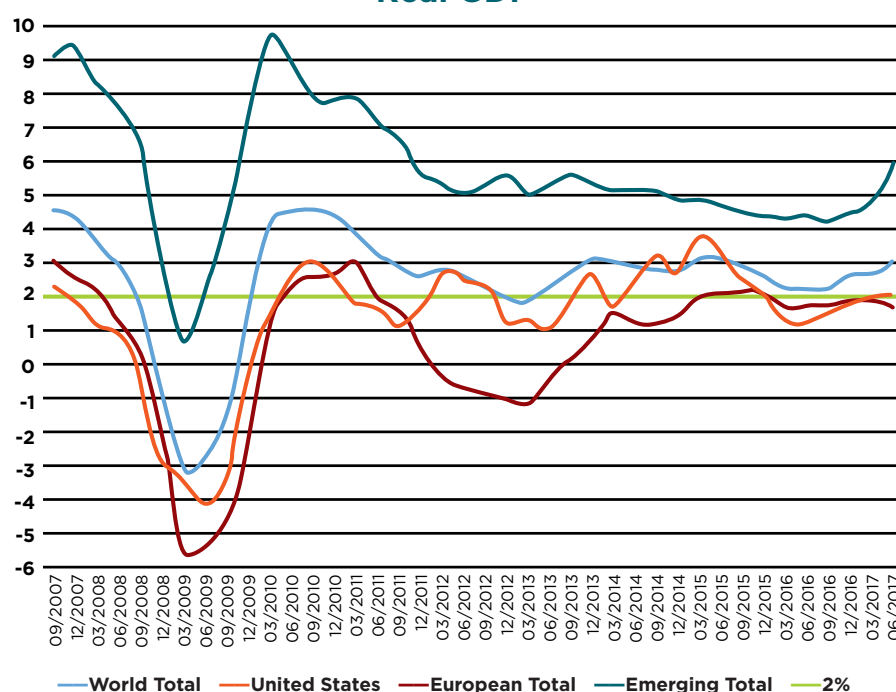
represents the total world economy: just more than 2% inflation, less than 6% unemployment, and about 3% GDP growth — well beyond green shoots.

Unemployment Rate



Source: Factset. As of 6/30/2017

Real GDP



Source: Factset. As of 6/30/2017

"Sure Things" Rarely Work in the Markets

"Terry, I can't predict the future. I pay professionals to do that, and even they get it wrong sometimes." – Reuben Tishkoff, *Ocean's Twelve*

Every year, investment analysts and economic forecasters have a list of events they are positive will happen. Larry Swedroe, Director of Research for The BAM Alliance, has been keeping score on these predictions since 2010, and since he started tracking them, only about 25% of these "sure things" have occurred.

Now that the second quarter is behind us, let's see where we are on the 2017 list:

1. Prediction: The Fed will continue to raise rates throughout the year, and thus bond returns will suffer.

For the first half of the year, longer-term Treasuries are up 5.7%, intermediate-term are up 1.5%, and short-term are up 0.4%. **FALSE.**

2. Prediction: Given expected fiscal spending, particularly on infrastructure, and continued monetary stimulus in the U.S., inflation will significantly increase.

U.S. CPI had a year-over-year change of 1.8% in the fourth quarter of 2016, went up to 2.6% in the first quarter of 2017, and went right back down to 1.9% in the second quarter. Let's call it a **DRAW.**

Year	Number of Sure Things	Yes/True (+)	No/False (-)	Tie/Draw
2017 - Q2	8	2	5	1
2016	8	2	6	0
2015	8	3	4	1
2014	10	3	7	0
2013	7	2	5	0
2012	8	3	4	1
2011	8	1	7	0
2010	5	1	4	0
Total	62	16	42	4

Source: ETF.com "Swedroe: Following Up On 2017's 'Sure Thing.' April 10, 2017

3. Prediction: With the stimulus mentioned above and expectations for tax cuts and deregulation, GNP growth will strengthen to 2.2%.

U.S. real GNP for the first quarter did hit exactly 2.2%. **TRUE.**

4. Prediction: The U.S.'s tightening of monetary policy and improving economy compared to other developed nations will cause the dollar to strengthen.

The dollar is down more than 6.5% through the second quarter. **FALSE.**

5. Prediction: Concerns over trade wars with emerging markets (EM) will lead to underperformance of the asset class.

The MSCI Emerging Markets Index is up 18.6% through the second quarter, about double the S&P 500. **FALSE.**

6. Prediction: With high valuations for the domestic stock market, coupled with more competitive rising bond

rates, the S&P 500 will return a mediocre 7% for the year.

The S&P 500 has returned 9.3% through the second quarter. **FALSE.**

7. Prediction: Small-cap domestic stocks are overvalued and should be avoided.

The Russell 2000 Index returned 5% through the second quarter. **TRUE.**

8. Prediction: With expectations for the U.S. economy to grow faster than other developed international markets, non-U.S. developed will underperform.

The MSCI EAFE Index is up 14.2% through the second quarter. **FALSE.**

So, of eight "sure things," two are true, five are false, and one is a draw. That's a 25% success rate.

The moral of the story: The future is uncertain and forecasts are often wrong, so it is important to stick to a well-disciplined and balanced investing approach to avoid surprises.

How to Own a Share of Berkshire Class A

"And coming out of the Upper West Side, we have the number three seed, 'Girl who thought I owned Google'." – Barney Stinson, How I Met Your Mother

It seems every day I find a new benefit of ETFs. The latest is the ability to own shares of high-price-per-share companies. A share of Berkshire Class A trades at close to \$270,000. How many of those shares can a typical investor buy? Not many. But, an ETF allows investors to own at least some portion of it for a much smaller price: \$70 in the case of the VT ETF.

From a more practical case, let's say an investor likes the U.S. technology sector and wants to buy all the sector's largest companies. Since he or she can't buy fractional shares, he or she would be paying (all approximate figures) \$160 for Apple, \$170 for Facebook, \$250 for Broadcom, and \$940 for Google parent Alphabet – along with the price of another

\$65 or so companies out of the S&P 500. That would cost him or her a small fortune, not to mention the transaction costs. But, he or she could own all of them for under \$60/share with an ETF such as XLK. And, if he or she wanted to rotate

out of it, it would only take one simple trade or transaction.

But obviously, the main benefit would be to go to a dinner party with his or her friends and let them know he owns some Berkshire A!

Top 5 Holders of Berkshire Class A Stock		
Ticker	Name	Weight
RALS	ProShares RAFI Long/Short ETF	1.16
VT	Vanguard Total World Stock ETF	0.21
VOO	Vanguard S&P 500 ETF	0.08
VTI	Vanguard Total Stock Market ETF	0.04
MGC	Vanguard Mega Cap ETF	0.02

Source: Ned Davis Research, As of 7/28/2017

Top 5 Holders of Alphabet (Google Parent) Stock		
Ticker	Name	Weight
IYW	iShares U.S. Technology ETF	11.00
XLK	Technology Select Sector SPDR Fund	10.40
VGT	Vanguard Information Technology ETF	10.30
FTEC	Fidelity MSCI Information Technology Index ETF	10.10
FDN	First Trust Dow Jones Internext Index Fund	9.30

Source: Ned Davis Research, As of 7/28/2017




Kostya Etus, CFA
Portfolio Manager

Konstantin "Kostya" Etus is a co-manager on two mutual funds (aggressive allocation and international) and manager on various separate account strategies, including Core Plus ETF, SRI/ESG, and 529. He specializes in international investments.

Mr. Etus has eight years of investment experience, including six at CLS. He began his career at CLS in 2011 as a trading specialist and became a research/portfolio analyst in early 2013. In 2016, he was promoted to Portfolio Manager. 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 degree in business administration and obtained Master of Investment Management and Financial Analysis and Master of Business Administration degrees from Creighton University. He holds the Series 65 securities registration and the Chartered Financial Analyst® (CFA) designation.

Did you know? [Kostya grew up in Soviet Russia.](#)



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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 Index is an index comprised of the 2,000 smallest companies on the Russell 3000. It serves as a benchmark for small-cap stocks in the U.S. The MSCI All-Countries World Index, excluding U.S. (MSCI ACWI ex US) is an index considered representative of stock markets of developed and emerging markets, excluding those of the U.S. 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 (or EM) Index is a composite index which tracks performance of large and mid-cap firms across 21 countries classified as emerging market countries. The Bloomberg Barclay's Capital U.S. Aggregate Bond Index measures the performance of the total United States investment-grade bond market. The Bloomberg 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 significance 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.