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1. Find the calm within the storm by assessing market volatility.
2. Why investors should go overseas for value.
3. How and why CLS embraces factor investing.

Stocks were mixed last week as concerns regarding North Korea’s nuclear weapons program and the impact of two hurricanes on the U.S. were felt across the markets. The Russell 3000 Index, a gauge for U.S. stocks, was down 0.7%, with large-caps taking less of a hit than small-caps. Overseas, international stocks based on the MSCI ACWI ex-U.S. Index jumped 0.6% with developed stocks outpacing emerging stocks. Investors flocked to bonds for safety as yields for the U.S. 10-year Treasury dropped 10 basis points from the prior week to finish at 2.06%.
Markets were tested as multiple newsworthy events hit over the course of last week. Security concerns with North Korea intensified as the regime tested another nuclear warhead, and a state of emergency was declared in Florida as Hurricane Irma gained strength and threatened to make landfall by the weekend. This provided the backdrop as uncertainty regarding the U.S. debt ceiling was temporarily reduced as the Trump administration broke ranks with a Republican-led Congress to make a deal with Democrats.

Last week was a clear reminder that risk can take multiple forms in the markets whether it is geopolitical, disaster-related, or financial. Risk in the markets means prices for stocks and bonds alike can swing both up and down. This can cause investors to feel concerned about where their investments will end up over the next few months.

But, how risky are markets in relation to historical averages? Surprisingly, although it may not feel like it, stock market volatility still remains very depressed. According to our analysis, stock market volatility, both domestically and internationally, is at its lowest levels for the data observed going back to February 1988.

For investors, managing to a consistent risk target can help remove the feeling of uncertainty and lessen hesitation about remaining invested in the markets. Risk Budgeting allows investors to accept a certain amount of risk even as volatility in the markets changes over time.
One of the most significant themes in CLS portfolios this year has been Global Value. As stated on page 56 of our Quarterly Reference Guide, we continue to favor value stocks over growth stocks as they generally do better in an improving global economic environment. But despite improving global growth, we’ve seen value stocks lag growth stocks so far in 2017, which has been a tailwind for CLS portfolios.

So, why do we still like value stocks? One reason has to do with the opportunity to find stocks on sale relative to the rest of the stock markets. We can determine this in a simple manner by comparing the constituent make-up of a global value index to its standard global benchmark.

What we find is, in order to access value stocks investors must go overseas – plain and simple. Whether it’s Japan, Europe, or the Asia/Pacific region, investors have to look abroad to find more opportunities to buy stocks that are on sale.

While it may be some time before value stocks shine through again, investors should realize buying cheap increases the odds for outsized returns over the long run.
I spent last week in Chicago with a few of my colleagues attending Morningstar’s annual ETF Conference. This conference is a great opportunity to hear from leading experts on ETFs and the major trends pushing ETF investing forward.

One of my favorite moments was the keynote presentation given by Dr. Andrew Ang from BlackRock. Dr. Ang is well known in quant investing circles for the work he’s done on factor investing and asset allocation.

Dr. Ang’s presentation, titled “Frontiers in Factor Investing,” hit on much of what we’ve been thinking about at CLS when it comes to one of our major 2017 Investment Themes: Smart Beta. We have used smart beta ETFs in CLS portfolios to target rewarded premiums that come from investing in stocks focused on size, value, momentum, minimum volatility, or quality as major equity risk factors. So, does this final frontier in investing make sense for investors?

Factor investing is all about passing along rewarded risk premiums at a lower cost to investors. As we have seen illustrated in many of our materials on factor investing, including on pages 59 and 60 of the Quarterly Reference Guide, factors can help add value over the market. Smart beta ETFs capture these risk premiums in a cost-efficient manner through the use of rules-based indices.

Factor investing is a promising area that will likely grow. At CLS, we continue to embrace it as a method of enhancing our value-add to clients within our Risk Budgeting framework.

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Joseph Smith, CFA
Senior Market Strategist

Joe Smith specializes in quantitative research, risk management, and ETF due diligence. He serves as Senior Market Strategist for the CLS AdvisorOne International Equity Fund, CLS’s Thematic Growth Strategy, and CLS’s Core Plus ETF Strategy.

Prior to joining CLS in 2015, Mr. Smith worked at Russell Investments where he served as an Analyst responsible for asset allocation research, portfolio construction, optimization design, and risk management research. He later joined Russell ETFs as Manager of ETF Product Development and Research, a role in which he developed quantitative indexing strategies implemented as ETFs. Mr. Smith also worked for Charles Schwab Investment Management as a Senior Product Specialist supporting product management activities for the Schwab ETFs fund family. In addition, he worked for CLS during the summer of 2014 as an Investment Analyst. Mr. Smith received his Bachelor of Science degree in Economics from the University of Washington. He later received his Master of Business Administration from the Tepper School of Business at Carnegie Mellon University.

Mr. Smith holds the Chartered Financial Analyst (CFA) designation and is a member of the CFA Society of San Francisco, Pittsburgh, and Nebraska. He is also a member of the Society of Quantitative Analysts and the Quantitative Work Alliance for Applied Finance, Education and Wisdom.

Did you know? In grad school, Joe spent 40 days in nine countries.
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 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 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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