CLS's WEEKLY 3

What You Need To Know About the Markets

JULY 10, 2018

1. Is Amazon's dominance of online retail good for consumers?
2. In the midst of a trade war, what's giving investors reason to breathe easier
3. History suggests recent U.S. outperformance may be short-lived

Market Performance

Equities	LAST WEEK	QTD	YTD '18
Total U.S. Market[1]	+1.72	+1.72	+4.99
Domestic Large-Cap Equity[2]	+1.56	+1.56	+4.25
Domestic Small-Cap Equity[3]	+3.12	+3.12	+11.02
International Equity[4]	+0.27	+0.27	-3.51
Developed International Equity[5]	+0.57	+0.57	-2.20
Emerging Market Equity[6]	-0.71	-0.71	-7.32
Fixed Income	**LAST WEEK**	**QTD**	**YTD '18**
U.S. Investment Grade Bonds[7]	+0.24	+0.24	-1.38
Cash Equivalent[8]	+0.03	+0.03	+0.80
Commodities	**LAST WEEK**	**QTD**	**YTD '18**
Commodity[9]	-1.34	-1.34	-1.34

[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 Index

As of 7/06/2018

Week in Review

It was a standout week for the U.S. equity markets. The Russell 2000 Index led the way with a gain of more than 3%. Growth did well as the Russell 3000 Growth Index was up more than 2%. Value lagged but has since increased by 1%. International markets lagged sharply as the MSCI ACWI ex-U.S. was up 27 basis points and emerging markets were down 71 basis points.

It was a decent week for bonds as the Bloomberg U.S. Aggregate Bond Index was up 24 basis points. The 10-year U.S. Treasury yield ended the week at 2.82%. Commodities struggled and were down 1% on the week.

Are Dynasties a Good Thing?

Dynasties in some form have been around forever. These days they are discussed frequently in sports, and they typically refer to teams or individuals that dominate their sport for an extended length of time. That includes the old and new New York Yankees, the old Boston Celtics in the 1960s and the 80s, the Showtime Lakers with Magic Johnson, the New England Patriots, and the Golden State Warriors. Heck, I would even say Tiger Woods is a dynasty!

There are good and bad sides to dynasties. The good? They draw in viewers. People talk about and watch those teams or individuals. Look no further than the ratings when Tiger Woods is in contention for a tournament victory. We love them, and we hate them, which brings us to the bad – those teams or players who know they are going into a season or tournament with no chance to win.

This also carries over to business. Amazon could be viewed as a dynasty. Its objective is certainly to dominate the market for an extended period of time. That can probably be taken a step further. It seems Amazon wants to be the market.

Do consumers benefit from this? Do we love or hate this? We shop on Amazon to get what we want at the best available price. It's the only name many people think of when they shop online. Amazon has become the dominant online retailer, and the company's success has translated into huge gains for its owners as the accompanying chart shows. The bad? There are numerous other retailers, large and small, struggling to compete and survive.

Several other businesses could be considered dynasties in the current market. Apple, Microsoft, and Google come to mind. It's the world we live in now. But when dynasties falter, sometimes they never recover. The Chicago Bulls with Michael Jordan was a dynasty in the 1990s. Jordan remains a dynasty, but the team does not. We can look back to the not-so-distant past for an example. Blackberry dominated for a decade, from the mid-90s to about 2010. Everyone who worked on Wall Street had one. Then Apple took over, and where is Blackberry now?

COMPANY	MARKET CAP. 12/2007	MARKET CAP. 12/2017	% CHANGE
Sears	$12.7B	$0.44B	↓-96%
JCPenney	$10.62B	$1.04B	↓-90%
Kohl's	$15.5B	$8B	↓-47%
Macy's	$13.2B	$7.6B	↓-42%
Target	$44B	$33B	↓-25%
Best Buy	$21.6B	$17.6B	↓-16%
Nordstrom	$8.9B	$7.5B	↓-15%
Walmart	$196.3B	$288.1B	↑46%
Amazon.com	$39.6B	$555.3B	↑1,318%

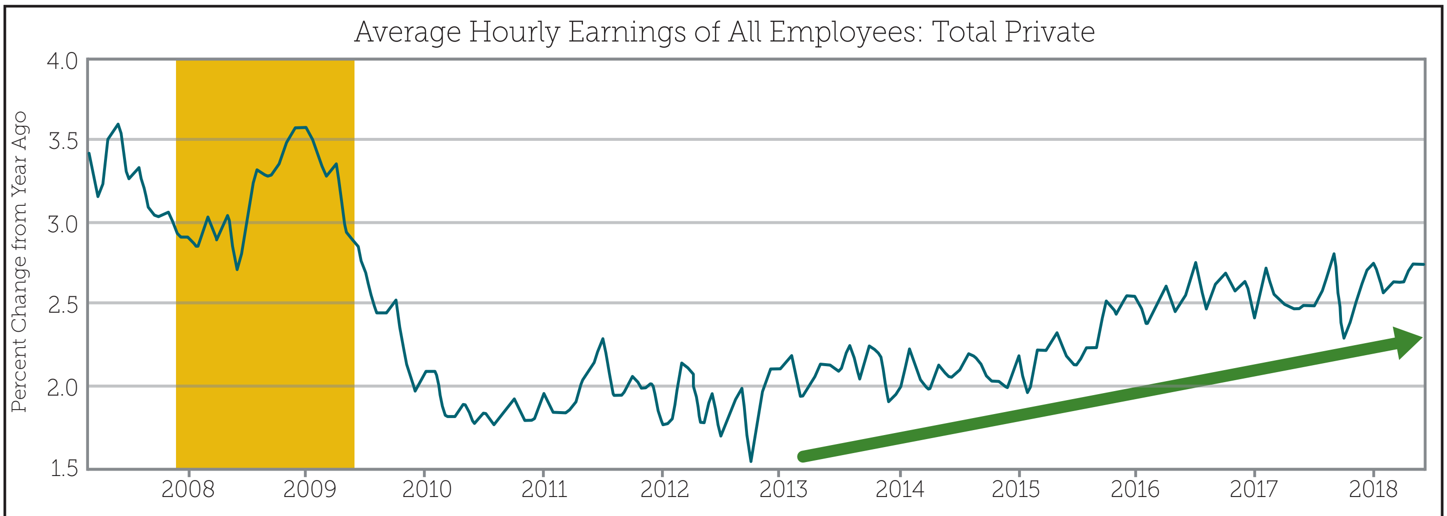
Source: ycharts.com (values for 2007 and 2017)

Sell the Rumor, Buy the Fact

Despite concerns about the Federal Open Market Committee (FOMC) minutes, a potentially damaging wage component in the June jobs report, and the beginning of an official trade war, investors were pleasantly surprised and rewarded with market-friendly data that sent out a coast-is-clear signal for now.

The equity markets, both domestically and globally, have had a rough go the last several weeks as the escalation of trade war rhetoric continued. The markets took a turn for the better mid-week. First, the FOMC minutes portrayed a very strong economy, indicating rate hikes should be gradual. The minutes also mentioned intensified risks around the U.S.-China trade war. These were cited by "many" rather than "some," which nudged the market to expect the Federal Reserve (Fed) will be slower to raise rates.

On Friday morning, the all important payroll data was released. While the headline number portrayed solid growth, the equity market took solace in the less-than-expected wage gains and the increase in the overall unemployment rate from 3.8% to 4%. Those trends gave the Fed more cover to raise rates even more slowly moving forward.



Source: U.S. Bureau of Labor Statistics as of June 2018. Shaded area indicates U.S. recession.

Marc Pfeffer

Managing Director, Institutional Fixed Income

Marc Pfeffer specializes in fixed income strategies. He is a Portfolio Manager on the CLS Flexible Income Fund team and manages the CLS Active Income X Strategy and CLS's ETF strategies. He also manages individual municipal bond portfolios for the CLS Master Manager Strategy and is a senior member of the CLS Investment Committee.

Mr. Pfeffer joined CLS in 2011, continuing as Senior Portfolio Manager for the Milestone Treasury Obligations Fund. The Fund was incorporated into CLS's fund family in January 2012. Mr. Pfeffer has more than 30 years of investment management experience, including time spent as the Chief Investment Officer at Milestone. He also worked previously at Goldman Sachs and Bear Stearns.

Mr. Pfeffer graduated from the State University of New York at Buffalo with a Bachelor of Science degree in finance. He received his Master of Business Administration degree, with a focus on finance, from Fordham University. Mr. Pfeffer holds his FINRA Series 7, 63, and 65 licenses.

Did you know? Marc is also an avid poker player.

America the Beautiful

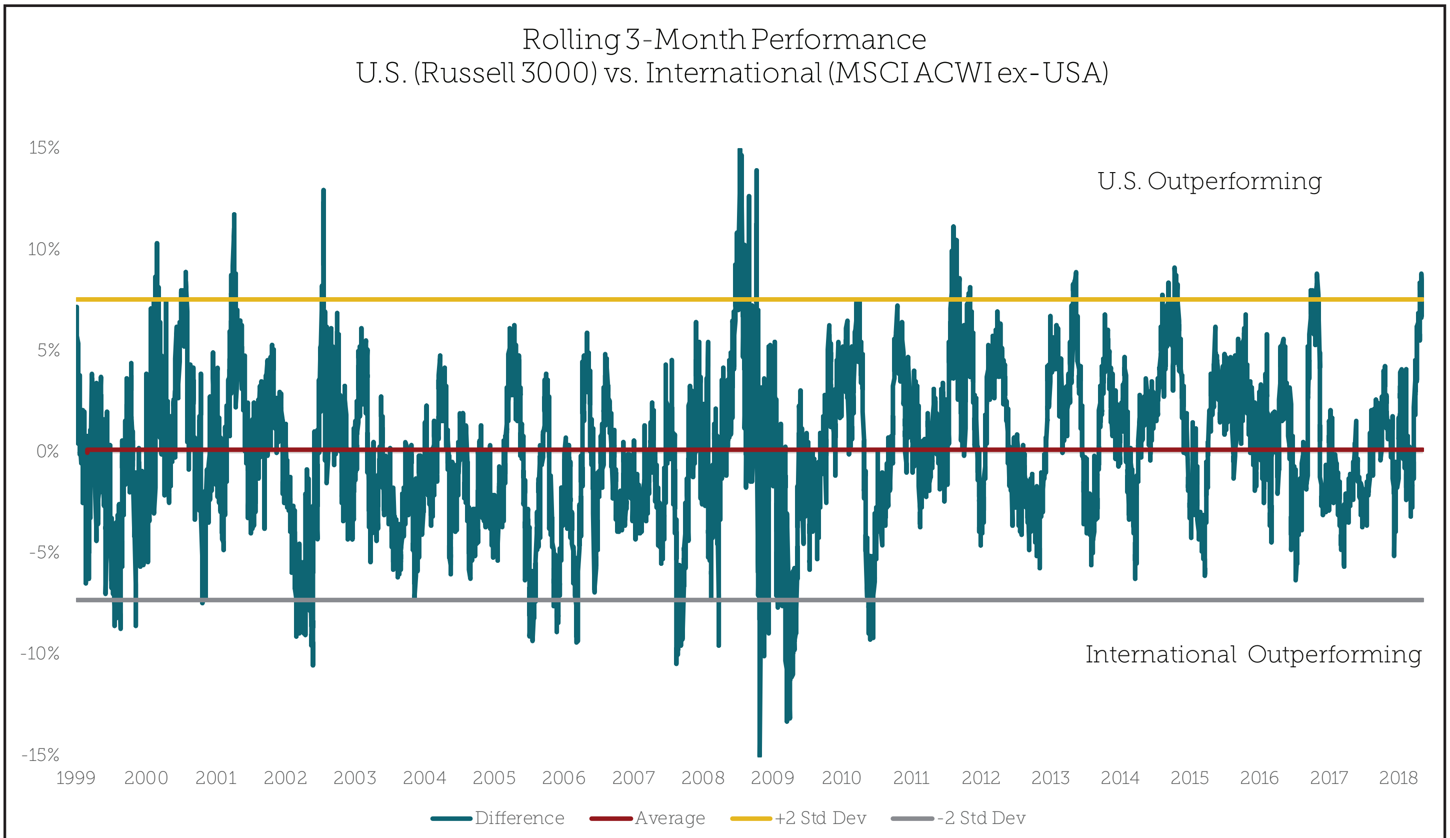
Content provided by: Grant Engelbart, CFA, CAIA, Portfolio Manager

The United States of America has been one of the most amazing success stories in history, particularly financially, after winning its independence from the British Empire. What began as a fledgling emerging economy has grown to capture more than 50% of the world's market-cap in just over 200 years. For context, the United Kingdom and Dutch stock markets were more than 100 years old when the U.S. stock market began, circa 1792!

All of this past success is reason to celebrate (and spend way more than necessary on fireworks), but it also creates a tendency to extrapolate that investing in the U.S. is the best, and the only, way. This leads to success and home country biases and can blind us from overseas opportunities.

Of course, to the CLS audience, this is nothing new. We have been preaching about the merits of global investing for some time. Unfortunately, the recent quarter proved trying for international equities, particularly due to the dollar's strength. In fact, it was one of the worst three-month stretches versus the U.S. stock market in some time. Rolling three-month performance over the past couple decades shows the recent degree of underperformance measured a whopping two standard deviations! Something that has only happened 2% of the time.

We all need reminders that investing is a long-term activity (much longer than three months), dwelling on short-term performance is a huge reason investors consistently underperform and sell out at the wrong times.



Source: Morningstar, CLS Investments

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 index 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 Index and offers investors a benchmark for small-cap stocks. The MSCI ACWI ex U.S. Index (MSCI All-Countries World Index, excluding U.S.) is an index considered representative of stock markets of developed and emerging markets, excluding those of the U.S. The MSCI EAFE Index is an index which tracks performance of international equity securities in developed countries in Europe, Australia, Asia, and the Far East, excluding the U.S. and Canada. The MSCI Emerging Markets Index is an index which tracks performance of large and mid-cap firms across countries classified as emerging market countries. The Bloomberg Barclays Capital U.S. Aggregate Bond Index measures performance of the U.S. investment-grade bond market. The Bloomberg Barclays 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 exchange-traded futures on physical commodities and represents 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.