

CLS's WEEKLY 3

What You Need To Know About the Markets

JANUARY 8, 2019



1. Global diversification makes a comeback
2. How did investors behave in 2018?
3. How trade tensions are impacting our largest companies

Market Performance

Equities	LAST WEEK	QTD	YTD '19
Global Equity Market ¹	+1.59%	+0.91%	+0.91%
Total U.S. Market ²	+1.98%	+1.10%	+1.10%
Domestic Large-Cap Equity ³	+1.88%	+1.01%	+1.01%
Domestic Small-Cap Equity ⁴	+2.95%	+2.13%	+2.13%
International Equity ⁵	+1.24%	+0.79%	+0.79%
Developed International Equity ⁶	+1.57%	+1.08%	+1.08%
Emerging Market Equity ⁷	+0.27%	-0.05%	-0.05%
Diversifiers	LAST WEEK	QTD	YTD '19
U.S. Investment Grade Bonds ⁸	+0.37%	+0.20%	+0.20%
Cash Equivalent ⁹	+0.05%	+0.03%	+0.03%
Commodity ¹⁰	+2.62%	+2.85%	+2.85%
Diversified Alternatives ¹¹	+0.19%	+0.43%	+0.43%

¹Morningstar GblMkt Large-Mid Index ²Morningstar U.S. Market Index ³Morningstar U.S. Large Cap Index ⁴Morningstar U.S. Small Cap Index ⁵Morningstar Gbl xU.S. Large-Mid Index ⁶Morningstar DM xUS Large-Mid Index ⁷Morningstar EM Large-Mid Index ⁸Morningstar U.S. Core Bd Index ⁹Morningstar Cash Index ¹⁰Morningstar Gbl Lng-Only Cmnty Index ¹¹Morningstar Diversd Alt Index As of 1/4/2019

Week in Review

Last week, one year ended on Wall Street, and another began. Market participants continued to see wild price swings. Global stocks were higher on Monday, flat on Wednesday, sharply lower on Thursday, and up big on Friday. In all, they finished the week higher. U.S. small-cap stocks led the way, followed by U.S. value stocks. Oil prices were sharply higher as positive trade talks persisted and supply cuts were announced.

Jobs growth numbers announced on Friday were blowout figures, with 312,000 jobs added, compared to estimates of 180,000. Jerome Powell, Chair of the U.S. Federal Reserve (Fed), continued his stance on remaining patient given muted inflation readings.

Apple cut its revenue forecast due to slower growth and trade tensions – more on this in the third section below.

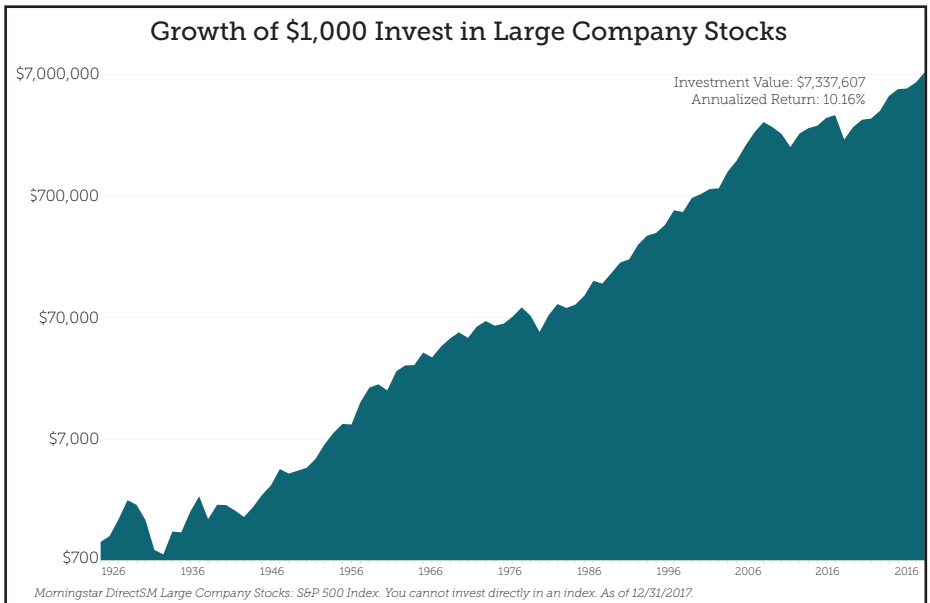
Global Diversification Makes a Comeback

It's a well-known human bias that we feel the pain of a loss about twice as much as the pleasure of a gain. If you don't believe me, ask yourself whether you have been taking more fretful calls lately? Have you been anxious looking at your 401(k) or other equity accounts?

When markets move higher for nine straight years, few investors worry about owning bonds, risk management, or diversification. But during drawdowns (yes, they happen, and no, they don't last very long compared to bull markets), we depend on diversification to help us stay the course and achieve our long-term goals.

The table below shows broad ETF returns for last quarter, last month, 2018, and 2017.

- **2017:** Why even own bonds?
2018: Different story.
- **2018:** Why own stocks from the other side of the globe?
December 2018: Different story.
- Investors should always hold an investment that is not working. That is how you know you are diversified.



- The key to sticking with a globally diversified, balanced portfolio is to accept that you aren't going to get the best asset class returns, but you won't get the worst either. And that's fine – that's successful investing.
- If your goal is to pick hot stocks, time the market, and invest in glamour companies, you can do that. But if you want to be financially responsible, it is best to do that with just 5% or so of your investments, and call it your 'mad money' account.
- The accounts that CLS manages are designed for long-term goals.

To help with tough conversations you may be having with investors, I encourage financial advisors to review the [CLS Reference Guide](#). There are some great insights in there. Some of my favorites that speak to long-term investing can be found on these pages: 12, 15, 26, 27, 28, 30, and 31.

The chart above (from [CLS's Reasons Not To Invest](#)) can be titled with a saying I borrowed: "Shut Up and Wait." It's all you need to see. The stock market can build wealth over time. This is what we believe in.

The stock market truly is like a roller coaster, full of ups and downs. But, like a roller coaster, the only way to hurt yourself is to jump off.

		Q4 2018	Dec-18	2018	2017
Domestic Stocks	U.S. Total Stock Market	-14.24	-9.28	-5.13	21.16
	U.S. Growth Stocks	-16.29	-8.61	-3.32	27.80
	U.S. Value Stocks	-10.91	-9.32	-5.39	17.12
	S&P 500	-13.49	-8.98	-4.45	21.69
	U.S. Small-Cap Stocks	-20.21	-11.88	-11.02	14.66
International Stocks	International Total Stock Market	-11.50	-4.51	-14.09	27.04
	International Developed Stocks	-13.03	-5.04	-14.20	26.42
	International Emerging Market Stocks	-7.34	-2.47	-14.69	36.78
	International Emerging Market Value Stocks	-5.79	-2.62	-8.13	25.70
Fixed Income	Core U.S. Bonds	1.62	1.82	-0.05	3.53
	High Yield U.S. Bonds	-4.34	-2.21	-1.93	6.09
	U.S. Treasury Bonds	2.56	2.16	0.74	2.19
	Cash	0.53	0.18	1.70	0.69
Diversifiers	Commodities	-9.41	-6.89	-11.25	1.70
	Actively Managed Commodities	-9.10	-3.16	-12.99	2.85
	U.S. Real Estate	-5.94	-7.70	-4.29	9.37

Source: Morningstar Direct

Investor Activity in 2018: How Did Investors Behave?

2018 was a tough year for investors and starkly different from 2017. If you came into the year expecting another 2017, you were in for a rude awakening. But several statistics show that 2018 was the 'normal' year, while 2017 was the outlier. We agree with this. One of our favorite financial authors, Ben Carlson, recently wrote about the differences between the two years. I encourage you to check it out [here](#).

To highlight a few differences:

- In 2017, the worst quarterly return was +3.1%.
- In 2018, the worst quarterly return was -13.5%.
- In 2017, it was almost impossible to lose money in the stock market.
- In 2018, it was very difficult to make money in the stock market.

	2017	2018
Positive	91%	19%
Negative	9%	81%
# of Asset Classes	103	103

Out of more than 100 investable asset classes tracked by CLS, 91% were positive in 2017. In 2018, more than 81% were negative. Quite the reversal indeed.

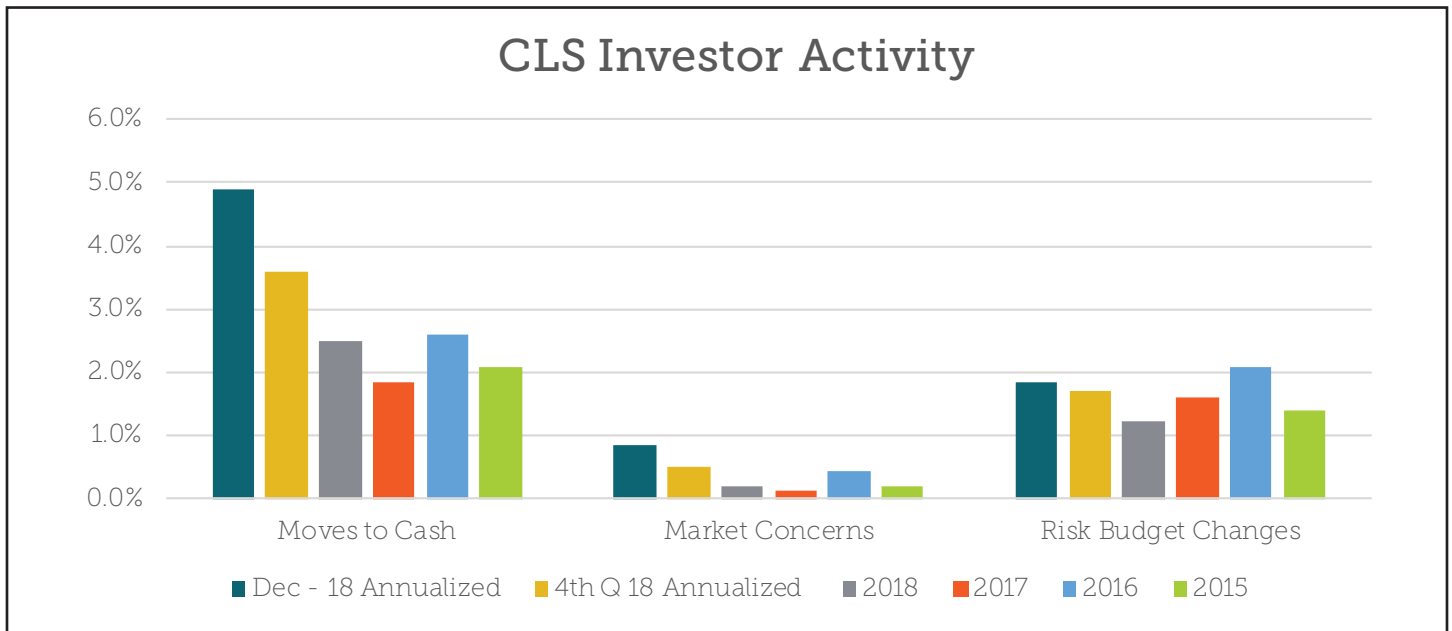
So, how did investors behave during this reversal in regimes? CLS ran stats to examine requests received from investors to move to cash and to change their Risk Budget scores. Within the move-to-cash requests, we segmented out the ones specifically due to 'market concerns.'

In the chart below, we show this same movement for 2015, 2016, 2017, fourth quarter 2018 annualized, and December 2018 annualized. The data is shown as a percentage of total accounts.

Some interesting findings:

- 2018 had more requests to move to cash than 2017 but fewer than 2016.
- 2016 had more Risk Budget changes than all other years.
- December 2018 and the fourth quarter of 2018 saw a material increase in requests to move to cash due to market concerns.

All in all, most investors are still behaving well. If 95% or more of clients are not taking action and staying the course with their long-term philosophies, that is a great thing. This a true testament to the value-add that financial advisors can provide for their clients during times of stress.



Some Thoughts on Apple and Trade

Some of the biggest news for the week came when Apple, formerly the largest company by market-cap in the world, [announced a cut to guidance](#) and an expectation for lower revenues in 2019. The company cited an unforeseen slowdown in China as well as trade tensions.

Now, to be sure, CLS does not manage money by picking individual stocks. We don't have a specific buy/hold/sell signal or 'price target' on the stock, but we do see certain actions as potential big-picture indicators for the future. As of November 30, 2018, Apple was the largest company stock in our global index, but as of December 31, it relinquished that spot to Microsoft. Apple is our second largest 'underweight' with our current value tilt.

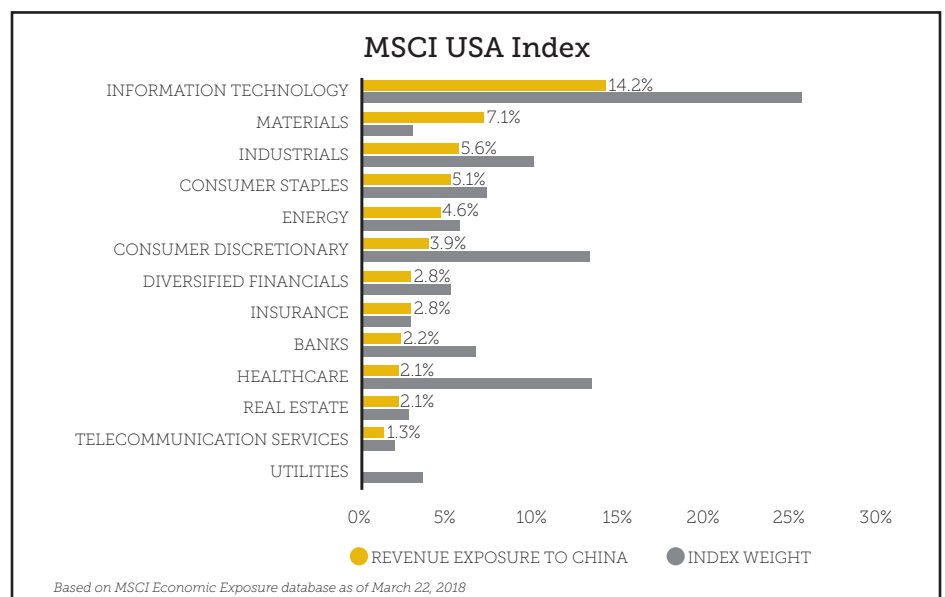
This got me thinking about a research study and blog we read earlier in 2018 from the global index provider Morgan Stanley Capital International (MSCI). The [study](#) addressed the winners and losers of the trade war between the world's two largest economic powers. It was published in mid-April, right around the time when rhetoric was picking up, tariffs were being placed on goods, and global markets were decoupling.

The blog noted that a trade war could be a lose-lose situation, and U.S. companies are more exposed to China than the other way around (see accompanying charts). It appears that we may be seeing more impacts now. This week, economic advisor to President Trump, Kevin Hassett, predicted "a heck of a lot of U.S. companies will join Apple in announcing lower-

than-expected earnings because of the trade war."

We've not been alone in saying that trade wars benefit no one. They could increase the cost of goods to consumers (inflationary) and also slow down the world economy (deflationary). It also appears that companies may feel the impact of trade tensions on their earnings. As CLS President and Chief Investment

Officer Rusty Vanneman [wrote last week](#), the president uses the stock market as a validator of his policies and actions. So, we may see more market-friendly actions in the future. This could spur both sides to come to a deal on trade. If this happens, we expect overseas assets to rally back to where they were at the start of 2017 relative to domestic markets. Time will tell.





Case Eichenberger, CIMA Senior Client Portfolio Manager

Case Eichenberger co-manages CLS's American Funds strategies and the CLS Shelter Fund, works closely with CLS's separate account strategies (Master Manager), and communicates with advisors and their clients both remotely and in-person.

Since joining CLS in 2007, Mr. Eichenberger has held various roles, including Relationship Representative and Internal Wholesaler. In 2015, he accepted the role of Client Portfolio Manager and was promoted to Senior Client Portfolio Manager in 2018.

Mr. Eichenberger received his Bachelor of Science degree in Business Administration from Midland University. He holds the FINRA Series 6, 63, and 65 licenses and Certified Investment Management Analyst (CIMA®) designation. During the accreditation process, he attended the Wharton School of Business at the University of Pennsylvania.

Mr. Eichenberger is a member of Greater Omaha Young Professionals and a volunteer for Habitat for Humanity.

Did you know? [Case comes from a long line of educators.](#)

The Morningstar Global Market Large-Mid Index is an index that measures the performance of the global market's equity markets targeting the top 90% of stocks by market capitalization. The Morningstar U.S. Market Index is an index that measures the performance of U.S. securities and targets 97% market capitalization coverage of the investable universe. It is a diversified broad market index. The Morningstar U.S. Large Cap Index is an index that measures the performance of U.S. large-cap stocks. These stocks represent the largest 70% capitalization of the investable universe. The Morningstar U.S. Small Cap Index is an index that measures the performance of U.S. small-cap stocks. These stocks fall between the 90th and 97th percentile in market capitalization of the investable universe. In aggregate, the Small Cap Index represents 7% of the investable universe. Morningstar Global ex U.S. Large-Mid Index is an index that measures the performance of Global Markets (ex-U.S.) equity markets targeting the top 90% of stocks by market capitalization. The Morningstar DM ex U.S. Large-Mid Index is an index that measures the performance of developed markets ex-U.S. equity markets targeting the top 90% of stocks by market capitalization. The Morningstar EM Large-Mid Index is an index that measures the performance of emerging markets targeting the top 90% of stocks by market capitalization. The Morningstar U.S. Core Bond Index is an index that measures the performance of fixed-rate, investment-grade USD-dominated securities with maturities greater than one year. It is market-capitalization weighted. The Morningstar Cash Index is an index that measures the performance of a Treasury Bill with six to eight weeks until maturity in the U.S. market. The Morningstar Global Long-Only Commodity Index is an index is fully collateralized commodity futures index that is long all in equitable commodities. This index provides investors with a means of understanding the performance of commodity futures markets and serves as a benchmark for investment performance of commodities as an asset class. The Morningstar Diversified Alternatives Index is an index that provides diversified exposure to alternative asset classes in the ProShares ETF lineup.

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