

# CLS's WEEKLY 3

What You Need To Know About the Markets

MARCH 6, 2019



1. The stock market is off to its best yearly start in nearly three decades, and odds suggest more gains
2. Just published: "2019 Credit Suisse Global Investment Returns Yearbook," providing valuable historical context for long-term investors
3. CLS Monthly Perspectives is a key resource that outlines what the CLS Portfolio Management Team is thinking

## Market Performance (as of 2/28/2019)

Fixed Income	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	FEBRUARY
Cash Equivalent <sup>1</sup>	+0.38%	+0.68%	+1.11%	+2.02%	+0.38%	+0.38%	+0.18%
U.S. Investment Grade Bonds <sup>2</sup>	+3.71%	+2.32%	+1.69%	+3.17%	+1.00%	+1.00%	-0.06%
Equities	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	FEBRUARY
Global Equity Market <sup>3</sup>	+12.96%	+6.32%	+12.88%	-0.82%	+10.76%	+10.76%	+2.66%
Total U.S. Market <sup>4</sup>	+16.85%	+10.29%	+15.54%	+5.08%	+12.34%	+12.34%	+3.49%
Domestic Large-Cap Equity <sup>5</sup>	+16.34%	+10.88%	+15.60%	+4.64%	+10.91%	+10.91%	+3.09%
Domestic Small-Cap Equity <sup>6</sup>	+17.65%	+7.31%	+15.21%	+5.74%	+17.33%	+17.33%	+4.59%
International Equity <sup>7</sup>	+9.99%	+2.73%	+10.76%	-6.18%	+9.54%	+9.54%	+1.91%
Developed International Equity <sup>8</sup>	+9.76%	+2.16%	+9.54%	-5.49%	+9.85%	+9.85%	+2.47%
Emerging Market Equity <sup>9</sup>	+11.10%	+4.71%	+15.21%	-8.33%	+8.63%	+8.63%	+0.25%
Diversifiers	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	FEBRUARY
Diversified Alternatives <sup>10</sup>	+4.97%	+0.65%	+1.91%	+0.70%	+2.66%	+2.66%	+0.47%
Commodity <sup>11</sup>	-2.19%	-8.81%	+3.57%	-5.67%	+6.51%	+6.51%	+1.01%

<sup>1</sup>Morningstar Cash Index <sup>2</sup>Bloomberg Barclays Capital U.S. Aggregate Bond Index <sup>3</sup>Morningstar GblMkt Large-Mid Index <sup>4</sup>Morningstar U.S. Market Index <sup>5</sup>Morningstar U.S. Large Cap Index <sup>6</sup>Morningstar U.S. Small Cap Index <sup>7</sup>Morningstar Gbl xU.S. Large-Mid Index <sup>8</sup>Morningstar DM xUS Large-Mid Index <sup>9</sup>Morningstar EM Large-Mid Index <sup>10</sup>Morningstar Diversd Alt Index <sup>11</sup>Bloomberg Commodity Index

## February Market and Portfolio Review

The S&P 500 Index just completed its best two-month start to the year since 1991, and the Dow Jones Industrial is off to its best start since 1987.

A combination of reasons can be cited for the gains, including improved U.S.-China trade discussions, an apparently more market-friendly Federal Reserve (Fed), and an economy that is doing better than many expected a few months ago. It also helps that the market is rebounding from the sharp losses it incurred late last year.

The overall global stock market ended February up nearly 3%. It is now up nearly 11% for the year. The U.S. stock market gained more than 3% and is now up more than 12% for the year. Smaller companies gained more than 4% (up 17% year-to-date), and

larger companies gained less than 3% (up nearly 11% year-to-date).

International equity markets were up just shy of 2% in February and are now up nearly 10% this year. Emerging markets were the clear laggards, despite a strong month from China, marking a small gain and ending just above 0% for the month; emerging markets are up nearly 9% for the year. Developed international markets, meanwhile, increased more than 2% and are up nearly 10% for the year.

The bond market had a small loss for the month, but it is up 1% for the year. The 10-year U.S. Treasury yield ended February at 2.73%. The three-month U.S. Treasury yield ended the month at 2.45%.

Real assets also had gains last month. Commodities gained over 1% and are

up more than 6% for the year, while global real estate investment trusts (REITs) ended just over 0% for the month but are still up more than 10% for the year.

In general, CLS portfolios performed well in absolute terms in February, and they have performed well so far this year. With all major asset classes starting off the year with healthily positive returns, globally diversified, multi-asset portfolios are participating in those gains. However, despite a strong January, February's relative returns compared to benchmarks lagged notably due to the underperformance of emerging markets. Our preference for value over growth stocks also detracted from performance.

## Best Start in Three Decades

In the last week of February, I was fortunate to be featured on live television with both Fox Business ([Making Money with Charles Payne](#)) and Yahoo Finance TV ([Midday Movers](#)). For both interviews, I was asked where the market goes from here, especially after such a strong start to the year.

My answer: It depends on the time frame. (The real answer is that nobody really knows, although we do have informed and reasonable estimates.) Over the long term, say, 10 or more years, we're bullish on the economy and markets. It's tough to fight the economy and the market's incredibly powerful tendency to move higher over time.

For this year's remaining outlook, we are also feeling positive. In years past, when the market had a strong start to the year, additional gains were usually realized over the remaining ten months. We entered the year bullish and continue to be so for a variety of reasons, including the anticipated bounce back from last year's weak fourth quarter, the fact that the third year of the presidential cycle is usually quite strong for the markets, indications of a more market-

friendly Fed, and a recession nowhere in near-term sight.

Despite those positives, the question now is how much of this year's potential has already been realized given the strength of the year's start. Double-digit returns early in the year are not typical. The average return for the stock market is generally considered to be 8-10% per year, and those numbers have already been realized! Thus, it would be reasonable for the market to pause to refresh or even take a step back before its next two steps forward. As investors, it would be prudent to expect the market to cool its torrid pace. On that point, it's prudent to always expect short-term losses, even though the historical odds strongly suggest otherwise.

Given the year's strong start, should investors draw back or dive in? My simple answer is: do nothing. If your portfolio has been appropriately constructed, it is already designed with your goals and risk tolerance in mind and should be able to weather the zigs and zags of the marketplace. To increase exposure to stocks now is, essentially, chasing performance, and that is the second most common reason investors lose out on returns over

time. (For the number one reason, read next month's commentary!)

Counseling against chasing performance is a significant part of what we do at CLS. It not only guides the way we build portfolios, it's often our top message. I believe the role of our investment team is not simply manufacturing a rate of return, although that is certainly important. Our role is larger than that. Ultimately, our calling is to help advisors and investors reach their goals by having a positive investment experience. Therefore, it's up to us to do more than just manage portfolios. We need to provide counsel. We do this through the commentary we write, the podcasts and videos we produce, the presentations we give, and the daily phone calls and emails we exchange with advisors and investors. In some ways, we are like a restaurant. We're not just providing a good meal; we're providing an experience – one that people trust and want to come back to. Of course, unlike some restaurants, we're trying to serve healthy food to our customers, so we're sneaking in a lot of broccoli while still making it look attractive and taste good!

## History Lessons to Remember

It's around this time of year that my colleagues and I race to be the first to forward the annual [Credit Suisse Global Investment Returns Yearbook](#) to each other. This annual publication is a fantastic resource. Not only does it make a fine study to keep on your desk or coffee table (actually, the Yearbook updates "[Triumph of The Optimists](#)," which is THE coffee table book in my opinion), its history lessons are ones that all investors should remember. It reminds us how markets have worked over time and how they will likely continue to work. As my high school history teacher often said: "In history, we learn that we don't learn." But these are lessons we hopefully will learn and remember.

The first lesson is that over time, stocks return more than bonds, and bonds return more than cash. Decisively more. Not every year, of course (last year is an example), but over time, these relationships hold true. For long-term investors, that's important to always keep in mind.

Here were some of my big takeaways from this year's

*Credit Suisse Global Investment Returns Yearbook*:

- Since 1900, the "equity risk premium" (the amount stocks return over cash) has averaged about 3-4% per year. This means that the stock market tends to double the return from cash every 20 years, and that makes a big difference in what investors can eventually fund with their investments.
- The "maturity premium" (the amount long-term government bonds return over cash) has been more than 1% per year. It should be noted that long-term government bonds are far more volatile than cash, but for long-term investment portfolios, long-term government bonds are generally still desirable compared to cash because they (1) may return more over time, even during rising-interest-rate environments and (2) diversify equity risk better and therefore provide more ballast for long-term, balanced portfolios.
- Investing in emerging markets isn't just about

enhancing returns. There is also material portfolio risk reduction (lower volatility) when an investor diversifies into emerging markets. This year's report spends quite a bit of time on emerging markets, especially China.

- Emerging markets, including "frontier markets," which are emerging markets at their earliest stages, account for nearly 70% of the world's population, nearly 60% of the world's economy on an inflation-adjusted basis, but only 12% of the world's stock market! This is despite the fact that since 1950 emerging markets have had an annualized return of 11.7%, while developed markets returned 10.5%.
- Currency-hedging for long-term investors "will at best reduce risk by a small margin and, at worst, may prove counterproductive." Relative inflation rates (commonly referred to as "purchasing power parity") matter greatly in regards to currency exchange rates.

One of the most important and popular communications produced by the CLS Portfolio Management team is CLS Monthly Perspectives, which is an example of advisor-driven messaging.

This communication was built over the years based on feedback from advisors, investors, and our own sales team. This monthly communication effectively illustrates how CLS builds portfolios and our current thinking and actions regarding the economy, markets, and portfolios. One of the keys to ensuring positive investor experiences is minimizing surprises in investment behavior, and this regular communication is very effective at accomplishing that goal.

Each month, the Portfolio Management team meets to review all the data for this report. Often internally deemed “the most fun meeting of the month,” this is where each member of the team goes through her or his outlook on the markets and various sectors. This meeting creates plenty of “creative tension” as we actively seek out the contrarian or changing opinions on the team and discuss our reasoning.

We truly seek and honor opposing views, and we even give out a monthly award (the “Maverick Award”) to the person on the team with the most contrarian and/or changing views. (We also give out the “Wimp Award” for the person who has the least contrarian and/or changing views.) We also monitor who has most accurately forecasted the stock and bonds

markets over the last 12 months, awarding the best forecaster the “Wizard Award” and noting the worst with the “Economist Award.”

The monthly table of contents:

- **Risk Budgeting Methodology**
  - This proprietary methodology is CLS’s unique method of building multi-asset, balanced portfolios.
- **CLS Investment Themes**
  - These are the ideas that CLS emphasizes across all CLS strategies.
- **U.S. Markets Outlook**
  - This is CLS’s 12-month outlook for the bond and equity markets.
- **Investment Continuums**
  - These represent how we’re allocating to different areas of the market.
- **Continuums Commentary**
  - This provides an explanation of our positioning in different areas of the market.
- **Equity Sector Outlook**
  - This shows the valuation and performance of each equity sector and CLS’s positioning and rationale of each sector.
- **Fixed-Income Outlook**
  - This shows the valuation and performance of each fixed-income sector and

CLS’s positioning and rationale of each sector.

- **Alternatives Outlook**
  - This shows the valuation and performance of each alternatives sector and CLS’s positioning and rationale of each sector.
- **CLS’s Top Reasons Markets Could Rise or Fall**
  - This is where the CLS portfolio management team reviews its top concerns and reasons the markets could move higher or lower.
- **New Content from CLS**
  - This lists our latest podcast, blogs, articles, videos, and more.
- **CLS Investment Team**
  - Contact information.

This piece is still evolving. If you see areas that need enhancement or clarification, or something that should be added or deleted, please let me know.

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### Thank You

As always, a sincere thank you for reading. If you have any questions or feedback, please let me know.

Stay balanced.

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**Rusty Vanneman, CFA, CMT**  
**President, Chief Investment Officer**

Rusty Vanneman is responsible for leading CLS's Portfolio Management Team and overseeing all investment operations at CLS, including investment philosophy, process, positioning, and performance. Mr. Vanneman is also responsible for internal and external communications regarding market environment and current investment strategies. He is part of the management team for several of CLS's proprietary mutual funds. In 2018, Mr. Vanneman took on the role of President of CLS, in addition to his position as CIO.

Mr. Vanneman joined CLS in September 2012 as Chief Investment Officer. Previously, he served as Chief Investment Officer and Portfolio Manager at Kobren Insight Management (KIM) in the greater Boston area. His 11-year tenure at KIM included a 5-year span during which the firm was owned by E\*TRADE Financial and he served as the Senior Market Strategist for E\*TRADE Capital. Prior to working at KIM, he was a Senior Analyst at Fidelity Management and Research (FMR Co) in Boston. He was also a Managing Analyst at Thomson Financial.

Mr. Vanneman received a Bachelor of Science degree in Management from Babson College where he graduated with high distinction. He has held the Chartered Financial Analyst (CFA) designation since 1994, and is a member of the CFA Institute. He has also been a Chartered Market Technician (CMT) since 1999, and is a member of the Market Technician's Association (MTA). In addition, Mr. Vanneman authored the book "Higher Calling: A Guide to Helping Investors Achieve Their Goals." He was named one of the Top 10 Portfolio Managers to Watch by Money Management Executive in 2017.

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 Barclay's Capital U.S. Aggregate Bond® Index measures the performance of the total United States investment-grade bond market. 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 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. 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 volatility of the indexes may be materially different from the individual performance attained by a specific investor. In addition, portfolio holdings of investors may differ significantly from the securities that comprise the indexes. You cannot invest directly in an index.

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CLS Investments, LLC ("CLS") Chief Investment Officer, Rusty Vanneman, CFA, CMT, was selected as a "Top 10 Fund Managers to Watch" in 2017 by Money Management Executive. Money Management Executive is an unbiased, third-party publication covering the asset management industry. Money Management Executive chose the list of managers to watch by screening Morningstar data from funds with a single manager, ranked as having the best three-year annualized returns in their respective categories. The list of managers was published March 27, 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.