CLS's WEEKLY 3

What You Need To Know About the Markets

MAY 14, 2019

1. There are always reasons NOT to invest in the stock market. But it's important to ignore the noise and focus on long-term success.
2. Find out how we're taking advantage of direct indexing to offer a new solution for tax-conscious investors.
3. We believe equal weighting can enhance returns and manage risk, and single-country ETFs may be a valuable tool for making equal weighting work.

Market Performance (as of 5/10/2019)

Fixed Income	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	LAST WEEK
Cash Equivalent[1]	+0.42%	+0.78%	+1.26%	+2.19%	+0.87%	+0.28%	+0.05%
U.S. Investment Grade Bonds[2]	+3.73%	+2.56%	+1.90%	+5.71%	+3.22%	+0.27%	+0.31%
Equities	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**LAST WEEK**
Global Equity Market[3]	+10.27%	+6.47%	+10.67%	+0.71%	+12.93%	+0.74%	-2.52%
Total U.S. Market[4]	+14.45%	+10.95%	+13.74%	+7.51%	+16.31%	+1.94%	-2.12%
Domestic Large-Cap Equity[5]	+14.24%	+11.44%	+14.17%	+8.39%	+15.40%	+1.96%	-2.12%
Domestic Small-Cap Equity[6]	+14.02%	+8.20%	+11.58%	+0.51%	+17.74%	+1.94%	-2.65%
International Equity[7]	+6.97%	+2.40%	+7.94%	-6.12%	+9.61%	-0.54%	-3.01%
Developed International Equity[8]	+7.04%	+2.09%	+7.05%	-5.86%	+10.47%	+0.00%	-2.55%
Emerging Market Equity[9]	+6.79%	+3.48%	+11.23%	-6.83%	+7.09%	-2.13%	-4.36%
Diversifiers	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**LAST WEEK**
Diversified Alternatives[10]	+3.88%	+0.48%	+1.61%	+0.35%	+3.36%	+0.39%	-0.26%
Commodity[11]	-3.76%	-9.58%	-0.59%	-11.15%	+3.43%	-2.72%	-1.43%

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

Week in Review

Global stock markets dipped last week, as all major indexes that we track were negative. The sole bright spot, as is typically the case when stocks turn sour, was bonds. A basket of broad bonds was up about 0.25%. Emerging market stocks and U.S. small-caps led the way downward for stocks. It was a risk-off week for sure, with an average of more than 2% lost on stocks.

For the year, markets are still very much positive, with global stocks up close to 13%, bonds up more than 3%, and commodities and diversified alternatives also up more than 3%. Next week, we'll parse through the final corporate earnings reports and keep an eye on retail sales and industrial production.

What caused the selling last week, as is typical, can be attributed to more than one event. But the main narrative was tariffs.

Tariffs and Reasons Not to Invest

The big news that moved markets last week was nothing regarding the global economy or corporate earnings, but rather a tweet. The tweet sent Sunday, May 5, by President Trump noted that the U.S. increased tariffs on China to 25% on more than $200 billion worth of goods and added that those tariffs would be expanded "shortly." The tweet caught market participants off guard. Many expected some sort of trade resolution as the two global economic superpowers met in Washington to continue negotiations.

CLS does not pretend to be able to forecast where the trade battle will go from here or when it will end, but we take solace in knowing that we have strived to properly diversify portfolios for our investors.

Quite simply, the market has bad days, bad weeks, and sometimes bad years (2018). It is a feature of investing, not a flaw. The market must go down in the short term intermittently to go up in the long term consistently. During times when we get caught off guard, I like to look at the history of the market and see if similarly surprising events have occurred in the past. Almost all of the time, they have.

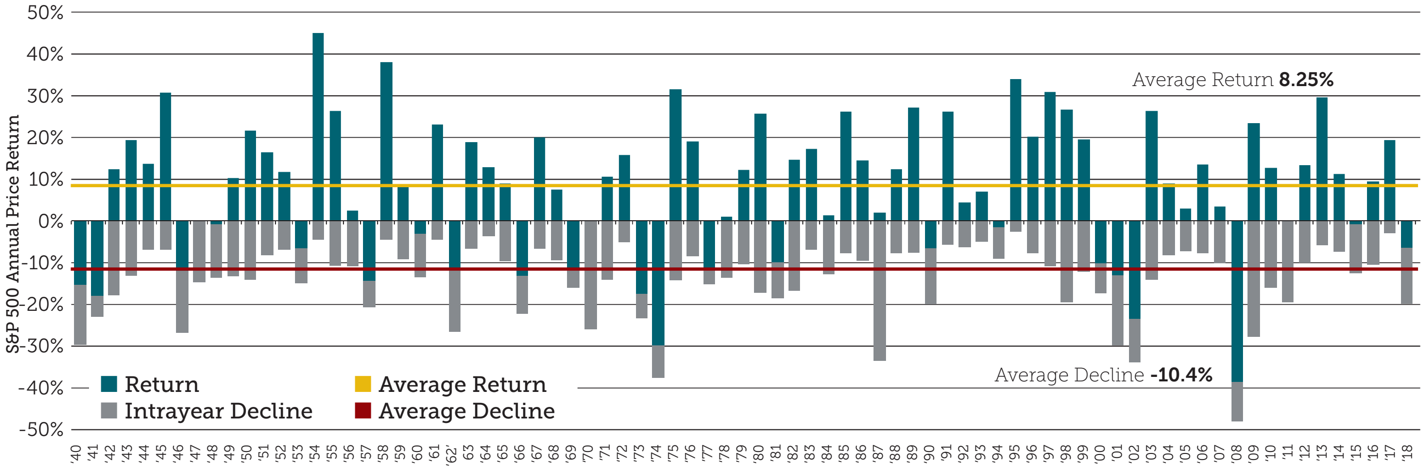
Reasons Why People Did Not Invest in the Stock Market

1998: President Clinton Impeached
1999: Y2K Scare
2000: Technology Bubble Burst
2001: Terrorist Attacks on America
2002 Corporate Accounting Scandals
2003: War in Iraq
2004: Tsunami in Asia
2005: Oil Prices Increase
2006: Interest Rates Rise
2007: Sub-Prime Mortgage Crisis
2008: Worst Market Conditions Since the 1930s
2009: General Motors Declares Bankruptcy
2010: PIIGS Crisis in Europe
2011: European Debt Crisis
2012: Financial Woes in Greece
2013: Federal Reserve Begins to Taper
2014: Oil Prices Collapse
2015: China Slowdown
2016: Brexit
2017: High Stock Valuations
2018: Trade tensions between U.S. and China

Take the chart below, from the CLS Reference Guide. The average intra-year decline is about 10%. We know this to be true; yet, the news headlines make declines seem scarier than they really are and may force weak hands to make short-term trades of their long-term capital.

There is always a reason not to invest in the stock market. See above, the chart of top market scares that we add to every year. Loss-averse investors often get scared out of the market, but the true value of prudent advice is

S&P 500 Annual Return, with Market Low During Year



Source: Morningstar Direct 12/31/2018. Returns are based on price index only and do not include dividends. Grey bars represent intra-year drops which refers to the largest market drops from a peak to a trough during the year. Returns are calendar year returns from 1940 to 2018.

educating investors properly and setting appropriate expectations.

Like Benjamin Graham said, in the short term, the stock market is a voting machine (determined by the behavior of investors); in the long run, it is a weighing machine (driven by fundamental growth in corporate earnings). If we didn't have short-term swings, there would be no premium allotted to patient investors for investing in the stock market. Stay balanced.

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.

Direct Indexing and Its Advantages for Your Clients

By Joe Smith, CFA, Deputy Chief Investment Officer

Direct indexing can be viewed as another way for advisors to harness the power of indexing but with their clients' unique circumstances in mind. This approach allows for the implementation of a separately managed account (SMA) that looks and behaves like a broadly diversified index but with a greater amount of flexibility than an ETF. Direct indexing can help advisors customize portfolios to address their clients' tax concerns and their ESG (environment, social, and governance) considerations. Direct indexing isn't necessarily new, but its availability has been limited, until now.

We recently launched our own direct-indexing offering, available on the FTJ FundChoice platform. It is intended to harness three key advantages that work well for advisors and their clients.

1. **Active Tax Management**: Direct indexing may possibly create enhanced tax efficiency through the active management of a client's taxes via tax-loss harvesting, matching capital gains with off-setting losses, avoiding wash sales (selling and buying back an asset within a short amount of time), and deferring capital gains for the long term. All of these steps may create a better after-tax experience for clients.

2. **Individualized Risk Management**: Direct indexing can be delivered to target a broad index strategy without requiring investors to own every security within the index. This can create opportunities to properly identify and target a specific amount of diversification around concentrated legacy holdings while matching the returns of the broader index over time.

3. **Personalized Investment Screening**: Direct indexing allows advisors to personalize a client's portfolio in order to screen out or include various industry, sector, or social views they believe are important to their investment success. These views, such as ESG criteria, are becoming an additional way for investors to identify sustainable investments.

Tune into our upcoming webinar on May 15, 2019, for more information on how this innovative approach to indexing can help deliver more individualized investment outcomes to your clients.

Joe Smith, CFA

Deputy Chief Investment Officer

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.

Not every management firm in the U.S. believes in risk management, let alone subsists on it day-to-day like we do. We often talk about what "risk" means. Sometimes it's volatility (the ups and downs); sometimes it's what prevents you from realizing your financial goals; other times it's the complete loss – or near loss – of your investment.

Bridgewater Associates, LP, released a [paper](#) on global diversification recently, and a few charts and tables caught my eye.

The data on pages four and five of the Bridgewater paper are intriguing to CLS as a global wealth manager. It charts equity performance across countries decade-by-decade since the 1900s and shows that not one country, including the U.S., consistently outperforms. Put the market-cap weighting of the easily investable globe on hold for a second, and consider the risk-management effect of an equal-country weight. I know, I know. Most U.S. investors cannot handle 40% of their stocks in foreign equities, so how could they handle this? Well, we believe it might be worth prodding them to do so.

We believe equal-weighting may enhance returns and, more importantly, manage risk. I think I know what you may say next: The data is interesting, but it's not relevant because it was not easy to invest in small, single markets during the last century.

You're right. But now we can. Markets are becoming more connected; technology allows that. Technology also allows us to access these markets cost-efficiently via ETFs.

CLS research analyst Michael Hadden and I reviewed the ETF landscape, including the funds that were live before 2000, to see if we could replicate the findings for the 2000s and 2010s.

Our results look similar. Today, we can invest in close to 50 single-country ETFs. We believe using more of these ETFs going forward will improve the chance that equal-weighting will deliver

Country	Ticker	2000s Cumulative Total Return
Mexico	EWW	228.9
Australia	EWA	206.3
Austria	EWO	177.8
Canada	EWC	137.1
Malaysia	EWM	126.3
Spain	EWP	118.4
Singapore	EWS	71.0
Equal Weight	N/A	67.0
Switzerland	EWL	51.7
Hong Kong	EWH	45.4
Sweden	EWD	19.1
France	EWQ	18.1
Italy	EWI	13.3
Germany	EWG	13.2
Belgium	EWK	12.4
United Kingdom	EWU	6.4
Netherlands	EWN	4.2
USA	SPY	-9.7
Japan	EWJ	-34.8

Source: Morningstar Direct

Country	Ticker	2010s Cumulative Total Return
USA	SPY	168.7
Hong Kong	EWH	88.4
Switzerland	EWL	72.4
Belgium	EWK	64.5
Sweden	EWD	63.2
Netherlands	EWN	55.3
Japan	EWJ	52.2
Equal Weight	N/A	41.0
Germany	EWG	35.7
Singapore	EWS	34.0
Malaysia	EWM	31.5
France	EWQ	29.6
United Kingdom	EWU	29.0
Australia	EWA	28.1
Austria	EWO	14.7
Canada	EWC	9.9
Mexico	EWW	-2.8
Spain	EWP	-15.6
Italy	EWI	-20.5

Source: Morningstar Direct

strong returns and manage risk. Note that a lot of firms do this already inside the S&P 500 Index by equal-weighting the stocks.

The table below, pulled from CLS's Why International: The Case for International Investing white paper, helps illustrate this, too. We believe the stronger or higher the return dispersion, the better equal-weighting works.

Other ways CLS looks to build resilient portfolios is to include high-quality bonds that are typically inversely correlated with stocks, commodities that have different return streams, and factors such as low-volatility stocks.

All of these tools are available to use, and we will continue to use them as long as we are prudently managing more than 40,000 unique investors.

Chart 11: Performance Dispersion Among Categories of Investments

Category	Return Dispersion	Correlation
Style	1.17%	0.99
Size	1.81%	0.99
Factor	3.58%	0.95
Sector	9.93%	0.87
Country	43.98%	0.82

Souce: Morningstar Direct, as of 12/31/2017.

Notes: Return dispersion is highest 10-year annualized return minus the lowest. Correlation is average 10-year correlation versus the ACWI ex U.S. Index.

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 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 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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