CLS's

WEEKLY 3

What You Need to Know About the Markets

JUNE 11, 2019

CLS INVESTMENTS

1 **Gaining exposure to corn amid a difficult planting season**

2 **Direct indexing could bring imminent change to the ETF industry**

3 **Reasons the Federal Reserve may or may not cut rates**

Week in Review

The equity markets rebounded strongly last week with the S&P 500 Index advancing more than 4%, the best weekly gain in six months. Several factors contributed to the move higher, including increasing expectations of a rate cut, the U.S.-Mexico tariff resolution, and improved valuations.

On a sector level, materials led all sectors, while consumer staples, industrials, technology, and real estate investment trusts (REITs) were not far behind. The communication services sector was a notable laggard. Within domestic equities, value bested growth, and large-cap stocks shined, besting their small-cap counterparts.

International markets showed signs of strength, with developed markets leading the way. European stocks performed well. France, Italy, Spain, and Sweden were particularly strong.

The fixed income markets continued to rally. Bond yields declined to the lowest levels in two years. Market expectations are now pricing in two to three rate cuts in 2019. Rising downside risks and softer inflation data have led to the shift in sentiment. Whether or not this is a realistic expectation is hotly debated by economists and our own Investment Team.

Despite their strong start in 2019, commodities are now lagging once again. Natural gas and metals remain key areas of weakness, while oil remained flat for the week.

Shana Sissel, CAIA

Portfolio Manager

Shana Sissel joined the CLS Portfolio Management Team in 2018. She is primarily focused on CLS's high net worth clients and solutions, including a variety of focused equity strategies and customized tax managed direct index optimization portfolios. Ms. Sissel contributes additional expertise on alternative asset solutions and portfolio construction.

Ms. Sissel has nearly two decades of industry experience at leading investment firms, primarily in Boston and Chicago. Most recently, she was a Client Portfolio Manager at Ariel Investments where she represented Ariel's Domestic Research Team. Ms. Sissel also brings a vast background in market research and analysis through various roles held at Fidelity Investments' Strategic Advisor Inc., Mercer Investments, Peak Financial Management, and Russell Investments.

Ms. Sissel earned a Bachelor of Science Degree in Sport Management from the University of Massachusetts at Amherst before receiving her Master of Business Administration Degree from Bentley University's McCallum School of Business. She also holds the FINRA Series 65 and the Chartered Alternative Investment Analyst (CAIA®) designation.

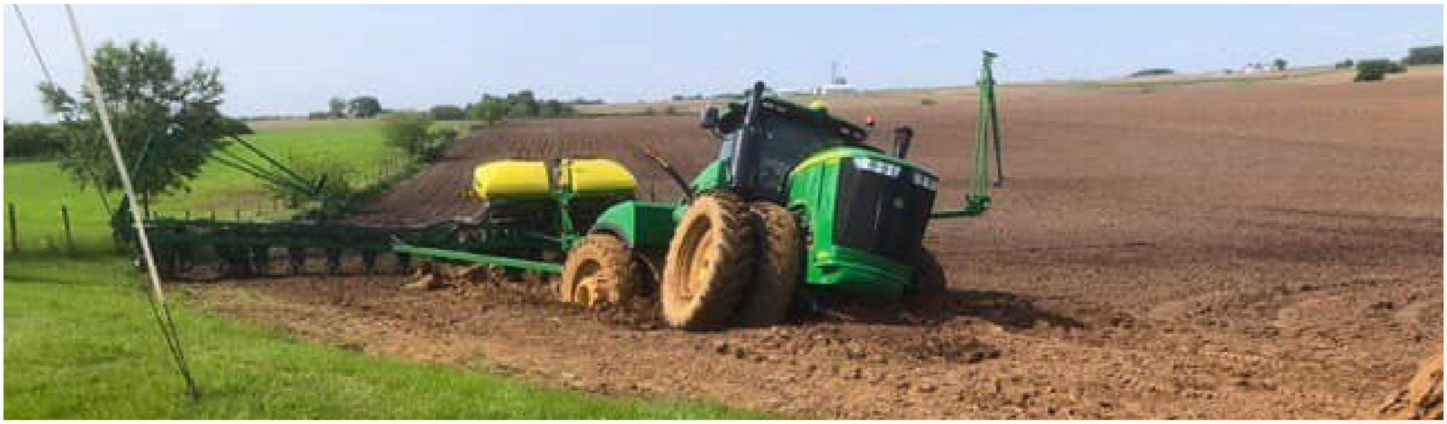
As a frequent media contributor, Ms. Sissel has appeared on CNBC and other regional news outlets. She has also been quoted extensively in the Wall Street Journal, Smart Money, and Investment News.

Market Performance *(as of 6/7/2019)*

Fixed Income	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	LAST WEEK
Cash Equivalent[1]	+0.44%	+0.82%	+1.32%	+2.25%	+1.06%	+0.47%	+0.05%
U.S. Investment Grade Bonds[2]	+4.00%	+2.88%	+2.40%	+7.37%	+5.17%	+2.17%	+0.36%
Equities	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**LAST WEEK**
Global Equity Market[3]	+9.82%	+5.77%	+9.81%	+0.04%	+13.00%	+0.81%	+3.59%
Total U.S. Market[4]	+14.23%	+9.99%	+12.92%	+4.97%	+15.98%	+1.65%	+4.39%
Domestic Large-Cap Equity[5]	+14.04%	+10.56%	+13.60%	+6.05%	+15.27%	+1.84%	+4.38%
Domestic Small-Cap Equity[6]	+13.36%	+6.50%	+8.97%	-5.76%	+14.43%	-0.93%	+3.82%
International Equity[7]	+6.34%	+1.89%	+6.89%	-5.34%	+9.95%	-0.23%	+2.63%
Developed International Equity[8]	+6.57%	+1.76%	+6.29%	-4.47%	+11.50%	+0.93%	+3.15%
Emerging Market Equity[9]	+5.62%	+2.33%	+9.20%	-7.87%	+5.40%	-3.67%	+1.08%
Diversifiers	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**LAST WEEK**
Diversified Alternatives[10]	+3.71%	+0.26%	+0.99%	-0.09%	+3.19%	+0.23%	+0.56%
Commodity[11]	-4.41%	-9.63%	-3.05%	-12.34%	+1.63%	-4.42%	-0.67%

[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.

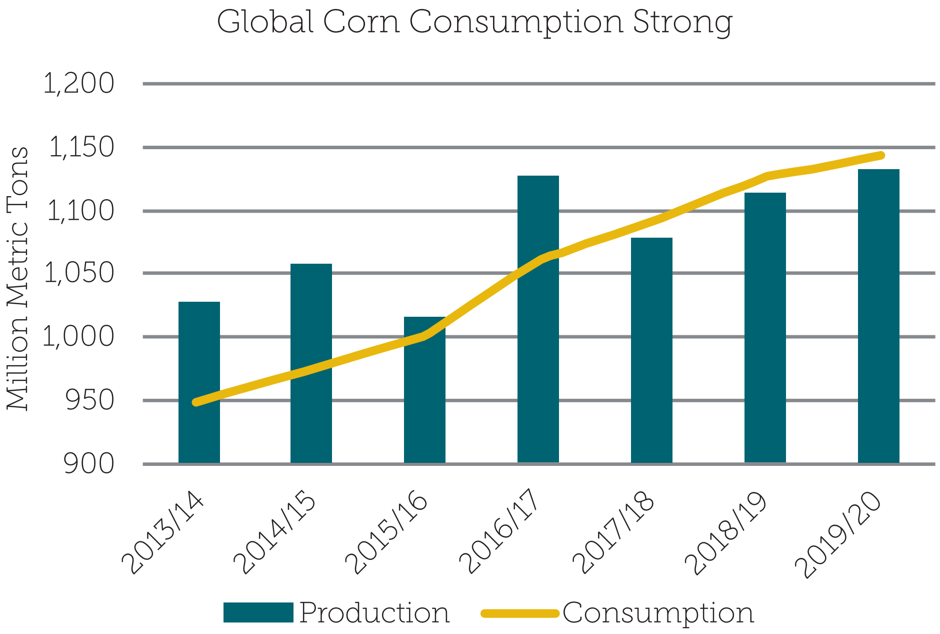
1 Corn: More Than Just a Tasty Summer Snack



When most investors think about investing in commodities, they think oil, natural gas, and gold. Fewer investors consider agricultural commodities, such as sugar, soy beans, and corn. Most of us think of corn as a tasty summer snack to add to the menu at cookouts. But when we discuss agricultural commodities, we aren't talking about sweet corn – we're talking about field corn, an important product in many different areas of our life. Corn is used in gasoline as ethanol, in our sugary snacks as corn syrup, and in the feed of most livestock we consume. The demand for corn has grown significantly as a result of its various uses. Unfortunately, production has been unable to keep up.

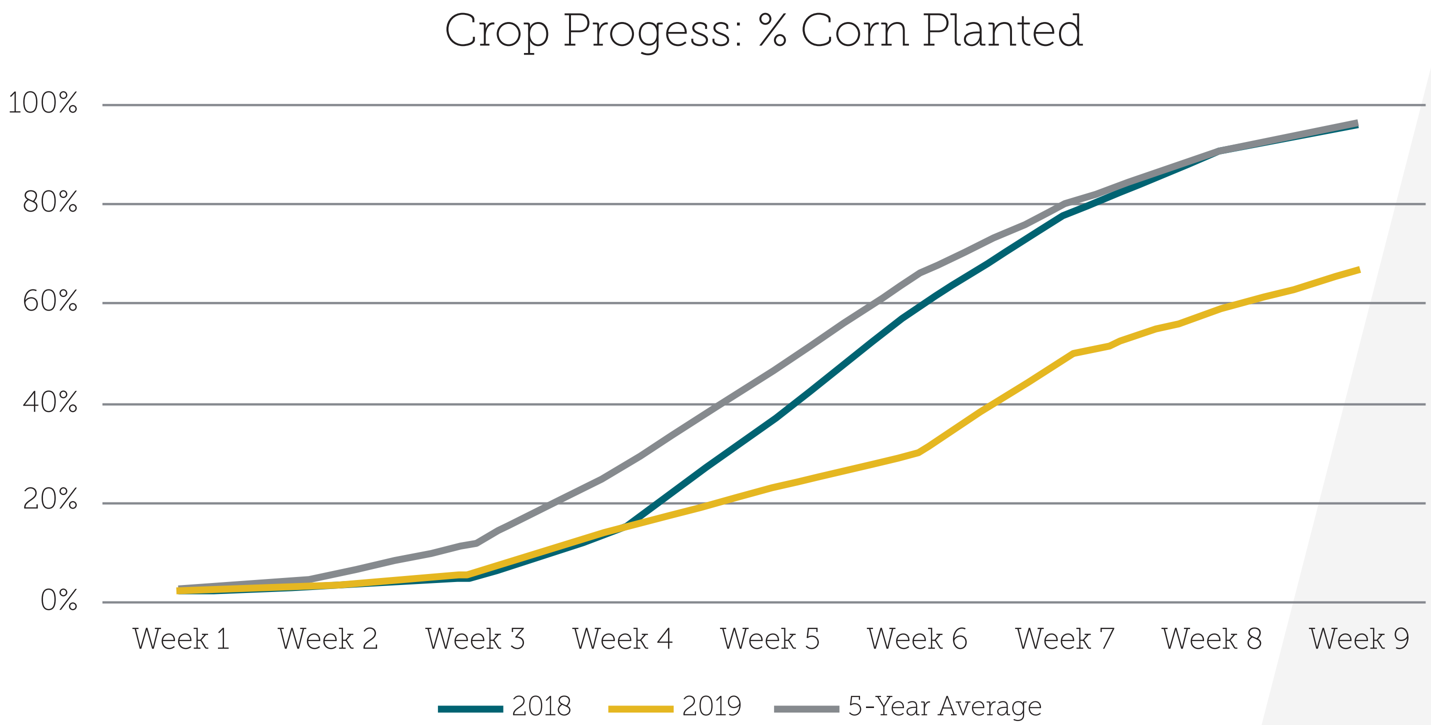
Here in the Midwest, corn is big business. You can't drive through many of the Midwestern states without encountering miles and miles of corn fields. Unless, of course, you were making that drive today. The Midwest's historically wet spring has seriously impacted U.S. corn production. Wet fields have resulted in an extremely difficult planting season in the Corn Belt. As planting season comes to a close, only about 68% of the corn has been planted, as illustrated in the chart on the following page. This is uncharted territory and we believe it will likely lead to much higher corn prices in the coming months.

Clearly, this could be a potential crisis for corn in 2019, but we view it as a tremendous investment opportunity. We believe a potential corn shortage in an environment of rising demand means the price of corn must rise to bring the demand curve to equilibrium. In the past, the only way an investor could invest in an opportunity such as this was through the corn futures markets. But opening a futures account is hard and not accessible for the average investor. Understanding how to actually trade futures is even harder. Thankfully, there are other ways to



Source: United States Department of Agriculture. Grain: World Markets and Trade Report May 2019.

Corn: More Than Just a Tasty Summer Snack (Cont.)



Data Source: United States Department of Agriculture Weekly Crop Progress Reports through June 2, 2019.

gain exposure to corn. We've used the opportunity to add an allocation to the Teucrium Corn Fund (CORN) in some portfolios.

Here at CLS, we advocate having an allocation to alternative asset classes as part of a global, balanced portfolio. We believe exposure to real assets like corn can provide risk diversification and an opportunity to enhance portfolio returns, too.

2 Direct Disruption

Change is coming to the ETF marketplace. ETFs once seemed unstoppable as industry trends evolved from closed-end products to mutual funds to ETFs. But the evolution isn't over yet. Now, while the industry continues to rake in an impressive $1 billion each day, some ETF players have become complacent, and their products are ripe for disruption.

Given their low costs (zero-fee ETFs hit the market in February) and tax-efficiency, ETFs may appear to be the perfect investment vehicles for investors. But they still have vulnerabilities. Namely: ETFs are not tax-maximized. In other words, trade activity isn't always done in the best interest of tax-sensitive investors.

Enter direct indexing! Matt Hougan, CEO of Inside ETFs, calls it the "Great Unwrapping" – a solution for investors who are looking for their own personal index within a certain band of tolerance, using a customized approach to maximize tax-efficiency.

The Advantages of Direct Indexing

So, what makes direct indexing a strong option for constructing portfolios? We believe there are three main advantages to implementing direct indexing:

1. Tax-Efficiency: ETFs are tax-efficient, but direct indexes may even be more tax efficient. Tax-loss harvesting, gain deferrals, and transition management are all benefits offered by direct indexes that are not available through a typical one-size-fits-all ETF.

2. Risk Customization: Unlike traditional ETFs, direct indexes may offer investors a better fit for their risk tolerance. We believe that direct indexes can manage around concentrated stock positions, avoid making outsized sector bets, and generally better control the risk associated with the portfolio by setting parameters to meet a specific investor's needs.

3. ESG/Social Criteria Customization: As with any rules-based approach, direct-indexed portfolios may meet client-specific desires to avoid certain industries or to seek out companies that meet a preferred ESG (environmental, social, governance) framework.

Direct indexing isn't new. Firms such as Wealthfront, Privé, Optimal Asset Management, Parametric, and Aperio have been doing it for years. With almost $100 billion in direct-indexed assets, if Parametric were an ETF issuer it would be the sixth largest and fourth fastest growing. But improvements in technology have made it possible for new entrants that offer direct-indexed solutions at lower minimums and lower fees than the legacy firms.

Using Direct Indexing

As this disruptive technology shakes up the industry, it is essential to stay ahead of the curve. In January 2019, Orion Advisor Services launched its proprietary optimization solution, ASTRO. This technology has changed the game for financial advisors who want to harness the power of direct indexing in their portfolios.

The initial launch of ASTRO gave advisors access to the software tool that helps them create an in-house, direct-index solution for their clients. The advantage was obvious; advisors could now offer high-net-worth clients an institutional-quality service without having to pay a big investment firm to do it for them. However, it soon became clear there remained a strong desire by many advisors to outsource the solution if the fee was reasonable enough. Recently, CLS launched a suite of Tax Managed Direct Index SMA Beta strategies available exclusively on the FTJ FundChoice platform. Utilizing Orion's ASTRO technology, CLS has created five new models, each of which replicates a different broad-market index to create tax-efficiencies. The models represent a separate portfolio for each client, not a commingled vehicle. These models are designed for clients seeking tax-efficient rebalancing and direct ownership of securities. With an initial minimum account size of just $50,000 and a fee of 25 basis points, these portfolios provide advisors an option unavailable through the established competitors.

At CLS, we empower financial advisors to help their investors succeed. Using a high-tech portfolio customization tool, these five tax-managed portfolios will utilize direct indexing to deliver what we believe will be a better after-tax experience for investors and empower advisors to stay ahead of the direct-indexing curve. The ETF industry brought innovation and transparency to our industry, and it enabled advisors to better serve investors. We believe as the next evolution, direct indexing will only make us better.

Stay tuned to find out more about the next phase of direct-indexing solutions CLS will be launching in the coming months.

3 Predicting the Fed

The hottest topic of debate within the CLS Portfolio Management Team right now is whether the U.S. Federal Reserve (Fed) will cut rates before the end of the year. Market prognosticators have offered strong opinions on the topic, too. Anyone who caught my recent interview on the TD Ameritrade Network knows where I stand on this issue.

Since there is a compelling argument to be made both for and against a Fed rate cut, let's review the key points on both sides.

Reasons the Fed *Will* Cut Rates:

1. The U.S. economy is weaker than it seems. Despite strong GDP data in the first quarter, economic growth appears to have weakened significantly in recent months. Currently, the forecast for GDP growth in the second quarter is only 1.3%, well below the 3.2% we saw in the first quarter. Economic indicators of job growth, retail sales, and business investment have been disappointing.

2. Inflation remains stubbornly low. In recent years, the Fed has been laser-focused on "price stability," maintaining a 2% inflation target to meet that goal. However, despite strong economic growth over the past few years, inflation has barely budged. A rate cut would be a means to stimulate inflation, especially wage growth, which has been one of the most stubborn inputs to the inflation calculation.

3. Political and market pressures for a rate cut are growing. While the Fed is supposed to be an independent entity, solely responsible for enacting monetary policy to achieve and maintain stable prices and maximum employment, the fact is that it is influenced by outside sources. For example, late last year, the Fed appeared to succumb to political pressures by choosing not to raise rates in an environment that clearly supported a rate hike. The recent market sell-off only fuels investor fears that a recession is just around the corner. The Fed has made decisions in the past to pacify equity investors, and there is no reason to believe it wouldn't do so again.

Reasons the Fed *Won't* Cut Rates:

1. Inflation is within target, and unemployment remains low. If the purpose of the Fed is to maintain stable prices and maximum employment, it has succeeded. Today, inflation is low and stable, and the economy remains at full employment. Yes, inflation is below the 2% target, but not by much, and it has remained structurally stable. Employment markets remain strong with the unemployment rate hovering near 4%, so there is no data to support the Fed taking stimulative action.

2. The Fed's ability to influence inflation through the federal funds rate has waned. The world has changed, and globalization has made inflation far less sensitive to Fed policy. As noted by Marketwatch columnist Rex Nutting, "globalization has created new sources of supply, independent of domestic interest rates. Technological advances have lowered the prices of many goods and services. Many digital services have no medium-term supply restraints. Workers have less bargaining power than before. Excess money in the economy is as likely to push asset prices higher as it is to drive up consumer prices."

3. The Fed has explicitly said it does not expect to cut rates. The Fed noted in its recently released FOMC minutes that it intends to take a patient approach and that current rates "would likely remain appropriate for some time, especially in an environment of moderate economic growth and muted inflation pressures, even if global economic and financial conditions continued to improve." Unless something drastically changes between now and January 2020, it would be hard for the Fed to change course on current policy.

Based on all the information available today, I find it difficult to envision the Fed cutting rates this year. But, as always, this is subject to change as new information becomes available. In the meantime, the debate will continue. As it turns out, predicting the Fed is not as easy as it seems.

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.

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.

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