CLS's

WEEKLY 3

What You Need to Know About the Markets

AUGUST 27, 2019

1 How news from the President and Federal Reserve is affecting the markets

2 Long-term investors need to take a different perspective on market volatility

3 Amid the ongoing trade tensions, we're seeing interesting developments in closed-end funds

Week in Review

U.S. stocks were down for the fourth consecutive week on heightened global concerns. On a positive note, international stocks were higher on the week.

Federal Reserve Chairman Jerome Powell spoke last week, leaving the door open for more rate cuts. In spite of the equity volatility, bonds were little changed on the week.

Fixed Income	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	LAST WEEK
Cash Equivalent[1]	+0.48%	+0.91%	+1.45%	+2.29%	+1.51%	+0.31%	+0.03%
U.S. Investment Grade Bonds[2]	+3.98%	+3.38%	+3.00%	+9.78%	+8.87%	+2.60%	+0.08%
Equities	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**LAST WEEK**
Global Equity Market[3]	+8.64%	+5.31%	+8.07%	-1.09%	+11.51%	-3.95%	-0.44%
Total U.S. Market[4]	+13.09%	+9.35%	+11.18%	+0.80%	+15.22%	-3.08%	-1.43%
Domestic Large-Cap Equity[5]	+13.02%	+9.96%	+12.02%	+2.13%	+14.96%	-2.64%	-1.41%
Domestic Small-Cap Equity[6]	+11.80%	+5.85%	+6.18%	-11.33%	+11.19%	-5.81%	-1.87%
International Equity[7]	+5.07%	+1.55%	+5.03%	-3.53%	+7.61%	-5.08%	+0.72%
Developed International Equity[8]	+5.25%	+1.75%	+5.06%	-3.40%	+9.31%	-4.42%	-0.83%
Emerging Market Equity[9]	+4.57%	+0.83%	+5.11%	-3.59%	+2.66%	-7.05%	+0.37%
Diversifiers	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**LAST WEEK**
Diversified Alternatives[10]	+3.20%	+0.15%	+1.18%	-0.50%	+3.33%	-0.46%	-0.01%
Commodity[11]	-4.54%	-8.64%	-2.56%	-6.33%	+0.65%	-4.20%	-0.88%

[1]Morningstar Cash Index [2]Barclays Capital U.S. Aggregate Bond Index [3]Morningstar Global Market 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 Global ex-U.S. Large-Mid Index [8]Morningstar DM ex-US Large-Mid Index [9]Morningstar EM Large-Mid Index [10]Morningstar Diversd Alt Index [11]Bloomberg Commodity Index. Data as of 8/23/2019.

1 The Fed and Trump (What Else?)

The annual central bank summit in Jackson Hole, Wyoming, last week generated lots of discussion and speculation about the slowing global economy. The Chair of the U.S. Federal Reserve (Fed) left the door open for another rate cut when the committee meets next week. He acknowledged again the risks to global and U.S. growth from trade uncertainty, but he also highlighted the envious position we are currently in. He suggested that the data has been good and, in his perspective, inflation is gradually increasing toward the stated goal of 2%.

The inverted yield curve (when long-term rates are below short-term rates) continues to cast a shadow on stocks amid fears that it's signaling an imminent recession. At CLS, we're careful not to dismiss this warning because the yield curve has a solid track record; however, it is not infallible.

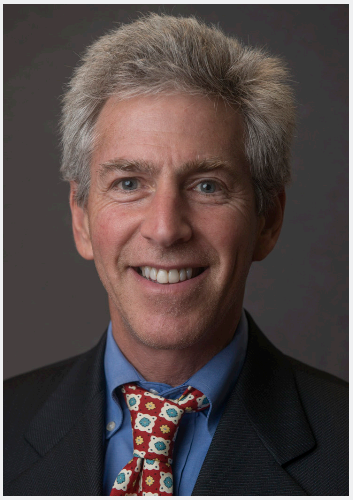
As we have seen for weeks and months now, nothing has moved the markets like a tweet from Trump or a retaliatory response from China. In the latest episode of escalation in trade tensions, China announced that it will impose tariffs ranging from 5% to 10% on $75 billion worth of U.S. goods in two batches, effective September 1 and December 15, including a 25% tariff on U.S. cars.

News changes quickly, and by the time you read this many of the threats may either be reversed or escalated.

There's no question that the impact can be felt on your investments, and we know this can be nerve-wracking. But that is why you hired CLS to navigate through these volatile times.

We try to rule out (and suggest you do, too) most of this as noise and focus on the fundamentals when making investment decisions.

Staying balanced, diversified and invested has worked over many years, and we believe it will continue to do so.



Marc Pfeffer
Chief Investment Strategist

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 an avid poker player.

2 Tweets, Tariffs and Great Expectations of Perfect Intel

By Aleck Liu, Investment Research Analyst

On Friday, seemingly out of the blue, the Chinese government announced additional tariffs, and the Trump administration responded by increasing the rate of current and future tariffs in a tit-for-tat exchange. This resulted in a broad equity market sell-off. However, Monday morning saw conciliatory responses from President Trump at the G-7 conference, leading to a broad rally across Asia and U.S. equities. There seems to be little-to-no lag time between policy shifts and market reaction, something I've been hesitant to embrace as the new norm.

At CLS, it is part of our investment philosophy to explore and understand the rationale behind behavioral biases.

One likely culprit of broad equity sell-offs and recoveries could simply be the manifestation of "bandwagoning," or even an itchy trigger finger twitching at the opportunity to make trades. After all, the market is the collective groupthink of many participants, and when the Dow Jones Industrial Index plummets 800 points (still barely 3% on the index), it creates a sudden and hard-to-resist urge to act. We understand that, which is why we heavily emphasize the importance of long-term planning and trusting the data over time to build wealth. But I'm willing to wager that behavioral biases don't capture 100% of the price movement behind news like this.

The grander theory I have is that investors are now expecting more perfect information – especially from notable and scrutinized pundits and leaders who can move markets every time they speak publicly – and acting upon that information in a systematic fashion. Usually, this power is reserved for single-stock names (think Elon Musk and Tesla), but more recently (circa 2017) it has expanded to the broad market. Watching the market gyrate after every Fed meeting first tuned me in to this phenomenon where investors price in every piece of information they possibly can at every opportunity they get. The market has come to expect that things must play out according to policymakers' actions and extrapolate further into the future than is realistically possible.

To circle back to the trade war and the tweets that jerk the markets around, this is just a new sign of the times as information gets released in a more frequent and aggressive fashion. President Trump has the power to affect the markets with a push of a button, and he often takes to Twitter to accomplish that. Approaching the why and how we invest really helps put this into perspective. For example, when I invest, I buy a share of a company that makes me a part owner. I'm only focusing on a specific aspect of this to keep my reasoning simple. What I get in return for investing is a portion of the company's earnings (EPS). I think it's tough to make a large call on the effects of a company's bottom line using tweets, and that in turn makes it tough for me to make a call on the price I pay for a company (P/E ratio).

I also think that tackling this phenomenon from the point of view of a longer-term investor makes sense, and to do that, I think about the realistic implication of both policy and volatility. If the market suddenly drops 10% then recovers just as suddenly, the movement doesn't have a material impact on my long-term goals. If the tariff policy is tweeted or scheduled to go into effect and then negotiated away, this doesn't affect the bottom-line of businesses.

The reality is that information isn't perfect, and it's not helpful to use information in flux, such as tweets and proposed policies, to make investing decisions.

I think investors responding to constantly shifting information has added more volatility and risk to the market and created more confusion and stress behind the relatively boring task of setting long-term goals and riding out the market's crests and waves.

[Here's a great resource to track the "Tariff Man."]

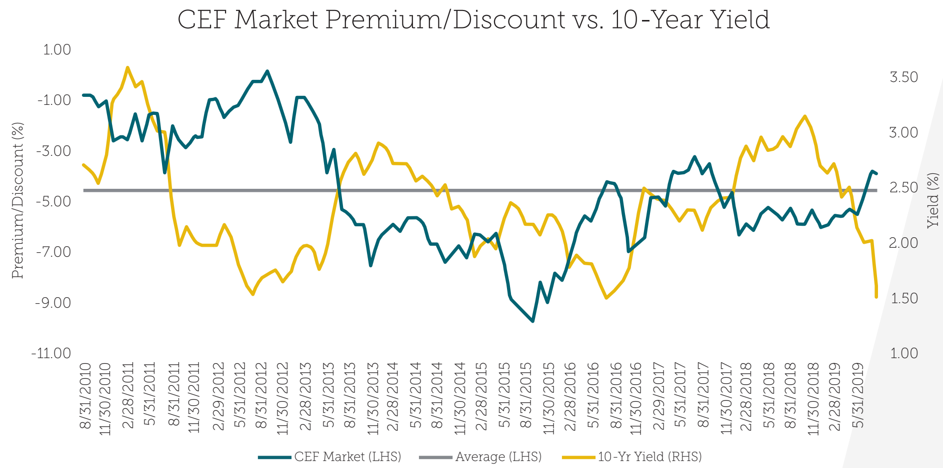
3 Closed-End Fund Market Update

By Jackson Lee, CFA, Quantitative Portfolio Manager

The yield on the 10-year Treasury bond took another nose dive Friday as the trade war escalated. As of Friday, the 10-year yield is hovering right above its historical low, at 1.52%. While many media outlets have focused on the price impact of the low yield on equity and bond markets, something interesting has been happening in a less-popular space: closed-end funds (CEFs). For the first time in two years, the CEF market is trading at a lesser discount relative the historical average.

For those who have heard of, or are using, our Active Income X (AIX) strategy, you are probably aware of the pivotal role CEFs play in the strategy. In an environment where the Treasury is yielding near-historical lows and traditional asset classes, such as stocks and investment-grade bonds, are yielding slightly above 2%, CLS must look elsewhere to achieve the stated target yields, which range from 5% to 8%. This is where CEFs provide value to portfolios as they can generate an income higher than their typical ETF counterparts. This is because these funds can use leverage or borrowings to gain a higher exposure to the market than they would otherwise. The goal of using leverage is to generate an income that's greater than the borrowing cost. In addition, they typically trade at a discount relative to net asset values (NAVs), which is perhaps the biggest benefit of using CEFs.

Like ETFs, CEFs are traded intra-day on an exchange. The main difference, however, is that a CEF has a fixed



Sources: Bloomberg and Morningstar Direct. Data as of 8/23/2019.

number of shares, hence the limited supply. When the demand for the fund exceeds the supply, it will trade at a premium. The reverse is true, too. When the supply exceeds demand, it trades at a discount. Going back to August 2010, the CEF market, as a less-popular vehicle, has traded at a discount of 5% on average.

The mismatch in supply and demand is just one of the many factors that contribute to the premium/discount, and it is important to understand why a fund is trading at a given level. Here are some examples of the factors CLS evaluates as part of the due diligence process.

- Brand recognition. While CLS believes there are benefits to paying a premium for active managers' specialties, we do not want to overpay.
- Distribution policy. All else being equal, a sudden reduction in distribution tends to have a negative impact on the fund or cause a widening in the discount because investors might lose faith in the fund's ability to fulfil their future distribution.
- The premium/discount. The premium/discount of the CEF market exhibits an inverse relation vs. the 10-year yield as the chart above shows. As the 10-year yield started to plummet beginning in the fourth quarter of 2018, the spread between the price and the NAV of the CEF market started to tighten. Now, investors perceive the outlook of CEFs to be more positive as borrowing costs are cheaper.

As a large user of this unpopular investment vehicle in the AIX strategy, we are monitoring this space closely. The benefits of the research done in this area have a spillover effect across CLS as they have made their way into other portfolios, particularly since the CEF market began to look extremely attractive in late 2015. While the current premium/discount of the CEF market is slightly above the historical average, we believe it is still trading within a reasonable range. We will continue to monitor this space and capitalize on it as opportunities arise.

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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