CLS's

WEEKLY 3

What You Need to Know About the Markets

SEPTEMBER 10, 2019

1 **For long-term investors, there's no wrong time to enter the markets**

2 **Do economic stimulus measures really help, or do they simply create a Placebo effect?**

3 **Whether you're watching football or investing, it's important to have realistic expectations**

Week in Review

For the second consecutive week, global equity markets had solid gains. The Labor Day shortened week saw global markets rise just shy of 2%. Positivity in the markets continued on the back of optimism around the U.S.-China trade dispute. The S&P 500 index is now within 2% of all-time highs set back in July.

In the U.S., value stocks led the way, outperforming growth stocks by 1% last week. Small-cap stocks trailed the rest of the domestic market but still returned 1%.

It was a great week for international markets with emerging market stocks leading the way up over 2%, slightly outperforming U.S. value stocks for the best performing asset class of the week. Developed markets also had a strong week up 2%.

Commodities, liquid alternatives, and global real estate all had positive performance for the week. Commodities led the way as oil rebounded nicely following lower inventories.

Bonds had slightly negative performance as we saw rates move back up from all-time lows on the long end of the U.S. treasury curve.

Jeovany Zelaya

Client Portfolio Manager

Jeovany Zelaya is a Client Portfolio Manager at CLS Investments. He is responsible for communicating CLS's investment philosophy, process, strategies, and performance to external clients and prospects.

Michael Hadden

Investment Research Analyst

Michael Hadden is involved in all aspects of investment research, including performance reporting and Global Investment Performance Standards (GIPS) reporting.

Aleck Liu

Investment Research Analyst

As an Investment Research Analyst at CLS, Aleck Liu is responsible for investigating new investment opportunities and assisting the Portfolio Management Team.

Market Performance *(as of 9/6/2019)*

Fixed Income	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	LAST WEEK
Cash Equivalent[1]	+0.49%	+0.92%	+1.47%	+2.29%	+1.58%	+0.38%	+0.03%
U.S. Investment Grade Bonds[2]	+3.90%	+3.41%	+2.99%	+10.12%	+8.93%	+2.66%	-0.15%
Equities	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**LAST WEEK**
Global Equity Market[3]	+9.08%	+5.93%	+9.23%	+3.24%	+15.91%	-0.17%	+1.94%
Total U.S. Market[4]	+13.69%	+10.08%	+12.78%	+4.57%	+20.41%	+1.29%	+1.73%
Domestic Large-Cap Equity[5]	+13.64%	+10.75%	+13.69%	+6.03%	+20.37%	+1.94%	+1.78%
Domestic Small-Cap Equity[6]	+12.33%	+6.38%	+7.36%	-8.00%	+15.21%	-2.41%	+1.04%
International Equity[7]	+5.38%	+2.03%	+5.72%	+1.41%	+11.10%	-2.00%	+2.15%
Developed International Equity[8]	+5.57%	+2.24%	+5.77%	+1.21%	+12.73%	-1.43%	-2.08%
Emerging Market Equity[9]	+4.83%	+1.27%	+5.70%	+2.46%	+6.36%	-3.70%	+2.35%
Diversifiers	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**LAST WEEK**
Diversified Alternatives[10]	+3.26%	+0.27%	+1.30%	+0.83%	+4.59%	+0.75%	+0.44%%
Commodity[11]	-3.95%	-8.11%	-0.73%	-3.30%	+3.14%	-1.83%	+1.18%

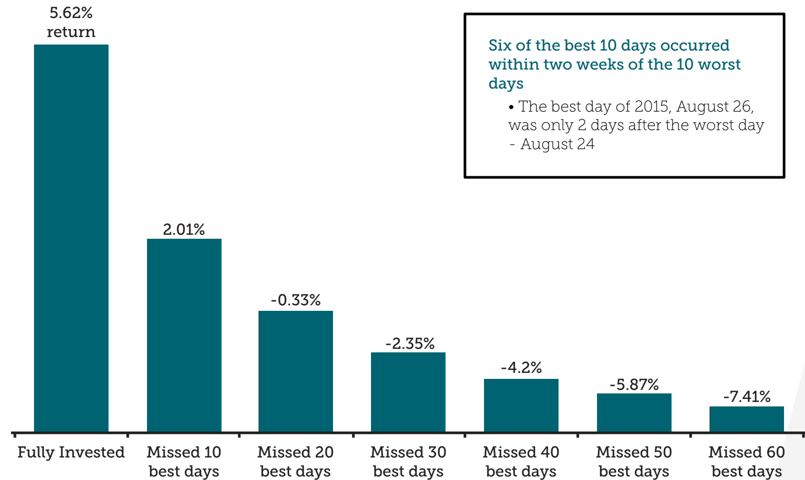
[1]Morningstar Cash Index [2]Bloomberg Barclay's Capital U.S. Aggregate Bond Index [3]Morningstar Globa Market Large-Mid Index [4]Morningstar U.S. Market Index [5]Morningstar U.S. Large Cap Index [6]Morningstar U.S. Small Cap Index [7]Morningstar Gbl xU.S. Large-Mid Index [8]Morningstar DM xUS Large-Mid Index [9]Morningstar EM Large-Mid Index [10]Morningstar Diversified Alternatives Index [11]Bloomberg Commodity Index.

1 When to Invest

By Jeovany Zelaya, Client Portfolio Manager

Returns of the S&P 500

Performance of a $10,000 investment between January 4, 1999 and December 31, 2018



Source: J.P. Morgan Asset Management analysis using data from Bloomberg. Returns are based on the S&P 500 Total Return Index, an unmanaged, capitalization-weighted index that measures the performance of 500 large capitalization domestic stocks representing all major industries. Indices do not include fees or operating expenses and are not available for actual investment. The hypothetical performance calculations are shown for illustrative purposes only and are not meant to be representative of actual results while investing over the time periods shown. The hypothetical performance calculations for the respective strategies are shown gross of fees. If fees were included, returns would be lower. Hypothetical performance returns reflect the reinvestment of all dividends. The hypothetical performance results have certain inherent limitations. Unlike an actual performance record, they do not reflect actual trading, liquidity constraints, fees, and other costs. Also, since the trades have not actually been executed, the results may have under- or overcompensated for the impact of certain market factors such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. Returns will fluctuate and an investment upon redemption may be worth more or less than its original value. Past performance is not indicative of future returns. An individual cannot invest directly in an index. Data as of December 31, 2018.

It's true that the chances of a recession have increased, the yield curve has inverted, tariff banter continues, geopolitical risks have escalated, etc.

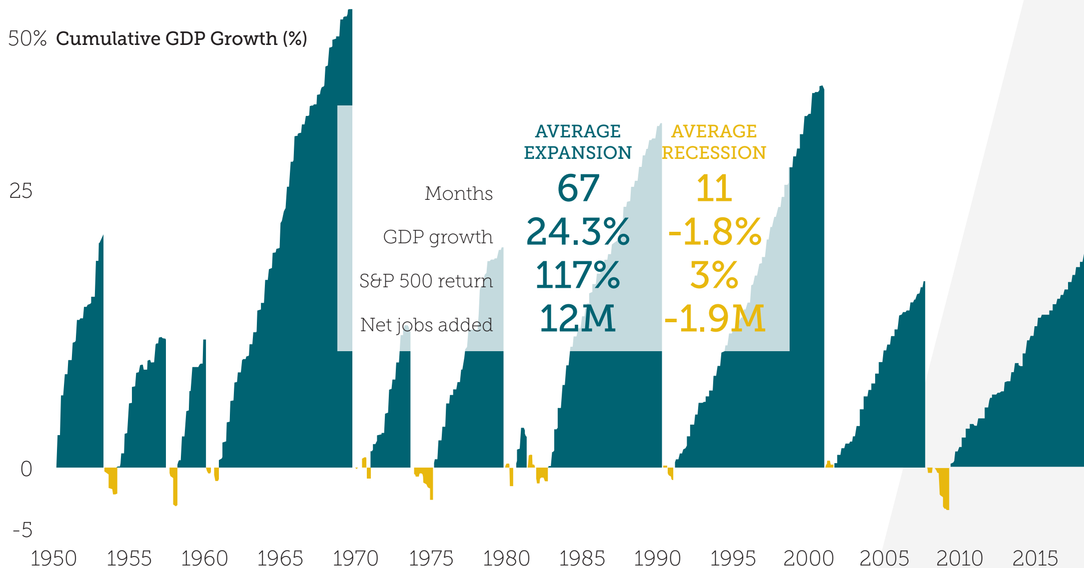
Some investors have been captivated by these headlines and, to a certain extent, paralyzed by them – caught like a deer in headlights. These investors are afraid that they'll make the mistake of investing their money just before the market crashes, so they'd rather leave it in cash until the dust settles.

However, the dust can be up in the air for a long time. Or it might settle briefly and then fly away, along with the "perfect" indicator that says it's time to get back into the market.

Recessions are notoriously difficult to predict. There have only been seven since 1965, lasting about a year on average. Expansions, on the other hand, have lasted much longer (about 67 months), and their positive effects have boosted portfolio returns far more (see chart below from Kostya Etus's recent Weekly 3).

Investors who are still thinking about staying on the sidelines (i.e., staying in cash) have to realize that they're more likely to miss the best days of the market. Those usually happen when there is above-average volatility, which is what we've been experiencing recently. The chart above, originally conceived by J.P. Morgan, shows that if you missed the best 10 days (just 10)

Recessions are Painful, but Expansions Have Been Powerful



Sources: Capital Group, National Bureau of Economic Research, Thomson Reuters. As of 9/30/18. Since NBER announces recession start and end months rather than exact dates, we have used month-end dates as a proxy for calculations of S&P 500 returns and jobs added. Nearest quarter-end values used for GDP growth rates. GDP growth shown on a logarithmic scale.

1 When to Invest (Cont.)

of the market between 1999 and 2018, your total return would have gone down by about 3.5%!

Even if investors time the market poorly, it's still better to stay invested. For example, let's say an investor invested at the worst times (i.e., market peaks) for the last 19 years. As the chart to the right, from the CLS Reference Guide, shows, their investments still would have earned them 6.58% compared to 0.99% from cash – this includes data from the dot-com and housing bubbles. Inflation would also have reduced some of their purchasing power throughout this time.

At CLS, we're optimistic about the future, and we still believe staying invested in the markets will help long-term investors reach their financial goals.

At the end of the day, the right time to invest is determined by identifying the financial goals you want to achieve with your money. Once you know this, you're one step closer to creating a portfolio that will meet your financial needs.

Growth of $1 Contribution at Each Year's Peak Price

	S&P 500	Cash
1999	$1.00	$1.00
2000	$1.78	$2.06
2001	$2.41	$3.14
2002	$2.64	$4.20
2003	$4.40	$5.24
2004	$5.88	$6.31
2005	$7.15	$7.50
2006	$9.27	$8.85
2007	$10.72	$10.28
2008	$7.39	$11.46
2009	$10.33	$12.48
2010	$12.88	$13.49
2011	$14.09	$14.50
2012	$17.33	$15.51
2013	$23.94	$16.52
2014	$28.20	$17.53
2015	$29.56	$18.53
2016	$34.09	$19.58
2017	$42.52	$20.74
2018	$41.52	$22.12
Rate of Return	6.58%	0.99%

Source: Morningstar Direct as of 12/31/2018

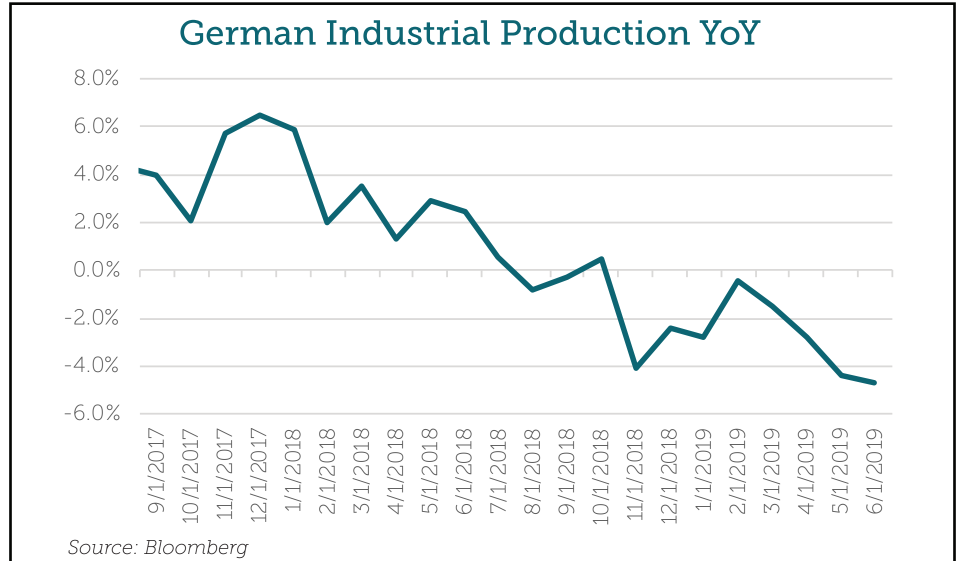
2 Stimulus Effects – Placebo or Effective Treatment?

By Aleck Liu, Investment Research Analyst

News broke Sunday that Mario Draghi of the European Central Bank was prepared to step up stimulus measures, primarily by introducing another interest-rate cut that would affect the borrowing costs of euro-denominated debt. The 10-year German bund is currently trading at a yield of 0.62%. In addition to the interest cut, the board members are debating the reactivation of bond purchasing (quantitative easing), which seems to be increasingly likely as year-end approaches. This comes on the back of progressively poor data out of the European region, highlighted by the manufacturing weakness in Germany, with industrial production and factory orders continuing to show greater weakness than expected.

In China, stimulus measures, such as tax breaks and a cut to the bank reserve requirement to 13% from 13.5%, were enacted to stave off negative effects of the ongoing trade war. China has a significant number of weapons at its disposal to hit weak spots in the economy, such as its benchmark interest rates and special municipal loans to increase the amount of cash in its economy and keep growth at the target 6% level. These tools have seen limited effects, according to Bloomberg. Tax cuts have not been able to lift business investment, and special municipal loans have not seen a large revival of infrastructure investment.

This sort of systematic easing across the second and third largest economies (China and eurozone) has put the Fed in a tough spot. On one hand, it makes the U.S. economy look relatively strong, and data from recent months seems to generally agree with that statement. On the other hand, with such a globally linked economy, any slowdowns overseas or those caused by external factors (see: trade war) will likely prompt a response from the U.S. Federal Reserve (Fed). According to Bloomberg, the markets are factoring in a nearly 96% chance of another 25-basis-point cut by the September 18 meeting in the U.S. The



Source: Bloomberg

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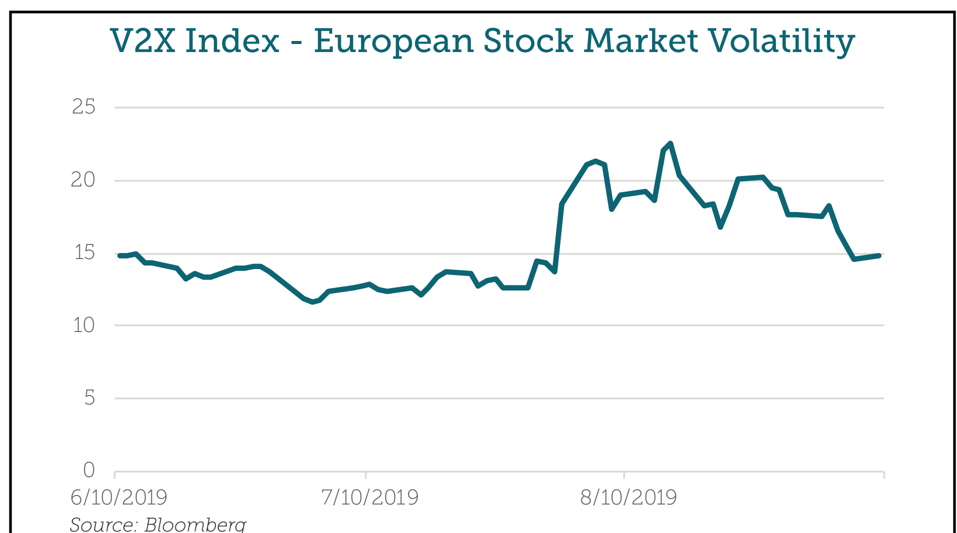
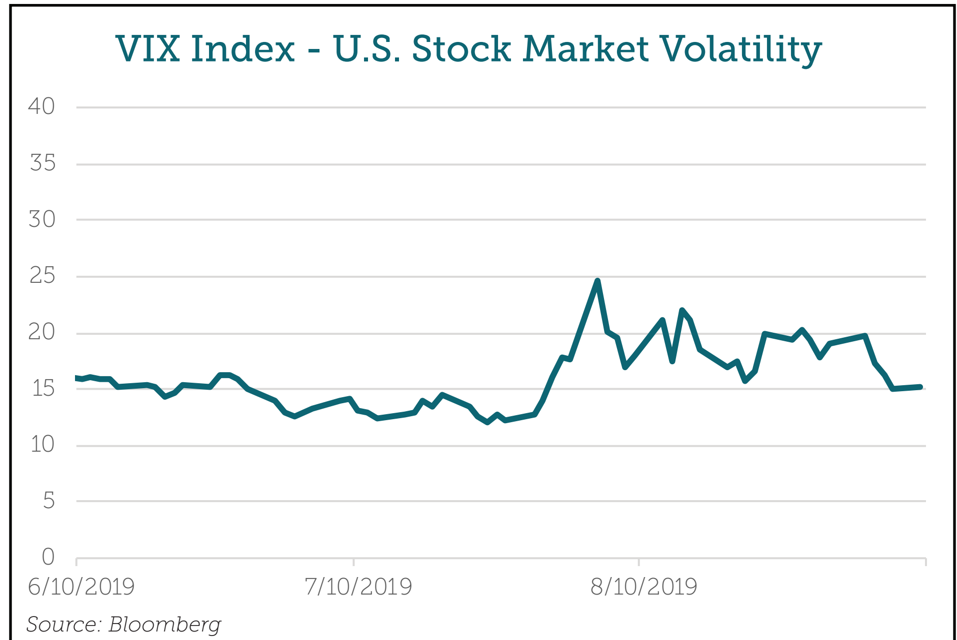


Source: Bloomberg

2 Stimulus Effects – Placebo or Effective Treatment? (Cont.)

eurozone is almost 50/50 between cutting to -0.50% or -0.60% by its September 12 meeting. With the macro outlook continuing to slow, the onus is on the central banks to step up the accommodative monetary policies.

At the very least, this puts the equity markets in a good mood. Volatility in Europe has dropped on the easing news, and we expect volatility in the U.S. to follow suit, at least in the short term. While this may be the case, it isn't exactly an opportunity to expect easy money to continue to prop up asset prices. We believe this is a good opportunity to examine your holdings and to reassess and adjust holdings as necessary, which is why "Be Resilient" is one of the three themes currently in action at CLS.



Source: Bloomberg

3 Expectations Matter

By Michael Hadden, Investment Research Analyst

Both the NFL and college football seasons are finally underway. Being located in Omaha, Neb., football season is as exciting a time as any as the Nebraska Cornhuskers play just 50 miles down I-80 from here.

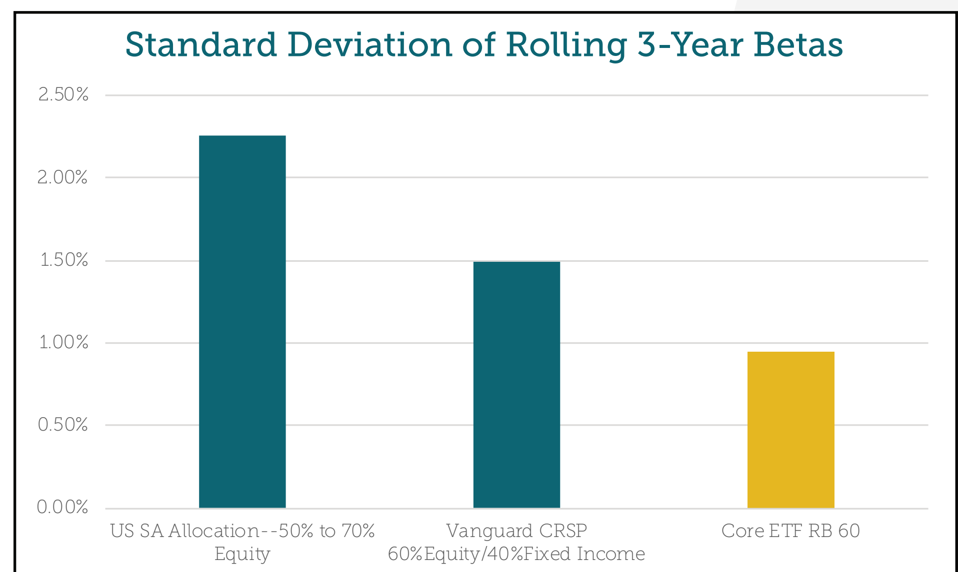
For those who aren't as familiar with college football, Nebraska has high expectations for this season after a fairly disappointing 2018. It is the first time in a few years that expectations have been this high. The Cornhuskers were heavy favorites in their first game against an inferior opponent. But as the game played out, it was much closer than people expected. Even though the Huskers won (something that took them seven weeks to do last season), many people, including me, left the stadium frustrated with the outcome. This is where expectations are key. Ahead of 2018's season opener, expectations were low – the fan base would have done anything for a win. And yet, despite a win in 2019's opener, fans were again disappointed. They expected a blowout, but their team pulled off just a squeaker victory. The change in expectations for 2018 to 2019 aroused similar emotions from two completely different results.

This mindset is very similar to investing. Our emotions can drastically differ based on expectations. When we want to do everything we can to avoid emotional decisions, it is important to have proper expectations. Imagine expecting the market to go up 20% each year. If it's up 12% – a great year that is helping investors move toward their financial goals – an investor with the wrong expectations may still be disappointed.

Expectations are also important when it comes to risk. The last thing anyone wants is to expect a fund or portfolio to behave one way, just to find out to their surprise that it has done something completely different. One of the great things about CLS's Risk Budgeting methodology is that investors know what they are going to get with CLS portfolios. If an investor has an Risk Budget (RB) of 70, they can be confident that the portfolio is going to take on 70% of the risk of the global market. Over long periods, if the market is up 10%, investors can expect to be up 7%. Losses work the same way. The chart below demonstrates this exact behavior of CLS portfolios.

The chart shows the standard deviation of rolling, three-year betas*. This may sound like some statistical nonsense, but it is essentially how much the beta of the portfolio moves around over time. Using CLS's Core RB 60 portfolio, it is clear that CLS portfolios stay much closer to their risk targets than Vanguard models or the peer group average does.

There are many unknowns when it comes to investments. No one knows if the market is going up or down tomorrow, or over the next year, with certainty. It should give great confidence to CLS clients that whatever the market does, CLS portfolios are behaving exactly as they should. There will be times that our portfolio tilts don't outperform, and there will be times that they do. But through the various market cycles, one thing is certain: CLS portfolios meet their risk expectations.



Beta is a measure of systematic risk with respect to a benchmark. Systematic risk is the tendency of the value of the fund and the value of benchmark to move together.

The beta of the market is 1.00 by definition. Morningstar calculates beta by comparing a portfolio's excess return over T-bills to the benchmark's excess return over T-bills, so a beta of 1.10 shows that the portfolio has performed 10% better than its benchmark in up markets and 10% worse in down markets, assuming all other factors remain constant. Conversely, a beta of 0.85 indicates that the portfolio's excess return is expected to perform 15% worse than the benchmark's excess return during up markets and 15% better during down markets.

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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