

# CLS's WEEKLY 3

What You Need to Know  
About the Markets

SEPTEMBER 4, 2019



# 1

**Tweet-sized answers  
to a variety of popular  
market questions**

## Month in Review

August is typically one of the weaker months of the year for the stock market. This year was no exception.

The global stock market lost more than 2% in August. The U.S. stock market marginally outperformed developed international stocks, though both still lost nearly 2% for the month. Emerging markets, however, were the laggard, losing nearly 4%.

The overall bond market had a great month in August, gaining nearly 3%. Long maturity Treasuries gained more than 11% for the month. The 10-year U.S. Treasury yield ended August over 0.5% lower than July's closing market with an August ending yield of 1.50%. The three-month U.S. Treasury yield ended at 1.99%. It is uncommon to see short-term interest rates higher than long-term rates, which is what we're seeing now. This is deemed an "inverted" yield curve, and it typically suggests lower economic growth is ahead but not necessarily imminent.

Real assets also had losses last month, and commodities lost nearly 5%.

CLS portfolios, given their globally diversified mandate, did underperform their benchmarks last month due to their emerging market and value tilts. Nonetheless, as long-term investors, these remain high conviction portfolio tilts.

# 2

**Berkshire Hathaway is  
not having a great year  
– but for good reasons**

# 3

**Spotlight on CLS's  
head of sales, Bruce  
Bischoff**



## 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 the management 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.\*

Did you know? [Rusty had a brief stint as a cowboy near the town of Valentine in Cherry County, Nebraska.](#)

# Market Performance (as of 8/31/2019)

Fixed Income	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	AUGUST
Cash Equivalent <sup>1</sup>	+0.49%	+0.91%	+1.46%	+2.27%	+1.55%	+0.35%	+0.17%
U.S. Investment Grade Bonds <sup>2</sup>	+3.87%	+3.41%	+3.14%	+10.17%	+9.10%	+2.82%	+2.59%
Equities	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	AUGUST
Global Equity Market <sup>3</sup>	+9.04%	+5.55%	+8.82%	-0.47%	+13.58%	-2.17%	-2.32%
Total U.S. Market <sup>4</sup>	+13.46%	+9.75%	+12.43%	+1.93%	+18.36%	-0.44%	-1.92%
Domestic Large-Cap Equity <sup>5</sup>	+13.41%	+10.41%	+13.30%	+3.27%	+18.26%	+0.15%	-1.39%
Domestic Small-Cap Equity <sup>6</sup>	+12.16%	+6.12%	+7.30%	-10.10%	+14.02%	-3.42%	-4.57%
International Equity <sup>7</sup>	+5.27%	+1.61%	+5.43%	-3.46%	+8.52%	-4.28%	-2.93%
Developed International Equity <sup>8</sup>	+5.42%	+1.78%	+5.39%	-3.44%	+10.12%	-3.71%	-2.37%
Emerging Market Equity <sup>9</sup>	+4.84%	+0.97%	+5.73%	-3.14%	+3.87%	-5.94%	-4.58%
Diversifiers	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	AUGUST
Diversified Alternatives <sup>10</sup>	+3.16%	+0.22%	+1.53%	+0.29%	+4.12%	+0.30%	+0.26%
Commodity <sup>11</sup>	-4.28%	-8.58%	-0.87%	-5.89%	+1.93%	-2.98%	-2.32%

<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.

**Q: How do the global financial markets in 2019 compare to prior years?**

A: Every year is exceptional in its own way, and this year is no different. This summer, for example, has seen incredibly bullish moves in some markets, such as bonds and gold. Stocks are having another above-average year and we believe they are poised for more gains.

**Q: Where are bonds and interest rates headed next?**

A: The extraordinary drop in yields hasn't been supported by fundamental economic data. Fickle investor flows are driving yields lower. I'm expecting 10-year Treasury yields to hit 2% before they hit 1% (they are currently at 1.5%).

**Q: Is the yield-curve inversion (short-term rates above long-term rates) cause for concern?**

A: Yes, an inverted yield curve is typically a signal that below-average growth is ahead, and it has been a more effective signal than the consensus view of economists. While there are some nuances to this inversion, it's still a storm cloud on the horizon that bears watching.

**Q: Will the Federal Reserve (Fed) keep cutting short-term interest rates?**

A: Most likely, but it's not a given. The market currently forecasts a 99% chance of one cut and 70% chance of at least two cuts in 2019. However, economic data and the Fed's comments don't support those odds.

**Q: What's the role of gold in this market?**

A: Gold has hit a new all-time high against many currencies. It's acting like

the traditional safe haven that it is and is signaling that something's up. Yet, gold's surge happened quickly. It may be a long-term buy, but it might be something to consider after it catches its breath.

**Q: Are tariffs going to destroy the global stock markets?**

A: Trade wars are not market positives, but remember the U.S. and China are two of the best-performing stock markets in the world this year. Wouldn't they be down the most if the connection was that simple? Nonetheless, the trade skirmish bears watching.

**Q: What's in store for the U.S. dollar?**

A: Classic currency valuations suggest the dollar is expensive, but that's been the case for a while now. With a president who wants a lower dollar, a Fed lowering rates, and inflation leaning higher, the dollar will likely be weaker in the years ahead.

**Q: Where is inflation headed?**

A: Various indicators, including falling short-term rates and wage growth, suggest that inflation is grinding higher, and core measures are already above 2%. Don't expect inflation to explode, but rather to continue to grind slowly upward.

**Q: Where are we in the Cycle of Investor Emotions (See below)?**

A: Based on correspondence with advisors and investors, the cycle appears to be between Depression and Hope. The Wall of Worry is firmly in place, suggesting more gains ahead.

**Q: How do investors feel about U.S. stocks?**

A: Remarkably, investor sentiment is very negative (according to the American Association of Individual Investors, one of the sentiment standards). This typically suggests above-average gains in the following one-to-12 months, boding well for a solid finish to the year.

## The Cycle of Investor Emotions



# 1

## Tweet-Sized Q&A (Cont.)

**Q: Is September the worst month of the year for the U.S. stock market?**

A: Yes, it historically has been. Over the last 20, 50, and 100 years, September has had the worst average returns (typically negative) and the highest probability of losses. Add it all up, and we see a strong buying opportunity!

**Q: What will be the catalyst for value stocks to finally start outperforming?**

A: A couple plausible catalysts:

1. Overvalued U.S. growth stocks falter, leading the overall market lower and value stocks to lose a lot less, or...

2. Inflation expectations and interest rates start to rise, which would be better and more enjoyable for investors.

**Q: What's the latest on commodities?**

A: So far, not good. Crude oil, copper, and even agricultural commodities are falling. Only precious metals are moving higher. Nonetheless, arguments can be made for owning commodities, based on the overvalued dollar, rising inflation, and being deep value versus financial assets.

**Q: What is our view on market volatility?**

A: It's always appropriate to expect more volatility. In the short term, this time of

year is when volatility typically ticks up. In the long term, volatility has been below average for years and is due to revert.

**Q: How are emerging markets (EM) faring?**

A: EM has lagged this year and in all recent trailing time frames. Momentum is not a friend. Nonetheless, EM equities are about the only asset class priced for above-average returns over the next five to 10 years. EM trades at a nearly 40% discount to the U.S.

# Warren Buffett's Track Record

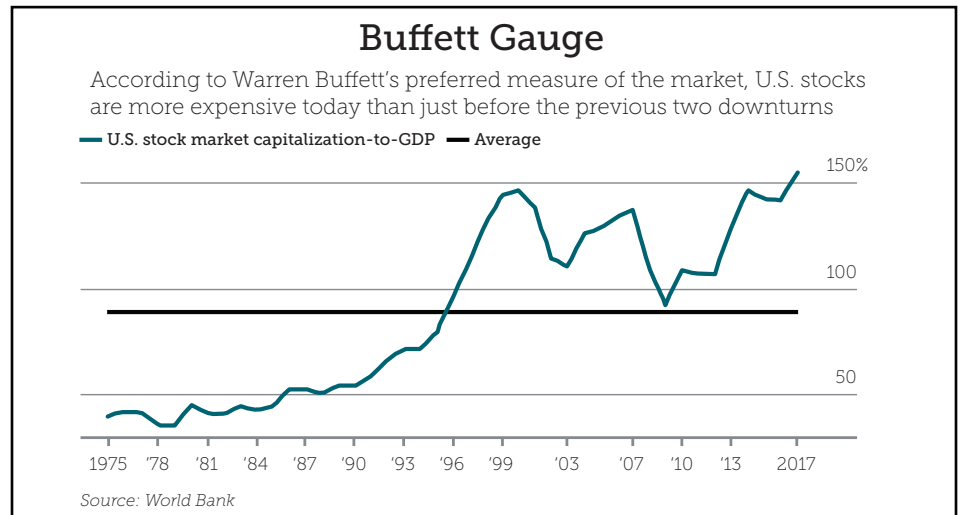
Warren Buffett turned 89 last week. Happy birthday, Warren! Buffett is arguably the best, or one of the best, contemporary investment managers. In addition – and perhaps just as important – he is the best, or one of the best, investment communicators, given his contribution to investor success around the world.

Communication is a crucial aspect of successfully managing money for other people. Investors must be comfortable with an investment philosophy and understand how their portfolio might behave in different market environments.

Because CLS Investments is based in Omaha, where Buffett is from and still lives, he has had an incredible influence on most of the investment professionals here. Buffett has been so successful because he's a value investor (although, he's a quality investor, too), and his philosophy undoubtedly impacts our decisions and investment portfolios.

Given how value investing has lagged in recent years, it shouldn't be too much of a surprise to see that Buffett, as expressed by his company, Berkshire Hathaway (BRK), and CLS have underperformed recently.

BRK has trailed the U.S. market in every time period, even recording a loss in



the year-to-date column, while the U.S. stock market has generated a double-digit gain. (You will also notice that U.S. value has underperformed U.S. growth in all time frames.)

Let's look at some major elements of BRK's positioning:

**International versus domestic.** Although BRK has some international holdings, it primarily holds domestic stocks. In the current environment, if you compare two money managers and one has a clearly inferior return, it's usually because they own more international. That's not the case here.

So, what is it? There are two notable differences, in my opinion, and they are

both very instructional, particularly since, over time, Buffett is usually right.

**Buffett's cash holdings.** Berkshire Hathaway has over \$120 billion in cash, which is more than half of the value of his public companies. Buffett said he will buy back stock, which many shareholders are clamoring for him to do, but he will do it when the time is right. While he hasn't stated it explicitly, my bet is that he is waiting for a correction (or something more) in U.S. stocks to put that money to work. Buffett has often mentioned that his favorite valuation measure of the stock market is its overall size compared to the size of the U.S. economy. That reading, reflected in the chart above, currently says the U.S. market has never been more expensive.

Name	10-Year	5-Year	3-Year	1-Year	YTD	QTD
Total U.S. Market <sup>1</sup>	+13.47%	+9.75%	+12.43%	+1.93%	+18.36%	-0.44%
U.S. Growth <sup>2</sup>	+15.45%	+12.57%	+17.51%	+4.02%	+24.27%	+0.43%
U.S. Value <sup>3</sup>	+11.22%	+6.97%	+8.45%	-0.64%	+11.59%	-2.05%
International Equity <sup>4</sup>	+5.07%	+1.63%	+5.96%	-3.24%	+8.77%	-4.06%
Berkshire Hathaway Inc B <sup>5</sup>	-11.96%	+8.19%	+10.57%	-2.54%	-0.38%	-4.58%

<sup>1</sup>Morningstar U.S. Market Index. <sup>2</sup>Morningstar U.S. Growth Index. <sup>3</sup>Morningstar U.S. Value Index. <sup>4</sup>Morningstar Gbl xU.S. Large-Mid Index. <sup>5</sup>Berkshire Hathaway Inc B. Source: Morningstar Direct as of 8/31/2019

# 2

## Warren Buffett's Track Record (Cont.)

**Financial favorites.** BRK is traditionally a financial stock, and although Buffett has clearly diversified his revenue streams, he likes financial companies (45% of his stock portfolio comprises financial companies, including eight of his top 12 holdings). While the current environment – notably an inverted yield curve, which discourages traditional bank lending and profitability – isn't friendly for financial stocks, that situation will eventually revert given the cyclical nature of the markets. As noted valued investor [Chris Davis](#), who is also a portfolio manager for some underlying holdings at CLS, recently stated, financial stocks currently have strong balance sheets and

might be at their most attractive purchase prices since the late 1940s. Wow!

### Winning in the End

Buffett is a long-term investor, and, given his disciplined approach, he usually comes out winning and beating the market. As with all disciplined investors, he can underperform over shorter time periods. For instance, BRK is trailing by approximately 20% this year alone. Berkshire's return trailed the S&P 500 Index by nearly 1% per year from 2009 to 2018, including dividends. He trailed the market by more than 3% per year around the Nifty Fifty\* craze from 1971 to 1975 and by more than 6% during the

dot-com boom from 1995 to 1999. In the end, he survived that underperformance and ultimately retained his reputation as one of the best, if not the best, investors of all time.

If Buffett is right again, what does that mean for CLS portfolios? If U.S. stocks are expensive, allocating more to international equities makes sense. And if financials are on sale with deep discounts, value stocks are poised to significantly outperform.

Of course, while it may look promising, nothing is guaranteed. But, yes, CLS portfolios are overweight to international and value stocks.

\*The Nifty Fifty was a group of 50 popular large-cap stocks in the 1960s and 1970s, regarded as solid buy-and-hold growth stocks.

# CLS Employee Spotlight: Bruce Bischoff

CLS Investments is having a great year. Portfolios have had attractive absolute returns, sales are solid, and asset retention rates are high.

The last two points are interesting. Consider this backdrop. The industry has seen net outflows due to the persistently cautious or outright negative investor sentiment. In addition, CLS is a global, active manager. "Global" and "active" have not been hot-sellers of late. And since CLS has been overweight to value and international stocks, we have trailed our benchmarks. Despite all of that, client redemption rates (the ultimate investor satisfaction number) are nearly half the conventional industry averages, and sales growth has been strong every month.

I believe there are a lot of reasons behind that. While I like to think that CLS portfolios have behaved as communicated, as they indeed have, and the investment team has provided ample communication and service, it truly takes a team to keep our clients satisfied. That team includes

operations, trading, client service, and, especially, sales.

Our sales team is led by [Bruce Bischoff](#). Bruce and I came to CLS Investments at about the same time, and it has been a real treat to work with him. He's a consummate professional who cares deeply for his team and his clients (check out his interview on the next episode of CLS's The Weighing Machine podcast).

Bruce has four key tenets when it comes to managing teams, and they work because he makes sure they work:

1. **Work hard.**
2. **Be accountable.**
3. **Have fun.**
4. **Reward the best performers.**

Bruce lives by these rules, and the numbers show that his teams perform. It's a win-win for everybody. Advisors and investors benefit from authentic, top-quality effort, and CLS teammates win because we're having fun and



*Bruce Bischoff*

making a difference. That's exactly what we all set out to do – empower advisors to help investors reach their investment objectives.

#### **Thank You**

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

Stay balanced, and stay the course.

***Rusty Vanneman, CFA, CMT***  
***President, Chief Investment Officer***  
*Rusty.Vanneman@CLSIinvest.com*  
*402-896-7641*



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.

CLS Strategies are not sponsored, endorsed, sold or promoted by Morningstar, Inc. or any of its affiliates (all such entities, collectively, "Morningstar Entities"). The Morningstar Entities make no representation or warranty, express or implied, to the owners of the CLS Strategies or any member of the public regarding the advisability of investing in CLS Strategies generally or in the specific strategy presented here in particular or the ability of the CLS Strategies to track general market performance.

THE MORNINGSTAR ENTITIES DO NOT GUARANTEE THE ACCURACY AND/OR THE COMPLETENESS OF THE CLS STRATEGIES OR ANY DATA INCLUDED THEREIN AND MORNINGSTAR ENTITIES SHALL HAVE NO LIABILITY FOR ANY ERRORS, OMISSIONS, OR INTERRUPTIONS THEREIN.

Any graphs and charts contained in this work are for informational purposes only. No graph or chart should be regarded as a guide to investing. While some CLS portfolios may contain one or more of the specific funds mentioned, CLS is not making any comment as to the suitability of these, or any investment product for use in any portfolio. The views expressed herein are exclusively those of CLS Investments, LLC, and are not meant as investment advice and are subject to change. No part of this report may be reproduced in any manner without the express written permission of CLS Investments, LLC. Information contained herein is derived from sources we believe to be reliable, however, we do not represent that this information is complete or accurate and it should not be relied upon as such. This material does not constitute any representation as to the suitability or appropriateness of any security, financial product or instrument. There is no guarantee that investment in any program or strategy discussed herein will be profitable or will not incur loss. This information is prepared for general information only. It does not have regard to the specific investment objectives, financial situation, and the particular needs of any specific person who may receive this report. Investors should seek financial advice regarding the appropriateness of investing in any security or investment strategy discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. Investors should note that security values may fluctuate and that each security's price or value may rise or fall. Accordingly, investors may receive back less than originally invested. Past performance is not a guide to future performance. Individual client accounts may vary. Investing in any security involves certain non-diversifiable risks including, but not limited to, market risk, interest-rate risk, inflation risk, and event risk. These risks are in addition to any specific, or diversifiable, risks associated with particular investment styles or strategies.

The CFA® is a globally respected, graduate-level investment credential established in 1962 and awarded by CFA Institute — the largest global association of investment professionals. To learn more about the CFA charter, visit [www.cfainstitute.org](http://www.cfainstitute.org).

The CMT Program demonstrates mastery of a core body of knowledge of investment risk in portfolio management. The Chartered Market Technician® (CMT) designation marks the highest education within the discipline and is the preeminent designation for practitioners of technical analysis worldwide. To learn more about the CMT, visit <https://cmtassociation.org/>.

CLS Investments, LLC ("CLS") and Orion Advisor Services ("OAS") are affiliated companies through their parent company NorthStar Financial Services Group ("NorthStar").

\*CLS Investment, 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.

1212-CLS-9/4/2019

