



Asset Allocation

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HOW CLS DEFINES IT (AND HOW OTHER FIRMS DO)



CLS
INVESTMENTS

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Introduction

CLS is a **strategic** risk allocator that makes **active** asset allocations depending on changes of risk among asset classes.

- We are **strategic** because we manage to a target risk level. That's the first promise of CLS's Risk Budgeting Methodology. We will deliver the risk levels that investors expect.
- We make **active** asset allocations in response to changes in risk and opportunities within the asset classes. That's the second promise of our Risk Budgeting approach. We will be active in our asset allocation decisions.

Enter the ETF Strategist

As the ETF industry continues to pick up steam and expand into more products — many that slice the market thinner and thinner — the need for ETF portfolio management increases. Enter the ETF strategist, a specialist in managing ETF portfolios for investors and advisors. There has been an influx of ETF strategists recently, and as this industry grows, a category system is needed to differentiate strategies and strategists for the financial advisor and retail investor. It's quite easy to misclassify a firm's management philosophy and process. Consider the "Morningstar Style Box" as an example. The research provider, Morningstar, attempts to categorize and classify all mutual funds, ETFs, and closed-end funds available, but it doesn't always get the classification right. For example, Morningstar could misclassify a growth manager as a core style box in certain market environments.

Examples of popular technical jargon for classifying strategies include, but are not limited to:

- Strategic
- Tactical
- Dynamic
- Hybrid
- Diversifiers
- Tactically constrained
- Tactically unconstrained

Envestnet, Morningstar, FTJ FundChoice™ (FTJ), Adhesion, and Sawtooth are all examples of platforms that offer directories of strategists. A handful of these firms also provide the research to help advisors make decisions.

Before diving into classifications of various platforms, we examine how CLS classifies its strategies.

CLS Investments

Recently, in a combined effort of the CLS Portfolio Management Team, we examined our own marketing material, internal training documents, and white papers in an attempt to unify the definition of our asset allocation philosophy. In our previous material, we found that our message was not clearly communicated to the end client and advisor. As a result, we felt this exercise was an important one. We need to not only unify our message as a firm, but also help our investors make sound investment decisions based on what they can expect CLS to do while managing their portfolios.

Below we define certain investment styles and how we fit into them. CLS fits best into the strategic classification. We set targeted allocations that are longer-term in nature. Strategic does not mean passive, though. Passive typically means just matching a benchmark. CLS is an active manager and seeks to beat a benchmark. We believe that you are either on one side or the other, strategic or tactical. As one starts to create more grey areas to fall into, the message becomes distorted and the investor experience may suffer as a result.

| INVESTMENT STYLE | TIME FRAME | DESCRIPTION | CORE OR SATELLITE ALLOCATION |
|------------------|------------|---|---|
| Strategic | Long Term | A buy-and-hold investment approach that attempts to balance capturing broad market returns with an appropriate level of risk. | Core |
| Tactical | Short term | <p>An unconstrained investment approach that can quickly change its allocation and risk profile by moving portfolio allocations from as much as 100% equities to 100% fixed income and cash (and vice versa) based on short-term changes in market environments. The goal is protection of capital in down markets, while participating in up markets.</p> <p>While CLS strategies are primarily strategic, there is a strategy which is tactical by definition. This strategy has a rules-based approach to entering and exiting the market in a further attempt to take emotion out of the process.</p> | Satellite or Complement to Core Holding |

Envestnet

Now, let's take a look at one of the more popular firms that provides both a platform of strategists as well as research on those strategists: Envestnet. This firm seeks to become an advisor's one-stop shop for investment services. It provides technology that allows advisors to choose from a list of ETF strategists, individual funds, SMA accounts, etc. Envestnet's "[Fund Strategist Portfolio](#)" is its research solution to providing categorization and due diligence of the strategists available to advisors. The table below breaks down Envestnet's investment style verbiage and where CLS would fit, as an example.

CLS is currently classified as a "dynamic" manager. While this classification seems to fit our style, we do not entirely agree with it. More correctly, CLS is a strategic risk allocator who employs active risk allocation of asset classes. The classification of "dynamic" appears to be a new term coined by Envestnet, seeking to find a middle ground between the commonly used terms: strategic and tactical. While CLS makes active moves between various asset classes, we must keep risk constant; thus, strategic appears to be a better fit.

| INVESTMENT STYLE | TIME FRAME | DESCRIPTION | CORE OR SATELLITE ALLOCATION |
|------------------|---|---|---|
| Strategic | Long Term | A buy-and-hold investment approach that attempts to balance capturing broad market returns with an appropriate level of risk. | Core |
| Dynamic | Long Term Combined with Short-Term Tactical Moves | A flexible investment approach that combines a strategic approach with a limited amount of short-term tactical moves to take advantage of short-term macroeconomic factors and enhance returns. | Core or Total Portfolio Solution |
| Tactical | Short Term | An unconstrained investment approach that can quickly change its allocation and risk profile by moving portfolio allocations from as much as 100% equities to 100% fixed income and cash (and vice versa) based on short-term changes in market environments. The goal is protection of capital in down markets, while participating in up markets. | Satellite or Complement to Core Holding |

Morningstar

A second firm that offers research on strategists is Morningstar. The Chicago-based independent research behemoth is widely known and has a similar style of categorizations. In the last couple of years, Morningstar started to rank, profile, and highlight ETF strategists in its popular “[Morningstar Landscape Report](#).” This report is created each quarter and tracks performance, assets, flows, risk statistics, etc. of more than 750 strategies from more than 150 firms. The table below shows Morningstar’s particular vernacular breakdown.

CLS is classified between strategic and tactical as “hybrid.” In this instance, we could make a stronger case to be classified as strategic, as it seems to fit closer with our own vernacular. CLS has a policy benchmark of 60% domestic stocks and 40% international stocks; we maintain long-term allocations to risk and certain core asset classes; and we deviate from the plan/benchmark during shorter-term periods based on opportunities to add value. Hybrid goes a little too far for CLS’s comfort by including “significant deviations” from the benchmark in its definition. Since we promise to keep risk constant, significant changes would not be prudent.

| INVESTMENT STYLE | TIME FRAME | DESCRIPTION | CORE OR SATELLITE ALLOCATION |
|------------------|---|---|---|
| Strategic | Long Term | Strategies that maintain long-term allocation plans across either asset classes, sectors, or a combination thereof. These portfolios may deviate from the plan in shortterm periods based on identified opportunities, but the deviation is typically to a lesser degree than tactical strategies. | Core |
| Hybrid | Long Term Combined with Short-Term Tactical Moves | This option indicates portfolios that utilize a combination of tactical and strategic elements in asset allocation. Hybrid portfolios, for example, start with a stated investment policy benchmark or asset allocation but allow for significant deviations of exposure with and between allocations, similar to “core and satellite” or “hub and spoke” operating models. | Core or Total Portfolio Solution |
| Tactical | Short term | Tactical strategies engage in shortterm and potentially large changes in the asset mix of a portfolio to capitalize on identified investment opportunities. These changes are typically intended to be reversed or removed. | Satellite or Complement to Core Holding |

FTJ FundChoice™

The last example is from FTJ FundChoice. CLS has been offering strategies on this platform since 2011, but recently the firm has looked to expand its reach by becoming a consultant to their advisors and not just a conduit to find strategies. To this end, they have created "[Market Movement Strategies](#)" branding. FTJ tracks a much more select group of managers and strategists on their platform. They use the traditional categories of strategic and tactical, but also add in a "diversifier." This is an interesting addition that can help differentiate certain models and single fund solutions available.

In this instance, CLS's core Risk-Budgeted strategies are classified as tactical. With no clear middle ground between the two, we are classified as tactical due to our flexible and active risk allocation of asset classes. Even though we keep risk a strategic constant and do not make all-in-the-market or allout- of-the-market bets, tactical is what was chosen. Diversifier does not particularly apply to us as it is identifying hedge-fund-type strategies that provide low correlations. Strategic is most undoubtedly a better fit.

| INVESTMENT STYLE | TIME FRAME | DESCRIPTION | CORE OR SATELLITE ALLOCATION |
|------------------------------|------------|---|---|
| Strategic Market Movement | Long Term | Strategists in this mandate optimize their portfolios utilizing traditional modern portfolio theory, with an expectation that their portfolio returns coincide with the movement of the market. | Core |
| Tactical Market Movement | Short Term | Strategists in this mandate are highly flexible and able to adjust for changing market conditions. Their active approach allows them to increase/decrease their exposure to market movement as their research dictates. | Satellite or Complement to Core Holding |
| Market Movement Diversifiers | N/A | Strategists in this mandate are employed to disengage from market movement and provide new sources of potential return and risk. These tend to exhibit low correlation to the other mandates. | Satellite or Complement to Core Holding |

Conclusion

So, why did CLS conduct this exercise? Our investment process and philosophy of Risk Budgeting is key to properly setting expectations for our advisors and investors. When the story is not clear and expectations are not met, the investor experience is a poor one. Strategists are undoubtedly needed in the increasingly complex world of investment management. Research providers are working to provide a service by categorizing them, but a misclassification can be worse than no classification at all. For example, if an investor expects a cash move as a result of recent volatility because a firm is classified as tactical and does not see anything done because that is not the firm's true investment process, the investor and advisor experience suffers.

Trying to pinpoint the perfect definition for how a money manager runs its strategy is nearly impossible and could sometimes do more harm than good. That is why advisors (as fiduciaries) need to conduct proper due diligence on a strategist before using them. Luckily, CLS is here to help. As a firm that is more accessible than most, we offer several levels of service that can help advisors make informed decisions. CLS has a long-tenured Sales Team and an Investment Team that is available for an in-depth dive on our process and philosophy.

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The charts contained in this work are for informational purposes only. No chart should be regarded as a guide to investing.

An ETF is a type of investment company whose investment objective is to achieve the same return as a particular index, sector, or basket. To achieve this, an ETF will primarily invest in all of the securities, or a representative sample of the securities, that are included in the selected index, sector, or basket. ETFs are subject to the same risks as an individual stock, as well as additional risks based on the sector the ETF invests in. Market capitalization, or market cap, refers to the total dollar value of all of an issuer's outstanding shares of stocks. Generally, large cap firms consist of companies whose market cap is between \$10 Billion and \$100 Billion; mid cap securities generally consist of companies whose market cap is between \$2 Billion and \$10 Billion; small cap securities generally consist of companies whose market cap is between \$300 Million and \$2 Billion. Additional diversifiable risks for mid cap companies include, but are not limited to, liquidity risk and business risk. These two risks are present to an even greater degree for small cap firms.

CLS is not affiliated with Envestnet, Morningstar, FTJ Fundchoice, Adhesion, or Sawtooth.