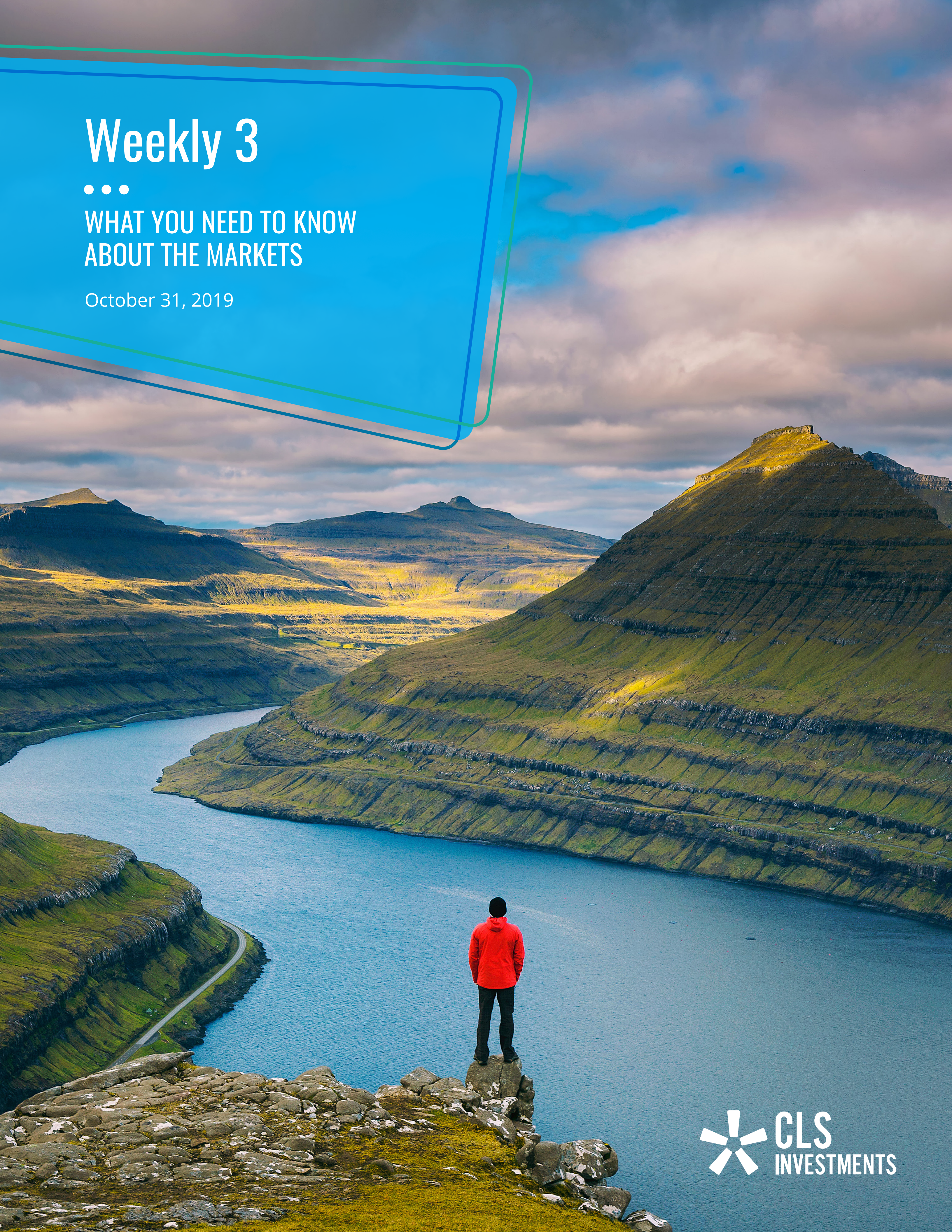
# Weekly 3

WHAT YOU NEED TO KNOW ABOUT THE MARKETS

October 31, 2019



CLS INVESTMENTS

# Week in Review

Last week was a strong one in equity markets as the global market rose more than 1%. U.S. value led the way, outperforming growth by nearly 1%. It was also a good week abroad as both developed and emerging markets kept pace with the broad U.S. market.

Bonds were one of the few negative asset classes on the week, but their losses were small. We continue to see a backup in yields with the once-inverted 10-year to two-year spread now up to 20 basis points.

It was a mixed bag for some of the diversifying asset classes. Commodities had a great week as oil saw some of its largest weekly gains in a while on the back of lower-than-expected inventories. Commodities were the best-performing asset class on the week, up nearly 2%. Diversified alternatives managed a small positive return on the week. Real estate joined bonds in the negative returns as higher yields weighed on the asset class.

This week is setting up to be an eventful one in the markets. Third quarter earnings season rolls on as 145 of the S&P 500 companies will report results this week. The Federal Open Market Committee (FOMC) will also meet starting on Tuesday. The FOMC has been a hot topic this year as they have completely changed course after four hikes last year by implementing two cuts so far in 2019. A third cut is expected this meeting, and comments by the chairman, Jerome Powell, will be watched closely. Finally, we will also get the October jobs report at the tail end of this week. The employment numbers are key metrics that give insight into the continuing health of the economy.

**1** *Stories of striking it rich by investing in a single company can lead investors down a dangerous path*

**2** *With every new generation of investors comes new opportunities for financial advisors*

**3** *As the ETF landscape changes, we're always looking for new ways to utilize these powerful investing tools*

# Market Performance

| FIXED INCOME | 10-YEAR | 5-YEAR | 3-YEAR | 1-YEAR | YTD | QTD | LAST WEEK |
|---|---|---|---|---|---|---|---|
| Cash Equivalent[1] | +0.51% | +0.97% | +1.54% | +2.28% | +1.85% | +0.13% | +0.03% |
| U.S. Investment Grade Bonds[2] | +3.72% | +3.07% | +2.96% | +10.59% | +8.17% | -0.32% | -0.15% |
| EQUITIES | 10-YEAR | 5-YEAR | 3-YEAR | 1-YEAR | YTD | QTD | LAST WEEK |
| Global Equity Market[3] | +8.49% | +7.58% | +10.94% | +13.08% | +18.74% | +2.27% | +1.25% |
| Total U.S. Market[4] | +13.16% | +10.97% | +14.15% | +13.83% | +22.43% | +1.68% | +1.28% |
| Domestic Large-Cap Equity[5] | +13.14% | +11.53% | +14.88% | +13.80% | +22.36% | +1.78% | +1.30% |
| Domestic Small-Cap Equity[6] | +11.92% | +7.91% | +9.61% | +7.36% | +18.56% | +2.28% | +1.44% |
| International Equity[7] | +4.79% | +4.48% | +7.87% | +12.54% | +15.02% | +3.05% | +1.23% |
| Developed International Equity[8] | +5.09% | +4.58% | +8.14% | +12.41% | +16.71% | +2.81% | +1.23% |
| Emerging Market Equity[9] | +3.81% | +4.09% | +7.12% | +13.43% | +10.09% | +3.77% | +1.21% |
| DIVERSIFIERS | 10-YEAR | 5-YEAR | 3-YEAR | 1-YEAR | YTD | QTD | LAST WEEK |
| Diversified Alternatives[10] | +2.99% | +1.02% | +1.93% | +3.48% | +5.18% | +0.39% | +0.31% |
| Commodity[11] | -4.79% | -6.41% | -1.01% | -3.91% | +5.53% | +2.33% | +1.09% |

*[1]Morningstar Cash Index [2]Bloomberg Barclay's 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 Gbl ex U.S. Large-Mid Index [8]Morningstar DM ex U.S. Large-Mid Index [9]Morningstar EM Large-Mid Index [10]Morningstar Diversified Alternatives Index [11]Bloomberg Commodity Index. Data as of 10/26/19.*

# All Your Eggs in One Basket

1

One of the fastest ways to become wealthy also happens to be one of the fastest ways to financial ruin. Investing predominantly in one stock is like walking a tight rope between wealth, fame, status, sleepless nights, family turmoil, and financial disaster. However, investors of all socioeconomic levels will venture into this precarious situation out of blind confidence, ego, or pure ignorance.

Is putting all or most of your proverbial eggs in one basket a successful strategy? Let's look at the facts and have you decide.

First, I'll share a recent conversation I had with an investor about this topic.

The investor – let's call him Charlie – started a company from his basement in his 20s. He is now a millionaire in his early 30s. Charlie has found success in every entrepreneurial ring he has thrown his hat into. His next conquest: his financial portfolio.

Charlie tells me, "Getting double-digit returns is easy. I just invested in a company that had steady revenue growth, and I've seen my money double."

I respond, "Interesting. How do you know this company will continue to do well into the future?"

Charlie tells me how this company has some groundbreaking technology that's going to reshape the industry. The story he told was absolutely hypnotizing. It truly sounded like the next Apple. It wasn't hard to see why he invested a large portion of his money in this one company.

The stories single-company investors tell themselves and share with others about their investments come to define them as investors. These narratives are the bacon-wrapped smokies of everyday conversations. They're so tempting and irresistible, it's hard not to want to eat them all up and dream that everything will pan out as expected.

The truth is that very few of these companies will provide the riches investors hope to achieve.

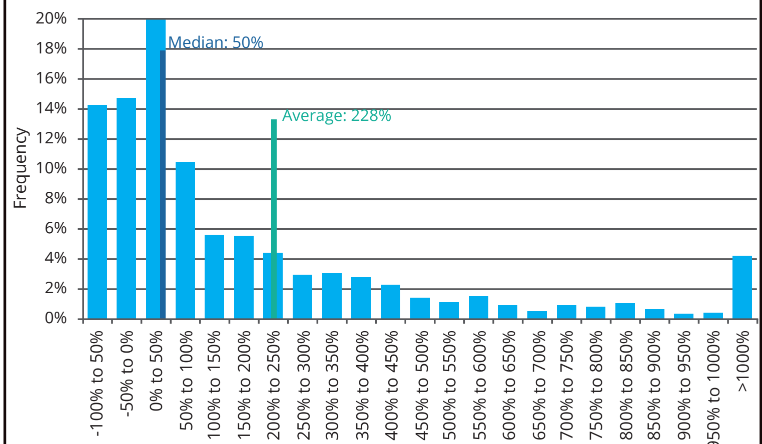
Hendrik Bessembinder, author of the paper *Do Stocks Outperform Treasury Bills?*[1], examined the 25,300 stocks held in the Center for Research in Security Prices (CRSP) database over the time period 1926-2015 and revealed some key information that investors should know.

- The average stock traded for seven years and lost money (including reinvested dividends).
- The most common return for an individual stock was a loss of 100%.
- Only 48% of stocks delivered a positive gain.
- Just 86 stocks – of the 25,300 – were responsible for half of the gains during this time period.
- Only 4% of stocks outperformed the return of a one-month Treasury bill.

The accompanying chart shows the return distribution for the constituents of the S&P 500 between 1998 and 2018.

The chart shows that half of the companies in the S&P 500 returned 50% cumulatively during this time, which is only a 2% annualized return. The average return of the 500 stocks was 228% or 6.1% annualized. This shows that each stock has less than a 50% chance of producing above-average returns.

Constituent Returns For S&P 500 Members Are Highly Skewed




*Source: S&P Dow Jones Indices LLC, FactSet. Data from 12/31/97 to 12/29/17.*

JEOVANY ZELAYA
*Client Portfolio Manager*

[1]*Bessembinder, Hendrik (Hank), Do Stocks Outperform Treasury Bills? (May 28, 2018). Journal of Financial Economics (JFE), Forthcoming. Available at SSRN: https://ssrn.com/abstract=2900447 or http://dx.doi.org/10.2139/ssrn.2900447*

1

If you were lucky enough to invest in one of these stocks that returned fabulous returns, then holding onto them would have been a true test of conviction and will power. These individual stocks provide a roller coaster of returns. For example, if an investor had held onto Apple since inception, they would have seen their money lose more than 70% of its value at some point during its life cycle. Amazon? 80%! Microsoft? More than 60%!

The asset manager, Alpha Architect, conducted a study of the largest 3,000 U.S. companies during the time periods 1983-2006 and 2007-2014 and how far their stock prices fell. They found the following eye-opening results:

- Between 1983 and 2006, about 73% of stocks saw their stock prices fall by more than 50%.
- Between 2007 and 2014, this number increased to 82% of stocks.

Investing in individual companies means taking on a lot of risk. The type of risk that makes your stomach turn.

Peter Bernstein, author of *Against the Gods*, once said, “Diversification is the only rational deployment of our ignorance.” Diversifying our portfolios properly may help us reach our ultimate financial aspirations with less headache, heartache, and stomachache.

Our financial advisor partners can provide guidance to mitigate this risk and help your basket of eggs hatch into the realization of your financial goals.

# Connecting with Generations

2

MICHAEL HADDEN
*Investment Research Analyst*

A couple of weeks ago, I attended the Nebraska Wealth Management Conference held at Creighton University in Omaha, Neb. There were various speakers throughout the day touching on a wide variety of topics all dealing with financial planning. One of the breakout sessions that I attended was intended to give insight into each generation and how we can connect with them.

The presenter, from Ivy Investments, noted the transition of wealth that will be taking place is a great opportunity, and a great risk, for those in our industry. The points below outline this sentiment:

- Over the next 50 years, $68 trillion will pass from one generation to the next. This is the greatest wealth transfer in history.
- Around 90% of prospective heirs said they will switch financial planning firms upon receiving their inheritance.
- But if given a strong recommendation from their parents, 85% said they would feel comfortable continuing to use the same advisor.

The speaker also touched on characteristics of each generation and the best ways to connect with them. At CLS, our wide client base exposes us to both advisors and their end clients spanning the generation spectrum. We want to provide information that can not only lead our advisors to have more meaningful relationships with their clients, but also position ourselves to better meet and serve our advisors' needs. The table below outlines the different generations, the deep values tied to them, how they prefer to communicate, and ways to build stronger relationships with them.

Ivy Investments has done quite a bit of research, and I encourage anyone who is interested to check out their website to learn more about this subject.

| Generation | Traits | Preferred Method of Communication | Ways to Build Stronger Relationships |
|---|---|---|---|
| **Traditionalist Pre-1946** | • Patriotic<br>• Loyal | • Phone calls<br>• Letters<br>• Personal notes | • Offer to facilitate wealth transfer conversations<br>• Show them their loyalty isn't taken for granted |
| **Baby Boomer 1946-1964** | • Optimistic<br>• Competitive | • Phone calls<br>• Face-to-face<br>• Email | • Make communication positive<br>• Keep them up-to-date on innovations<br>(they want to keep up with their kids and technology) |
| **Generation X 1965-1979** | • Skeptical<br>• Entrepreneurial | • Voicemail<br>• Text<br>• Email | • Be a resource and an expert<br>• Anticipate skepticism<br>• Be 100% transparent<br>• Don't get defensive |
| **Millennial 1980-1995** | • Collaborative<br>• Tech-savvy | • Instant message<br>• Text<br>• Email | • Show them how they can make a difference<br>• Offer education<br>• Make it a team effort |
| **Gen Edge 1996-TBD** | • Self-reliant<br>• Visual communicators | • FaceTime<br>• Text<br>• Face-to-face | • Start the conversation early<br>• Personalize interactions with them<br>• Keep it visual |

*Source: Ivy Investments*

# The Changing Face of ETFs

3

The ETF is a millennial, and the first U.S. ETF was born in 1993. Just like the rest of its millennial colleagues, the ETF has gone through some significant changes in the 26 years since its creation. Initially, there were only three providers in the business; State Street dominated the scene with 90% of the $30 billion invested in U.S. ETFs. Today, about $4.1 trillion is invested with more than 150 ETF providers. iShares is the new giant, controlling about 40% of total assets under management (AUM), and the top 10 ETF firms control 90% of ETF AUM.

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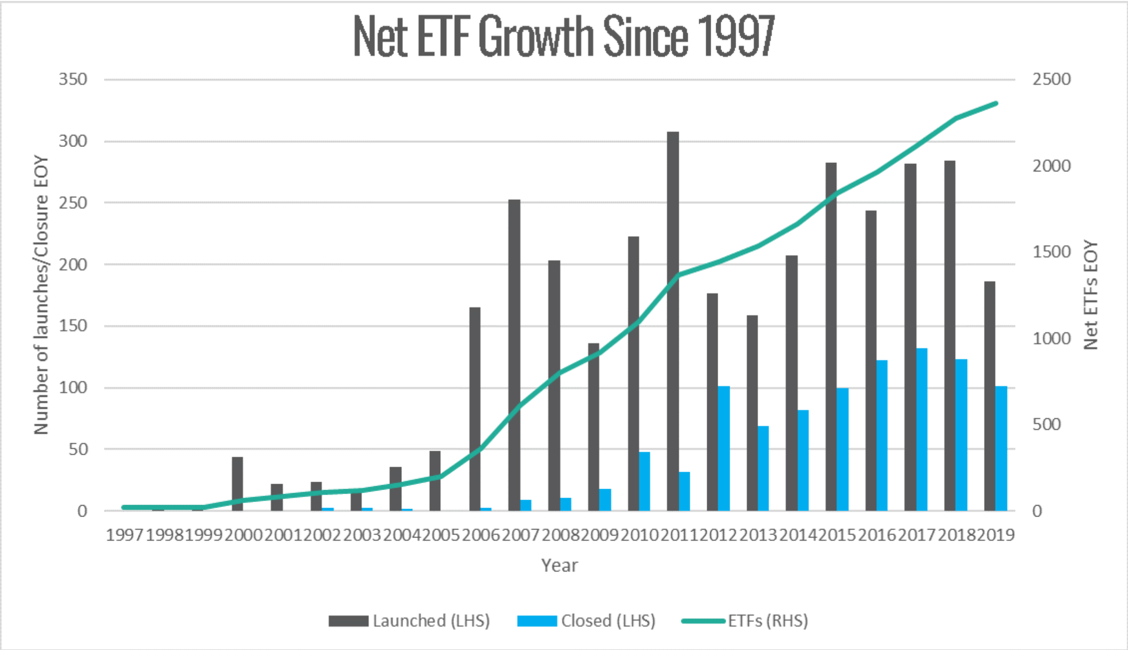
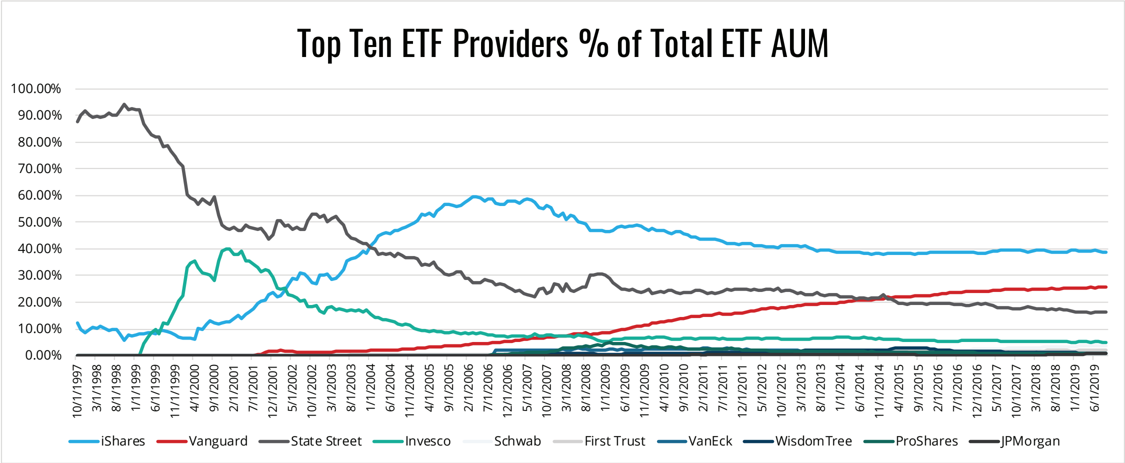
*Junior Investment Research Analyst*

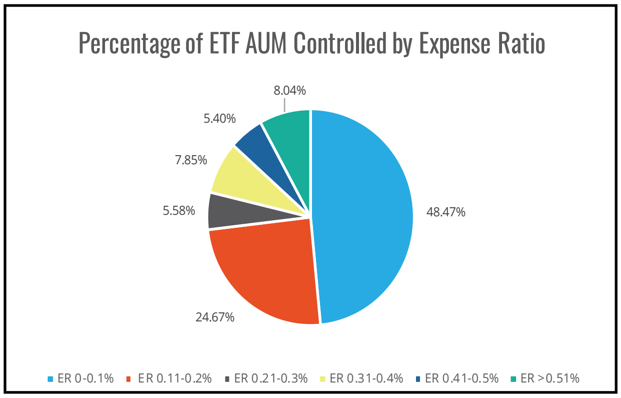



*Source: Morningstar*

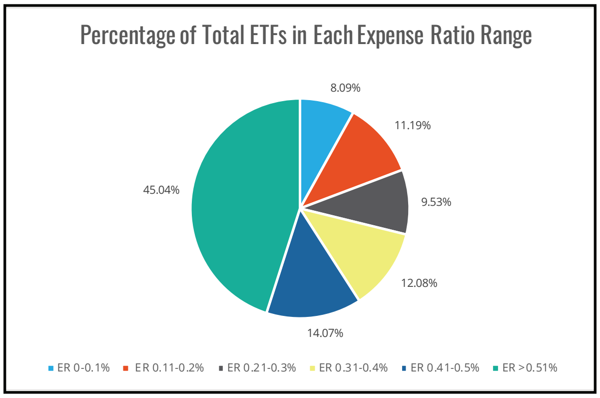



*Source: Morningstar*

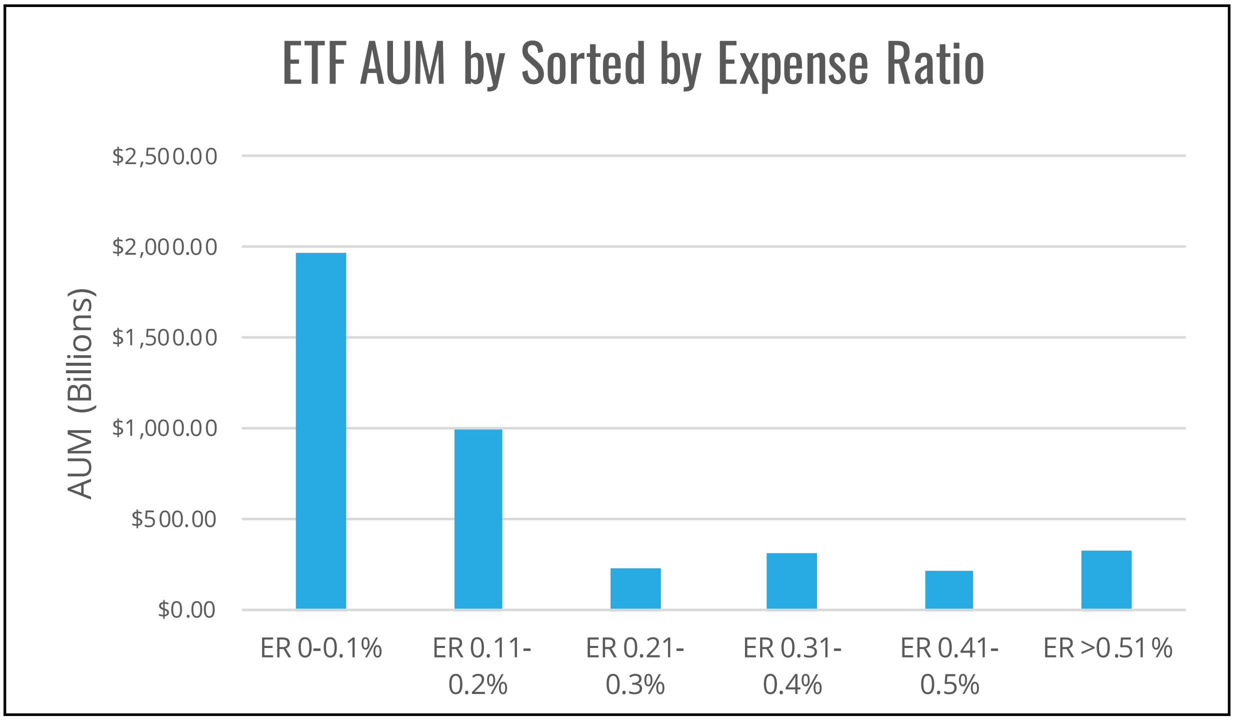
Sporting lower expense ratios than conventional mutual funds, and trading like stocks, the modern ETF is dynamic and allows the everyday investor to gain broad exposure to a wide variety of asset classes at a low cost. Currently, there are about 2,500 ETFs available to choose from, and more than 500 have expense ratios at or below 0.2%. These low-cost funds command the lion's share of AUM and attempt to replicate an index fund (think S&P, Russell 3000, etc.), less administrative fees.




*Source: Morningstar*




*Source: Morningstar*




*Source: Morningstar*

Despite their higher costs, we believe the higher fee ETFs should be included in portfolios. These ETFs are part of a new wave that use familiar-sounding monikers, such as “thematic” or “smart beta.” Their unique investment strategies may fit a niche. If an investor prefers environmental, social, and governance (ESG) investing, or thinks an industry – such as videogames and eSports – will have a big year, there are thematic ETFs that cover those sectors.

Smart beta is a relatively new form of investing that tries to have its cake and eat it, too. Like conventional ETFs, they track indexes, but they analyze alternative portfolio allocation styles to achieve above-average returns. Indexes are market-cap weighted (the size of a company’s representation on the index is based on its worth). That means a large company will have an outsized effect on performance – think the FAANG (Facebook, Apple, Amazon, Netflix, and Google) stocks; a great deal of the U.S. stock market’s gains since 2008 were generated by these companies.

But what if they have a bad year? Even if all the other companies in the index do well, the poor performance of these big-name, big-wallet companies would have an outsized impact on an investor’s portfolio and wallet.

At CLS, we love using ETFs. They are Swiss Army knives that help us construct portfolios for our clients. Their wide variety offers an investment strategy for every investor’s palate and helps see that a country, industry, sector, or even individual company’s success translates into our success and, in turn, our clients’ success.

Each ETF has an important place in our funds that empower us to help our investors achieve their financial goals.

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 Morningstar Diversified Alternatives Index allocates among a comprehensive set of alternative underlying ETFs that employ alternative and non-traditional strategies such as long/short, market neutral, managed futures, hedge fund replication, private equity, infrastructure or inflation-related investments. The Russell 3000 Index is an unmanaged index considered representative of the U.S. stock market. The index is composed of the 3,000 largest U.S. stocks. 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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