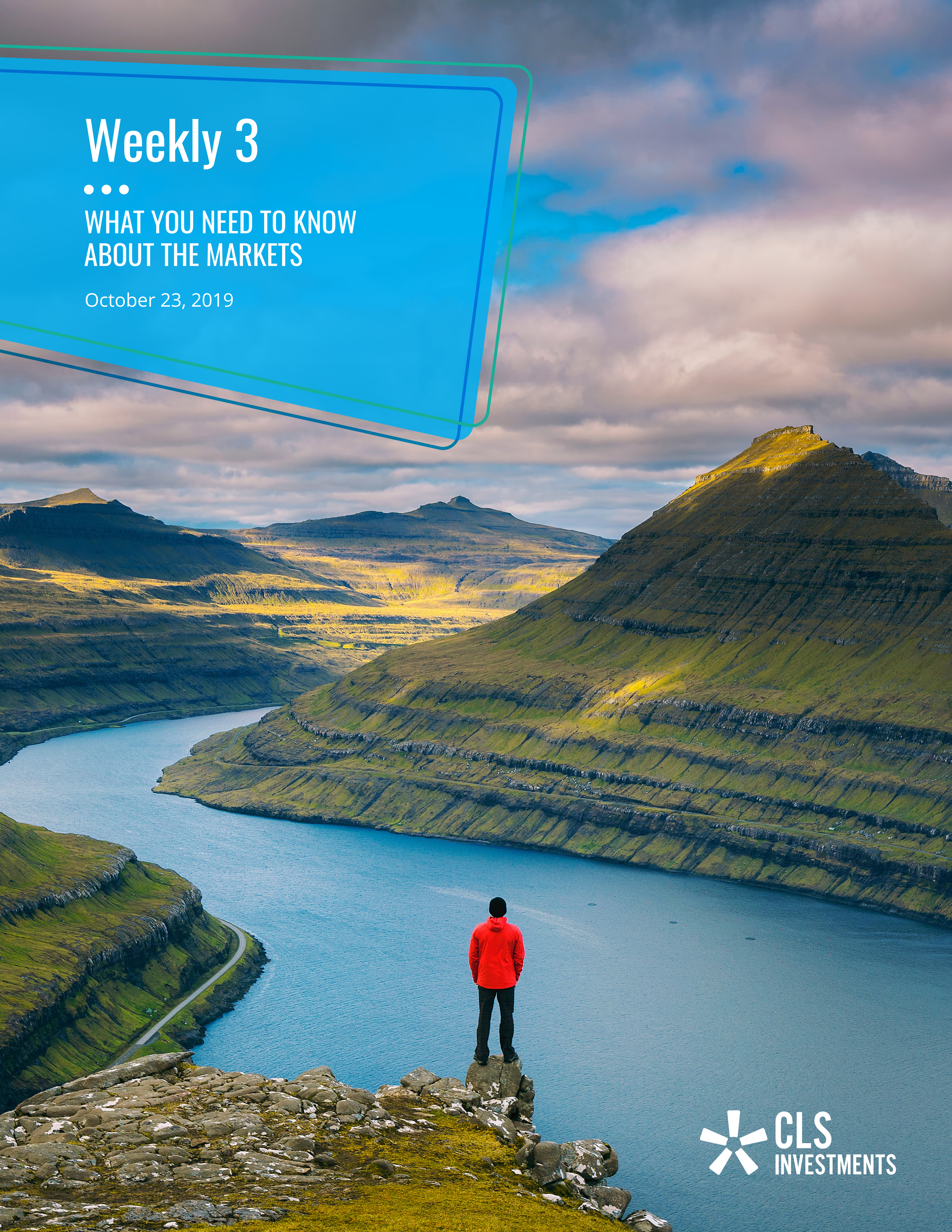
Weekly 3

WHAT YOU NEED TO KNOW ABOUT THE MARKETS

October 23, 2019



CLS INVESTMENTS

Week in Review

U.S. stocks ended modestly higher as better-than-expected earnings and optimism around Brexit were offset by ongoing global growth concerns. The S&P 500 index was up less than 1%. The market was led by small caps up over 1%. Value outperformed growth. European equities, as measured by the European Free Alliance (EFA), were up over 1%. Emerging market (EM) stocks were up over 1% as well. Commodities were modestly lower. Bond yields didn't move much either. The 10-year Treasury ended the week at 1.76%, up 3 basis points on the week.

Market Performance

FIXED INCOME	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	LAST WEEK
Cash Equivalent[1]	+0.51%	+0.97%	+1.53%	+2.29%	+1.82%	+0.10%	+0.02%
U.S. Investment Grade Bonds[2]	+3.73%	+3.04%	+3.01%	+10.89%	+8.34%	-0.17%	+0.10%
EQUITIES	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	LAST WEEK
Global Equity Market[3]	+8.33%	+7.98%	+10.52%	+8.44%	+17.28%	+1.01%	+0.85%
Total U.S. Market[4]	+12.99%	+11.60%	+13.71%	+9.62%	+20.88%	+0.40%	+0.54%
Domestic Large-Cap Equity[5]	+12.92%	+12.14%	+14.49%	+9.97%	+20.79%	+0.48%	+0.46%
Domestic Small-Cap Equity[6]	+11.54%	+8.39%	+9.02%	+1.82%	+16.87%	+0.83%	+1.22%
International Equity[7]	+4.69%	+4.65%	+7.45%	+7.25%	+13.62%	+1.80%	+1.26%
Developed International Equity[8]	+4.98%	+4.83%	+7.62%	+6.77%	+15.29%	+1.56%	+1.20%
Emerging Market Equity[9]	+3.71%	+4.00%	+7.05%	+9.31%	+8.77%	+2.52%	+1.45%
DIVERSIFIERS	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	LAST WEEK
Diversified Alternatives[10]	+2.83%	+1.16%	+1.84%	+2.26%	+4.86%	+0.09%	+0.24%
Commodity[11]	-4.49%	-6.75%	-1.57%	-6.14%	+4.40%	+1.23%	-0.17%

[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.

1 *The U.S. stock market has had a good year, but bonds have done even better.*

2 *News headlines can create unnecessary distractions, what should investors be reading instead?*

3 *The number of U.S. stocks has dropped over the past few decades, we break down the reasons why.*

MARC PFEFFER
CHIEF INVESTMENT OFFICER

Marc Pfeffer serves as CLS's Chief Investment Officer. In his role, Marc is responsible for leading CLS's Portfolio Management Team and overseeing all investment operations at CLS, including investment philosophy, process, positioning, and performance.

Prior to taking on the role of CIO, Marc was CLS's Chief Investment Strategist. He was also previously a Portfolio Manager on the CLS Flexible Income Fund team, and managed the CLS Active Income X Strategy and CLS's ETF strategies. He also managed individual municipal bond portfolios for the CLS Master Manager Strategy and continues to serve as a senior member of the CLS Investment Committee.

Marc has more than 30 years of investment management experience, including time spent as the Chief Investment Officer at Milestone Treasury Obligations Fund. He also worked previously at Goldman Sachs and Bear Stearns.

Mrac 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 Series 7, 63, and 65 licenses.

Did you know? Marc is also an avid poker player.

Bonds Had a Great Year, Too

1

All the talk so far in 2019 has been about how well the U.S. equity market has performed. The total return on the S&P is 20%. Tech stocks are up more than 22%. Even financials are up about 20% (tying into our value thesis).

However, on a relative risk basis, bonds have had an even better year! Yes, if you are a saver and have money in a money market fund, your yield has been lower, similarly if you are rolling over T-bills or a CD. But taking a look outside of the sector, we see several reasons that make a strong case for diversification.

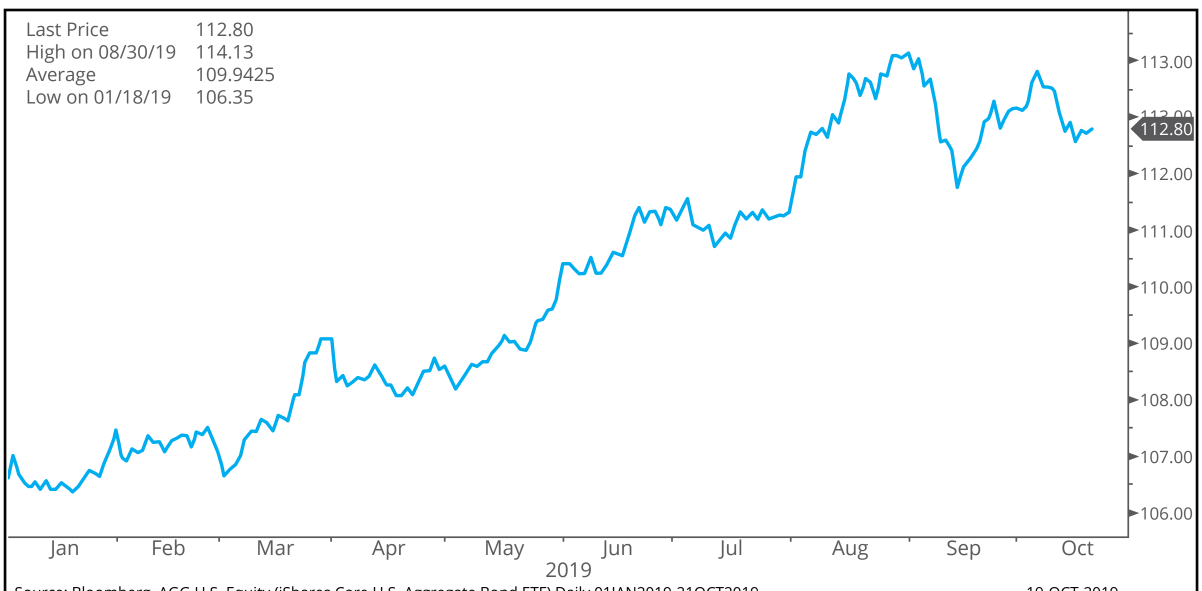
- High-yield bonds and ETFs are up more than 10% YTD.
- Emerging market debt and ETFs are up more than 10% YTD.
- Many investment-grade bonds and ETFs are up more than 20%.
- Preferred stocks, which have qualities of both equities and fixed income, are up more than 10%.

In addition, many actively managed bond ETFs that are up between 7% and 9% so far this year. The AGG ETF is also up more than 8% on the year. These go-anywhere funds buy an array of fixed-income securities and allow the managers to be nimble within the space.

At CLS, we have long stated we run diversified, balanced portfolios and will continue to do so.

The investment team doesn't expect these types of returns in stocks or bonds over the next six to 12 months, but we are looking for positive returns. And, within that, fixed income is sure to be part of these portfolios.

That's all I've got.



Source: Bloomberg. AGG U.S. Equity (iShares Core U.S. Aggregate Bond ETF) Daily 01JAN2019-21OCT2019

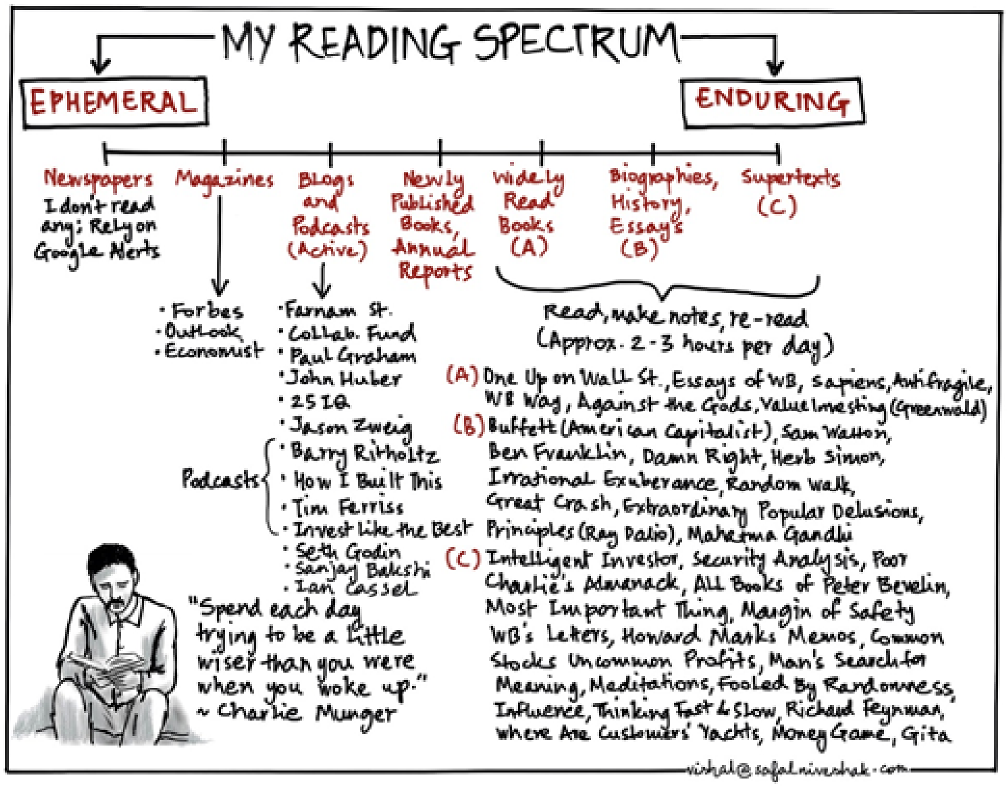
What Should Investors Read?

Over the past couple of decades, advancements in technology have made a positive impact on the investment industry. For average investors, one of the biggest benefits is the availability and accessibility of data and information. Thanks to the advent of mobile devices, investors now have access to a constant stream of financial news anywhere, at any time. While being informed is a good thing, investors need to be wary about what they read and how they react to news headlines. As history has taught us, overreactions to market noise can be detrimental to returns, and 2019 has not been an exception.

There are plenty of reasons news often does not translate into actionable trades. Media companies, including financial news, are in the business of entertainment. Their target audiences vary and news coverage usually focuses on what interests those audiences today. However, as investors, we have unique investment objectives, and it's extremely rare to find news that is relevant to individual circumstances and time horizons. Even in those cases, the market would likely have already priced in the news before an average investor could take any action.

So, what should investors read?

In my opinion, the "Reading Spectrum" below from Safal Niveshak's blog nails it:



In short, avoid the noise that arises from market speculations and spend more time reading articles and books that are unbiased and relevant in the long-term. This includes gaining knowledge in fields outside of finance as investing is more than just numbers and theories.

This insight is why the investment team at CLS introduced "The Reading Hour" a couple years ago, allowing and encouraging every person on the team to carve out an hour each day to read. The content of the readings can be on any subject, and there are no questions asked. In addition, a "CLS Library" was created for employees to check out books free of charge. As Warren Buffett once said when asked how people can get smarter, he held up stacks of paper and said, "Read 500 page like this every week. That's how knowledge builds up, like compound interest."

2

JACKSON LEE, CFA
Quantitative Portfolio Manager

Jackson Lee specializes in data analytics and is responsible for researching and managing data, including the CLS Edge and Risk Budget scores, used by the Portfolio Management Team. He serves on the Domestic Equity BACE team, which researches and analyzes domestic equity ETFs.

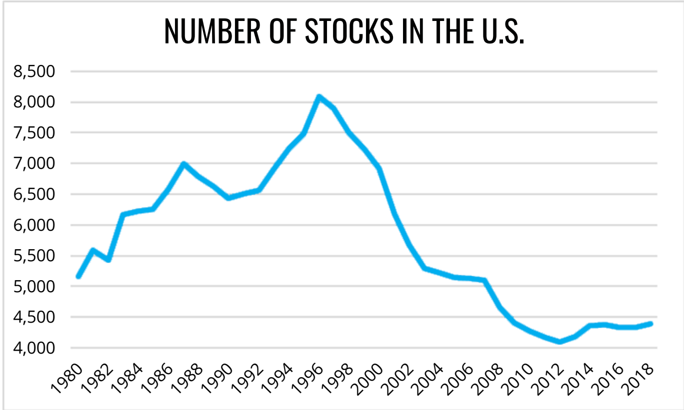
Prior to joining CLS in 2014, Mr. Lee was an Accounting Analyst for CLS's sister company, Orion. Mr. Lee graduated from Creighton University with a Bachelor of Science degree in Finance. He holds the Chartered Financial Analyst® (CFA) designation and the Series 65 securities license.

Where Have the Stocks Gone? Where Have the Returns Gone?

3

Since the peak of 8,000 stocks in 1996, the number of publicly listed stocks in the U.S. has experienced a rapid decline, ending at around 4,400 as of the most recent World Bank data. This has shrunk the investable domestic market, and it seems to tell a counterintuitive story about the health and success of the U.S. economy. After all, a booming economy should have booming companies, right?

Like many commentators before me, I would hesitate to link the number of stocks and the health of the economy too closely together. I will, however, try to explain where these stocks have gone and some of the implications for portfolio construction going forward. Many companies have undergone mergers and acquisitions – some have liquidated, and some have been taken private (the latter being less frequent). These are all largely common corporate activities. The real culprits behind a lack of public stocks is the reluctance for current companies to conduct IPOs and the resurgence of private equity during a time of cheap and easy money.

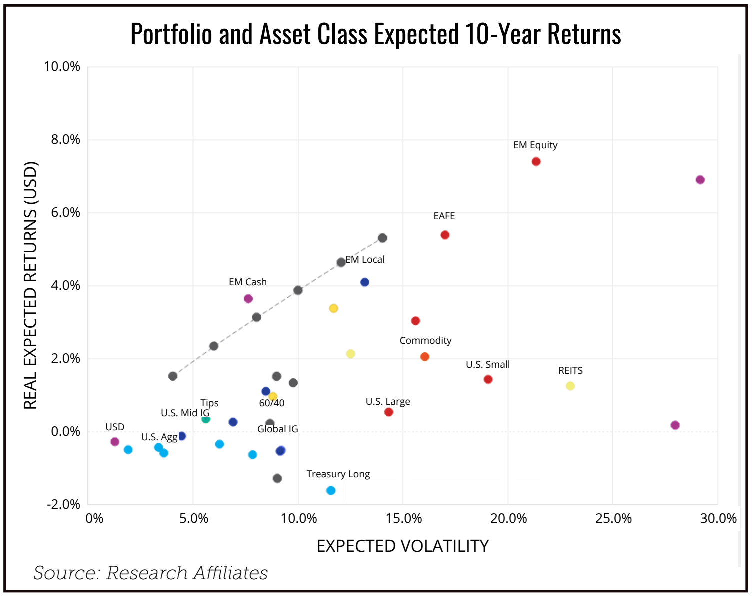


Source: World Bank

In order to generate returns, more and more institutional investors are turning toward alternate vehicles to meet their return objectives. I believe that this trend is likely to continue. According to RAFI, the expected returns of U.S. large-cap stocks over the next 10 years is less than 1%. Returns for U.S. small-caps are expected to be over 1%, both with significant levels of volatility (14% and 19%, respectively). These expectations make it impossible for pensions to meet their investment objectives, especially as increasing amounts of baby boomers enter retirement age and up the ante for these pension obligations to deliver. Thus, enter the private equity vehicle, where results can be juiced up using copious amounts of debt to deliver superior returns on equity.

I think arguing about the virtues/vices of private equity is more philosophical than practical – as subscribers of traditional financial concepts, we tend to believe in the models of CAPM, valuation, and good corporate governance – the discussion behind private equity is subjective. The fact is that the shrinking public markets make it more and more difficult for retail investors to achieve their individual investing goals. So how do we account for a shrinking public market? Luckily, CLS has embraced international investing, which significantly increases the number of stocks available to investors and is, in my opinion, one of the best solutions to this problem while remaining within the same asset class.

I think capital will flow to where it is able to go – eventually there will be less acceptance of privately financed companies with murky transparency policies, and money should flow the other way back in the public markets spurring new IPOs. Until then, we try to stay as diversified as possible, both within the U.S. and international stock markets.



Source: Research Affiliates

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.

Mr. Liu joined CLS in 2018 after earning a Bachelor of Arts degree from the University of Chicago, where he graduated with honors. He studied Political Science with a Minor in Statistics.

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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