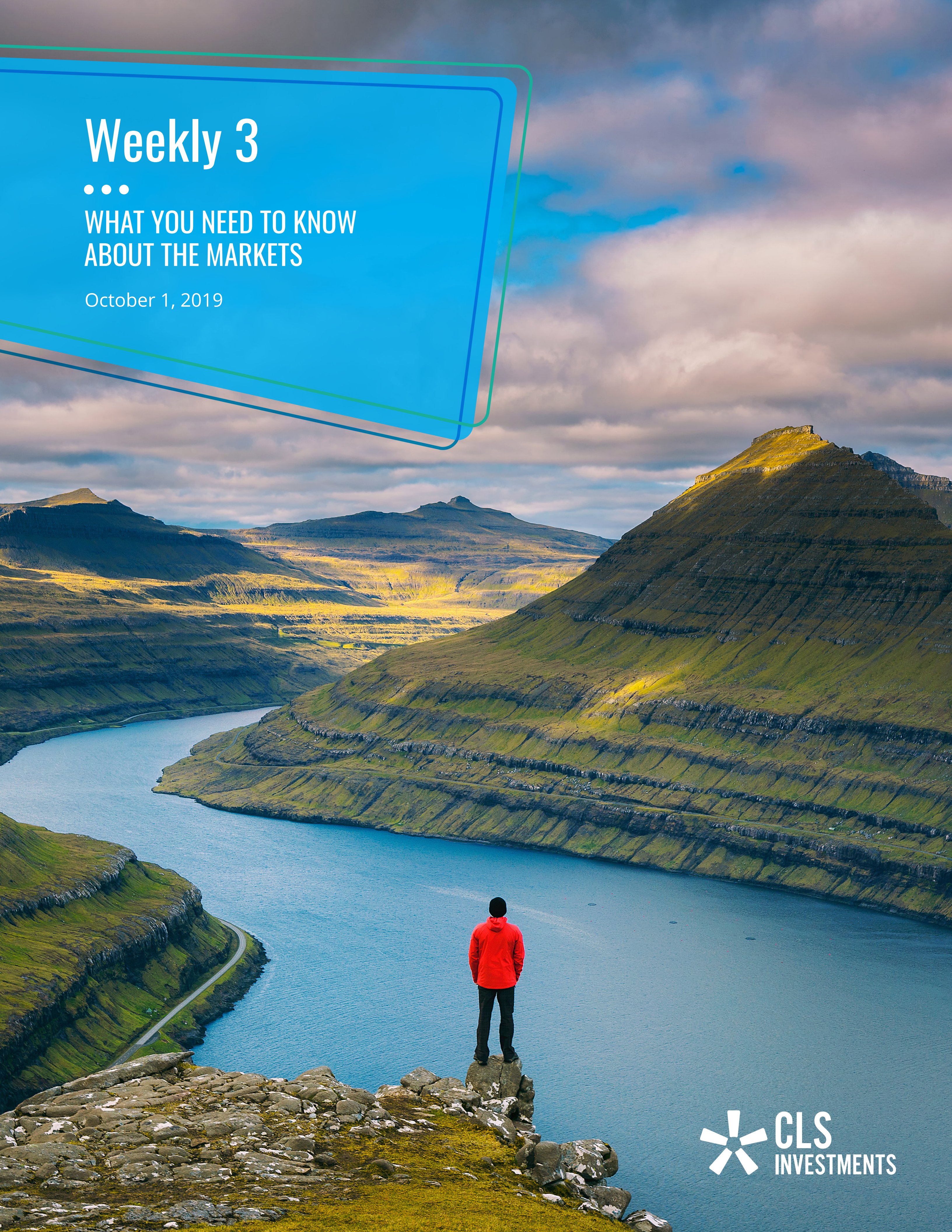
Weekly 3

WHAT YOU NEED TO KNOW
ABOUT THE MARKETS

October 1, 2019



CLS
INVESTMENTS

Week in Review

September bucked the seasonal trend of being the weakest month of the year, with the stock market posting an above-average return. Bonds and U.S. large-cap growth stocks were the clear laggards for the month, bucking another trend, as they had been market leaders earlier.

The global stock market gained over 2% in September. The U.S. stock market gained less than 2%, while non-U.S. stocks nearly gained 3% for the month. Notable for the month is that value stocks gained nearly 5% while growth stocks lost over 1%. This is a reversal of prior market leadership.

The over-all bond market meanwhile, nearly lost 1%. The 10-year U.S. Treasury yield ended September with a higher yield of 1.68%. The three-month U.S. Treasury yield ended at 1.88%. It is uncommon to see short-term interest rates higher than long-term rates. This is an "inverted" yield curve, and it typically suggests lower economic growth is ahead but not necessarily imminent.

Real assets also had gains last month, as commodities gained over 1% and global real estate investment trusts (REITs) gained over 2%.

CLS portfolios, given their globally diversified mandate, performed well versus their benchmarks last month due to their emerging market and value tilts. These tilts remain high-conviction views. More on each later in this report.

1 *CLS's global, diversified, value-oriented portfolios have lagged, but Risk Budgeting has helped*

2 *Want to buy investments on sale? Value stocks are cheap, and history suggests the potential for outperformance*

3 *U.S. stocks are nearly the most expensive they've ever been relative to the rest of the world. Is the premium reasonable?*

Storm clouds remain on the market's horizon. Tough trade talks between the U.S. and China and now, perhaps more importantly, the impeachment inquiry into the president will likely continue to roil markets. In this uncertain environment, investors should expect more price volatility. While volatility is often destabilizing, it should best be treated as an opportunity. In fact, according to research by CLS Director of Research and Senior Portfolio Grant Engelbart, when economic policy uncertainty is high, one standard deviation point or more above its average, future returns for the U.S. stock market skew strongly positive.

Economic Policy Uncertainty Index Level	One-year Forward Russell 3000 Return
One standard deviation above average	15.5%
Within +/- 1 standard deviation of average	9.3%
One standard deviation below average	3.8%
All Time (since 1985)	9.6%

Source: Bloomberg as of 9/20/2019

As Grant stated in a recent commentary, "This is just another example of the various things that have the potential to get in the way of your goals. As issues heat up in Washington, don't let it weigh on your portfolio."

Market Performance

as of 9/30/2019

FIXED INCOME	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	SEPTEMBER
Cash Equivalent[1]	+0.50%	+0.95%	+1.51%	+2.29%	+1.72%	+0.52%	+0.17%
U.S. Investment Grade Bonds[2]	+3.75%	+3.38%	+2.93%	+10.30%	+8.52%	+2.27%	-0.53%
EQUITIES	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**SEPTEMBER**
Global Equity Market[3]	+8.54%	+6.72%	+9.72%	+1.35%	+16.10%	+0.00%	+2.11%
Total U.S. Market[4]	+13.20%	+10.58%	+13.04%	+3.45%	+20.40%	+1.28%	+1.73%
Domestic Large-Cap Equity[5]	+13.21%	+11.05%	+13.93%	+4.23%	+20.22%	+1.81%	+1.65%
Domestic Small-Cap Equity[6]	+11.68%	+7.70%	+7.82%	-6.73%	+15.92%	-1.81%	+1.66%
International Equity[7]	+4.80%	+3.18%	+6.45%	-1.12%	+11.62%	-1.55%	+2.62%
Developed International Equity[8]	+5.05%	+3.26%	+6.54%	-1.18%	+13.53%	-0.74%	+2.80%
Emerging Market Equity[9]	+4.03%	+2.91%	+6.36%	-0.42%	+6.10%	-3.93%	+2.10%
DIVERSIFIERS	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**SEPTEMBER**
Diversified Alternatives[10]	+2.91%	+0.66%	+1.39%	+0.43%	+4.77%	+0.93%	+0.62%
Commodity[11]	-4.32%	-7.18	-1.50%	-6.57%	+3.13%	-1.84%	+1.17%

[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 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.

RUSTY VANNEMAN, CFA, CMA
CIO of Orion

Rusty Vanneman serves as Chief Investment Officer (CIO) for Orion Advisor Solutions, where he is responsible for overseeing the investment processes across Orion and its subsidiaries, including CLS Investments.

*Mr. Vanneman joined CLS in September 2012 as CIO. Previously, he served as CIO 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. In 2018, Mr. Vanneman took on the role of President of CLS, in addition to his position as CIO. He became CIO of Orion in 2019.*

*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® designation since 1994, and is a member of the CFA Institute. He has also been a Chartered Market Technician® 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.

CLS Performance: Five Key Characteristics

1

The essence of investment performance at CLS can be boiled down to five key characteristics:

- **Risk Budgeted**. Most portfolios at CLS are managed to a target risk level. If a portfolio has a Risk Budget of 50%, that means the portfolio assumes half the risk of the overall global stock market. If the Risk Budget is 80, it is taking 80% of that risk. Most balanced portfolios are managed to a target asset allocation, but CLS portfolios are managed to a target risk allocation.

- **Global**. Given our diversified asset allocation approach, we strongly believe in the strategic importance of maintaining international investments in long-term portfolios. A larger investment universe provides more opportunities to enhance returns. More importantly, we believe that adding international helps reduce and manage overall risk.

- **Diversified**. All else being equal, we like to own more asset classes instead of fewer. We believe that doing so provides more opportunities to manage and reduce portfolio risk and to ultimately enhance risk-adjusted performance over time.

- **Active**. We believe in being different from the overall market. Investors shouldn't buy securities simply based on their market capitalization. Instead, we believe that investments should be purchased and sold based on their fundamentals and valuation merits.

- **Relative value**. We believe relative valuations should, at least initially, drive the investment decision-making process. For example, if an asset class or investment is as cheap as it has been in many years and below its long-term average valuation, we're probably buying. And if the relative valuation is above its long-term average and the asset is as expensive as it has been in many years, we are most likely selling, underweight, or both.

We believe each of these characteristics helps us manage risk and achieve attractive, long-term, risk-adjusted performance. Each has academic, real-world, common sense, and intuitive support (except for active management, which doesn't have as much real-world support *after* fees).

Some of these characteristics have enhanced performance over the past few years, and some have hindered it. Here's a breakdown in both absolute terms (in other words, were returns positive?) and relative terms (how did our portfolios perform versus benchmarks and peers?).

Risk Budgeting has worked! Maintaining a consistent risk level in a 10-year-plus bull market has helped create attractive absolute returns. It also helped in relative terms. Versus our peer groups, we have consistently maintained a higher level of portfolio beta, particularly within our flagship ETF strategy and proprietary mutual funds, primarily because our peers have been more defensive on the markets in recent years.

Global has not helped, especially in relative terms. International stocks have posted positive absolute returns during this bull market, but they have lagged considerably this year and in the past one, three, and five-year time frames. Nonetheless, we still believe in investing for both strategic and tactical reasons, especially during a once-in-a-generation spread between international and domestic equity. More about that later in this report.

Diversification has not helped either. When U.S. large-cap stocks dominate the performance charts, it's hard for other equity asset classes, never mind non-equities, such as commodities, to perform well. Commodities have significantly lagged over the last one, three, and five years. While our exposure to real assets is generally low in terms of overall portfolio weights, it's enough to see the difference in performance compared to the U.S. stock market.

Active managers have lagged in recent years. Being active means striving to differ than the overall market in an effort to outperform. While net performance subtracts fees from active investment decisions, another key variable in explaining the performance of active managers is the performance of small-cap stocks compared to large-cap stocks. This is because

CLS Performance: Five Key Characteristics (cont.)

1

most active money managers decide between securities based on factors other than market-cap, such as intrinsic value, which naturally creates a bias toward smaller companies. Given that small-cap stocks' valuations relative to the valuations of large-cap stocks are close to their cheapest levels in nearly two decades, it shouldn't be a surprise that small-caps have underperformed over the last few years.

Our **relative valuation** bias to security selection has also not helped relative performance. While this bias has led to tilts toward international and small-caps, our most significant bias is our preference for value over growth stocks. Value stocks have underperformed over the last one, three, and five years.

2019 Headwinds for Globally Diversified Portfolios		
First 8 Months of the Year Performance 1/1/1979 – 8/31/2019		
CLS tilt	**Underperformance**	**Percentile**
U.S. vs. International	7.6%	70%
Stocks vs. Commodities	11.6%	78%
Growth vs. Value	9.5%	90%
Large vs. Small	6.6%	85%

Source: Morningstar Direct as of 8/31/2019

This year there have been significant headwinds against global, diversified, actively managed portfolios, as the table above illustrates.

Since 1979, through the first eight months of the year:

- International stocks lag U.S. stocks by this much (8%) only 30% of the time.
- Commodities lag U.S. stocks by this much (12%) only 22% of the time.
- Value stocks lag U.S. growth stocks by this much (10%) only 10% of the time.
- Small-cap stocks lag U.S. large-cap stocks by this much (7%) only 15% of the time.

CLS High-Conviction View: Value Stocks

2

- Value stocks have posted strong absolute returns over the last three and 10 years.
  - Growth stocks, however, have had much stronger returns over these time frames.
- As a result, looking at trailing, 12-year relative performance, value stocks have only underperformed by this much once before – during the dot-com boom of the late 1990s.
- Relative valuations between growth and value stocks have only been wider twice before – during the dot-com era and the Great Depression of the 1930s.
  - Value stocks handily outperformed growth stocks after both periods.

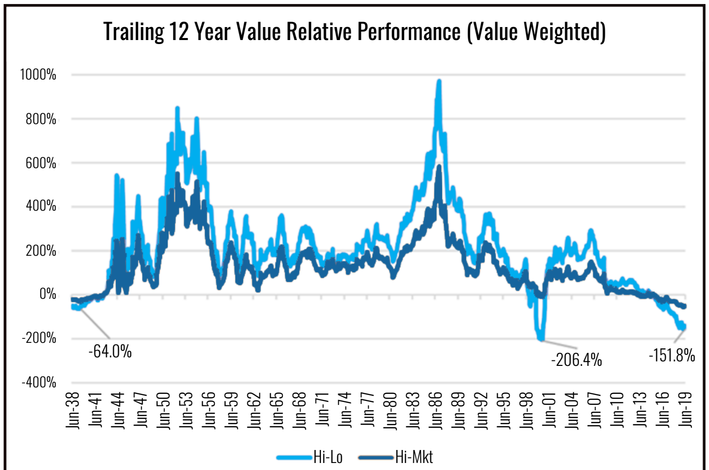
In September, we may have witnessed an important inflection point in terms of market leadership: Value stocks rebounded and handily outperformed growth stocks. There were also dramatic one-day moves: Value stocks posted their seventh-best day in 20 years on Sept. 10, while momentum stocks had their worst two-day stretch in a decade.

According to research by Verdad, the investment firm that produced the charts in this article, the last dozen years have been rough on value stocks' relative performance. For the study, Verdad reviewed 90 years of market history and compared the cheapest 30% of the market minus the most expensive 30% of the market.

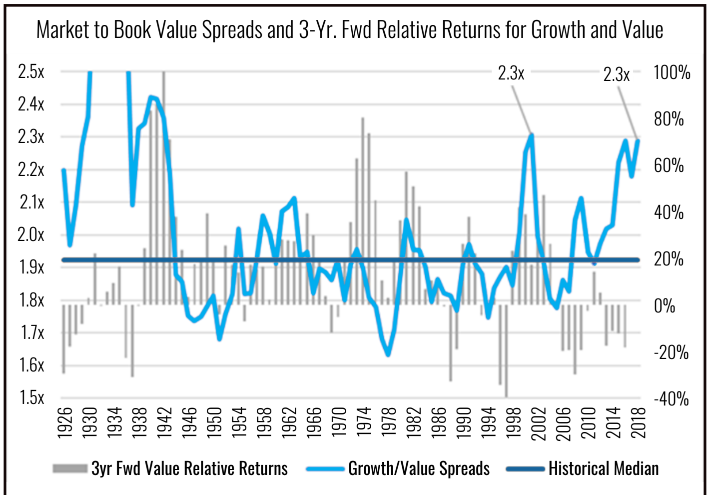
Verdad found value underperformed by this much over a 12-year time frame only one other time: during the dot-com boom, which eventually busted and set the stage for significant outperformance by value stocks over the next decade.

Verdad also pointed out that value underperformed growth in nine of the last 12 years, which has never happened before.

It should be stressed that value investing hasn't necessarily performed poorly. It has posted double-digit returns over the last three and 10 years. That's above the long-term average for stocks (8-10% per year). Value's relative underperformance compared to the overall market, however, has been due to the surge in valuations for growth stocks.



Source: Verdad using data from Ken French Library



Source: Ken French library. Spreads on BE/ME for top 30% growth and top 30% value stocks.
Relative returns are on the same 30% portfolios for value – growth over the next three years.

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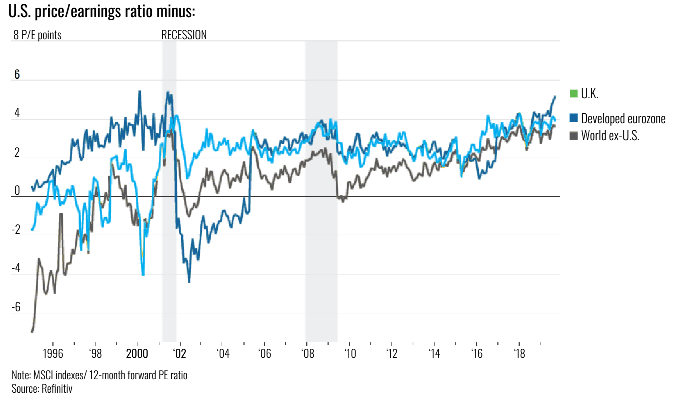
CLS High-Conviction View: International Versus Domestic

3

There are three typical rebuttals when we remind investors that international stocks are cheaper than domestic stocks. Each has merit, but none changes the basic story. U.S. stocks are expensive relative to international stocks. Or, to state another way, international stocks are on sale.

The first rebuttal is that U.S. stocks typically trade at valuation premiums relative to international stocks. That has indeed been the case for the last 15 years, and I'm not going to argue the U.S. doesn't deserve to trade at a premium. But U.S. stocks now trade at their largest premiums (outside of the dot-com era) since at least 1980. Do they deserve that much of a premium? Probably not. If history teaches us anything, it's that the markets are cyclical and relative performance will revert.



Note: MSCI indexes/ 12-month forward PE ratio
Source: Refinitiv

The second rebuttal, which the top chart to the right, produced by Refinitiv, also addresses is that the argument against international is due to the fact that we are reviewing historical numbers and not factoring in forward-looking estimates of growth. The chart, however, does illustrate forward (estimated) earnings, not historical.

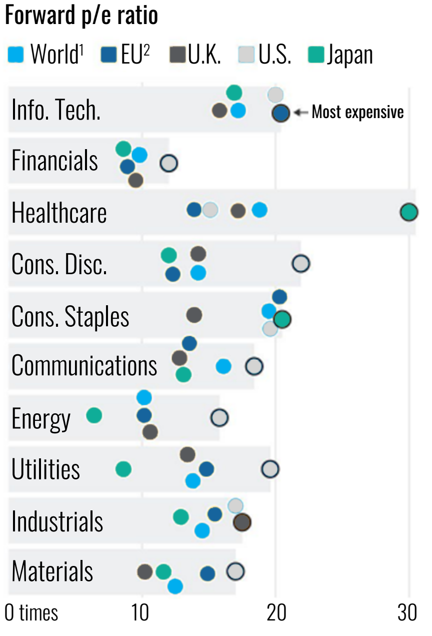
The third rebuttal is a smart one, but it also doesn't hold up when we factor in current sector valuations. This argument is that the composition of the U.S. market, in terms of sector exposures, is different from international benchmarks. That's typically true. The U.S. market does have more growth-oriented companies, including those within the technology and consumer sectors, while international benchmarks are often dominated by value-oriented sectors, including financials and energy.

The bottom chart to the right, however, shows that U.S. shares in nearly every sector are clearly more expensive than they are in non-U.S. sectors. In fact, the U.S. is easily the most expensive. So, even if we adjust for sector compositions, the U.S. market is still expensive.

In sum, the U.S. market is clearly expensive. For the long-term investor, international markets are the ones on sale.

The Price of Leadership

U.S. shares are more expensive than international peers in six of the 10 major economic sectors tracked by MSCI indexes.



[1]All-country world ex-U.S. [2]Developed eurozone
Source: Refinitiv

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.

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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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*CLS Investments, 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.

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