Weekly 3

WHAT YOU NEED TO KNOW
ABOUT THE MARKETS

December 4, 2019

CLS INVESTMENTS

November Market and Portfolio Review

It’s been a great year for investment portfolios. Last month was the best November for U.S. large-cap stock in 10 years. Heading into the last month of the year, we believe the U.S. stock market is still in a good position to generate its best calendar-year returns in several decades. There’s even a slugger’s chance that 2019 could be the best year since the 1950s.

Positive factors include a bevy of short-term indicators. Seasonals suggest a strong December. December has historically been one of the stock market’s best months of the year, moving the market into positive territory 70% of the time over the last 20 years. The market is also currently experiencing positive price momentum, regularly hitting new all-time highs, which typically suggests more short-term gains.

The near term looks bright, but long-term return expectations may be compromised (but still positive) by above-average valuations. However, there are attractive opportunities to potentially enhance long-term returns, including a few that might qualify as “once-in-a-generation” opportunities. These will be reviewed later in this report.

For November, the global stock market gained more than 3%. The U.S. stock market gained just under 4%, while non-U.S. stocks gained nearly 2%. Emerging markets were essentially unchanged.

The overall bond market had a slight loss on the month. The 10-year U.S. Treasury yield ended November at 1.78%. The three-month U.S. Treasury yield ended at 1.59%.

Real assets slipped last month, with real estate investment trusts losing less than 1% and commodities losing just over 1%.

CLS portfolios, given their globally diversified mandate and their tilts toward international and emerging market equities, have performed well in absolute terms. We continue to have high conviction in our portfolios, especially with so many asset class segments possessing their most attractive relative valuations in decades.

1 *You might be taking on more portfolio risk than you think.*

2 *How much should you invest in non-U.S. stocks?*

3 *Active management’s time to shine.*

Market Performance

as of 11/30/2019

FIXED INCOME	10-YEAR	5-YEAR	3-YEAR	1-YEAR	YTD	QTD	NOVEMBER
Cash Equivalent[1]	+0.53%	+1.00%	+1.59%	+2.21%	+2.02%	+0.29%	+0.13%
U.S. Investment Grade Bonds[2]	+3.59%	+3.08%	+4.10%	+10.79%	+8.79%	+0.25%	-0.05%
EQUITIES	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**NOVEMBER**
Global Equity Market[3]	+8.84%	+7.33%	+12.00%	+13.74%	+22.25%	+5.30%	+2.44%
Total U.S. Market[4]	+13.50%	+10.73%	+14.47%	+15.83%	+27.63%	+6.00%	+3.79%
Domestic Large-Cap Equity[5]	+13.38%	+11.30%	+15.66%	+16.52%	+27.80%	+6.31%	+3.80%
Domestic Small-Cap Equity[6]	+12.69%	+7.71%	+8.28%	+8.80%	+23.43%	+6.48%	+4.03%
International Equity[7]	+5.12%	+4.19%	+9.49%	+11.64%	+16.79%	+4.64%	+0.98%
Developed International Equity[8]	+5.45%	+4.32%	+9.57%	+12.69%	+18.88%	+4.72%	+1.30%
Emerging Market Equity[9]	+4.04%	+3.75%	+9.46%	+8.75%	+10.76%	+4.40%	+0.00%
DIVERSIFIERS	**10-YEAR**	**5-YEAR**	**3-YEAR**	**1-YEAR**	**YTD**	**QTD**	**NOVEMBER**
Diversified Alternatives[10]	+3.15%	+0.73%	+1.81%	+2.40%	+5.29%	+0.50%	+0.06%
Commodity[11]	-5.01%	-6.36%	-1.97%	-4.54%	+2.52%	-0.59%	-2.56%

[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.

RUSTY VANNEMAN, CFA, CMT
Chief Investment Officer

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 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.*

You May Be Taking More Portfolio Risk Than You Think

1

Risk can be defined in different ways, but the ultimate risk is not meeting one's investment objectives. The biggest reason investors do not meet their goals is an inability to stick with an appropriate investment plan.

There are two primary reasons investors get off course. One is that an investment portfolio didn't behave as expected. The second is that an investor's return expectations were unduly influenced by recent performance. Let's discuss both.

Investments Not Performing as Expected

Risk Scoring of Investors

In the investment profession, investor risk tolerance (the financial and emotional capacity to take stock market risk) is typically profiled with risk scores from zero to 100. If an investor scores a zero, they are very conservative and probably shouldn't be investing! If an investor scores a 100, they are very aggressive, suggesting they have a long-term investment horizon and are very knowledgeable and comfortable with stock market risk. The 100-score investor's portfolio would then assume 100% (or more) total market risk, and a zero-score investor's portfolio would assume zero stock market risk.

("Total market risk" should be defined by the global stock market, which is the broader investment opportunity set, not a subset of the global market, such as U.S. large-cap stocks listed on the S&P 500.)

To drive the point home: If an investor scores a 100, they would be comfortable with 100% market risk. If they score an 80, they would be comfortable with 80% market risk; with a score of 50, they'd be comfortable with 50% market risk, and so on.

For an investor's expectations to be met, they need an investment portfolio with a risk level that matches their risk score.

Risk Scoring of Investments

Investments, meanwhile, have a wider range of risk scores and will often score outside the zero to 100 range. An easy way to understand this is if the "total market risk" is defined by the entire global stock market, then it's obvious that some stocks are riskier than the overall index and others are less risky.

It's rare that two total equity portfolios have identical risk. For example, one all-equity portfolio could comprise all volatile, small-cap technology stocks, while another all-equity portfolio could be entirely invested in stable, large-cap consumer staples stocks. These portfolios might both be all-equity, but their risk scores will differ significantly from the overall market.

Yet another example is an investment portfolio that may be leveraged, perhaps taking three times the risk of the market. Obviously, its risk score should not be 100; it should be closer to 300, depending on what it's leveraging.

You May Be Taking More Portfolio Risk Than You Think (cont.)

1

Risk Changes All the Time

Another crucial consideration for investors when building investment portfolios is the fact that investment risk scores change over time. In fact, they can change a lot over relatively short periods of time, and that can make a big difference to how portfolios behave. Risk-scoring methodologies should reflect that, ideally being updated as frequently as possible.

The table below is an example of why more frequent risk scoring is important. When we review the global market and break down standard investment risk statistics over the last one- and 10-year periods, we see significant changes.

This may surprise many investors, but non-U.S. stocks have been less risky/volatile than U.S. stocks over the last year. For instance, the one-year beta, which is a measure of relative risk, for non-U.S. stocks, is only 0.76. That means non-U.S. stocks have had a bit less than 80% of the risk of the global equity market over the last year. Over the last 10 years, however, international stocks were more volatile, with a beta of 1.08.

U.S. stocks, meanwhile, have had 118% of the risk, while the 10-year average beta has been a bit less than 1.00. (The total U.S. stock market is defined by the total market Russell 3000. Note that the S&P 500 excludes small-capitalization companies and most mid-cap stocks, too.)

BENCHMARK	TICKER	1-YR. BETA	10-YR. BETA
Global (60% US, 40% Non-US)	TSM	1.00	1.00
Vanguard S&P 500 ETF	VOO	1.16	0.93
iShares Russell 3000 ETF	IWV	1.18	0.96
iShares MSCI ACWI ex US ETF	ACWX	0.76	1.08

Source: CLS Risk Budget Scores

Why have these risk characteristics changed? The biggest reason is price volatility has sharply risen for U.S. stocks relative to non-U.S. stocks, at least for the indices that represent them. That is clearly different from historical market behavior. Investment portfolios should be managed accordingly, given this information, to match investor expectations.

Wrong Benchmarks

Another reason portfolios don't behave as expected is investors may be matching them against the wrong benchmark. This is a common problem in the investment industry. An investment's return and risk expectations need to be based on the typical asset classes the portfolio invests in. For instance, if a portfolio is balanced with a blend of assets classes, then simply matching it against an index of U.S. large-cap stocks, such as the S&P 500, doesn't make practical sense.

If portfolios of different asset classes are being judged together, then a risk-based benchmark is a preferred way to understand risk and measure portfolio performance over time. In other words, if a portfolio has exhibited 50% of the risk of the global equity market (and assuming no change in investment philosophy or process), then it should be expected to have approximately 50% of the risk of the global equity market moving forward.

How Much to Invest in International Stocks

2

As seen in the opening performance table on the first page of this report, U.S. stocks have outperformed non-U.S. stocks in recent time periods. The latter has performed well, but the U.S. has performed better. As a result, many investors are chasing this performance by buying more domestic equities and selling international equities.

Chasing performance, not fees or lack of information or intelligence, is the most common reason investors underperform. Chasing performance leads investors to buy what has already gone up in price and sell what has already gone down. This is often called the behavior gap, and it costs investors up to 1.5% per year according to this study. Other studies, such as those conducted by Dalbar, show that chasing performance costs investors even more.

Currently, investors are chasing the U.S. market. To offset that, we believe they should buy more international. From a shorter-term perspective, there are two compelling reasons. First, as we've seen above, international markets are currently less risky. Second, we believe international markets are more attractively priced for better future returns.

How much should an investor invest in international stocks (as a percentage of their equity holdings)? There are several frames of reference. First, the U.S. Security Exchange Commission (SEC) defines "global" investment funds in the U.S. as having at least 40% in international securities. Second, the all-country world index is currently 45% international (and thus 55% U.S.). Finally, for portfolio risk reduction, studies show 40-50% in international is the sweet spot for long-term investment portfolios.

As for the typical U.S. investor, the current average allocation to international equities (as a percentage of equity exposure) is 27%. (Source: Morningstar; a review of all mutual funds, ETFs, and separate management investment accounts). So, from both a strategic (long-term) and tactical (short-term) perspective, we believe investors should have more international equities in their portfolios.

Active Management's Time to Shine

3

What is the difference between a passive and an active investment portfolio? The passive strategy attempts to match a benchmark's return (before fees) and risks over time. Success is defined as having a low tracking error. An active fund, however, differs from a benchmark as it attempts to achieve a higher risk-adjusted performance over time.

While more actively managed funds actually tend to beat their benchmarks than passively managed funds, the average actively managed fund is not expected to outperform the average passively managed fund over time (in fact, they usually don't in many asset classes, particularly the more popular ones, such as U.S. large-caps). It's just simple math. For every active decision an investor makes, another investor makes exactly the opposite decision. These decisions must net out to zero — and that's before transactions costs. Note this is the case even in environments where active managers should do well, such as when there are larger return differences (dispersion) between sectors, industries, and stocks. Thus, relative performance is a zero-sum game, and it's a net loser after transaction costs.

Passive investing has become very popular in recent years, as one would expect during a long bull market led by U.S. large-cap stocks. Its popularity has grown not only because it has generated better average numbers in recent years (in most asset classes), but because it typically has lower costs. However, there are times when active management does better — and we believe that time is due to occur. The main factors that have led to passive investing's outperformance are all poised to revert or lessen in significance.

First, passive funds usually have lower expense ratios. That is still the case, but the cost differential is not nearly as pronounced as it once was because actively investment funds and strategies have become more attractively priced in recent years.

Second, passive funds are fully invested, while the average actively managed fund typically has some cash holdings. This is often called "cash drag;" in markets with strong positive returns, cash drag can be more significant in explaining relative performance than expense ratio differences.

Third, active management typically does better during periods of rising interest rates and rising market volatility — two market conditions that have not been predominant in recent years. Why might this be the case? As Fidelity Investments recently stated in a report[1]:

1. (Passive)-based investment strategies are agnostic to quality differences in the business models of the underlying holdings.

2. In periods of stability, the quality of a firm's business model is of lesser importance, as the business is usually not threatened by economic uncertainty. When uncertainty increases, these threats become real and the strength of a business model matters more.

3. In the same vein, a company's cost of capital is more important to weaker firms; but when interest rates are falling, this importance is diminished. In contrast, when interest rates are rising, the strength of a business model increases in importance.

[1] "Fidelity Weekly Report: Initial Thoughts on When to Consider Active or Passive Vehicles in Portfolio Construction." November 25, 2019

Active Management's Time to Shine (cont.)

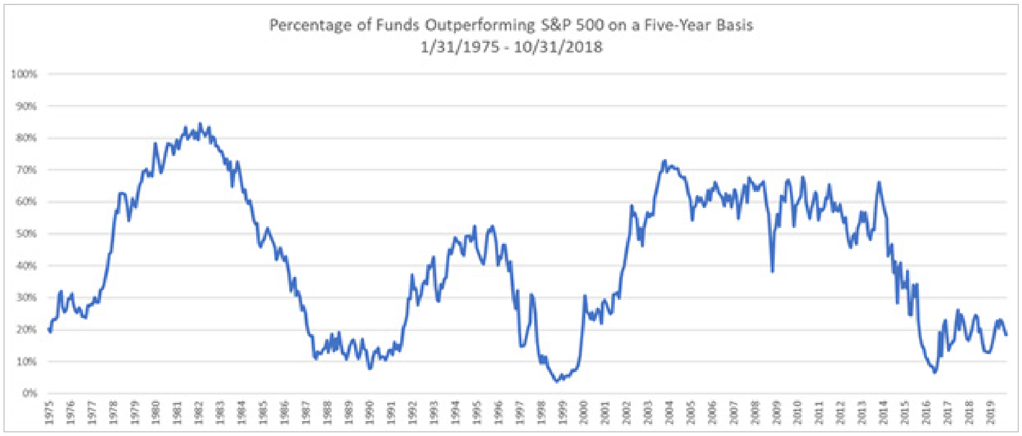
3

Fourth, and this might sound like inside baseball, but it's a legitimate reason, actively managed funds tend to have less exposure to large-caps and thus have small-cap tilts. It's a function of how active money managers typically think of selecting securities and building portfolios. They decide between Investment A and Investment B based on their "intrinsic values" instead of their market-cap weight in the benchmark. Since large-caps have outperformed in recent years, this helps explain recent relative returns between active and passive funds.

Many market commentators define the success of active management by reviewing the performance of all equity funds (whatever their benchmark may be) versus the S&P 500. While this is technically incorrect (as success should be defined against a fund's benchmark, not the S&P 500), it is how many people assess the success of active management.

The chart below shows five-year relative returns of all domestic equity funds versus the S&P 500 going back to 1975. Like all market-related charts, there is a cyclical behavior. When the line is going up, active managers are typically outperforming. When the line is dropping, passive funds are generally outperforming.

As you can see, the relative performance of active managers appears to have bottomed. If history is any indication, that rebound should become more robust in the years ahead and suggest strong relative performance by active managers. That would make sense. Value stocks are the cheapest they have been in decades versus growth stocks. Small-caps are the cheapest they have been in nearly two decades versus large-caps. International stocks are the cheapest they have been in decades versus U.S. stocks, and real assets are the cheapest they have been in decades, too.



Source: Data from Morningstar Direct using U.S. equity active mutual funds versus S&P 500 TR index

As an investor (and consumer) who likes to buy stuff on sale, I'll admit that over time I have had troubles with passive investing in broad market averages. As stated by Rob Arnott in his recent article "Standing Alone Against the Crowd:"

"Since the 1957 launch of capitalization-weighted indices, critics of these indices have pointed out it makes no sense to put more money into a company just because the company is expensive — that is, all else equal, if a company's valuation multiple doubles, the cap index's

CLS INVESTMENTS

Active Management's Time to Shine (cont.)

3

exposure to the stock doubles."

Besides, the market leaders are not on sale now. Consider these stats, also from the Arnott article, regarding FANMAG stocks (Facebook, Apple, Netflix, Microsoft, Amazon, Google), as of September 30:

- These six companies make up 14% of the U.S. stock market.
- If treated as a country, their combined stock market cap would be greater than the individual market capitalization of China, France, Germany, or the U.K. In other words, only two countries have a larger stock market capitalization than the FANMAG cap: the U.S. and Japan.
- If FANMAG was removed from the technology sector, it would become smaller than the health care or financial sectors.
- Apple is worth more than the entire energy sector.
- Apple and Microsoft are worth more than the entire small cap (Russell 2000) universe.

The large index funds are dominated by FANMAG. This sort of concentration has happened before. The last time the tech bubble burst (data from www.syntaxindices.com), the tech sector lost more than 50% over the next year, while all other stocks gained more than 7%. The five-year annualized numbers also show significant differences: tech was down 17% per year, while non-tech was up 5%. The numbers are more sensational when reviewing the performance of securities outside of the S&P 500 that did very well during that time, including small-cap and non-U.S. stocks.

Tech Bubble Aftermath

S&P 500 Sector Weight and Performance

		ANNUALIZED TOTAL RETURN YEARS AFTER 3.31.2000		
	WEIGHT	1	3	5
Info. Tools	29.0%	-63.3	-39.2	-20.5
Information	17.5%	-30.9	-24.8	-10.4
Financials	12.3%	15.8	-0.9	7.2
Healthcare	11.5%	15.1	-1.4	2.4
Industrials	9.9%	-10.7	-12.0	2.3
Energy	7.8%	14.7	-6.1	9.0
Consumer	6.8%	-8.6	-6.7	3.7
Food	6.6%	13.8	1.1	6.7
S&P 500		-19.7	-18.0	-5.0
S&P 500 ex tech		**7.5**	**-4.2**	**5.1**
Tech sector		**-51.1**	**-33.8**	**-16.7**

Source: www.syntaxindices.com

CLS INVESTMENTS

Thank You

Thank you for reading. If you have any questions or feedback, please let me know.

Stay balanced, and stay the course.

Happy Holidays!

RUSTY VANNEMAN, CFA, CMT
Orion Advisor Solutions
Chief Investment Officer
Rusty@Orion.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 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 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.

At certain places we offer direct access or 'links' to other Internet websites. These sites contain information that has been created, published, maintained or otherwise posted by institutions or organizations independent of CLS Investments, LLC (CLS). CLS does not endorse, approve, certify or control these websites and does not assume responsibility for the accuracy, completeness or timeliness of the information located there. Visitors to these websites should not use or rely on the information contained therein until consulting with their finance professional. CLS does not necessarily endorse or recommend any product or service described at these websites.

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 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

Contact Us Today

17605 Wright Street | Omaha, NE 68130

888.455.4244 | CLSinvest.com

1406-CLS-12/4/2019