Directions

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CLS INVESTMENTS

Market Review

MARC PFEFFER
CLS Chief Investment Officer

It has been a tumultuous quarter. While the global markets started the year strong, they ended the first quarter down more than 20%. As we grapple with the fallout of shutting down our global economy to save lives during the Covid-19 pandemic, we are seeing levels of volatility not experienced since the Great Depression. The historic, 11-year bull market ended, and recession fears have increased.

In response to the crisis, the Federal Reserve lowered short-term interest rates to near zero and vowed to inject liquidity into the system by buying back various types of debt. Additionally, fiscal stimulus is on the way to small businesses and households to help those in need and soften the blow of record high unemployment. We believe these measures are aggressive and timely and will help to stem the economic damage.

Please reach out to us or your financial advisor if you have any concerns about your portfolio or risk tolerance. Now more than ever, it is important to keep your Risk Budget at a score you are comfortable with, in both up and down markets.

We wholeheartedly believe we will get through this if we stick together and abide by the guidelines set forth by our leaders in health and government. The markets have weathered significant storms before — and they will weather this, too. Stay invested and stay well.

5 Market Takeaways

1. Are we in a new bull market already?

One market index — the Dow Jones Industrial Average — increased more than 20% in late March, rising from its low point on March 23 to a high on March 26. However, even with this recent rally, the index still sat more than 20% beneath its peak on Feb. 19. Will the next move be higher or lower? At some point, the index will bottom out, and we may have already experienced it.

2. Emerging markets have performed better than you may think.

From peak to trough, Feb. 19 to March 23, emerging markets outpaced U.S. stocks by 4%. This is somewhat odd, given investors' perception that emerging markets always fall more in times of stress. What is even more remarkable is the outperformance came as their currencies were getting crushed, down more than 11% during that time span.

If you hedged your currency risk (as a U.S. investor) or were a local, investing in emerging markets, you fared even better, outpacing U.S. stocks by more than 9%!

3. Fiscal and monetary policy has been welcomed.

The Fed vowed to purchase an extended list of fixed-income assets to introduce stability and liquidity in fixed-income markets. On Friday, March 27, the U.S. passed the largest stimulus package in its history, valued at more than $2 trillion. Both moves helped set the stage for the largest three-day stock rally since the 1930's, with most indexes up more than 15%.

4. Unemployment claims rise to a new record.

It wasn't all good news, especially on the labor front. A full 3.28 million people applied for unemployment benefits the week of March 16, a new all-time high that far exceeds the previous record of 695,000 set in 1982. It's also much larger than the Great Recession's peak of 665,000.

However, unemployment claims are viewed as a lagging indicator for stocks, and the news was already 'priced in' when stocks were down sharply the previous week. On the day the claims data were released, stocks rallied. No one can know for sure why, but it serves as a reminder that it's impossible to time the market. Stay balanced.

5. We are tracking Covid-19 data and market impacts.

CLS Investment's Quantitative PM, Jackson Lee, along with analysts Nick Codola and Brad Lenz have been doing great work setting up our 'command center' for tracking the virus and keeping tabs on global impacts. This may not directly impact investment decisions, but staying informed and watching trends may prove useful once we see worldwide cases plateau. So far, we are watching Japan and the Philippines, where confirmed cases are low relative to population size.

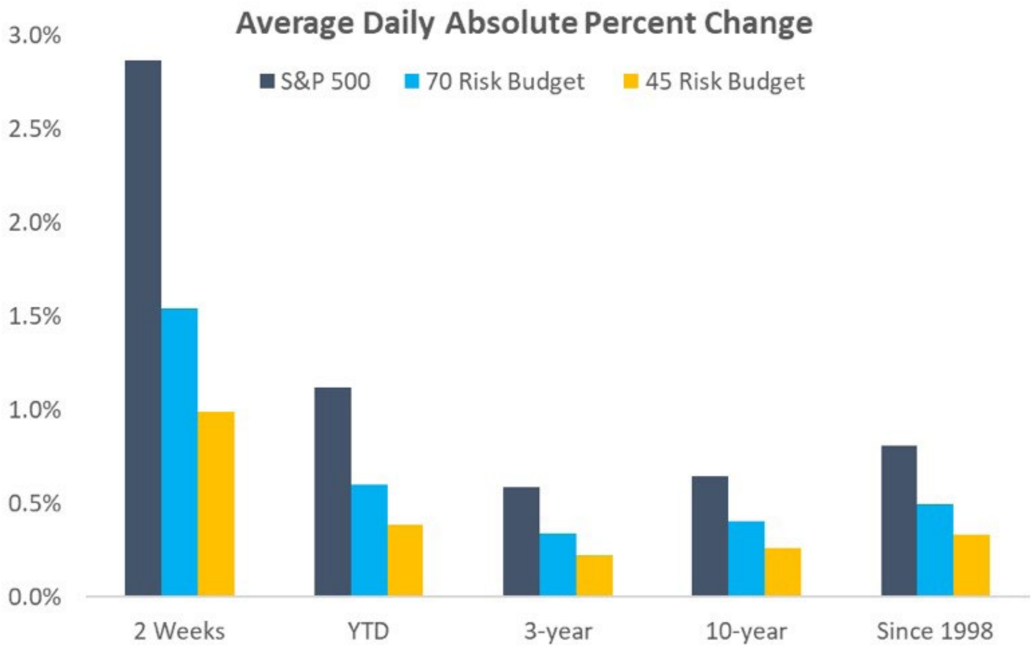
Another key indicator we are watching is the infection rate. At this point, every U.S. state infection growth rate is increasing. When that slows, markets may be off to the races.

A Remedy for Volatility

GRANT ENGELBART, CFA, CAIA
CLS Director of Research/Sr. Portfolio Manager

1,000 points up, 1,000 points down. It goes without saying that volatility has returned (maybe someday people will stop quoting points). There are several ways to weather this volatility. Diversification is likely the best (sure beats cash or bonds right now), but we think it should be taken a step further. Measuring and knowing the risk clients are taking is crucial to becoming comfortable with their allocations and staying invested. This was the fastest market correction in history; who's to say it won't be the quickest recovery in history when it does happen?

Measuring this risk also helps the stomach-wrenching daily fluctuations of markets. In the chart below, we compare the benchmarks for two different Risk Budget levels (70 - a very common 60/40-like allocation, and a more conservative 45) and show the daily fluctuations for those portfolios versus the S&P 500 index. As you can see, the measured-risk portfolios mitigate the daily moves by even more than expected (for example, the 70 Risk Budget benchmark has daily moves that are 50-60% of those of the S&P 500). Risk management is key to navigating clients and advisors through this volatile period. Let us know if you want to measure your risk tolerance or your portfolio's Risk Budget.



As of 3/6/2020 Source: Morningstar, CLS Investments

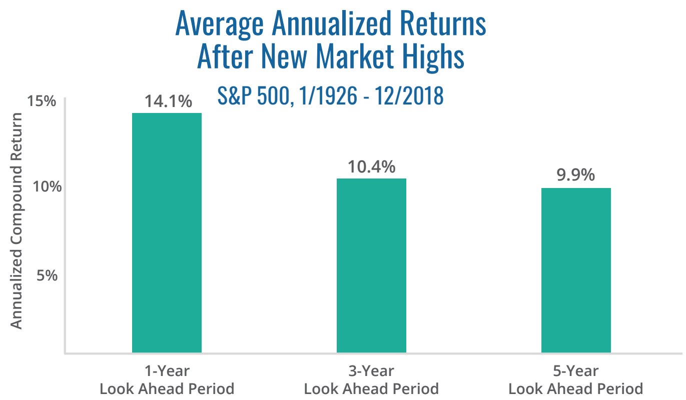
Is it Wise to Invest at Market Peaks or After a 10% Drop?

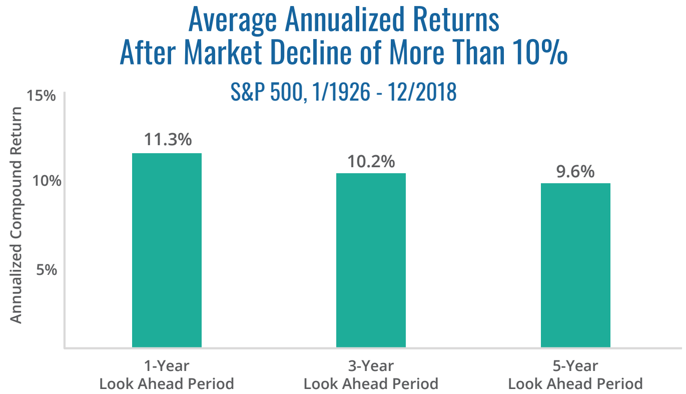
This year, the S&P 500 both hit an all-time high and experienced over a 10% decline. Many investors are wondering whether this is a good time to invest. There are a couple charts I love to reference for this type of question.

- The chart on the top shows that after reaching new highs, the market typically returns nearly 14% over the following year.
- The chart on the bottom shows that after a market decline of 10% or more, the average return over the following year is about 11%.

Despite market positioning — whether the market is at all-time highs or has recently experienced a pullback — history suggests it may be a good time to invest.

KOSTYA ETUS, CFA
OPS Director of Research





Source: Dimensional Advisors

**Market decline of 10% is defined as a month in which cumulative return from peak is -10% or lower. Annualized compound returns are computed for the one-, three- and five-year periods subsequent to a market decline of at least 10%. 1,093 observations for one-year look-ahead, 1,069 observations for three-year look-ahead, and 1,045 for five-year look-ahead. One-year, three-year, and five-year periods overlap. The bar chart shows the average returns for the one-, three-, and five-year periods following a market decline of at least 10%.*

January 1990-12/31/2017: S&P 500 Total Returns Index. S&P data © 2016 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. January 1926-December 1989; S&P 500 Total Return Index, Stocks, Bonds, Bills and Inflation Yearbook™, Ibbotson Associates, Chicago. For illustrative purposes only. Index is not available for direct investment; therefore, its performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results. There is always a risk that an investor may lose money.

95th Reason Why People Did Not Invest in the Stock Market

KOSTYA ETUS, CFA
OPS Director of Research

Aside from the wealth of information that the Reference Guide offers, we have some impactful one-pagers that can be easily digested. One of my favorites is titled "94 Reasons Why People Did Not Invest in the Stock Market," found **here.** Another way to phrase the title is 94 reasons why people sold stocks each year and deposited cash in the bank, or even under their mattress! Here is what the piece depicts:

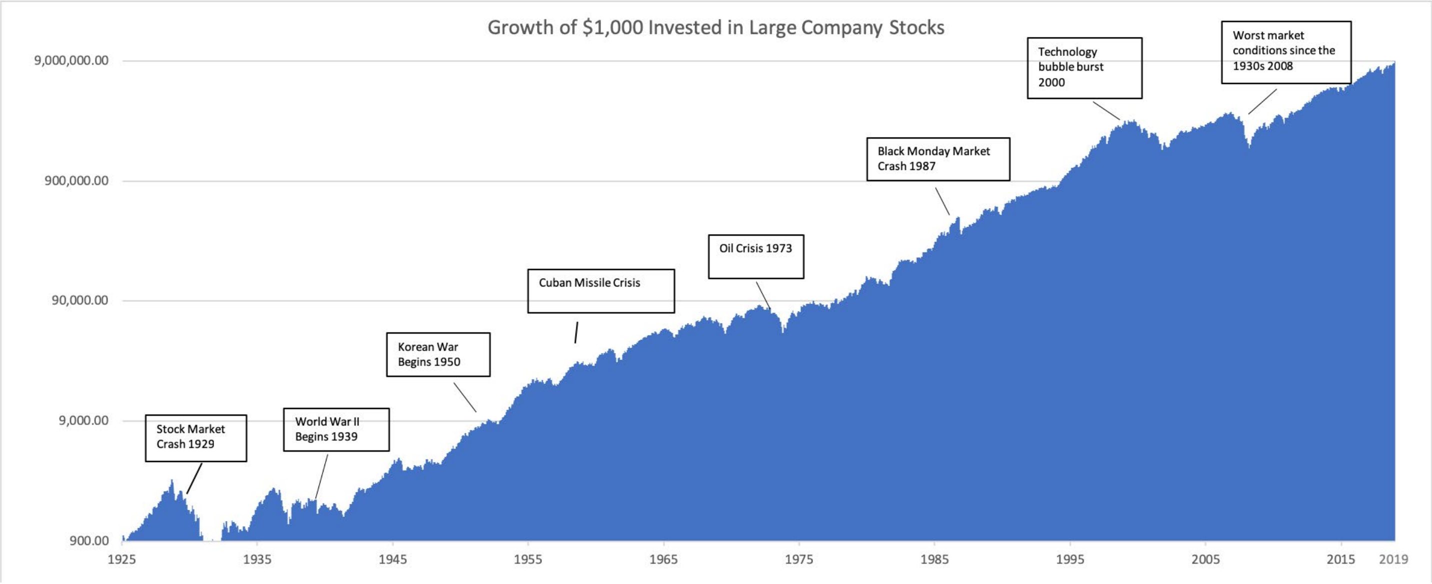
- Page 1 lists major geopolitical events that occurred each year since 1926 (it equates to 94 years of concerning events).
- Page 2 shows the performance of the U.S. market over that period.

To help illustrate the long-term impact, I included some of the more notable events on the chart below. It's a classic illustration of the importance of not getting too focused on a single tree, but instead taking a step back to enjoy the beauty of the entire forest.

There are plenty of excuses for not investing in the stock market. Despite all the events listed, $1,000 invested in large company stocks in January 1926 would have grown to more than $9 million at the end of 2019.

This exercise yet again points to the benefits of utilizing financial professionals who can help investors avoid emotional decisions that could be detrimental to their investment portfolios and long-term goals.

When we update the document for 2020, we'll certainly have some contenders for the 95th reason — not only the coronavirus, but the oil price war and U.S. presidential elections. And the following year, there will no doubt be contenders for 96.



**Morningstar DirectSM Large Company Stocks: S&P 500 Index. You cannot invest directly in an index. As of December 31, 2019.*

Bonds Behaving Badly

CASE EICHENBERGER, CIMA
CLS Senior Client Portfolio Manager

With assistance from Grant Engelbart, CFA, CAIA

We have experienced the quickest decline into a bear market in history. The speed and ferocity of our declining stocks is something never felt before.

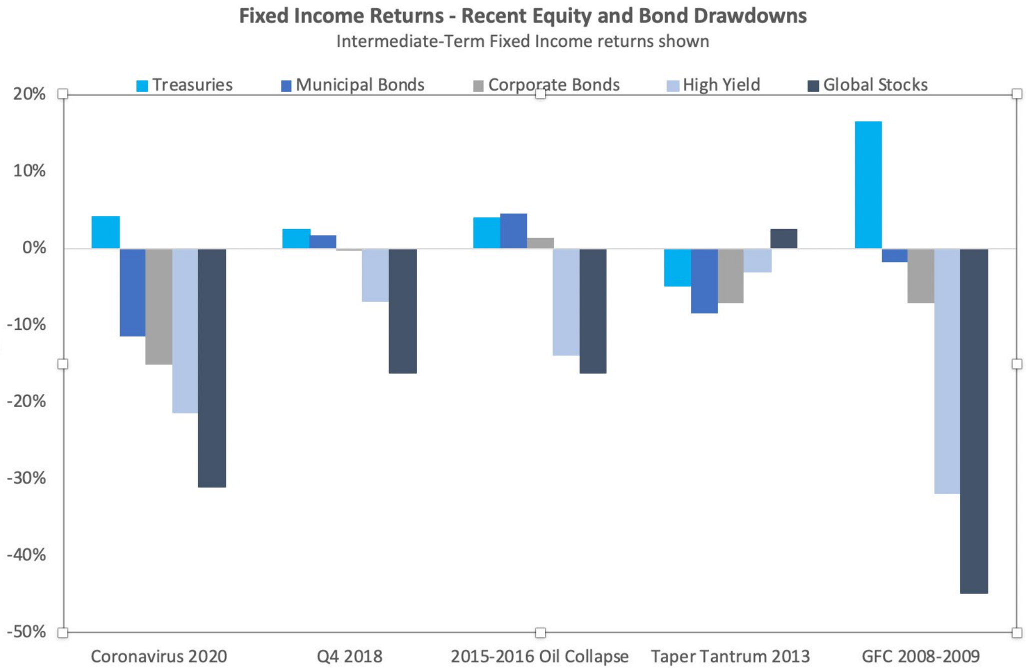
Stock market volatility, in terms of daily closing prices, has now rivaled the great depression era. It has been a little more than a month, but it has felt like six.

The above points are related to stocks, but bonds have been having a rough go as well.

Bonds in investor portfolios are there for their 'boring' attributes. Fixed payments make them a typical anchor to stock market volatility. Stocks are intended for participating in a company's growth and prosperity, while bonds are there to generate income and dampen the volatility of your portfolio.

However, recently, bonds have been under pressure as well. We occasionally see this during times of panic and extreme declines. Liquidity is something investors crave in mass quantities during these times, which can affect bonds just as much as stocks.

The below shows various bond market responses to volatility; you can see that bonds, particularly investment grade bonds, have had a rough go lately.



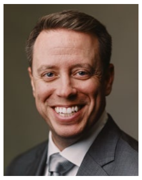
Bonds Behaving Badly with assistance from Grant Engelbart, CFA, CAIA 2 Source: Morningstar, as of 3.20.20 7

During short-term panics, investors may look to unload their bonds at any cost (unless they are treasuries, which have held up well). This can cause short-term price dislocations from their fundamental underlying value.

We have seen bond Mutual Funds, bond ETFs, and individual bonds become affected. It is important to understand that if you are a forced-seller of bonds, you must take whatever price you can get at the time – and since bonds trade far, far, far less than stocks and don't get valued as much, this can be bad for investor selling and great for the dealer buying at a discount. However, if you are a long-term investor, like we are, this may create opportunity to purchase while at a discount. And if you are a client invested in the bond or bond funds, be patient, the losses you see are the product of other investors acting badly. In fact, since the Fed stepped in to provide extra liquidity, we have seen various discounts in bonds close and become closer to where we expect them to be valued at.

In summary, the bonds you own are there for the same reason we discussed above – income and price stability; patience is key. There is no doubt that we are in a very difficult time, and it is only natural for the public to be concerned. Through all this tragedy, however, there are a few silver linings. First and foremost, this is a wakeup call for all of us to practice good personal hygiene, even after this pandemic is over. This is also a good time to take a step back and spend some quality time with our families as we do our part by social distancing. Take the opportunity to learn a new skill set that will help you advance either professionally or personally. At the end of the day, this too shall pass, and the current market environment provides great opportunities for active managers.

Economic Update: Sharp Recovery



CASE EICHENBERGER, CIMA
CLS Senior Client Portfolio Manager

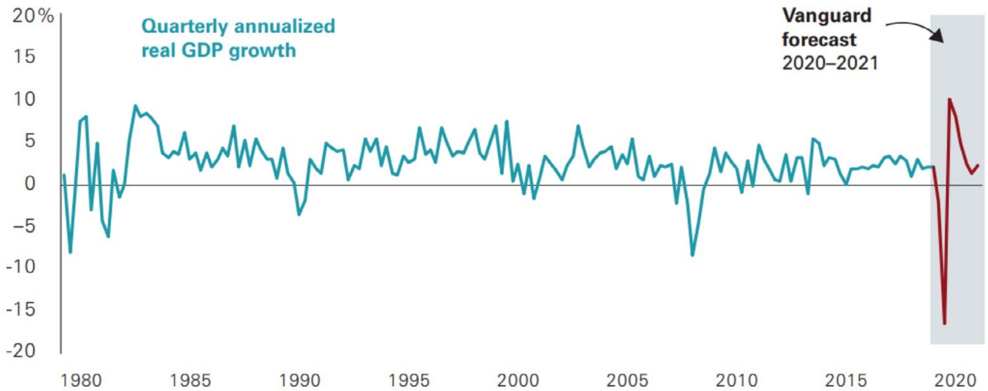
Our investment team has been busy gathering all sorts of new information to best make long-term investment decisions in this unprecedented time. We note that various Wall Street estimates for GDP are starting to come in for 2020 – and they don't look great – which we knew already. To our earlier note, the stock market is always discounting the future, and the sharp decline should tell us that GDP may not be stellar. Below are some summary findings.

- First Quarter GDP may still be positive
  - Our average and median estimate, from Wall Street banks and analysts, shows a growth between 1 and 1.5%.

- Second Quarter GDP looks to be a very sharp drop
  - The average estimate coming in at a loss of 3%, but ranging to as low as down 30%.

- Third and Fourth Quarter estimates then pick up as citizens ultimately get back to work Typically, an event driven shock like a virus results in a quick decline, then a quick recovery back to some sense of normality. We believe this to be the case in front of us. The below chart from our partners at Vanguard illustrates this.

A sharp but short contraction



Sources: U.S. Bureau of Economic Analysis historical data, Vanguard calculations.

We don't know when the market will bottom, but we do know that this will end eventually. The news is set to get worse regarding deaths and people contracting the virus. Unemployment will go up and GDP will decline, but just know that most of this is 'priced in' to the market already and a little bit of good news can get us back on track to stock market growth once again.

Do not underestimate our ability to adapt and prosper. Stay well.

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Contact Us Today

17605 Wright Street | Omaha, NE 68130

888.455.4244 | CLSinvest.com

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