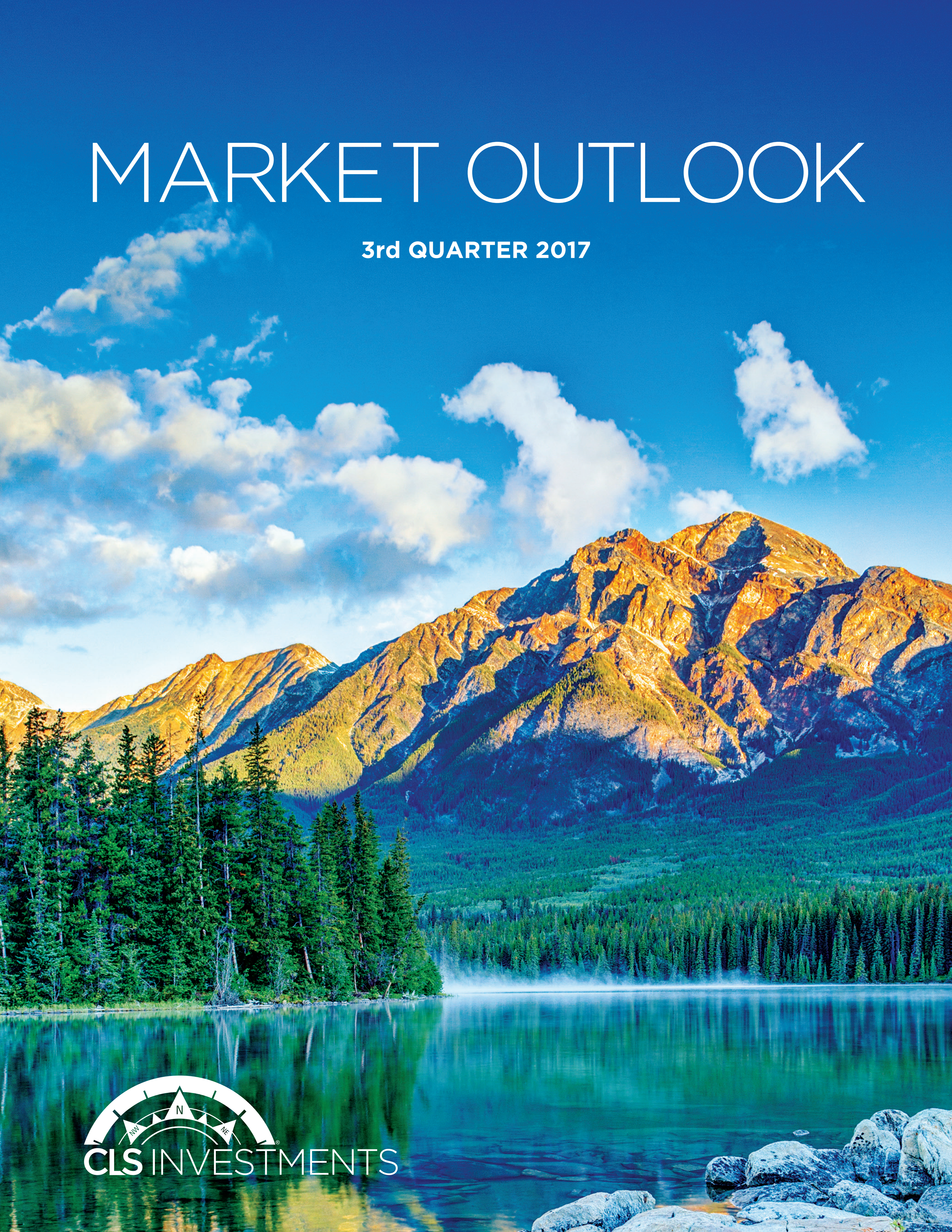
MARKET OUTLOOK

3rd QUARTER 2017



WELCOME TO THE QUARTERLY MARKET OUTLOOK FOR THE THIRD QUARTER OF 2017.

In this report, we will review market and CLS portfolio performance in the last quarter, along with the 2017 Investment Themes. We will also address questions concerning commodities, and why CLS continues to favor emerging markets.

STOCK MARKET	QTD	YTD	1 Year	3 Year	5 Year
Total U.S. Market *Russell 3000*	3.02%	8.93%	18.51%	9.10%	14.58%
Domestic Large-Cap Equity *S&P 500 Index*	3.09%	9.34%	17.90%	9.61%	14.63%
Domestic Small-Cap Equity *Russell 2000 Index*	2.46%	4.99%	24.60%	7.36%	13.70%
International Equity *MSCI ACWI ex-U.S. Index*	5.78%	14.10%	20.45%	0.80%	7.22%
Developed International Equity *MSCI EAFE Index*	6.12%	13.81%	20.27%	1.15%	8.69%
Emerging Market Equity *iShares MSCI Emerging Markets Index*	6.27%	18.43%	23.75%	1.07%	3.96%
FIXED INCOME					
U.S. Bonds *Barclays Capital U.S. Aggregate Bond Index*	1.45%	2.27%	-0.31%	2.48%	2.21%
Cash Equivalent *Barclays Capital 1-3 Month U.S. Treasury Bill Index*	0.20%	0.30%	0.45%	0.20%	0.14%
COMMODITIES					
Commodity *Bloomberg Commodity*	-3.00%	-5.26%	-6.50%	-14.81%	-9.25%
Equity Baseline Portfolio Benchmark	4.13%	11.02%	19.42%	5.91%	11.78%

Source: Morningstar Direct Performance as of 6/30/2017

The bull market is alive and well., just look at the performance numbers in the table to the right. In short, they are fantastic. It's been a great time to be an investor, and particularly a global investor.

For the second quarter, the overall U.S. market, including large-, mid-, and small-cap companies (as captured by the Russell 3000) gained a little over 3%. Large-cap companies (S&P 500) also gained slightly above 3%, while small-cap companies (Russell 2000) gained over 2%.

International stocks (MSCI ACWI-ex U.S.) had a strong rebound this quarter and beat the domestic market with a 5% return. While developed international markets performed well, the shining stars were emerging markets, up more than 6% for the quarter.

The bond market finished higher by over 1% for the quarter, in the face of a rate hike. Commodities were the laggards, however, down 3% for the quarter.

CLS Performance

CLS portfolios have posted attractive absolute returns so far this year. Our global orientation has definitely helped performance when compared to domestic-only portfolios, as our position favoring international equities, especially in emerging markets, has boosted returns. Our two largest economic sector overweights (looking at aggregate CLS assets) have also been in the two best-performing sectors for the last quarter and for the year: healthcare, which we have been buying for months, and technology, which is a long-time overweight.

Yet, there are two notable portfolio positions that have *not* helped. First, we have been underweight (less exposure than the overall market) in what has been dubbed the "FANG" stocks (Facebook, Amazon, Netflix, and Google). Also, while Apple and Microsoft are two of our largest positions when all of CLS's underlying holdings are considered, we are still underweight these companies relative to their weights in the market benchmarks. Second, we have had exposure to the commodity asset class. Though the exposure to commodities is not heavy, it is large enough to make a difference in performance this year since the asset class has lagged the global benchmark by a whopping 25%.

Before we dive into these portfolio tilts and what we are thinking and doing about them moving forward, let's review our current CLS Investment Themes.

CLS 2017 Investment Themes

Global Value

- *What it means:* We are emphasizing value stocks around the world, meaning anything from emerging markets to financial stocks.
- *Impact of theme on year-to-date performance:* On balance, while the emerging markets tilt has provided a huge boost, the relatively light exposure to the FANG stocks (more on this later) and the overweight to financials have not helped.
- *Outlook and positioning:* We still like this theme — a lot. Since we have more attractive buying points again (we didn't earlier this year given how well this theme worked late last year), look for *increased* exposure to value stocks in the months ahead.

Smart Beta

- *What it means:* We are heavily using smart beta ETFs in CLS portfolios. Smart beta ETFs emphasize equity factors such as quality, value, momentum, and fixed income factors, such as credit and duration. We believe emphasizing smart beta ETFs will help enhance returns and manage risks versus traditional market-cap-weighted ETFs moving forward. We are an industry leader in the use of smart beta ETFs.
- *Impact of theme on year-to-date performance:* On balance, this theme has not worked given our weights in value-based smart beta ETFs. However, we have had positive contributions from non-value smart beta ETFs this year.
- *Outlook and positioning:* We still like this theme - a lot too. As with the global value theme, we now have more attractive buying points, so again look for *increased* exposure to smart beta ETF stocks in the months ahead.

Creative Diversification

- *What it means:* Given how low interest rates are, how can we still diversify equity-dominated portfolios with fixed income? We can do it by actively managing our fixed income exposures, including the maturities, credit qualities, and sectors of our holdings. We can also use alternatives, including commodities.
- *Impact of theme on year-to-date performance:* While we have had positive contributions from our overall fixed income positioning (particularly with our actively managed, fixed income ETFs), the exposure to commodities has not helped.
- *Outlook and positioning:* Again, there will be no changes to this theme. We will continue with our fixed income positioning, including the heavy use of actively managed, fixed income ETFs. As for commodities, we will more than likely increase our positions in the near future.

Commodities — Lowest Prices Ever

Due to falling prices in various commodities, including oil prices (brent and crude) reaching official bear market status (20% decline from recent highs), many investors are negative on the asset class. At CLS, our relatively low exposure to commodities has not helped performance this year. So, is it time to throw in the towel and dump commodities?

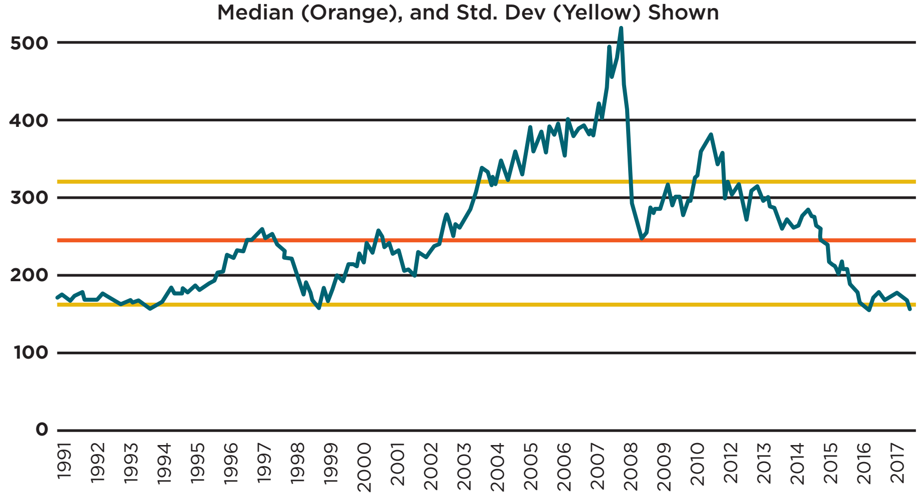
Not so fast.

Adjusting prices for inflation, the Bloomberg Commodity Index is nearing an all-time low! In a world of ever-increasing valuations, does it make sense to sell an asset this depressed in price? Commodity correlations with equities are often negative, and if they remain so, adding commodities to portfolios makes a lot of sense. In addition, as more and more investors retire, the need to protect their purchasing power against unanticipated inflation rises. Commodities often help portfolios in such situations.

Diversifying overall portfolio risk remains a powerful reason to

Real Bloomberg Commodity Index

Median (Orange), and Std. Dev (Yellow) Shown



Sources: Morningstar, Robert Shiller online data own commodities. So does the potential to enhance portfolio reruns. Expected returns moving forward are attractive. For instance, Research Affiliates (Newport Beach, CA) believes commodity returns will be attractive. Research Affiliates produces forward-expected, 10-year returns for a variety of asset classes and projects that commodities should outperform both domestic stocks and bonds in the years ahead. This is based on mean reversion, rebalancing effects, roll yield, and collateral returns. It doesn't even take into account growing global food demand, etc.

Fools Rush In: Why Now is Not the Time to Invest in FANG

The FANG stocks are the stock market darlings this year. Facebook, Amazon, Netflix, and Google-parent Alphabet have been atop the leader board in market performance for the last few years. As a result, investors have clustered into these stocks at a pace not seen in the technology sector since the late 1990s and early 2000s. Correspondingly, FANG's overall contribution to market performance has increased 8.5x since 2012.

This performance chasing has resulted in a herd-like activity. This concerns us. It's not uncommon for investors to pile into investments at market highs, completely ignoring the time-tested adage of buying low and selling high.

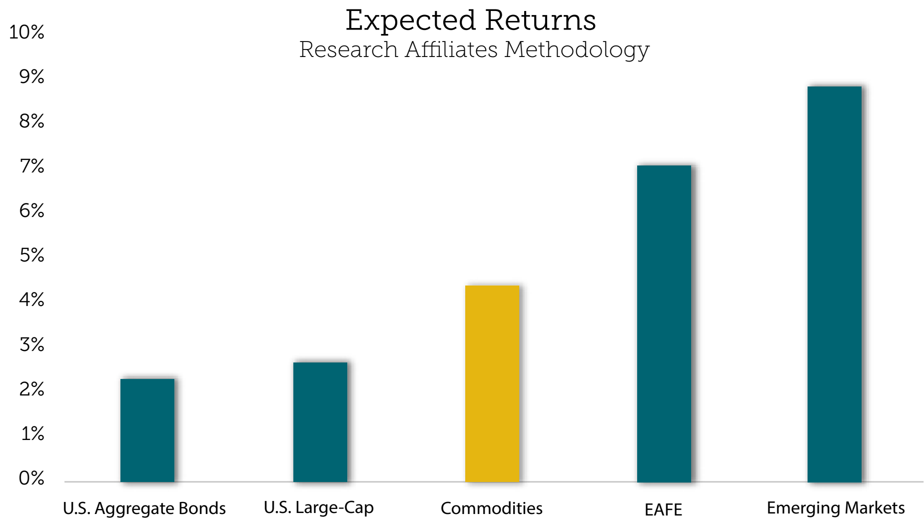
The FANG stocks are now trading at a significant premium to the global market. But, as the famous portfolio manager Howard Marks said, "No group or sector in the investment world enjoys as its birthright the promise of consistent high returns." Outperformance isn't permanent, and the notion of mean reversion is almost inevitable.

In summary, we like value stocks more than the high-flying FANG stocks. There are a few reasons. First, as economic conditions continue to tick up (although at a somewhat sluggish pace), the breadth of performance tends to expand and a larger number of companies will offer gains in the marketplace. Additionally, an economic environment gaining steam is conducive to wider dispersion, a prime environment for stocks exhibiting value characteristics. These characteristics include low-price multiples typically trading at discounts to the overall market, high-cash-flow yields, and strong fundamentals. Lastly, strengthening the argument for a value-led market is the extended period of growth outperformance relative to value over roughly the last decade with the exception of a brief stint in 2016. As such, and as shown in the graph below, value is as cheap as it has been in nearly 10 years.

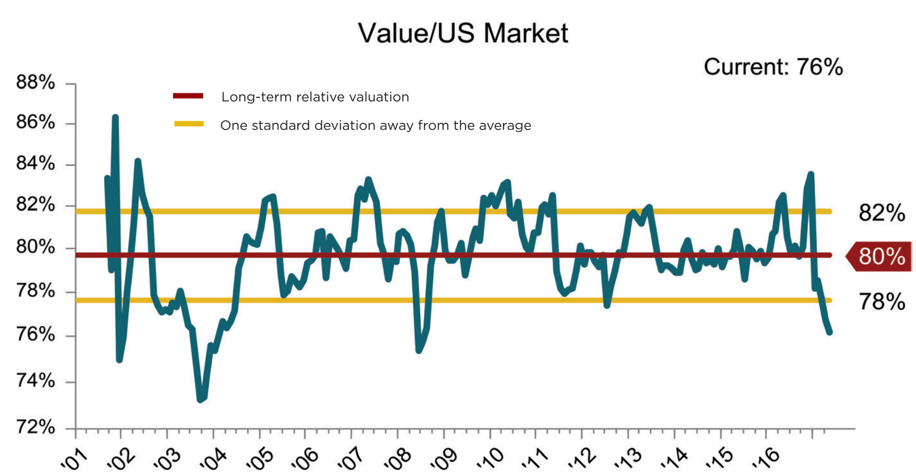
Emerging Markets: The Laundry List of Why We Love Them

Emerging markets (EM) remain our most significant portfolio tilt. There are many reasons we like EM. They include:

- EM stock markets have much more attractive valuations. Lower valuations translate into higher expected returns.



Sources: Research Affiliates, As of 5/31/2017



Source: Morningstar, as of 5/31/17

- EM market earnings growth is accelerating from low levels.
- EM stock markets have significantly lagged U.S. market returns in recent years. Market performance is cyclical.
- EM economies are home to 85% of the world's population, but EM makes up only approximately 10% of the global stock market.
- EM economies produce more than 50% of the world's GDP. Less than 20 years ago, EM made up only about 20% of the world's GDP.
- Though EM makes up about 10% of the world's stock market, U.S. investors have, on average, only 3.5% allocated to EM.
- EM economies are younger and have more favorable demographics, suggesting higher economic growth in the years ahead.
- EM economies are already growing faster than developed economies, such as the U.S., Japan, and Europe. GDP in 2017 is expected to be 4.5% for EM, but only 1.9% for developed markets.
- Consumption among EM consumers is the next big push for economic growth in EM economies. China, Brazil, Russia, and Mexico are current examples of economies that are getting ready to "take off" as they advance from building infrastructure to increasing industrialization and, eventually, producing consumer-led economies like the developed world. As McKinsey and Company recently said, "The biggest growth opportunity in the history of capitalism" is the growth of the emerging market consumer.
- EM are not large yet, in terms of market size. For example, did you know:
    - Apple's market cap is bigger than South Korea's?
    - Berkshire Hathaway's market cap is bigger than the entire country of India's?
    - Johnson & Johnson's is bigger than Brazil's?
    - GE's is bigger than South Africa's?
    - Disney's is bigger than Mexico's?
    - Pepsi's is bigger than Russia's?
    - Dr. Pepper/Snapple's is bigger than Peru's?
- Last, but surely not least for a portfolio risk manager like CLS, investing in EM provides diversification benefits to equity portfolios (in other words, it helps reduce overall portfolio return volatility over time).

What Concerns Us?

It's been a great run for the stock market. While investor sentiment has clearly improved, we still get questions about an imminent correction or bear market. When will it happen?

Currently, there are clues that a correction is imminent. However, there are also clues that a correction is not imminent. This backdrop is almost always the case. So, how does one prepare? In short, it is to understand that while the stock market has a strong positive return expectation over time (even when the market is overvalued), one should always expect that a correction could happen — as soon as tomorrow. And, it can run deep. For an equity-only portfolio, a 50% bear market could always be in the cards, just like it has been twice in the last two decades. The best way to prepare is to not invest money that is needed for liabilities in the near future in the stock market.

So, what are CLS's top concerns at present? Each quarter we list these concerns in the CLS Reference Guide. Currently, our top concerns are:

1. Investor expectations
    - Given the duration of the bull market in stocks, many investors are expecting above-average returns to continue. Our counsel is to not expect that.
    - In addition, many investors expect losses from the bond market given the low level of interest rates and the fact that the Federal Reserve (Fed) is raising rates. Again, our counsel is this view is probably misguided given bond market math and history, though we do agree that low interest rates are not super attractive.
2. U.S. stock market valuations
    - Related to the mature bull market, our view is that forward returns in the U.S. stock market are likely to be below average since stock market valuations are above average.
3. Global debt
    - Global debt levels are very high, and that is likely to put a lid on economic growth and interest rates in the year ahead.

Given these concerns, we have built our portfolios accordingly. We are emphasizing international securities, particularly in economies with less debt (EM). We are also creatively diversifying risk since interest rates remain low.

Thank you for reading. Until next quarter, if you have any questions on this material, or anything outside of this, please let me know. Thank you for your time and trust.

Stay balanced.

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 S&P 500® Index is an unmanaged composite of 500-large capitalization companies. This index is widely used by professional investors as a performance benchmark for large-cap stocks. The Russell 2000® is an index comprised of the 2,000 smallest companies on the Russell 3000 list and offers investors access to small-cap companies. It is a widely recognized indicator of small capitalization company performance. The MSCI All-Countries World Index, excluding U.S. (ACWI ex US) is an index considered representative of stock markets of developed and emerging markets, excluding those of the US. The MSCI EAFE Index is a composite index which tracks performance of international equity securities in 21 developed countries in Europe, Australia, Asia, and the Far East. The MSCI Emerging Markets Index is a composite index which tracks performance of large and mid-cap firms across 21 countries classified as emerging market countries. The Barclay's Capital U.S. Aggregate Bond® Index measures the performance of the total United States investment-grade bond market. The Barclay's Capital 1-3 Month U.S. Treasury Bill® Index includes all publicly issued zero-coupon U.S. Treasury Bills that have a remaining maturity of less than 3 months and more than 1 month, are rated investment grade, and have $250 million or more of outstanding face value. The Bloomberg Commodity Index is made up of 22 exchange-traded futures on physical commodities and represents 20 commodities that are weighted to account for economic significant and market liquidity. An index is an unmanaged group of stocks considered to be representative of different segments of the stock market in general. You cannot invest directly in an index.

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