MONTHLY MARKET REVIEW

MAY 2017

In This Edition

- *Another positive month for the global financial markets.*
- *How CLS is building portfolios.*
- *Why sports fans and investors think alike.*

CLS INVESTMENTS

Market Performance

Stock Market	MAY	YTD '17	12-MONTH
Total U.S. Market[1]	+1.02%	+7.96%	+17.69%
Domestic Large-Cap Equity[2]	+1.41%	+8.66%	+17.47%
Domestic Small-Cap Equity[3]	-2.03%	+1.48%	+20.36%
International Equity[4]	+3.24%	+13.74%	+18.24%
Developed International Equity[5]	+3.67%	+14.01%	+16.44%
Emerging Market Equity[6]	+2.96%	+17.25%	+27.41%
Fixed Income	**MAY**	**YTD '17**	**12-MONTH**
U.S. Investment Grade Bonds[7]	+0.77%	+2.38%	+1.58%
Cash Equivalent[8]	+0.06%	+0.22%	+0.40%
Commodities	**MAY**	**YTD '17**	**12-MONTH**
Commodity[9]	-1.33%	-5.07%	-2.45%

[1]Russell 3000 [2]S&P 500 Index [3]Russell 2000 Index [4]MSCI ACWI ex-U.S. Index [5]MSCI EAFE Index [6]MSCI Emerging Markets Index [7]Barclays Capital U.S. Aggregate Bond Index [8]Barclays Capital 1-3 Month U.S. Treasury Bill Index[9]Bloomberg Commodity

As of 5/31/2017

May Market Review

The winning streak continues for the global stock markets, notching another consecutive gain in May. For the month, the U.S. stock market (Russell 3000 Index) was up about 1%. Larger companies (S&P 500 Index) were up more than 1%, while smaller companies (Russell 2000 Index, which makes up about 10% of the overall market capitalization of the Russell 3000) were down more than 2%.

International stocks (MSCI ACWI-ex U.S. Index) were up more than 3% for the month. Developed international led the way, up 4%, while emerging markets were up 3% for the month. The bond market (Bloomberg Aggregate Bond Index) was also up about 1% in May.

With the exception of small-caps in recent months, it should be noted that all major indices (including bonds) in all time frames have positive returns going out 10 years. It's been a great time to be an investor.

CLS portfolios have also benefited from the gains, as one would expect from a globally diversified portfolio manager. This year is no exception with strong absolute gains and competitive relative returns. What has helped us this year is our exposure to the international markets, especially our emphasis on emerging markets. What hasn't helped, however, is our tilt towards value-oriented securities, including to financials and natural resource sectors.

Let's dive into our current thinking.

Current CLS Investment Themes

CLS manages a variety of strategies, funds, and portfolios. Besides being Risk-Budgeted, one common thread to all of these portfolios is the CLS Investment Themes. The themes are specific enough to capture essential elements of how we manage assets, but broad enough to allow each portfolio manager to express her or his view. Our current themes include:

Source: MSCI

1. Global Value

CLS is a relative value money manager. In other words, we do not buy assets that appear cheap in absolute terms; we buy them in relative terms. For example: If an asset is trading at a 10% premium to the overall stock market but typically trades at a 50% premium on an historical basis, we would consider that asset relatively inexpensive and worthy of investment consideration.

What appears to be on sale now? First and foremost: international stocks, particularly emerging markets. We are heavily emphasizing international securities, and we are currently more likely to add to those positions than decrease them.

In stocks, particularly within U.S. markets, we like smaller companies more than larger companies, and value stocks (financials and natural resources) more than growth stocks (consumer discretionary companies, such as FANG stocks). Among other sectors there is relative value in healthcare and technology.

2. Smart Beta

Smart beta ETFs are enhancing investor portfolios, but disrupting the fund industry as market share continues to migrate from actively-managed mutual funds to smart beta ETFs. CLS is one of the leading users of smart beta ETFs among ETF strategists.

Smart beta ETFs invest based on certain rules, or factors, instead of the traditional market capitalization that many benchmarks are built around. These factors are the screens, or filters, that many traditional portfolio managers use to begin building portfolios. In other words, smart beta ETFs capture the essence of active management in a disciplined fashion, at a fraction of the cost.

The chart above (from MSCI) provides a short summary explaining the difference between active and passive investing, and how factor investing compares.

3. Creative Diversification

This theme builds on the idea that we don't "set it and forget it" when it comes to selecting diversifying assets. We actively manage our fixed income holdings. We adjust credit (we are getting more conservative lately) and duration (we emphasized longer maturities earlier this year, but we are reversing that view given the recent drop in longer-term rates). We also heavily use actively-managed fixed income ETFs from some of the premier fixed income shops, including PIMCO, Fidelity, TCW Met West, and DoubleLine. In addition, we will use commodity and alternative asset class segments and strategies to further diversify portfolios.

Why LeBron is the Best

Obviously, being a sports fan and an investor are different. The former is entertainment, while the latter is about building a future that includes a comfortable retirement, meeting philanthropic goals, and paying for homes, educations, vacations, and more. While investing for many is all-consuming — for instance, I love everything about managing money, both personally and professionally — it should not qualify as entertainment.

One element they have in common, however, is they both create strong emotional reactions. For investors, this can jeopardize their goals by getting them off course. We write about this often. This detrimental behavior, known as the "behavior gap," causes investors to lose money by chasing performance and making emotionally driven decisions. Sports fans, meanwhile, even though pride is on the line instead of money, experience similar emotional reactions.

The following are two examples of similar emotional behavior from sports fans and investors.

First, the *"recency effect."* This occurs when too much emphasis is placed on the latest results instead of the full body of results. If a good team, for instance, has a bad loss, the reaction is usually swift and sharp that the sky is falling. It almost never is.

Another example is the over-emphasis on winning championships. This might sound like heresy — after all, why do we play games if we're not playing to win? As one of the great sportsmen of all time, Ricky Bobby from Talladega Nights, said, "If you ain't first, you're last."

In my opinion, good teams — and good investment firms — are those that are consistently good over a course of many years. Being consistently good takes a culture, a process, and talent to execute. It doesn't need luck or a strange bounce of a ball, which, quite frankly, is needed in many championship games.

So, why is LeBron James the best ever? Because he is so consistently good! He has been in seven straight NBA finals, and he has been able to do it with different teams and coaches. In addition, his all-around stats, MVPs, versatility, intelligence, and humility make him, in my opinion, unquestionably the best ever.

What about the championships of Bill Russell and Michael Jordan? They were definitely awesome

RustyVanneman, CFA, CMT

Chief Investment Officer

*Rusty Vanneman joined CLS in September 2012 as Chief Investment Officer. Previously, Mr. Vanneman was Chief Investment Officer 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. During this time, Mr. Vanneman was 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.*

Mr. Vanneman received a Bachelor of Science in Management from Babson College, where he graduated with high distinction. He holds the Chartered Financial Analyst (CFA) designation and is a member of the CFA Institute. He is also a Chartered Market Technician (CMT) and a member of the Market Technician's Association (MTA).

players, but it's a team sport. They had incredible casts to support them. LeBron, meanwhile, has carried teams on his shoulders and played valiantly in losses (think the Spurs) when he was nearly a one-man show. Russell's teams were loaded with all-stars. Jordan had one of the best all-around players of all-time, Scottie Pippen, supporting him. If it was just about championships, didn't LeBron and the Cavs just beat the "greatest team of all time" in 2016?

For the record, I'm rooting for the Warriors, like I did last year. What a team.

I'm getting off track. The keys to success in any endeavor aren't the trophies (though they are nice). It's the consistent process that puts a team or organization in a position to win year in and year out. When picking a money manager, for instance, it is better to pick one with a proven and repeatable process instead of the one that was "No. 1" in its category recently. It takes luck to be "No. 1," but it doesn't take luck to have a consistent process. Go with the proven process over the latest championship.

The key is to emphasize process over outcomes. We do that at CLS, and we have good company from the sports world that agrees with this notion, including:

- John Wooden
- Nick Saban
- Bill Belichick

Thank you for reading. If you have any questions or feedback, or want to debate why LeBron isn't the best, please let me know!
Stay balanced.

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Some Worthwhile Reads From the Past Month:

"Higher Calling: A Guide to Helping Investors Achieve their Goals"
https://www.amazon.com/Higher-Calling-Helping-Investors-Achieve/dp/0692838627

"Action Trumps Everything"
http://www.babson.edu/news-events/babson-news/Pages/101202-action-trumps-everything.aspx

Sir John Templeton
https://www.templeton.org/about/sir-john

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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