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CMG Opportunistic All Asset Strategy
2017 Q2 Quarterly Update

The CMG Opportunistic All Asset Strategy began the quarter in an aggressive risk-on position with a high allocation, over 80%, to equities. The strategy significantly increased bond exposure during April from 18% at the start of the month to 46% by month end. Fixed income ETFs showed strong relative strength leading into the French election as investors' concerns led to mild de-risking of equity exposure and created a bid on bonds, primarily government bonds. The strategy finished the month flat as allocations to government bonds (long duration primarily), REITs and consumer stocks offset gains in emerging market stocks and bonds, which benefited from the relief rally that followed Emmanuel Macron's victory in France. The strategy further increased fixed income exposure in May. It was the first time in a year that the portfolio had a larger allocation to fixed income than equities. The portfolio benefited from being overweight government bonds as concerns over fiscal policy and the new administration's agenda cooled equity markets. Additionally, emerging market equities and consumer discretionary sector exposure contributed to positive performance. In June, the strategy increased risk exposure, rotating out of several fixed income positions back into equities. Positions in emerging market stocks and REITs contributed positive performance while exposure to consumer discretionary stocks detracted from portfolio performance. By quarter end, the strategy was again aggressively positioned, with approximately 72% of the portfolio in equities, primarily international, and only 28% in fixed income related positions. Additionally, fixed income exposure also rotated from primarily long duration positions early in the quarter to mostly short duration bond ETFs by quarter end. The portfolio had no commodity exposure during the quarter. The strategy held the following allocations (individual portfolio allocations may vary) to equities, fixed income, commodities and cash at the end of April, May and June:

	Equities	Fixed Income	Commodities	Cash
April	53.96%	46.04%	0.00%	0.00%
May	44.86%	55.14%	0.00%	0.00%
June	72.22%	27.78%	0.00%	0.00%

Equity markets finished another positive quarter and the Fed continued to normalize monetary policy by increasing rates in June. While there has been plenty of excitement on the geopolitical front, the U.S. economy continues to plod along, unspectacular but steady. The current economic expansion is now the third longest on record (going back to 1854) and shows few signs of hitting a recession in the immediate future. Goldman Sachs is now predicting that this may end up being the longest economic expansion in U.S. history.

Although the recovery from the financial crisis has pushed markets to new highs and job growth has been consistently positive (a record number of straight months of job growth), the outlook for economic growth remains tepid. Wage growth has lagged job growth despite complaints by companies that they lack skilled workers and productivity growth has reverted to long-term averages. Robust productivity gains in the late 90s and at the turn of the millennium stemming from technology, primarily the internet, now look more like an anomaly rather than a new paradigm. The new reality for the U.S. is economic growth of 2%, not 3 or 4%, and while markets have been excited about fiscal policy reforms that could stimulate growth, the politics of achieving reforms in healthcare and taxes have proven more difficult. The excitement of election night has been eclipsed by the stark reality of governing and passing legislation.

GLOBAL BUSINESS SENTIMENT

Investors have taken note and they are not confident that the current administration can deliver. Apparently, corporate executives feel the same way. In the June Economic Conditions Snapshot, a McKinsey Global Survey of over 1000 global

executives, geopolitical instability was cited as the greatest risk to global economic growth over the next year. This was consistent across every region surveyed and for North America, the percent of respondents that cited it as the greatest threat rose 15 points over the past quarter (65% of respondents in June, up from 50% in March). Other interesting observations from the report include:

- International executives are more optimistic than North American executives.
- European executives are the most optimistic with over 50% responding that conditions in their home economy will improve. This is up from 38% in March.
- North American executives are now the least likely to expect improvements out of any region. Only 38% now expect conditions to improve, down from 48% in March and 53% in December. Clearly, the post-election euphoria is fading.

A buoyant mood in Europe, after the election of Emmanuel Macron, has created an additional tailwind for the Euro, driving it to the highest level against the dollar in over two years. The dollar index also recently hit a 13-month low. International markets continue to outperform U.S. equity markets as investors are looking for higher growth elsewhere. They are more confident they will find it outside of the U.S. This sentiment is echoed in the McKinsey survey where for the first time since March 2016, more emerging market executives than developed market executives predict their profits will increase in the next six months. Strong growth out of China is yet another positive sign that suggests smooth sailing for the global economy for the time being. This feeling is again corroborated in the McKinsey report. The percentage of executives citing a China slowdown as a risk to global growth in the next 10 years dropped from 37% in December to 30% in June.

Although we see prospects of tax reform and infrastructure fading, there is no storm cloud on the immediate horizon that is likely to trigger a correction or something worse. Most risks to the downside are in the geopolitical realm, like the status of cabinet members in the current administration, North Korean missile tests or the ongoing conflict in Syria. To some extent, repeated exposure to these events has numbed investors to their significance and in a practical sense there is little investors can do to hedge exposure. Global executives grapple with these risks on a daily basis – think about the impact on global supply chains and productivity a conflict on the Korean peninsula would have. Despite those concerns, overall sentiment in the survey is more buoyant about economic growth scenarios, albeit with the caveat that growth will be uneven: some regions will grow faster than others.

BREXIT?

North Korea headlines may be scary on the nightly news but it's the UK that could bring a chill to your portfolio. Of more significance to asset allocation is the state of Brexit negotiations. The UK represents approximately 18% of the MSCI EAFE Index (second largest exposure after Japan) and 5% of the MSCI ACWI Index (third largest allocation after the U.S. and Japan). The sun may have set on the British Empire, but economically, the UK still punches above its weight. Prime Minister Teresa May called an election in June that was meant to solidify her mandate (bear in mind she was never elected) ahead of Brexit. The result was a disaster for May and her party. Rather than consolidate her party, schisms on Brexit and May's leadership have opened with party members openly calling for her resignation. The opposition Labour Party is also divided on Brexit (stay or go and how to go about it). It's been 13 months since the referendum; there appears to be no cohesion to the UK's position in either party and negotiations are to conclude in autumn of 2018. Will we see a hard Brexit, soft Brexit, moderate Brexit, another election or a referendum on the referendum?

At this point, anything is possible. At the core of the dysfunction is the paradox of Britain's position: regain control of borders from the EU but maintain open flow of capital and preserve the economic relationship. The EU, of which only one of its members need use its veto in the future to scuttle an agreement, is unified (and indeed feeling more buoyant after the French election) in its opposition to Britain choosing what parts of its relationship it likes or doesn't like. The British government has not released an analysis of the impact of Brexit but other studies have pointed to a 20% decline

in trade over ten years (soft Brexit – think Norway's relationship with the EU) to a 40% decline in trade over ten years and a 2.6% decline in annual income per capita (hard Brexit – Britain abides by WTO rules). Clearly these are just estimates but they are alarming in that time is being wasted. Given the market tantrums that occurred around Grexit, it is surprising how little effect Brexit has had this year on investor sentiment.

Kindest regards,

PJ Grzywacz
President

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