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CMG Opportunistic All Asset Strategy
2017 Q4 Quarterly Update

The CMG Opportunistic All Asset Strategy was aggressively invested to start the quarter, with over 80% of the portfolio allocated to equities. Equity markets trended higher to finish the year and the strategy was able to capture market upside in October with allocations to large caps, emerging markets, primarily India and Latin America, and sector positions in consumer discretionary and energy. The strategy reduced risk in November by trimming large cap equity allocations and moving into a cash position. Performance was driven by allocations to U.S. equities (mid and large cap) and emerging markets. Fixed income allocations throughout the quarter were primarily short duration and modestly additive to performance. In December, the portfolio rotated out of emerging markets back into U.S. large cap equities while maintaining its allocations to fixed income and cash. U.S. equities again drove positive performance, particularly consumer discretionary sector allocations, while utilities were the primary detractor during the month. The strategy finished the year in a moderately aggressive risk position. The portfolio was heavily tilted to equities the entire year with an average equity exposure of approximately 74%. Fixed Income allocations during the year averaged 22% but were as high as 55% in May and as low as 9% in August. The strategy had very little exposure to commodities (we held a position in gold during the height of the North Korean missile testing) during the year as the asset class had a difficult first half of the year and while commodity performance picked up in the second half of the year, equities continued to prove a more attractive allocation. The strategy remains well positioned to capture market upside to start 2018 and we anticipate that the market environment will continue to be supportive of equities for the time being in spite of elevated valuations. The strategy held the following allocations (individual portfolio allocations may vary) to equities, fixed income, commodities and cash at the end of October, November and December:

	Equities	Fixed Income	Commodities	Cash
October	81.69%	18.31%	0.00%	0.00%
November	72.59%	18.10%	0.00%	9.31%
December	73.20%	18.05%	0.00%	8.75%

Equity markets continue to make new highs, continuing the year-end rally into a strong start in 2018. The global economy is in the midst of the strongest global expansion since before the financial crisis. The current bull market expansion is one of the longest on record without a recession or major market correction (greater than 20% drawdown). Valuations are expensive but not at historical extremes and the corporate tax cut should alleviate the pressure on PE's by helping juice earnings in the short-term, making valuations more tolerable. International stocks, emerging markets in particular, beat U.S. equities last year and appear to signal a new period of relative cyclical outperformance that could last several years. Commodities, after a difficult couple of years, struggled in early 2017 but picked up steam at the end of the year. Oil has hit levels that have not been seen since mid-2015 and there are several trends now supporting a sustained upward trend across all commodities. Fixed income is the asset class that is most likely to struggle this year despite (or rather because of) a solid economy. There are some areas of concern but by and large there is little macroeconomic data that market bears can hang there hat on. The bottom line is that things are good and there is a market tailwind for the foreseeable future. So, why worry?

History, however, is not on our side as all good things must come to an end – at some point markets will hit some road bumps, maybe even a recession or a market correction. For managers focused on risk-managed strategies, be they quantitative or qualitative, the focus is on timing not inevitability. So while we are optimistic about the economy this year and expect positive equity market returns, below are some risks we are keeping our eyes on.

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THE BULL MARKET IN BONDS IS DEAD (THIS TIME IT'S REALLY TRUE!)

The single biggest threat to the equity bull market is rising interest rates and the end of the multi-decade bull market in fixed income. Like the Japanese Widowmaker (the decade-long call for Japanese Government Bonds to blow up and the short bond trade that has hurt many managers' portfolios), market sages call for the end of the bond bull every year – it's a forecasting rite of passage. With that in mind, we believe this year could be different as several trends suggest bonds are in for a struggle. First, the Fed is in the middle of a tightening cycle that entails normalizing short-term rates (raising rates) and winding down asset purchase programs. The Fed's actions are clearly a headwind for bonds. Furthermore, within the Fed's dual mandate (full employment and modest inflation – approx. 2%) lies the macroeconomic justification for tighter policy. Unemployment is at multi-decade lows (the current unemployment rate is the lowest since 2000) and inflation in December, ex food and energy, hit its highest level since January 2017. Labor markets are tight in many sectors as companies are now struggling to find qualified workers for certain positions. If conditions remain tight, we could see sustained wage pressure for the first time in years – again an inflationary headwind that will put pressure on bond prices. Finally, the debt-financed tax cuts that passed in November puts pressure on monetary policy, putting the Fed in a quandary. If the tax cuts succeed in stimulating growth, additional inflationary pressure could force the Fed to speed up its normalization of interest rates. However, the structural impact of adding 10% or more to the national debt may lead to a downgrade and higher costs to fund the government. The Fed would then be in the unenviable position of having to backtrack on its asset purchase program in an attempt to prop up Treasury markets. It also doesn't help that the Chinese (and indeed the rest of the world) may be less than enthused to finance "America First" at current rates. Rates have already ticked up significantly to start the year and show a more concerning trend as rates have gotten too far ahead of growth and earnings expectations. The 10 year has moved from 2.35% in December to a high of 2.74% in January and the 30-year has similarly increased from 2.69% to a high of 2.97%. Both moves have pushed bond yields to significant technical levels that indicate the long-term bull market is being tested.

GEOPOLITICS

The other main source of risk to the current economic expansion is global politics. CEOs continue to cite geopolitical instability as the number one risk to global growth over the next twelve months. Alongside concerns about asset bubbles, geopolitical instability is one of only a few concerns that blemish what is overwhelmingly optimistic sentiments from global business surveys. There are a number of hot spots that could derail the coordinated global growth we are experiencing.

> BREXIT: With less than a year left to get a deal with the EU, the train continues to roll towards a hard BREXIT with no one at the wheel in Britain. Theresa May continues to struggle to unite her party behind any cohesive policy view. In fact, it appears that May has no strategy at all. It would not be surprising if we saw a change of leadership or another election this year.
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> Trade Conflicts: There is a legitimate risk that the U.S. pulls out of NAFTA. The impact on supply chains would hit a wide range of companies and no doubt be a drag on equity prices. Longer-term, it is concerning that the U.S. under Trump has shown no desire to lead on global trade, a policy area that Republicans once owned. The U.S. has already withdrawn from the TPP, with the result being everyone moving on without the Americans. While it would be painful for Canada and Mexico in the short-term if the U.S. plays hardball, the result could be to drive those countries into the arms of China who is more than willing to set new terms for the global economy. The recent McKinsey global survey of economic conditions shows that opinions on trade are dividing more and more on developed vs. emerging terms. Respondents to the survey from emerging economies are 50% more optimistic about trade than respondents in developed countries.

Geopolitics and Black Swans: While ISIS has been vanquished and Assad, with Putin's support, has retained control of Syria, the next war in the region is already brewing. Turkey has attacked Kurdish positions in northern Syria in an operation that risks dragging the U.S. into conflict with Turkey (a NATO member) and Russia. U.S. support for Kurdish militias will be tested. No one in the region is supportive of the Kurds dream of regional autonomy or outright sovereignty and it is likely that U.S. support will evaporate much as it has in the past. Although ISIS has been pushed out of Syria and Iraq, it is likely to expand its foothold in the Sinai, Yemen and North Africa. There is a renewed and elevated risk of another conflict between Israel and the Palestinians as all basis for negotiation has broken down. Both of these conflagrations overshadow the simmering tension of the cold war between Saudi Arabia and Iran. The current brutal conflict in Yemen could spread to other theaters that put further strain on Middle East power dynamics and Shia / Sunni strife. While these conflicts have been simmering for quite some time now, the impact on oil prices has been muted as the risk premium has been disregarded. An escalation in any area could push oil prices higher and serve as a tailwind for precious metals.

North Korea remains on everyone's radar as the risk of a nuclear conflict increased significantly and needlessly last year. Any war with North Korea would be massively disruptive to global supply chains that primarily run through Asia. A conflict would most definitely lead to a large market decline and potential global recession. Finally, the last major risk is another refugee crisis that could destabilize a regional power. The war in Syria has shown the ripple effect of refugee migrations on politics in developed countries. The effect on populist, right wing parties in Europe (and beyond) has been more pronounced, leading to campaign victories for nationalistic politicians. The side effect is that the same political movements (populist, nationalist) typically go hand in hand with protectionism and scapegoating when growth slows, jobs are lacking or benefits are strained. The flight of refugees from war or natural disasters is something we have to get used to as the world will see larger and more frequent crises. This year, the risk is that the genocide and expulsion of Rohingya Muslim refugees from Myanmar could impact India, Bangladesh, Pakistan and the regional balances that keep simmering tensions between Hindus, Muslims and other ethnic groups from boiling over. China's passive aggressive attitude to North Korea reveals their concerns over exactly this issue: any refugees from North Korea are likely to end up en masse on China's border. Asia is the most dynamic economic region in the world right now and the driver of global growth but also a region of instability that bears watching closely for investors with international exposure.

Kindest regards,

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President

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