Wealth through ingenuity.

CMG Opportunistic All Asset Strategy
2018 Q2 Quarterly Update

The CMG Opportunistic All Asset Strategy began the quarter in a defensive position and continued to reallocate into cash/ short-term debt instruments as the second quarter progressed. Our relative strength models have kept the portfolio in a defensive positon for several months. More specifically, short duration fixed income positions have, on a risk-adjusted basis, scored much better than other asset classes in our model. For years, low short-term rates pushed investors out on the yield curve, but the market is finally coming back. As the Fed's rate tightening continues, the short end of the yield curve is finally offering value compared to equity dividend yields and a better risk/reward trade-off than longer duration fixed income instruments that are much more sensitive to changes in interest rates. The yield curve has reflected these changes in investor sentiment and has flattened significantly since the start of the year. The front end of the curve has risen as the Fed has raised rates six times in the past two years while the back end of the curve has flattened as investors fret about the sustainability of current GDP growth trends.

The relative strength process we utilize in our strategy is designed to identify assets that are trending higher in price and are likely to keep trending. Assets that have lower volatility will receive a higher score. In layman's terms, we look for a trend but prefer that trend to be smooth and steady. Relative to equity positions and long duration fixed income, short duration positions have looked much more attractive over recent months, hence the higher than normal cash positions in the portfolio. Additionally, equity market strength has been primarily in domestic equities within small caps and technology specifically, both of which have higher betas and volatilities than the broader market as a whole. Furthermore, international stocks rank poorly in our model as they have struggled since the start of the year due to a strong dollar rally and the ongoing sparing over tariffs. Both serve as sustained headwinds for developed and emerging market investments. At the end of the quarter and in early July, our model started to see equities move up the rankings and we anticipate the portfolio re-entering the market and adding risk in equities soon. As recently as January, the strategy was fully invested in equities and inside of a quarter or two could get back to fully invested assuming markets remain stable and start trending upward.

The ability to change asset allocations in response to changing market conditions is the essence of the value proposition for tactical strategies and why they play such an important and complementary role to traditional long-only portfolios. 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	8.63%	9.23%	0.00%	82.14%
May	0.00%	9.26%	0.00%	90.74%
June	8.75%	0.00%	0.00%	91.25%

After a difficult end to the first quarter, equity and fixed income markets stabilized during the second quarter but remain range bound. While small caps and tech have surpassed the highs from earlier this year, mid and large caps continue to trade below their highs and remain in a choppy channel bracketed by the highs and lows of this year. Fixed income has also recovered after a difficult start to the year but rates also remain range bound as evidenced by the 10 year bond. The 3 to 3.15 percent level seems to be to the ceiling on rates for the time being barring a catalyst. For those of us who still remember board games, the quarter had the feel of the old Milton Bradley board game, Chutes and Ladders. The game is actually based on an ancient Indian board game, originally called snakes and ladders, which represented a life journey. Milton Bradley changed snakes to chutes as it was better received by children. In the Indian version, the

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ladders represented virtues and the snakes represented vices along that journey of life. The markets had that same feeling during the quarter as the virtues and vices of tariffs lifted stocks higher one day only to see them come back down the next. After three months, the journey towards higher prices made limited progress and the threat of tariffs remains a black cloud over this market, overshadowing other factors like inflation and the withdrawal of QE. In the spirit of that game, our outlook is broken down into snakes (what can take the market lower) and ladders (what can make this market go higher). In contrast to the name of the game, let's start with the good news first.

Ladders

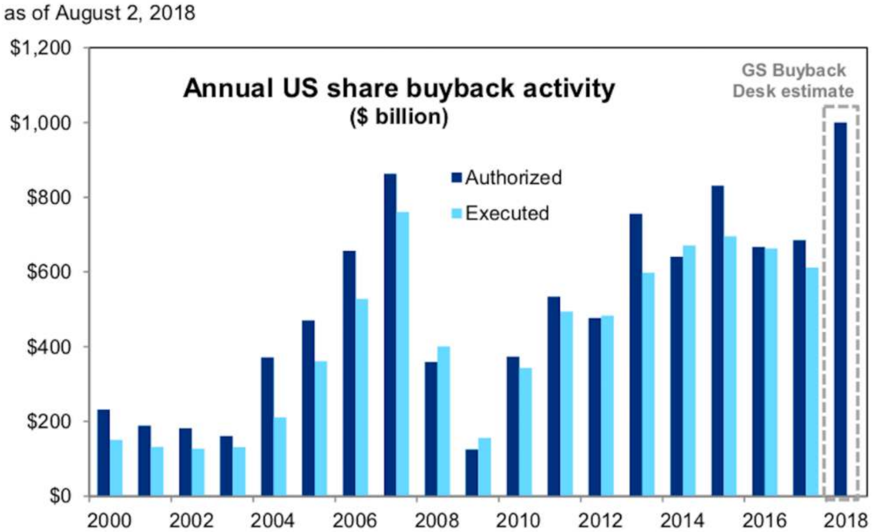
- GDP: GDP growth for the second quarter came in at 4.1%. A robust growth rate that reflects the massive amount of tax cut stimulus. The question is whether that growth rate is sustainable. There were a number of factors that suggest that growth will revert back to a more moderate pace (less than 4%). In addition to the tax cuts, a surge in government spending and accelerated exports positively impacted the growth rate. All of these factors will be absent moving forward during the year and it is likely that growth reverts back to a rate closer to 2.5 – 3.0%.

- Unemployment: Job growth remains solid but has slowed modestly in recent months. The unemployment rate fell to 3.9% but despite a tight labor market, wage growth has been tepid.

- Tariffs: They have had limited impact on growth (so far). Although the rhetoric has escalated from the start of the year, the actual impact of tariffs on growth has been negligible. Furthermore, the majority of economists believe that at the current intensity, and the back and forth on tariffs is likely to have a de minimis impact on global growth. However, tariffs have had the opposite effect the administration has desired on the trade deficit and the U.S. dollar. For Trump, who sees the deficit as a type of scorecard and who as recently as last year attacked the Chinese for manipulating their currency, the current trends are not encouraging. The problem with trade wars is that there are unintended consequences. The Chinese yuan is down approximately 10% against the dollar this year and has helped to soften the blow of tariffs.

- Buybacks (for now): No surprise here as the tax cuts and repatriation of assets have been funneled into share buybacks. This has been a big tailwind for markets as buyback activity is trending towards record highs. Buyback authorizations are forecast at over $1 trillion where historically, 80-85% of that amount is actually executed. A huge bid for markets for the time being.

Exhibit 2: Buyback authorizations have surged in 2018
as of August 2, 2018



Source: Birinyi Associates, Goldman Sachs Global Investment Research

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- QE (not negative yet): As the Fed continues to unwind stimulus by increasing rates, its commitment to quantitative easing (QE) is also nearing an end. Since the global financial crisis, the U.S., along with the EU and Japan, have propped up global debt markets and moderated interest rates. While the EU and Japan will continue with their programs for the foreseeable future, the Fed is moving in the other direction. That does not necessarily mean we will see bond markets fall off a cliff (the Fed is not going to sell any bonds they are holding) but it does suggest that the Fed, as a large buyer, is likely to be on the sidelines.

Snakes

- Trade War: The biggest headwind for the markets during the quarter was the escalation of trade war rhetoric. While currently a moderate threat, there is a real risk that the current situation escalates as each side tries to save face and talk tough to domestic constituencies. There is a lot to address in this section and we go into greater detail in a breakout below.

- Strong Dollar: The strong dollar will continue to be a headwind for domestic firms as it makes them less competitive in global markets. China, in particular, has benefited as the yuan has declined measurably this year and softened the blow of tariffs.

- Moving Growth Forward: Although growth has been strong this year, particularly the second quarter which came in at 4%, there is increasing concern that it will not be sustainable. Tax cuts, increased government spending and accelerated exports boosted growth this year; but economists agree that what amounts to a large Keynesian stimulus is likely to have a temporary and limited effect on growth. Former Fed Chairman Ben Bernanke said as much at a recent AEI event. According to Bernanke, the stimulus has come at the "wrong moment," when unemployment is at historic lows and interest rates are accommodative. Bernanke believes the economy is set up for a "Wile E. Coyote" moment in 2020 when that stimulus fades, the economy goes off a cliff and the Fed has a much more difficult time achieving its dual mandate.

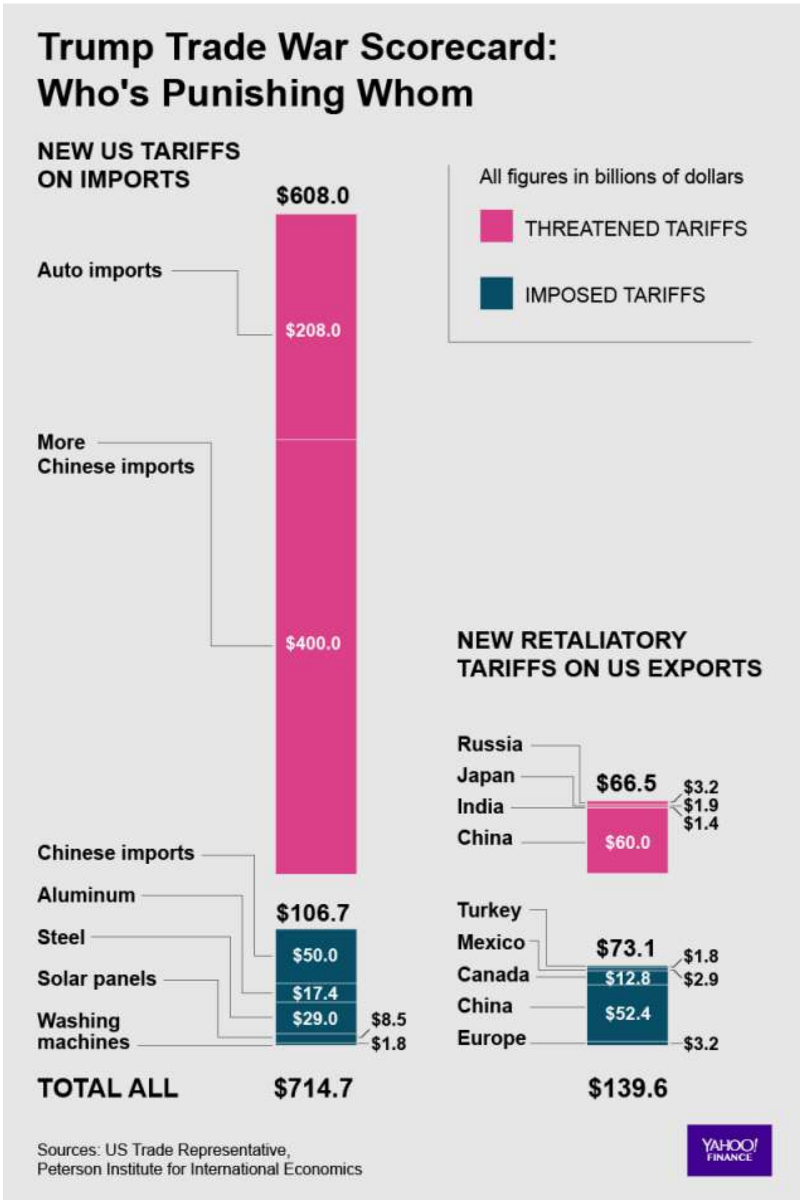
- Flattening Yield Curve – Is it the Harbinger of a Recession?: Historically, when the yield curve flattens (typically a yield curve of short-and long term-interest rates is upward sloping reflecting long term growth and inflation expectations), it signals an increased risk of a recession. Rate watchers typically look at the spread on two and 10-year Treasury notes and we recently hit levels last seen in 2007, just before the global financial crisis. While not a definitive predictor of recessions, it bears watching more closely. Why is the curve flattening? Short-term rates are rising due to the Fed tightening policy and long-term rates have risen by less than short-term rates due to investor demand for yield and concerns about long-term, sustained growth.

- Debt, Debt and More Debt: Given where GDP growth and unemployment are at, it is odd and troubling that the Treasury is on track to issue $1 trillion in debt this year. Furthermore, the forecast for 2019 is an additional $1.4 trillion in debt. The largest annual issuance of marketable debt was during the Great Depression and came in at $1.8 trillion. Several factors have contributed to the increased need for funding including tax revenue decline resulting from tax cuts, increased growth has not translated to increased revenue (too early to tell if revenues will ultimately grow as the economy grows but the forecasts taxpayers were sold during the tax cut debate have been proven wrong), increased government spending, and budget deficit forecasts that exceed $1 trillion for each of the next couple of years. So far, fixed income investors have absorbed the supply of debt at reasonable rates but will it continue?

Trade Wars are Easy to Win

Last quarter we discussed the impact of a trade war on the global economy and how it could undermine the status of the U.S. as a global political and economic leader. Over the past several months, both trends have accelerated and the risk of a material impact on growth has gone up. However, the real damage could be long-term as the rest of the world is in contingency mode with numerous countries working to secure their trading flanks in the event of an escalation.

The first tariffs that set off the current skirmish began in January. In a little over seven months the total amount of trade that is threatened (either imposed or scheduled to be imposed) has reached approximately $300 billion (15.7% of total U.S. imports) of goods entering the U.S. and $80 billion (5.1% of total U.S. exports) of goods leaving the U.S. Below is a summary of what countries the U.S. has targeted and vice versa.



It seems like every day brings news of more tariffs. While the economy in aggregate may not feel the impact, there are certain segments of the economy where this is very real; such as the soybean farmers that are likely to lose a large portion of their income this year or the manufacturers who are now facing the difficult prospect of passing price increases on to end clients due to steel tariffs.

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China and the U.S. are by far the two largest combatants in this battle but the EU and other countries like Canada, Mexico, India and Japan have also been pulled in. That antagonism towards historic allies from the current administration has undermined what could have been a united front against China's trade practices. The lack of strategy started with a withdrawal from the TPP immediately after the election that only served to isolate the U.S. When the administration's hostility to political multi-lateral institutions and agreements such as NATO, the UN, or most recently the withdrawal from the Iran deal is taken into account, it points to a more isolated America, one that is less trusted by allies and foes alike. This type of climate makes it extremely difficult to negotiate trade deals and increases the likelihood that heated rhetoric and posturing turn into real economic blows.

The WTO, the intergovernmental organization that regulates trade replaced the GATT (General Agreement on Tariffs and Trade) in 1995 and overhauled the system of regulations for trade that had been set in 1948 with GATT. Since 1995, there have been several attempts at renegotiation of trade agreements to reflect a more globalized world. The Doha round of negotiations, started in 2001, has struggled to make progress as the developed and emerging economies have had a difficult time finding common ground. The result has been more bilateral deals that ultimately undermine the prospect of a global system. Ironically, it is now the Chinese who are arguing for the preservation of the WTO while the U.S. looks ambivalent. Corrosive rhetoric towards the U.S.'s traditional allies has caused a flurry of activity.

- In February 2017, Canada and the EU formalized CETA and the European Parliament approved the deal. The agreement still needs to be ratified by the EU and each member. It is Canada's largest trade initiative since NAFTA.

- In January, the remaining countries from the TPP agreed on a revised accord, renamed the CPTPP, without the U.S. Look for China to try to join or co-opt this agreement.

- In April, Mexico and the EU reached agreement on a new free trade deal which follows a deal struck between Mexico and Japan last year.

- In July, while Trump was meeting with Putin in Helsinki, the EU and Japan agreed on a huge trade deal that has been negotiated for years. The lack of exemptions from U.S. steel tariffs on both the EU and Japan spurred leaders on both sides to finish the deal.

It is very likely that this type of activity will continue as the EU and China are now teaming up to reform the WTO. Historically at odds with each other over trade, they have been driven together as a response to the current administration's position. Furthermore, China continues to press forward with the Belt and Road initiative (also known as the Silk Road Economic Belt) which will foster Chinese investment and development in central Asia. Those trade routes run through Central Asia, Russia and connect through to Europe. As this flurry of activity continues, the U.S. risks sitting on the sidelines as the rules for global trade are rewritten.

We expect the current rhetoric to escalate as the US approaches mid-term elections. The current administration is at odds with Republicans in Congress on free trade and most recently responded negatively to the administration's proposal to bail out farmers with a $12 billion assistance package. Furthermore, while Trump has been willing to flip flop on certain policies depending on how they poll, he has consistently, even before running for President, been a protectionist. Since his election, markets have seen Trump moderate his positions on a number of economic policies and as such equities trended higher in 2017. But this year, the rhetoric sounds more like Trump from the campaign trail and it has put a ceiling on the market and created an anxiety that serves as a headwind in an otherwise solid economic climate. This is showing up in sentiment polls and indicators. In the most recent McKinsey Global Economic survey, trade related concerns are cited as the largest risk to global growth. A year ago, only 27% of respondents cited changes in trade policy as a risk. The most recent survey shows 64% of respondents (global corporate leaders), clearly making this the largest risk that business leaders see to growth. Finally, asset allocators are also responding. A recent report by Envestnet shows that the investment community is reducing risk as the percentage of assets moving into cash reached 15% in the first half of 2018, compared to 9% in the same period last year.

Kindest regards,

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President

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