Wealth through ingenuity.

CMG Opportunistic All Asset Strategy
2018 Q4 Quarterly Update

The CMG Opportunistic All Asset Strategy significantly outperformed its peer group and benchmark on a relative basis during the quarter as the portfolio was conservatively positioned before the market sell-off. The strategy managed risk exposure well this past year and although our positioning has been defensive for a large portion of the year (after the first quarter sell-off) costing us some upside, we are pleased that the strategy weathered the downside and preserved capital. As we discussed last quarter, our view was that market conditions were signaling an event, and although our model was early in reducing risk exposure, we were rewarded for our patience by avoiding most of the drawdown in a historically bad fourth quarter.

The strategy began the quarter in a defensive position with only three positions on: Indian equities and two lower beta equity positions in utilities and pharmaceuticals. The sell-off in October turned our relative strength indicators negative on equities and by the end of the month the portfolio held only short-term fixed income positions – ultrashort duration bonds. Markets stabilized in November and as equity market rebounded, our models added risk, investing approximately 20% of the portfolio in consumer staples and Latin America. It was a short reprieve before the selling resumed in December driving equity indices into correction mode and wiping out gains for the entire year. CMG Opportunistic quickly rotated out of Latin America and consumer staples into utilities and several bond positions. Unlike the start of the year when equities and bonds declined at the same time, fixed income positions rallied as investors sought safe havens. In addition to holding the majority of the portfolio in short duration bond ETFs, the portfolio also held exposure to municipal bonds and long duration bonds, two of the best performing segments of the fixed income markets in December.

After a difficult quarter and the worst December on record since 1931 (yes, since the Great Depression), we are pleased with the performance of the strategy under such difficult conditions. Our value proposition is not to capture all of the upside and then some – it has always been and will continue to be risk managed returns. While strategies like ours are not always in vogue, especially when markets set new highs, we believe strongly that risk managed strategies have an important role to play in a portfolio. Most investors, whether they be professional or individual, need to manage risk while staying invested. For most investors, a long-term investment horizon means that asset allocation decisions are slow moving and they (or their financial advisor) have to make difficult decisions about increasing or reducing risk, often under strenuous emotional conditions. It's easy to say "stay the course" or the "economy is fine – buy the dip" before or after the crisis. But when you are in the heat of it, or "in the arena" as Teddy Roosevelt once said, it is hard to keep your cool, think logically and make the right decisions. It is for these reasons that we feel strongly that risk managed strategies play an essential role as portfolio diversifiers; reducing risk through tactical, unemotional asset allocation decisions to preserve capital and patiently wait for better opportunities. This mindset has been the essence of our investment philosophy since we opened in 1992 and it has helped us successfully navigate difficult markets, from the Dot.com bubble to the Global financial crisis. The strategy weathered a storm in the fourth quarter and as we can see the end of the line for the current record long economic expansion, we anticipate more storms (market declines, recession, and volatility) ahead.

The strategy held the following allocations (individual portfolio allocations may vary) to equities, fixed income, commodities and cash/cash equivalents at the end of October, November and December:

	Equities	Fixed Income	Commodities	Cash
October	0.00%	0.00%	0.00%	100.00%
November	16.81%	0.00%	0.00%	83.19%
December	9.05%	16.48%	0.00%	74.47%

What an end to the year. After reaching all-time highs during the year, it was remarkable to witness the fear and panicked selling that characterized the fourth quarter for global equity markets. More than one market veteran had flashbacks of the financial crisis or the crash of '87. The quarter was in many ways like a hurricane: coming ashore in October, the calm eye of the storm in November and then a resumption of the destructive onslaught in December. When the clouds passed, the decline in December ended up being the second worst on record. The worst: 1931 during the Great Depression and what was a decidedly different economic environment. Furthermore, there were few places to hide during the quarter with the exception of cash. It was the first time since 1972 that all major asset classes had returns below zero and not one returned more than 5%. The best performing assets for the entire year were cash or cash like proxies that benefited from a surge in short-term interest rates on the back of tighter monetary policy. These are not the normal characteristics of a strong economy or a bull market.

The decline at the end of 2018 has a silver lining for 2019: markets look a lot cheaper on a valuation basis then they did 3 months ago, thereby making forward looking returns slightly more attractive (assuming earnings growth remains on path). Add in the fact that pessimism had reached extreme levels in recent months there is opportunity for upside in 2019. The bad news is that there remain risks that are not easily quantified or managed, namely of the political variety. After much criticism, the Fed has finally signaled that it is willing to slow down its pace of tightening. Chairman Powell may also well have been looking to deflect some of the political pressure coming from the White House. If so, it may prove to be a shrewd move as the focus will now turn to the administration's trade negotiations with China as the primary market driver over the next quarter in the absence of activity from the Fed. If the administration fumbles, it will be much harder to push the blame back to the Fed. Rate hike prospects have declined with the median expectation of FOMC members falling from three to two for this year while investors, via futures markets, are signaling none at all.

Despite strong economic growth in the past year, there remains an anxiety about this market that is keeping equity markets from moving higher. That the source of those concerns is political and difficult to quantify continues to unnerve global markets. It feels like markets could move to new highs or fall to multi-year lows depending on which way things break on a few issues we highlight below. The risk of recession has risen in the EU and China and the U.S. is at risk of a slowdown as well. The uncertainty of these outcomes has increased volatility as investors have less clarity about the direction of markets. Below we break down some of key events that will impact markets in 2019.

The Art of Not Wanting a Deal

After a year of sabre rattling and tit for tat tariffs, the U.S. and China are sitting down to negotiate a trade deal. The stakes are high and the expectations, or more appropriately the hopes of investors for a positive 2019, are even higher. The outcome of these negotiations more than any other event this year may determine whether the global economy expands or declines, potentially into a recession. The success of the negotiations will be determined by the most mercurial politician of recent times. Recent signs from the administration that it is considering removing some tariffs to hasten a trade deal are encouraging. Additionally, Trump is besieged by negative news on all sides and a deal with China would allow him to positively affect the news cycle. The real question is will he take a deal? Aside from immigration, trade and China are the other big issues that Trump cares about. Both issues are the core of his message to a base that has narrowed after losses during the midterm elections. Will that core group of supporters remain energized in the

absence of these fights? There is no doubt that a trade deal would be a positive for markets irrespective of the substance of the deal. In fact, the renegotiation of NAFTA yielded little of substance other than a more complicated acronym but markets saw it as an obstacle removed and hence a bullish sign. The ultimate outcome of the negotiations with China may end up looking similar. That's not necessarily a bad thing.

BREXIT

The Economist has it right on the cover of its recent edition: the mother of all messes. The start of 2019 has not been kind to Prime Minister Theresa May. After surviving a no-confidence vote from her own party last year, May had her Brexit deal rejected. The scale of the loss was staggering: 432 votes to 202 with her own party members voting against the proposal by three to one. It is the largest defeat for a ruling party on record, a long record at that. Subsequently, May barely survived a full parliamentary no confidence vote (325 to 306) in her government and narrowly avoided a snap election. In a twist of fate, the same members of her party who voted against her Brexit deal helped keep her in power. You can't make this stuff up. May has spent the last two years negotiating with the EU and the current deal is the best that can be made of trying to, as Boris Johnson put it, "have your cake and eat it too". There is now not enough time to negotiate a new deal and two things are likely to happen: Britain will ask for an extension to avoid leaving with no deal at the end of March and the calls for a second referendum will grow louder. It is the right thing to do as Brits are extremely divided on Brexit and have been misled on the cost of leaving. Only a second referendum where the specifics of a Brexit deal are presented to voters will move this forward. Will May still be in power to oversee such a referendum? To say her leadership has been uninspiring is an understatement but is there really anyone who wants to take on this impossible task?

Dollar Down

Last year was a good year for the dollar, but after rising 7% against a basket of currencies, it might have peaked. Strong economic growth and rising interest rates drove the dollar higher over the past several years. Both factors are likely to have a neutral or negative impact on the dollar's value this year. As mentioned earlier, the Fed has indicated that it is close to its interest rate targets and has signaled more dovish overtones since the hike in December. Other developed economies, namely Europe and Japan, are well behind the U.S. with respect to tightening monetary policy. The reason has been lackluster growth compared to the U.S. A resolution to the trade war between the U.S. and China could be the spark for growth in Asia and other emerging markets. The EU and Japan benefit more than the U.S. from emerging market demand. Stronger growth would push interest rates up (or remove accommodative policy) and give a lift to the Euro and the Yen. Clarity on Brexit may well lift the pound off its lows as well. Of course, a deal with China could fall apart, economic growth stumbles and the dollar remains elevated and overvalued in the short- to intermediate-term (although the Yen and Swiss Franc would likely benefit more during a flight to safety). Finally, another trend is reducing demand for the dollar (albeit on a relatively small scale right now) and bears watching: divesting from the dollar in foreign reserve holdings. In response to sanctions, Russia sold $101 billion worth of dollar holdings, moving into the euro, yen and yuan. Russia's yuan holdings, at about ten times the average for global central banks, is a clear outlier. I have discussed for several quarters the slow moving impact of America First policies. This is one of them. An acceleration of these types of shifts is another side effect if the negotiations with China do not bear fruit.

Business Confidence and Consumer Sentiment

After giving Trump the benefit of the doubt during his first year in office, consumers, investors and business leaders are now showing reduced confidence. Sentiment indicators remained high in 2017 on the heels of several bullish signs from the new administration: less regulation and a corporate tax cut helped push markets to new highs. However, in 2018 these positive factors were negated by fears of rising interest rates and trade wars. Sentiment readings are reflecting anxiety about these changes as evidenced by the most recent consumer sentiment reading which declined to the lowest level since Trump was elected. The magnitude of the decline was a surprise relative to estimates and reflects concerns

about the volatile fourth quarter for stocks, the ongoing trade war and the government shutdown. The next several readings of the index will be critical in assessing whether this negativity is temporary or the sign of something more substantial. Sentiment amongst global business executives, in contrast to consumers, has been negative for most of the past year. McKinsey's December survey of global executives resulted in the least-positive views on the economy in over a year. Fewer executives expect economic conditions and growth rates to improve over the next 6 months, a dramatic reversal from the start of 2018. Emerging economy respondents in particular have become more apprehensive: in developed Asia for example, half of respondents now say economic conditions have worsened. Three months earlier only 27% felt that way. The most cited threats to growth persisted all year: most respondents see changes to trade policies (53%) and geopolitical instability (46%) as the biggest threats. A resolution to the trade war with China would help raise spirits amongst both consumer and business leaders. A failure to secure a deal or draw a truce will entrench negative sentiment further and increase the probability of a recession.

Kindest regards,

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