CMG Mauldin Smart Core Strategy Update

John Mauldin
Chief Economist & Co-Portfolio Manager

Steve Blumenthal
Executive Chairman, CIO & Co-Portfolio Manager

2018 Market Summary

After reaching all-time highs in mid-2018, the S&P 500 Total Return Index reached the low for the year in December 2018. December's 9.0% decline was the second worst December on record since 1931.

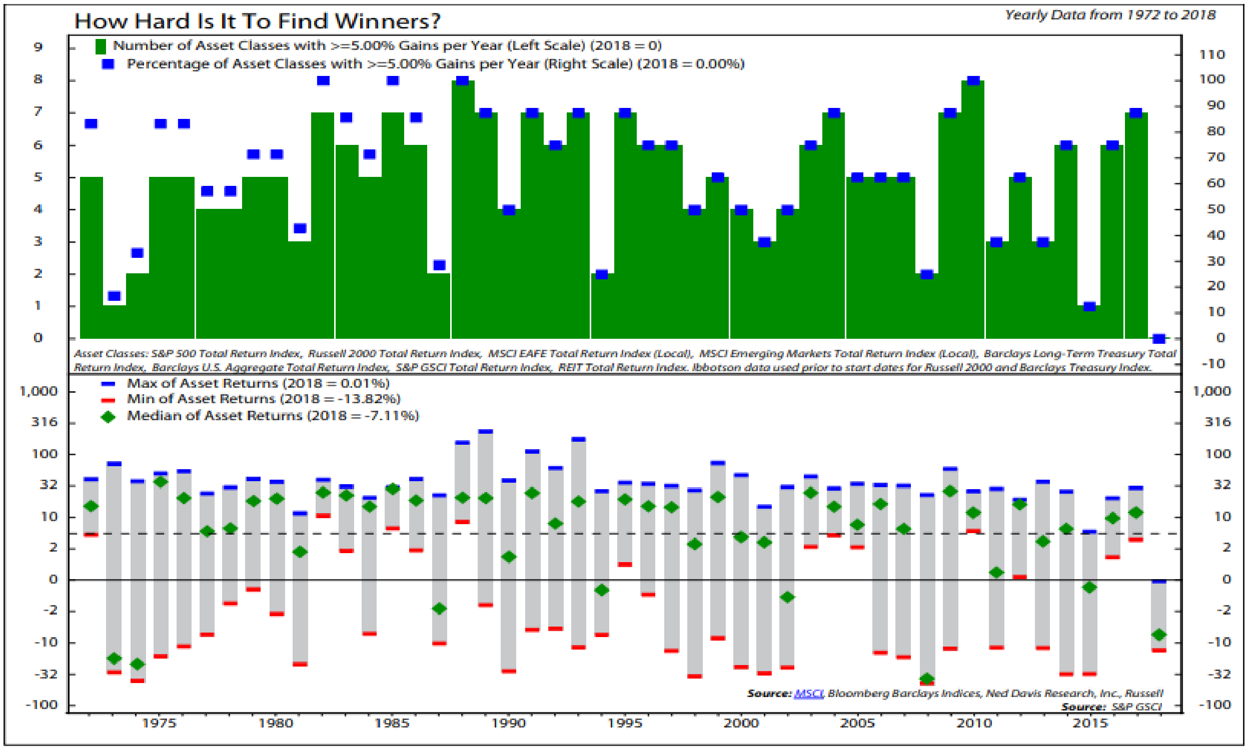
The idea that "there is always a bull market somewhere" was put to the test in 2018. There wasn't. A look at major asset classes shows that only cash gained in 2018 (note 2018 column). Even during the challenging Great Financial Crisis in 2008, several asset classes performed (bonds and gold).

ETF Total Returns (2008 - 2018, as of 12/31/18) @CharlieBilello

ETF	Asset Class	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2008-18 Cumulative	2008-18 Annualized
SPY	US Large Caps	-36.9%	26.4%	15.1%	1.9%	16.0%	32.2%	13.5%	1.2%	12.0%	21.7%	-4.5%	114.4%	7.2%
IWM	US Small Caps	-34.2%	28.5%	26.9%	-4.4%	16.7%	38.7%	5.0%	-4.5%	21.6%	14.6%	-11.1%	106.4%	6.8%
EEM	EM Stocks	-48.9%	69.0%	16.5%	-18.8%	19.1%	-3.7%	-3.9%	-16.2%	10.9%	37.3%	-15.3%	-2.6%	-0.2%
EFA	EAFE Stocks	-41.0%	27.0%	8.2%	-12.2%	18.8%	21.4%	-6.2%	-1.0%	1.4%	25.1%	-13.8%	4.1%	0.4%
PFF	Preferred Stocks	-23.9%	37.6%	13.8%	-2.0%	17.8%	-1.0%	14.1%	4.3%	1.3%	8.1%	-4.7%	69.0%	4.9%
HYG	High Yield Bonds	-17.5%	27.4%	11.9%	6.8%	11.7%	5.8%	1.9%	-5.0%	13.4%	6.1%	-2.0%	69.2%	4.9%
LQD	Investment Grade Bonds	2.5%	7.9%	9.3%	9.7%	10.6%	-2.0%	8.2%	-1.3%	6.2%	7.1%	-3.8%	68.0%	4.8%
TLT	Long Duration Treasuries	34.0%	-22.1%	9.0%	34.0%	2.6%	-13.4%	27.3%	-1.8%	1.2%	9.2%	-1.6%	84.2%	5.7%
TIP	TIPS	-0.5%	7.5%	6.1%	13.3%	6.4%	-8.5%	3.6%	-1.8%	4.7%	2.9%	-1.4%	35.3%	2.8%
BND	US Total Bond Market	5.2%	2.9%	5.3%	7.7%	3.9%	-2.1%	5.8%	0.6%	2.5%	3.6%	-0.1%	40.9%	3.2%
BIL	US Cash	1.5%	0.3%	0.0%	0.0%	0.0%	-0.1%	-0.1%	-0.1%	0.1%	0.7%	1.7%	3.9%	0.3%
EMB	EM Bonds (USD)	-2.1%	15.4%	10.8%	7.7%	16.9%	-7.8%	6.1%	1.0%	9.3%	10.3%	-5.5%	77.4%	5.3%
VNQ	REITs	-39.4%	28.0%	28.4%	8.6%	17.6%	2.3%	30.4%	2.4%	8.6%	4.9%	-6.0%	86.1%	5.8%
GLD	Gold	4.9%	24.0%	29.3%	9.6%	6.6%	-28.3%	-2.2%	-10.7%	8.0%	12.8%	-1.9%	47.0%	3.6%
DBC	Commodities	-31.8%	16.3%	11.9%	-2.6%	3.5%	-7.6%	-28.1%	-27.6%	18.6%	4.9%	-11.6%	-52.7%	-6.6%
Highest Return		TLT	EEM	GLD	TLT	EEM	IWM	VNQ	PFF	IWM	EEM	BIL	SPY	SPY
Lowest Return		EEM	TLT	TIP	EEM	TLT	GLD	DBC	DBC	TLT	TIP	EEM	DBC	DBC
% of Asset Classes Positive		33%	93%	93%	60%	93%	33%	67%	33%	100%	100%	7%	87%	87%

Source: Pension Partners

Further, a look at eight major asset classes (next chart) reveals that 2018 was the first year since 1972 that all eight major asset categories returned 0% or less and not one returned more than 5%.



Let's review the last quarter and take a look at what we're seeing in the portfolio today.

Fourth Quarter Portfolio Review

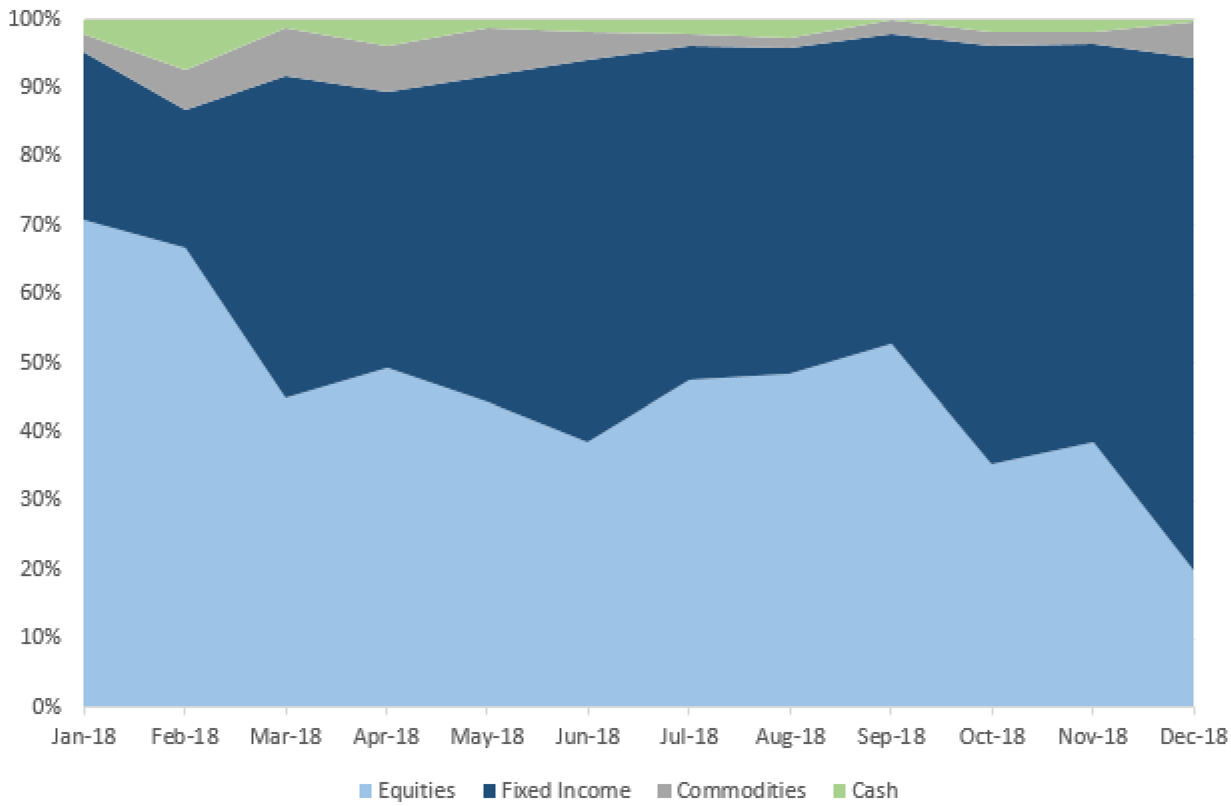
The CMG Mauldin Smart Core Strategy (MSC) is an equally-weighted blend of quantitatively driven, systematically managed strategies combined into a single strategy. The portfolio has a global tactical allocation mandate, meaning we can invest in just about any asset class anywhere in the world utilizing ETFs as the tool to gain the exposures. Importantly, each of the strategists has a "participate and protect" investment process. The process seeks growth opportunities while seeking to minimize losses generally associated with the challenges that present during times of economic recession.

In light of Fed rate hikes, increased geopolitical risks, and a slowdown in China, this next chart shows how MSC proactively and systematically reduced exposures to equities (light blue in chart) from approximately 70% to approximately 20% at year-end while increasing exposure to fixed income (dark blue) from approximately 20% to 74% at year end.

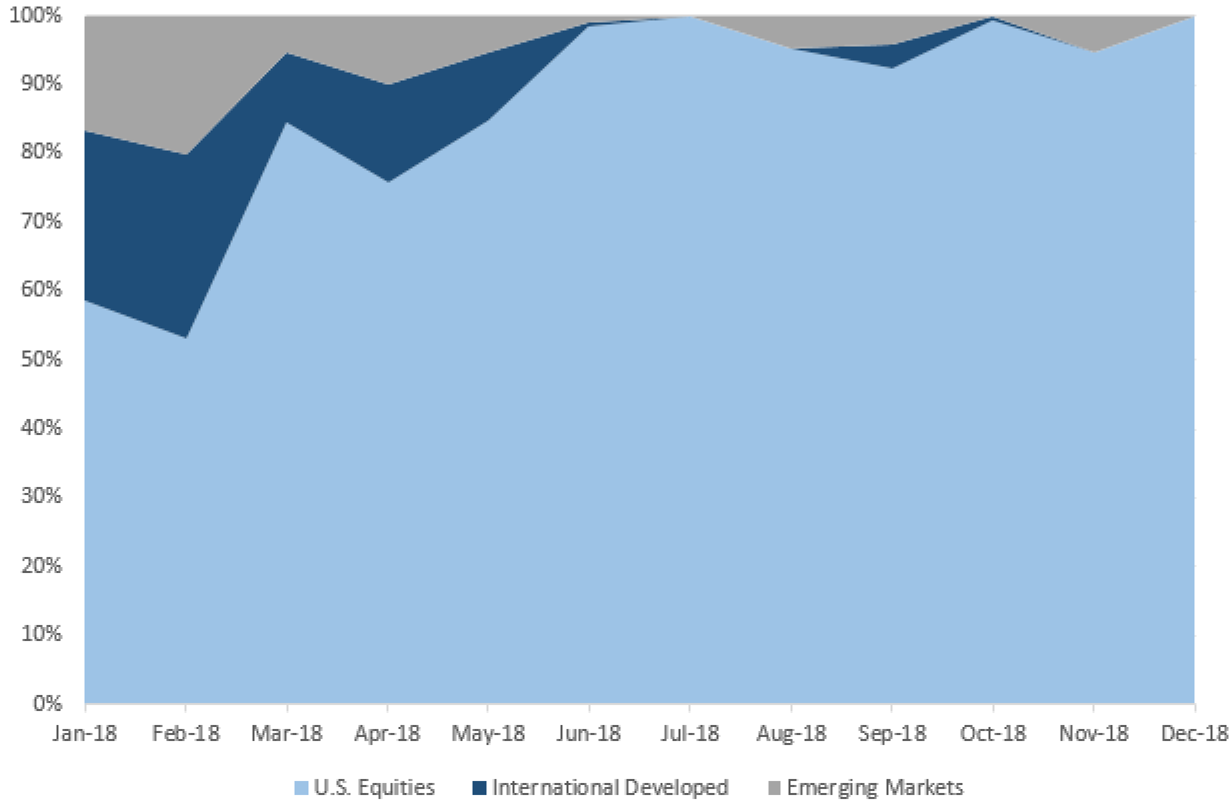
The following three heat maps show our monthly portfolio exposure by asset class, equity exposure (differentiating domestic, international developed and emerging markets exposure) and fixed income exposure broken down by fixed income category.

CMG Mauldin Smart Core Strategy

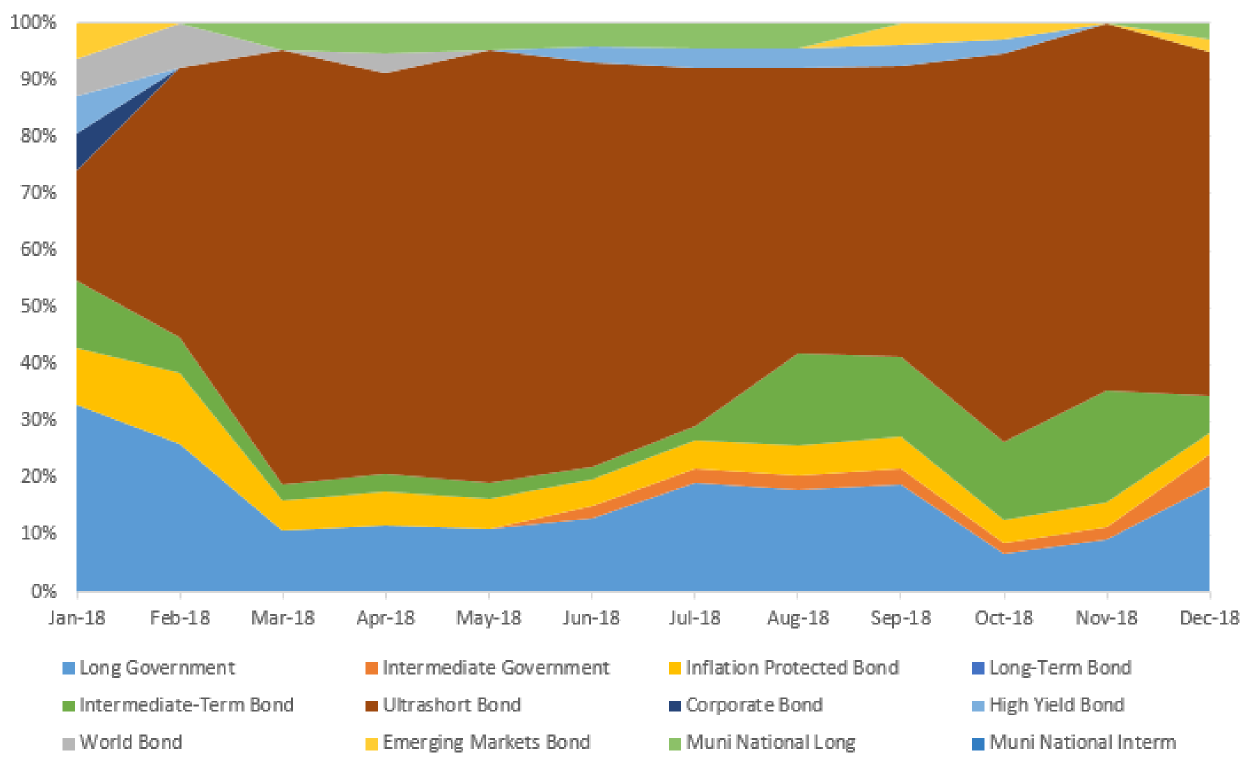
Asset Allocation Changes Across Major Asset Classes



Equity Exposure



Fixed Income Exposure



All in all, the MSC portfolio performed to our expectations. December was a prime example where, by most standards, the fund performed relatively well. Although we were unable to lock-in earlier gains, we were able to avoid the more painful losses realized by other equity or blended portfolio indexes. Indeed, our primary objective remains focused on avoiding a serious bear market of 40% or more. If the market had continued on down (or if it does), then we believe we continue to be optimally positioned. If a recovery begins to appear, we would expect that the various managers will begin to rotate back into equities over time. That "over time" is important. While we may miss a sudden market spike in the near-term, the emphasis of MSC is to have the dry powder on hand to take advantage of a more sustained recovery.

But since none of us know the future, we just do what the quantitative models instruct and allow them to adjust for us, without our emotions dictating trades. We're of the opinion that over a full market cycle that is what will be the best for our portfolios. That true bear brought on by a recession is coming, whether this year or next or even later.

We assume that you are reading, or should be reading, John's weekly letter, as well as Steve's free weekly letter. These letters give you up-to-date analysis of our market outlooks and collective wisdom around how to invest through periods of greater market turbulence. While volatility can often be painful, we believe the use of a properly designed opportunistic, multi-asset, multi-manager investment strategy is the key to long-term success.

In general, we both expect that the U.S. economy will begin to slow this year. In particular, I see risk from both China and Europe, which will inevitably have an impact on the U.S. There is also a significant and rising risk in corporate debt in the U.S. And while it is not a perfect analogy, I think these risks are on a par with the sub-prime debt bubble back in 2006. It will, of course, play out in a different manner, but the result will be a liquidity crisis that will impact both debt and equity markets.

And just as I was warning about the risk of sub-prime debt at least one year before the credit market actually broke, I may be "early" again. But the MSC portfolio is one part of a reasonable response to such a potential crisis.

Several Important Observations

- In December 2018, MSC lost 1.71% (net of fees). In comparison, a global 60/40 stock and bond portfolio lost 4.26% (gross). The S&P 500 Total Return Index lost 9.03% (gross).
- For 2018, MSC lost 5.05% (net of fees). In comparison, a global 60/40 stock and bond portfolio lost 5.70% (gross). The S&P 500 Total Return Index lost 4.38% (gross).
- At the beginning of 2018, MSC allocated 70.85% to equities, 24.38% to fixed income, 2.57% to commodities and 2.20% to cash. The year began with an overweight to U.S. equities with modest exposures to international developed and emerging market equities, but finished the year with 100% of the strategy's equity exposure to the U.S. market.
- On December 31, 2018, MSC was positioned 19.94% in equities, 74.41% in fixed income, 5.38% in commodities and 0.27% in cash. (Note that, for the "cash" component, short-duration government bonds, a cash alternative, represented 45.08% of the portfolio.) All of the equity exposure was to U.S. equities, long-duration government bonds made up 13.78%,

intermediate-duration government bonds 9.19%, muni bonds 2.16% and inflation protected bonds 2.59%.

Risk Meter: Currently, MSC remains conservatively positioned.

Mauldin's Investment Outlook – The Great Reset Update

More than ever, I am of the opinion that we have what I have termed "The Great Reset" in our economic future. Global government and corporate debt is going to have to be "rationalized," which is another way of saying that it has to be adjusted or monetized or...? No matter how it is dealt with, it will create pain on the part of some or all of the market participants.

I think we have a liquidity debt-driven recession beginning in either late 2019 or 2020. The risks are that if the China tariff and trade wars or the government shutdown doesn't get resolved soon, that recession could be sooner rather than later. The next recession will see total U.S. debt rise to $30 trillion. That will be a significant increase in interest rate expense in the federal budget, accompanied by an ever- increasing cost of entitlements. And since I see no politically possible path forward to seriously controlling entitlement expansion, it means that debt will continue to increase. Depending on which political party is in control, the resolution could be increased taxes and or other draconian solutions, all of which will be a drag on the economy and can tip us into a series of "echo recessions." Which brings us even closer to The Great Reset crisis.

As I described in my recent *Thoughts from the Frontline* letter, Europe has some serious problems, but they also have a history of kicking the can down the road. There is not much road left for them to play with, which means they have to have a major restructuring (which seems unlikely in the current environment) or they have a crisis that forces all sorts of interesting decisions. And by crisis, I mean a true recession, which will spill over into the rest of the world.

China is going to continue to try to use debt to forestall any slowdown in its economy, but it is now taking many multiples of a dollar's worth of debt to create a dollar's worth of growth. Rapidly shrinking. And the debt carrying cost is increasing. China can, of course, come up with ways to pay for that debt, but all those methods have their own cost, either in terms of growth or in terms of currency valuation.

All of this points to a period of true challenge in our future. While we all have our own personal situations, the common feature or goal that we all have will be to get as much of our assets and the buying/purchasing power those assets represent to the other side of that crisis as possible. We expect market volatility to remain high and will continue to seek growth opportunities when they present while doing so in a way that manages the downside risk of loss.

Concluding Thoughts

All that being said, John just returned from California after spending two days reviewing some of the most incredible new biotechnology companies and projects. Even as the economy is going to be challenged, the march of technological progress is inevitable. Which means that the future will be brighter than we can possibly imagine if we can manage the economic transition in our own personal lives.

We are all relentlessly hyper-focused on trying to help you accomplish exactly that. John will be traveling more in 2019 than he has been in a long time. We feel the need to spend time with clients and friends. Feel free to reach out, and we will keep you informed when we get to an area near you that we can get together. All the best, and until we can hopefully meet...

Thank you for your continue interest in MSC. We hope you find this update helpful. If you have any questions, please reach out to your CMG Advisor Representative. To learn more about the strategy or how to invest, email John at mauldin@cmgwealth.com.

Yours truly,

John Mauldin

Steve Blumenthal

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