CMG Mauldin Smart Core Strategy Update

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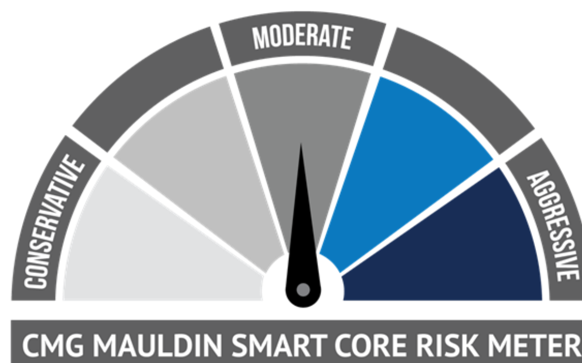
Q3 2019 Performance Update

The CMG Mauldin Smart Core Strategy gained 1.25% for the quarter ending September 30, 2019, and is up 6.7% YTD. The Strategy has performed in line with our expectations in terms of managing risk and total return. Please note that past performance is not indicative of future results.

The largest driver of returns YTD are coming from Peak Capital Management's volatility trading strategy and Tectonic's endowment-like allocation trading strategy. 3EDGE's global macro investment approach contributed positive gains from exposure to U.S. large caps, fixed income and gold miners. CMG's Opportunistic All Asset Strategy is defensively positioned in muni bonds, corporate bonds and Treasury bills.

Current Risk Exposures and Strategist Commentary

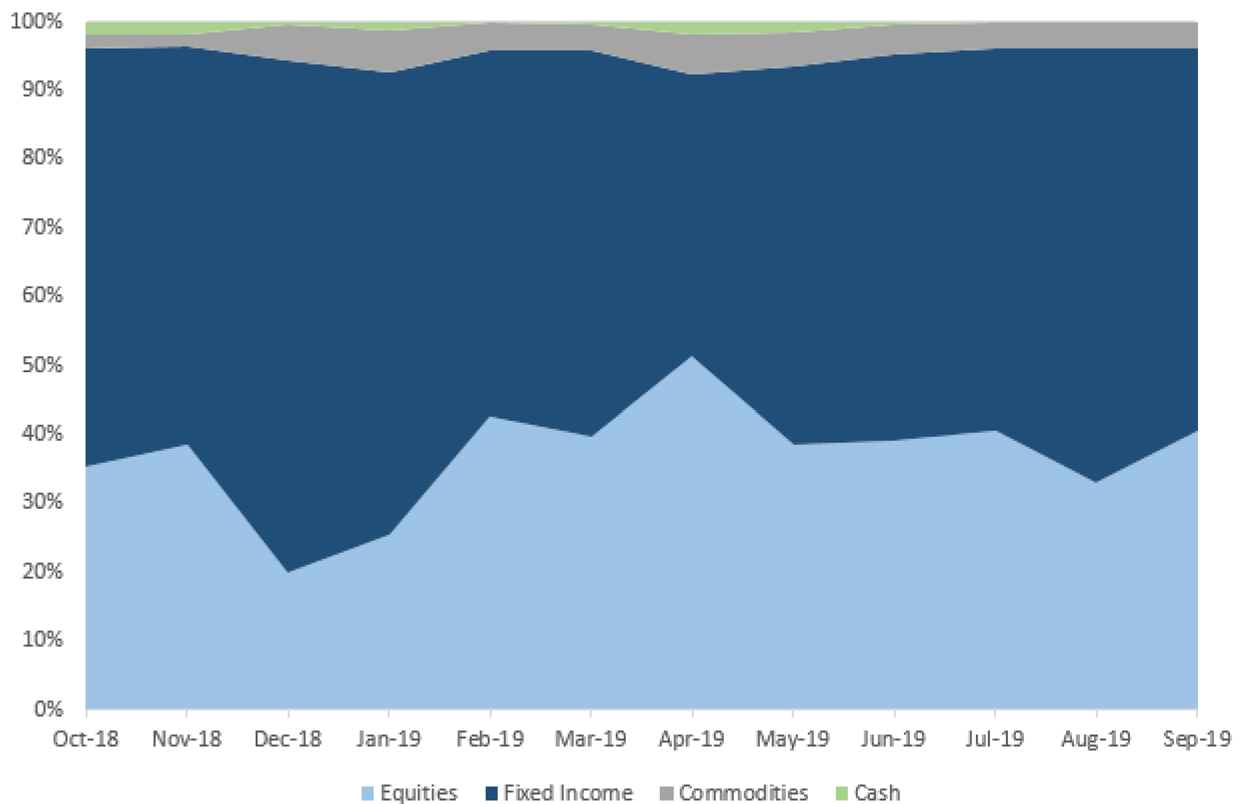


At quarter-end, the portfolio had moderate risk exposure with approximately 40% allocated to equity ETFs, 56% to fixed income ETFs and 4% to commodity-related (predominantly gold) ETFs. Because the strategists can increase or decrease risk and shift allocations to various asset classes, risk exposures increase and decrease over time. This simple risk gauge is our interpretation of the Strategy's overall risk exposure at quarter-end. Bottom line: Our portfolio's risk exposures are relatively unchanged from last quarter.

Exposures by Asset Category

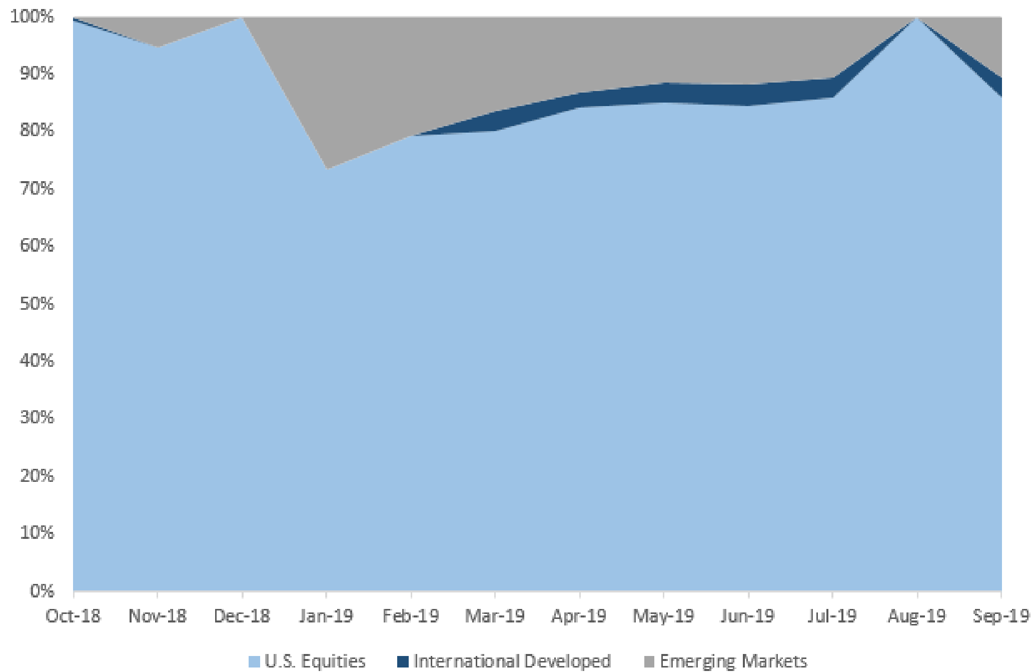
Next we share several heat maps with you. They are designed to show you the total combined monthly portfolio exposures by asset class: equity exposure (differentiating domestic, international developed and emerging markets exposure), fixed income exposure (broken down by fixed income category), commodities and cash.

There was little change in overall equity, fixed income and commodities over the quarter.



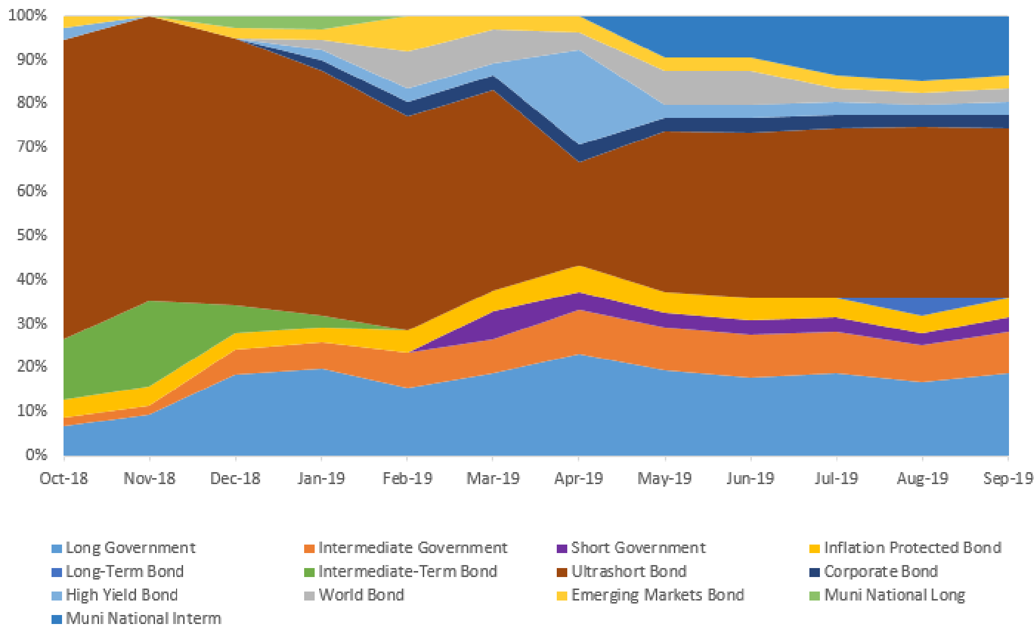
Equity Exposures by Geography

We are overweight U.S. equity market exposure and underweight exposure to Emerging Market and Developed Market equities.



Fixed Income Exposures by Category

Short-term government bond ETFs continued to hold the strongest weighting in the fixed income portion of the portfolio. Intermediate and long-term government bond and muni bond ETFs had together accounted for the majority of the balance of fixed income exposure.



Brief Summaries from the Strategists

Peak Capital - Of the four strategists, the Peak strategy is the most correlated to the S&P 500 Index. Though instead of a pure buy-and-hold approach, it uses increases in volatility as a trigger to reduce risk exposure. Returns were driven higher for the quarter primarily by long-term Treasurys and low-volatility stocks. With deeply negative stock-bond correlations, the Strategy's risk profile remained fairly stable for the quarter. As such, there were no rebalances for the quarter. The portfolio continues to maintain an allocation of roughly 70% to equities and 30% to Treasurys.

3EDGE - The most significant market news during last quarter was that the Federal Reserve reversed course and lowered short-term interest rates twice, once in July and then again in September. Federal Reserve Chairman Jerome Powell's reasoning was that the Federal Open Market Committee (FOMC) acted in response to signs of a continuing global economic slowdown, particularly outside the U.S., as well as the ongoing uncertainty surrounding the U.S.-China trade tensions.

However, the pronounced slowdown taking place in China today is due not only to trade tensions with the U.S. but also as a consequence of its attempt to rein in a rise in non-performing loans. Given that China stimulus had been a major driver of the global economic recovery since the financial crisis of 2008, a sustained slowdown in China has the potential to negatively impact global growth.

During the last quarter, the Investment Committee took action to reduce exposure to Emerging Market equities. Although EM equities remain undervalued relative to U.S. equities, a number of factors shifted our outlook during the third quarter to negative due in part to the relative weakness of EM currencies with respect to the U.S. dollar, most notably the Chinese yuan.

As we head into the fourth quarter, we are maintaining reduced equity exposure as markets appear vulnerable to a wide variety of potential risks. We recognize that over the long-term investors are typically well served holding a relatively higher allocation to equities. However, our research findings identify three periods during the last century when the U.S. stock market was extremely overvalued based on our measure:

1) prior to the crash of 1929;

2) before the bursting of the tech stock bubble in 2000; and

3) the summer of 2019.

History demonstrates that overvalued markets are capable of becoming even more overvalued before correcting. However, in our view, the rising risk of significant loss outweighs the potential for what we believe to be limited upside, suggesting a lower U.S. equity allocation.

Despite the recent lowering of short-term interest rates by the Fed, our model research continues to indicate that U.S. equities remain significantly overvalued. In addition, signs of slowing global growth, particularly outside the U.S., have generally diminished the outlook for non-U.S. equity markets.

Gold remains an attractive asset class and continues to benefit from low and declining real yields (nominal yields less inflation). Additionally, gold should continue to act as a hedge during periods of heightened geopolitical uncertainty and/or sustained money printing.

Tectonic Advisors - The portfolio is largely fully invested, save for MLPs and the majority of our small commodity sleeve. Robust equity performance and fixed income performance suggest the portfolio will remain fully invested absent the return of volatility, which would cause our embedded risk management processes to kick in.

CMG - Overall, the third quarter was a mixed quarter for equities with the S&P 500 Index and the Dow up just over 1%, while the NASDAQ was slightly negative.

July was a solid month for equities. The second quarter market rally continued through most of the month. Investors were widely expecting the FOMC interest rate cut at the month-end meeting. Q2 GDP was also restated to be slightly above analyst expectations.

In August, the government yield curve inversion coupled with a global economic slowdown, particularly in Europe, and an escalation in the trade war between the U.S. and China contributed to market losses for the month.

The Federal Reserve lowered rates twice during the quarter with the second rate cut occurring in mid-September. These cuts along with an interim trade deal between the U.S. and China caused equity markets to rally in September to end the quarter.

Against this backdrop of increasing volatility the CMG Opportunistic All Asset Strategy was largely defensive in its allocations for the quarter. Short-term fixed income and municipal bonds received the largest allocation for the quarter. High yield bonds, preferred and consumer discretionary stocks also buoyed portfolio performance during the quarter. To begin the fourth quarter, the portfolio was fully allocated to a diverse collection of equity, real estate, fixed income and commodity holdings.

Why CMG Mauldin Smart Core

It is very hard for most investors to have envisioned the bond market we see today. After the Fed reduced the federal funds rate to zero after 2008, we did not read predictions that the 30-Year U.S. Treasury Bond would yield less than 2% or the 10-Year yield would be less than 1.5% as occurred in the third quarter this year. Today, we even see predictions of the 30-Year yield falling below 1%.

There is a historical perspective for low yields. After the great depression in the 1930's, the Fed took the federal funds rate to zero as well and while rates were not quite as low as today, they were low and stayed low for a long time. The return on the 10-Year Treasury for the decades of the 1940's, 1950's and 1960's yielded less than 2%. We sit at the end of a long-term debt cycle. The last time this occurred was in the 1930's and, until the debt problem is solved, expect ultra-low fixed income yields to continue.

For investors, fixed income just does not help a portfolio like it used to do. Treasury bill and money market rates are oddly higher than the yield on the 30-Year Treasury. The problem this

poses for investors is they will not be able to meet their investment return needs using fixed income as they have traditionally.

Historically, investors shifted from an emphasis on equities to an emphasis on fixed income in their portfolios as they went from the accumulation phase to the distribution phase of their lives. They accomplished two things by making this shift: (1) they reduced the volatility of their portfolios and (2) they increased their income. With yields so low, fixed income can no longer play this role.

Today, by allocating to fixed income, investors reduce their yield and increase their volatility given the risk of loss in the value of a bond in the event of rising interest rates. The best solution we see for this dilemma is to use diversified ETF managers who focus on broadly diversifying asset classes and while they seek growth they do so in a way that seeks to minimize downside loss. Our solution to the fixed income problem is to create a return stream with similar return and risk characteristics fixed income historically provided a portfolio but can no longer provide. We do this by diversifying to experienced ETF managers whose trading strategies diversify and risk manage exposes to asset classes.

The CMG Mauldin Smart Core Strategy allocates equally to four experienced investment strategists. Each firm has a unique process and uses proprietary research and trading processes that allows them to produce portfolios with reasonable historic and expected returns, but as importantly produce levels of volatility and maximum drawdown risk tolerances that are prudent. The following are the highlights of the CMG Mauldin Smart Core.

- Liquidity: The Strategy is implemented using ETFs for daily liquidity and efficiency.
- Diversification: The Strategy is actively managed both in terms of allocations and ultimately in terms of strategists. Simply, the Strategy diversifies to trading strategists that diversify asset classes. By diversifying to four different active management styles, portfolio risk is not dependent on a single manager.
- Seeks Growth and Preservation of Capital: Low correlations to the primary capital markets allow the Strategy to dampen overall volatility and solve for today's low yield fixed income problem.
- A Fixed Income Solution: The combination of these managers is designed to reflect the beta/return of the overall hedge fund industry without the high costs and poor investor liquidity.

Our Forward Outlook

While returns for U.S. large-cap stocks, as measured by the S&P 500 Index, have been exceptional YTD gaining 20%, we remind investors that, over the prior 12 months, the return for the index is just 4%. We believe the path forward will somewhat similar over the coming 10 years. Vanguard expects equities to return 3.8% and with bonds yielding 2% and, if they are correct, the probable outcome for the traditional 60% stocks/40% bonds portfolio will be a return of just 3.1% annualized. As you'll see below, we believe equities will return -1.8% to +3.6% over the coming 10 years. We expect the path to be similar. Big gains, large declines and in the end net returns in the forecast range. Therefore, we advise investors to seek broader solutions and incorporate those solutions into a well-diversified investment portfolio. Investment portfolios are not and should not be compared to the stock market. Yet that is exactly what many investors do, which is ill advised.

We believe investment portfolios should combine a number of different types of risks (assets and strategies) put together in a way to provide a relatively predictable risk and return experience suitable for your personal goals and needs. If you are young and have many years to invest, we recommend you consider a targeted allocation to a basket of stocks owned in a balanced way. And keep adding to your positions every year, especially at times when the stocks nose dive. However, if you are pre-retiree or retiree, we suggest building a broadly diversified portfolio. Unfortunately, you and we (John and Steve) don't have the time it may take to recover from the next -50% stock market decline. We believe CMG Mauldin Smart Core plays an important role in your portfolio; especially, as a replacement consideration for bonds yielding just 2%. .

Our view remains that we sit late cycle. The bull market is aged and extremely overvalued. We see the likelihood of a recession in the coming 6-18 months. If we are correct, much of the year-to-date stock markets gains will be reversed. Further, annualized gains over the coming 10 years will be either negative or low single-digits. John wrote the following in a recent *Thoughts from the Frontline* post:

> Based on historical numbers using the Shiller model (other models would be slightly worse) it looks like this. We are currently in the top decile. Get that? Historical returns based on 110-year models suggest future returns will be anywhere from -1.8% to +3.6%, from where we are today. Note that 3.6% compound is the top end past historical performance. Also note that I have continually cited academic arguments that the debt situation that we are in today, both as a government and privately, preclude the potential for above-historical-average growth, suggesting lower growth is more likely."

S&P 500 INDEX TOTAL RETURN BY DECILE
10 Year Periods Ending 1909 - 2018 (110 periods)

DECILE	TOTAL RETURN BY DECILE RANGE FROM	TO	RETURN DECILE AVG	AVG BEGIN P/E	AVG END P/E
1	-1.8%	3.6%	1.3%	27.0	14.8
2	3.7%	5.4%	4.7%	16.3	9.5
3	5.4%	6.5%	5.9%	17.8	12.6
4	6.5%	7.6%	7.1%	19.3	18.0
5	7.6%	8.7%	8.0%	17.3	15.6
6	8.8%	10.0%	9.3%	17.0	15.7
7	10.6%	13.0%	11.6%	14.5	19.3
8	13.7%	14.7%	14.2%	12.2	20.1
9	14.7%	16.3%	15.6%	10.2	18.9
10	16.4%	19.2%	17.3%	11.4	24.0

Notes: Total Return Includes Dividend Yield; P/E is CAPE P/E10

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Further, we believe in front of us over the coming decade will be several recessions, a debt crisis and a restructuring of the massively underfunded state and local pension systems. We'll get through it, but the challenges ahead are, as Steve shared in a recent *On My Radar* post, "Unlike Any Period Since the Late 1930's." Buck up and stay focused on risk management.

Our forward view remains unchanged. We are closer to what John has called, "The Great Reset." You can find his paper here.

How to Access CMG Mauldin Smart Core

The CMG Mauldin Smart Core Strategy is available in a managed account or mutual fund structure. The benchmark is the Morningstar Moderate Target Risk Index and the Morningstar category is U.S. OE Tactical Allocation. For more information on performance and risk analytics, please reach out to your CMG Advisor Representative. To learn more about the Strategy or how to invest, email sales@cmgwealth.com.

Yours truly,

John Mauldin and Steve Blumenthal

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