SENDERO™
WEALTH MANAGEMENT

TACTICAL ASSET ALLOCATION

as of June 2017

This report reflects the current opinions of the Sendero Investment Committee on various asset classes used or considered for client portfolios versus their strategic allocation. The comments reflect opinions as of the specific date listed above and can change quickly based on market conditions.

STABILITY

ASSET CLASS	OVERWEIGHT	NEUTRAL	UNDERWEIGHT
CASH	○		
FIXED INCOME			○
ALTERNATIVE STRATEGIES	○		

GROWTH

ASSET CLASS	OVERWEIGHT	NEUTRAL	UNDERWEIGHT
DOMESTIC MARKETS			○
INTERNATIONAL MARKETS		○	
EMERGING MARKETS		○	

OPPORTUNISTIC

ASSET CLASS	OVERWEIGHT	NEUTRAL	UNDERWEIGHT
HEDGED EQUITY	○		
ENERGY		○	
REAL ASSETS		○	
PRIVATE EQUITY			○

● SIGNIFICANTLY UNDERWEIGHT ○ UNDERWEIGHT ○ NEUTRAL ○ OVERWEIGHT ● SIGNIFICANTLY OVERWEIGHT

MARKET HIGHLIGHTS

- Global economic momentum continues to be broad and earnings growth remains supportive of higher equity prices in the second half of the year.
- To be sure, stocks are not cheap, but valuation is a poor indicator of short-term performance. Tighter monetary conditions cloud our outlook as we turn our attention to 2018.

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CASH ○ OVERWEIGHT

We have a higher allocation to cash awaiting deployment when opportunities arise. We are wary of equity valuations and the potential for higher volatility in the near term amid economic and political uncertainty globally.

ALTERNATIVE STRATEGIES ○ OVERWEIGHT

We recommend full allocations to Multi-Strategy and Market Neutral strategies to reduce overall risk and long only beta exposure in the Growth bucket as the markets eventually begin to reprice risk. While equity based strategies have had a good first half of the year on an absolute basis, their positioning has gotten more conservative over recent weeks with less cyclical and more defensive exposure. Gross exposures are high and net are moderate to benefit from long and short opportunities, which should be beneficial if the gap between high valuations and low volatility narrows. Higher interest rates and higher volatility are tailwinds for spread trades in strategies such as Merger Arbitrage and Equity Relative Value.

FIXED INCOME ○ UNDERWEIGHT

We are keeping our underweight recommendation as we see U.S. fiscal expansion amplifying expectations for a steepening yield curve. Potential tax cuts and infrastructure spending could boost growth and inflation as well as widen the fiscal deficit. This should lead to higher long-term U.S. yields. While long-term rates have come down so far in 2017, we prefer short duration debt as we shift from a deflationary environment to a more reflationary outlook. We prefer TIPS over other government debt as we expect the Federal Reserve to raise rates further in 2017 as well as start reducing its balance sheet. We favor managers in this area that have the ability to capture both the long and short side of the opportunity set. We also tend to favor credit risk over duration risk given the current opportunity set.

INTERNATIONAL MARKETS ○ NEUTRAL

Monetary policies remain accommodative in Europe and Japan; however, fiscal and economic policy changes remain even as economic data continues to improve. Looking ahead, central banks will come under increased pressure as policies begin to diverge depending on a given countries' phase of economic recovery. Although valuations remain attractive relative to U.S. equities, concerns over the financial sector exist, specifically European banks, as well as their poor earnings growth. While we are recommending keeping full allocation to International Markets, the emphasis is on having an active manager not exposed to benchmark sectors, but quality companies.

EMERGING MARKETS ○ NEUTRAL

Our recommendation is to keep Emerging Market equities at a full allocation. We remain confident the long-term prospects for Emerging Market equities are solid. GDP in Emerging Markets is expected to exceed their developed market counterparts over the next few years. Valuations are still reasonable, despite their year-to-date performance. Improving economic growth and better expected earnings are positives for EM, while a rising U.S. Dollar and potential trade restrictions could bring some bouts of volatility in the coming quarters. The long-term prospects for Emerging Market equities are solid and active managers should benefit in that dislocations will likely provide attractive entry points for quality companies. Exposure to Emerging Market equities through developed international managers should also be considered.

DOMESTIC MARKETS ○ UNDERWEIGHT

Despite some recent mixed economic data and anxiety about nominal growth, most global leading indicators and broad measures of economic activity suggest that global growth should remain on solid footing through the second half of the year. However, upside potential could be limited as some indicators have peaked. The significant move higher in various confidence measures has generally held up despite the lack of progress on the hoped-for pro-growth agenda. The synchronous economic revival that began long before the November election has continued unabated and resulted in spectacularly broad earnings growth this year. Ironically, the aggressive fiscal policy agenda could, at this stage of the cycle, lead to inflation, prompting the Federal Reserve to tighten policy faster than expected, which is how all business expansions end.

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We are cautious on the markets in the short term due to the recent run up in performance and possible market disappointment at the first misstep on tax and regulation reform. In the long run, we still believe there is room for economic growth and fiscal policy changes. Our expectation for long only domestic equities is for muted returns with higher volatility and periods of heightened downside risks for the rest of 2017, resulting in lowering our allocations to U.S. equities. With political and policy risks abound, we see an opportunity for active managers to continue to take advantage of dispersion between company and sector winners and losers.

HEDGED EQUITY

OVERWEIGHT

We recommend a full allocation to Hedged Equity to diversify overall risk and long only beta exposure in the Growth bucket as the markets eventually begin to reprice risk. While the drivers for this allocation are similar to our Multi-Strategy and Market Neutral recommendation, fundamentally based equity strategies in general should also benefit. The main risk to our recommendation is the market continues to march higher in which case funds with lower net exposure will likely underperform on a relative basis.

ENERGY

NEUTRAL

We are changing the name “Commodities” to “Energy” to more properly reflect our allocations and investment strategies. We are reducing our allocation as energy equities have led the commodity sell-off due to shale supply concerns. As expected, higher oil prices incentivized a supply response, but the velocity at which the ‘self-defeating’ supply response took place was unexpected. In addition to the velocity of supply, the velocity of investments in the overall commodities complex, where positioning swung from record longs to near-record shorts in many markets, happened in a matter of weeks. The unwinding of these trades put further pressure on energy related equities. The future is cloudy as the markets digests how US shale has disrupted the energy landscape and has fundamentally changed how oil supply responds to demand. Near-term rebalancing continues to get pushed out in this multi-year “W” scenario of short, violent cycles. Though these concerns maybe overdone in the near-term, prompt tightness in inventories will be required to push the market higher given the market has now lost confidence in forward-looking indicators.

REAL ASSETS

NEUTRAL

While we are keeping allocations unchanged, our current exposure to Real Assets is through MLPs and not Real Estate. Expectations for higher nominal growth leading to higher demand for carbon products and the new administration’s desire for infrastructure spending initiatives are supportive. Compared to last year, MLPs also have less debt, better distribution, and a lower cost of capital. However, pipelines have been weighed tactically, rising or stable oil prices supported by near-term tightening should alleviate some of the pipelines’ counterparty risk and improve access to the capital markets. Also, the new administration should be supportive of fracking activity and pipeline construction. Compared to last year, MLPs also have less debt, better distribution, and a lower cost of capital. However, pipelines have been weighed down in the second quarter by the risks of slower-than-expected growth in oil and gas production due to commodity prices at 2017 lows. Investors are still enamored by REITs and as long as their yields are above U.S. Treasury yields, that should continue. However, we are late in the cycle and valuations remain above long-term averages. A rising interest rate environment, combined with muted Funds from Operations (FFO) growth lead us to maintaining very limited to no exposure to REITs. Real Estate is a core holding for investors, but fundamental and macro forces are conspiring against the sector at this time.

PRIVATE EQUITY

UNDERWEIGHT

Low interest rates and a low return environment have continued to drive investor interest in private equity. Funds selling into this setting have benefited from investor demand; however, those with current to near-term vintages are not finding valuations as favorable for new capital. If purchased properly, allocations to private equity should help buffer higher interest rates and heightened market volatility.

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