SENDERO
WEALTH MANAGEMENT

TACTICAL ASSET ALLOCATION

as of September 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

- Equity markets reach new highs, but global economic momentum continues to be broad and earnings growth remains supportive.

- Low, or lack of, volatility remains the story of the year. Barring any exogenous event, the biggest risk to the market remains a more aggressive Fed and (much) higher interest rates.

- While recession risk is low, we are in the later stage of this bull market and recommend a more cautious portfolio positioning as we enter 2018.

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CASH ○ OVERWEIGHT

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

ALTERNATIVE STRATEGIES ○ OVERWEIGHT

We recommend full allocations to Market Neutral and Diversifier strategies to reduce overall risk and long only beta exposure in the Growth bucket as the markets eventually begin to reprice risk. The reasons for including these strategies have not changed and in fact low market volatility, despite macro challenges, extended equity valuations and continued flows to passive give us even more reason to include them in portfolios. Sentiment for the asset class continues to improve due to performance and resulting flows. A sustainable period of higher interest rates and higher volatility should provide a better environment for spread trades in strategies such as Merger Arbitrage and Equity Relative Value/Market Neutral.

FIXED INCOME ○ UNDERWEIGHT

Given our expectations of steady economic growth, the Federal Reserve's willingness to further raise interest rates and starting to reduce it's balance sheet, we maintain our underweight positioning to fixed income. We still believe in the fundamentals of the asset class as a tail-risk hedge, and we continue to favor credit risk over duration risk. Potential tax cuts and infrastructure spending could still boost growth and inflation as well as widen the fiscal deficit. As such, we prefer short-duration debt as we shift from a deflationary environment to a more reflationary outlook. We prefer TIPs as we expect the Federal Reserve to raise rates further in 2018. We favor managers in fixed income that have the ability to capture both the long and short side of the opportunity set.

INTERNATIONAL MARKETS ○ NEUTRAL

While we are recommending full allocation to International Markets, the emphasis is on active management not exposed to benchmark sectors, but quality companies. Monetary policies remain accommodative in Europe and Japan; however, the focus will turn to the European Central Bank in 2018 which may also announce tapering of its QE program. Valuations still remain attractive relative to U.S. equities as eurozone growth has remained resilient, even as the Euro has continued to strengthen this year.

EMERGING MARKETS ○ NEUTRAL

Our recommendation is to keep Emerging Market equities at a full allocation. GDP in Emerging Markets is expected to exceed their developed market counterparts over the next few years. A solid global economic picture and expectations for higher relative earnings growth offset structural concerns. Valuations are still reasonable, despite their year-to-date performance. 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

Not much has changed since our June meeting: most global leading indicators and broad measures of economic activity still suggest that global growth should remain on solid footing through the end of 2017. However, upside potential could be limited as some valuation indicators are near their historical highs. The significant move higher in various confidence measures has generally held up despite the lack of progress on the hoped-for pro-growth agenda. We remain cautious on the broad equity 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.

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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 ○ OVERWEIGHT

Bear markets wear people out and makes it more difficult to stand apart from the consensus, even if the data supports it as fundamentals often improve slowly. With recent fundamental improvements such as: excess inventory shrinking, demand strength, downward U.S. production revisions, and investor sentiment being so poor, we recommend a tactical allocation to energy as an overweight position. Though we have been right on the fundamentals of space improving in 2017, energy equities have not reflected these improvements and have lagged the broader market. Valuations for energy equities are near several long-term lows and represent an attractive risk-reward profile, even as we still expect volatility in energy as this “W” scenario of short, violent cycles plays out on the global stage over the next several years.

REAL ASSETS ○ NEUTRAL

We are keeping our Real Assets allocation unchanged. Our current exposure is through MLPs and not Real Estate. The risk-reward profile has improved within the midstream sector as companies are better positioned to capture upside and handle downside movements in the price of crude oil and natural gas. Valuations are attractive on an absolute and relative basis. Companies have reduced their cost of capital and balance sheets are healthier. Risk to higher interest rates have been reduced, but investor confidence remains in a state of lingering disrepair in the aftermath of staggering value destruction over the last few years. Range-bound crude prices should stabilize MLP’s access to capital markets, while growth in US production of oil and natural gas should drive strong distribution growth. We expect midstream companies to oscillate with macro events until third quarter earnings results. At which point, individual stock events can still lead to sharp moves in either direction for individual names. Real Estate is a core holding for investors, but fundamental and macro forces are conspiring against the sector at this time. However, we are late in the business 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.

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 benefitted 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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