SENDERO®
WEALTH MANAGEMENT

TACTICAL ASSET ALLOCATION

as of December 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 continue to reach new highs as synchronized economic growth and strong earnings remain supportive.
- This Goldilocks scenario should continue in the near-term, but the impact of higher interest rates globally could bring more volatile market conditions in 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 continue to recommend full allocations to Multi-Strategy, Market Neutral and Diversifier strategies to reduce overall risk as the markets eventually begin to reprice risk. Low market volatility, extended equity valuations and continued flows to passive give us conviction about the role alternatives play in building diversified portfolios. Also, uncorrelated assets should provide dry powder during market stress to reinvest in Growth assets at better valuations. Sentiment for alternatives continues to improve due to performance and resulting flows.

FIXED INCOME
UNDERWEIGHT

Given our 2018 expectations of continued economic growth, further interest rate hikes and the Federal Reserve reducing its 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 an inflation hedge and favor managers in fixed income that have the ability to capture both the long and short side of the opportunity set.

INTERNATIONAL MARKETS
NEUTRAL

We continue to recommend full allocation to International Markets with an emphasis 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 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 strong 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.

DOMESTIC MARKETS
UNDERWEIGHT

Not much has changed since our September meeting: most global leading indicators and broad measures of economic activity still suggest that global growth should remain on solid footing through the first half of 2018. However, upside potential could be limited as some valuation indicators are near their historical highs. 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. Our expectation for long only domestic equities is for muted returns with higher volatility and periods of heightened downside risks for 2018, 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.

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HEDGED EQUITY

OVERWEIGHT

We continue to recommend a full allocation to Hedged Equity to diversify overall risk and long only beta exposure as the markets eventually begin to reprice risk in 2018. While the drivers for this allocation are similar to our Multi-Strategy and Market Neutral recommendation, fundamentally based equity strategies 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 under perform on a relative basis.

ENERGY

OVERWEIGHT

Oil prices are responding to improving market fundamentals as WTI has rallied three times as much as energy equities since the June lows. Energy HY Bonds have outperformed during the commodity rebound with falling risk premiums and rising prices. Though we have been right on the fundamentals and the commodity, we have not yet been rewarded for holding energy equities. Continued demand strength and OPEC's commitment to restrict exports should keep the oil market supported. 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. We recommend a tactical allocation to energy as an overweight position.

REAL ASSETS

NEUTRAL

We are keeping our Real Assets allocation unchanged. Our current exposure is through MLPs and not Real Estate. The midstream sub-sector is in flux as investors rethink valuation methodology, the business/funding model, and fund flow-related technicals. Though MLP management teams have done a good job managing operations in the downturn, the disconnect between fundamentals and performance is due to the identity crises in the space. During this transition process, MLPs are using a balance of healthy distribution coverage, reduction in leverage, and financial self-sufficiency to attract investors back into the space. MLP bonds have outperformed during the commodity rebound with falling risk premiums and rising prices. Regarding taxes, both House and Senate bills currently appear largely favorable to midstream entities as the corporate and pass-through tax rates are reduced from current levels.

We remain positive on MLPs and C-corp midstream companies given strong fundamentals and attractive valuation. However, investors are hesitant to re-enter the space as they monitor management team decisions and macro variables. Real Estate is a core holding for investors, but 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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