SENDERO®

WEALTH MANAGEMENT

TACTICAL ASSET ALLOCATION

as of March 2018

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		○	

DIVERSIFIER

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

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

MARKET HIGHLIGHTS

- The global economy is on solid footing and the probability for a U.S. recession remains minimal in the next six to nine months. A sharp slowdown in China, unintended consequences from fiscal and trade policies, and the possibility of heightened protectionism present risks to the outlook.

- After February's volatility crash, the market may remain in purgatory until investors reprice a new environment of higher rates, higher volatility and higher inflation.

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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 higher volatility in the near-term amid political uncertainty globally.

ALTERNATIVE STRATEGIES ○ OVERWEIGHT

We continue to recommend full allocations to Multi-Strategy and Market Neutral strategies to reduce overall risk. The episodic nature and the velocity of the volatility we saw in February are great reminders as to the role such strategies add to 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 expectations of sustained economic growth, further interest rate hikes and the Federal Reserve continuing to reduce it's balance sheet in 2018 and beyond, we maintain our underweight positioning to fixed income. We still believe in the fundamentals of the asset class as a tail-risk hedge, but we prefer short-duration debt as we shift from a deflationary environment to a more reflationary outlook. We favor TIPs as an inflation hedge and managers that have the ability to capture both the long and short side of the fixed income 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 later in 2018 which may also announce tapering of its QE program. While valuations remain attractive relative to U.S. equities, the full impact of potential trade wars is a big unknown and the strength of the Euro is beginning to translate into weaker-than-expected economic data.

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. Valuations are reasonable given expected EPS growth rates, but country selection remains key, especially as trade risks emerge. Active managers should benefit in that dislocations will likely provide attractive entry points for quality companies.

DOMESTIC MARKETS ○ UNDERWEIGHT

A lot has changed since our December meeting as the market experienced a volatility crash in February. Broad measures of economic activity are still suggesting that global growth should remain on solid footing through 2018. Yet, the broader market experienced its first correction since 2016. While valuations are now more reasonable, we remain cautious on the overall equity markets due to the potential for higher volatility from uncertainties over the weaker dollar, trade policies, and worries over earnings momentum for 2019. Our expectation for long only domestic equities is for muted returns with periods of heightened downside risks for the remainder of 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 market continues 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 bounces right back and resumes marching higher in which case, funds with lower net exposure will likely underperform on a relative basis.

ENERGY
OVERWEIGHT

Though fundamentals in the space have improved, energy equities have lagged the broader market and the commodity. The primary overhang has been investor sentiment, which has driven weakness in the energy sector more than any fundamental factor. Energy equities have a stronger foundation than previous years. The combination of strong oil demand, high OPEC compliance, and moderate Shale drilling response creates a constructive macro outlook. Management of energy companies have become disciplined with spending by using any excess cash to pay down debt or pay back shareholders. We expect to see an uptick in shale production this year, which should translate into better top line growth and earnings. 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. We remain positive on MLPs and C-corp midstream companies given strong fundamentals and attractive valuation. However, despite the positive fundamental backdrop and post-election optimism regarding a friendlier regulatory environment, midstream equities continued to struggle due to structure/governance fears, poor investor confidence, and overall energy market softness. Investors continue to desire elimination of IDRs, management incentivized to focus on unit growth and shareholder return, and a shift toward a self-funding model. The recent FERC decision will accelerate the conversion of older partnerships into traditional corporations. Deleveraging efforts have also helped MLPs develop into stronger franchises with higher dividend coverage ratios, lower leverage, and less reliance on capital markets. Despite a generally healthy real estate market, we recommend maintaining an Underweight to REITs and CRE due to elevated valuation and lower AFFO expectations amid heightened short-term sensitivity to interest rates.

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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