SENDERO
WEALTH MANAGEMENT

TACTICAL ASSET ALLOCATION

as of June 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

- While trade has been a source of headline risk, the equity market has so far remained resilient on the back of supportive earnings estimates for 2019. We are watching for any deterioration in the path of earnings growth which could spell trouble for stocks.

- The higher volatility environment in equities and other asset classes is providing opportunities for skilled managers to take advantage of dispersion across regions, sectors, currencies, and industries.

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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.

FIXED INCOME ○ UNDERWEIGHT

Given our expectations of sustained nominal economic growth, further interest rate hikes this year and 2019 along with the Federal Reserve continuing 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, but we still prefer short-duration benchmark exposure. 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.

ALTERNATIVE STRATEGIES ○ OVERWEIGHT

We continue to recommend full allocations to Multi-Strategy and Market Neutral strategies to reduce portfolio risk. Overall performance has improved due to a higher level of dispersion across sectors, geographies and currencies. The recent AT&T/TWX ruling is also a tailwind for both merger arbitrage and long/short equity managers as the risk of deals being litigated is reduced. The volatility crash we saw in the first quarter was not a market crisis as the underlying fundamentals of the economy were and are still in good shape. What we continue to see is managers in the CTA, Systematic, Quant, risk parity spaces targeting volatility, which creates dispersion in momentum, value and growth factor returns. This risk of low volatility remains as these managers continue to target volatility as market complacency has returned.

DOMESTIC MARKETS ○ UNDERWEIGHT

Broad measures of economic activity are still suggesting that US growth should remain on solid footing through the rest of 2018. 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 stronger dollar, trade and tariff policies, and concerns over earnings sustainability in 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 keeping a lower allocation 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.

INTERNATIONAL MARKETS ○ NEUTRAL

We continue to recommend target 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 European Central Bank announced it will stop asset purchases later this year, but not raise rates until the summer of 2019. While valuations remain attractive relative to U.S. equities, the full impact of potential trade wars is a big unknown and some recent economic indicators have slowed down combined with a rise in geopolitical headlines.

EMERGING MARKETS ○ NEUTRAL

Our recommendation is to keep Emerging Market equities at target allocation. Valuations are reasonable given expected EPS growth rates, but country selection remains key, especially as trade risks and currency impact from a higher dollar evolve over the rest of the year. Active managers should benefit in that dislocations will likely provide attractive entry points for quality companies.

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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 should the market 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 an upward trend. In this scenario, funds with lower net exposure will likely underperform on a relative basis.

ENERGY
OVERWEIGHT

Energy equities have begun to close the performance gap with crude oil and are outperforming the market. History suggests the move has farther to go as attractive valuations and strong underlying business fundamentals provide an opportunity for a continued recovery. June oil price weakness was due to concerns over higher OPEC production, weaker EM demand, escalating trade wars and rising inventories. However, we also expect higher disruptions from Venezuela and Iran and stronger developed market demand growth. On aggregate, this creates a modestly tighter market. We recommend a tactical allocation to energy as an overweight position.

REAL ASSETS
UNDERWEIGHT

We recently removed our exposure to MLPs and are changing our overall Real Assets allocation to Underweight. Despite the recent positive commodity fundamental backdrop, midstream equities have continued to struggle due to structure/governance fears, poor investor confidence, regulatory concerns, and access to capital markets. While the underlying real assets have some value, the space is undergoing a radical change with respect to their structure, correlations to commodity prices, customer fee structure, and the absence of the retail investor. Despite a generally healthy real estate market, we continue to 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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