SENDERO® | WEALTH MANAGEMENT

as of December 31, 2018

Tactical Asset Allocation

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
U.S. Markets		○	
Developed Markets			○
Emerging Markets	○		
Real Estate/REITs			○
Private Equity			○
Energy	○		

Diversifier

ASSET CLASS	OVERWEIGHT	NEUTRAL	UNDERWEIGHT
Hedged Strategies	○		

Market Highlights

- We believe global growth is poised to slow moderately. Underlying this view is a slowdown in earnings growth, higher rates, fading fiscal stimulus, and tighter financial conditions.
- Global geopolitical uncertainties are likely to be important drivers of both returns and volatility, as the market adjusts to trade uncertainties, spillovers from Brexit and Italian risks, and the potentially disruptive consequences of populism.
- We believe 2019 will continue the trend established in 2018: relatively low average volatility, but episodic spikes that reflect policy uncertainty and structural market fragility.

CASH | OVERWEIGHT

We have a higher allocation to cash awaiting deployment when opportunities arise. We are wary of higher volatility in the near-term amid political and economic uncertainties globally.

FIXED INCOME | UNDERWEIGHT

We are reducing our Underweight allocation to Fixed Income. As fears of a recession rise over the next year, bonds may play a bigger role as a ballast and core allocation in client portfolios. We still prefer short-duration benchmark exposure and favor TIPs as an inflation hedge as well as managers that have the ability to capture both the long and short side of the fixed income opportunity set.

ALTERNATIVE STRATEGIES | OVERWEIGHT

We are keeping our Alternative Strategies allocation at Overweight but recognize they have generally disappointed in the latest period of market weakness despite higher volatility and higher rates. The underperformance is a combination of the rotation from momentum to value, poor stock picking/sizing of positions on the long and short, crowded trades and market plumbing/quant funds/indexes causing more pain as hedge funds de-grossed their books, which set program trading triggers in place. Dispersion continues across regions, sectors, currencies, growth expectations, geopolitical, trade, etc. Within the alternative space, returns have and should continue to be generated for skilled managers navigating an increasingly complex backdrop. We except this path to continue to follow a jagged line.

U.S. MARKETS | NEUTRAL

We are maintaining our Neutral allocation to Domestic Equities. We base our market outlook on the view that while the business cycle will not end in 2019, we see a slowdown in global growth and corporate earnings, with the U.S. economy entering a late-cycle phase. While valuations are now more reasonable, we remain cautious on the overall equity markets due to the potential for higher volatility from continued uncertainties over the stronger dollar, trade and tariff policies, and concerns over earnings sustainability in the next few quarters. Our expectation for long only domestic equities is for muted returns with periods of heightened downside risks for 2019. 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.

DEVELOPED MARKETS | UNDERWEIGHT

We are downgrading our Developed Markets allocation from Neutral to Underweight on the back of relatively muted earnings growth, weak economic momentum and political risks. We continue to maintain an emphasis on active management not exposed to benchmark sectors, but quality companies. While valuations are attractive relative to U.S. equities, we are cautious on Europe as economic growth and profit momentum have continued to disappoint relative to other regions. Structural reforms will be tougher, given political fragmentation of mainstream parties across Europe, while Italy's budget negotiations with the European Union is raising fiscal concerns. Japan offers better risk/reward after the global selloff, as monetary and fiscal policy remains supportive and valuations remain attractive.

EMERGING MARKETS | OVERWEIGHT

We are upgrading our Emerging Markets allocation from Neutral to Overweight. We believe that EM economies and markets have turned the corner and that receding EM risks and low valuations will lead to outperformance of EM assets in 2019 given attractive expected EPS growth rates. Country selection remains key, especially as trade risks and currency impact from a higher dollar evolve into 2019. Global election uncertainty and policy direction are key risks. Active managers should benefit in that dislocations will likely provide attractive entry points for quality companies in a higher volatility environment.

REAL ESTATE/REITs | UNDERWEIGHT

We are maintaining our Underweight allocation to REITs and CRE due to elevated valuation and lower AFFO expectations amid heightened short-term sensitivity to higher interest rates within a late cycle environment.

PRIVATE EQUITY | UNDERWEIGHT

Within the broad private equity universe, we currently favor special situation strategies that can benefit from pockets of stress and offer important diversification benefits due in part to their counter-cyclicality.

ENERGY | OVERWEIGHT

We are keeping our Energy allocation as a tactical Overweight as we see prices stabilizing after the recent slide sent oil into a bear market. Oversupply was a key culprit in the downturn, but we believe OPEC and Russia can manage by dialing back production. Output cuts have put a floor under prices in recent years. Other potential catalysts for oil price stabilization: slower U.S. oil output growth in 2019 due to lower prices and rising demand amid still above-trend global growth. On the supply side, US output hit a record 11.35 million barrels in August, up nearly 20% from a year ago. The oil market may rebalance in 1H19 as Iranian production is squeezed by U.S. sanctions and a lack of new pipeline out of the Permian Basin. Both energy-related equities and debt suffered to varying degrees along with crude. Yet we believe the price resets may open attractive entry points for investors.

HEDGED STRATEGIES | OVERWEIGHT

We are also maintaining a tactical Overweight allocation to Hedged Strategies to diversify overall risk and long only beta exposure as the market reprices risk from higher interest rates and desynchronized economic growth. We believe the environment for active management remains favorable and recommend allocations to equity long/short and uncorrelated strategies. If recent trends persist, performance will likely be manager-specific in 2019. The main risk to our recommendation is the market snaps right back up and continues on an upward trend. In this scenario, funds with lower net exposure will likely underperform on a relative basis.

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Benchmarks

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