

JULEX CAPITAL

Good and bad designs for TAA portfolios

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Success/failure factors

What to look for

- **Setup**

- Performance objective
- Decision frequency
- Playing field
- Cash?

- **Operation**

- Trading costs
- Exposure limits
- Diversification minimums

- **Evolution**

- Subjective intervention
- Model adaptation

Setup

Performance objective

Decision frequency

Playing field

Cash ?

Setup - Performance objective

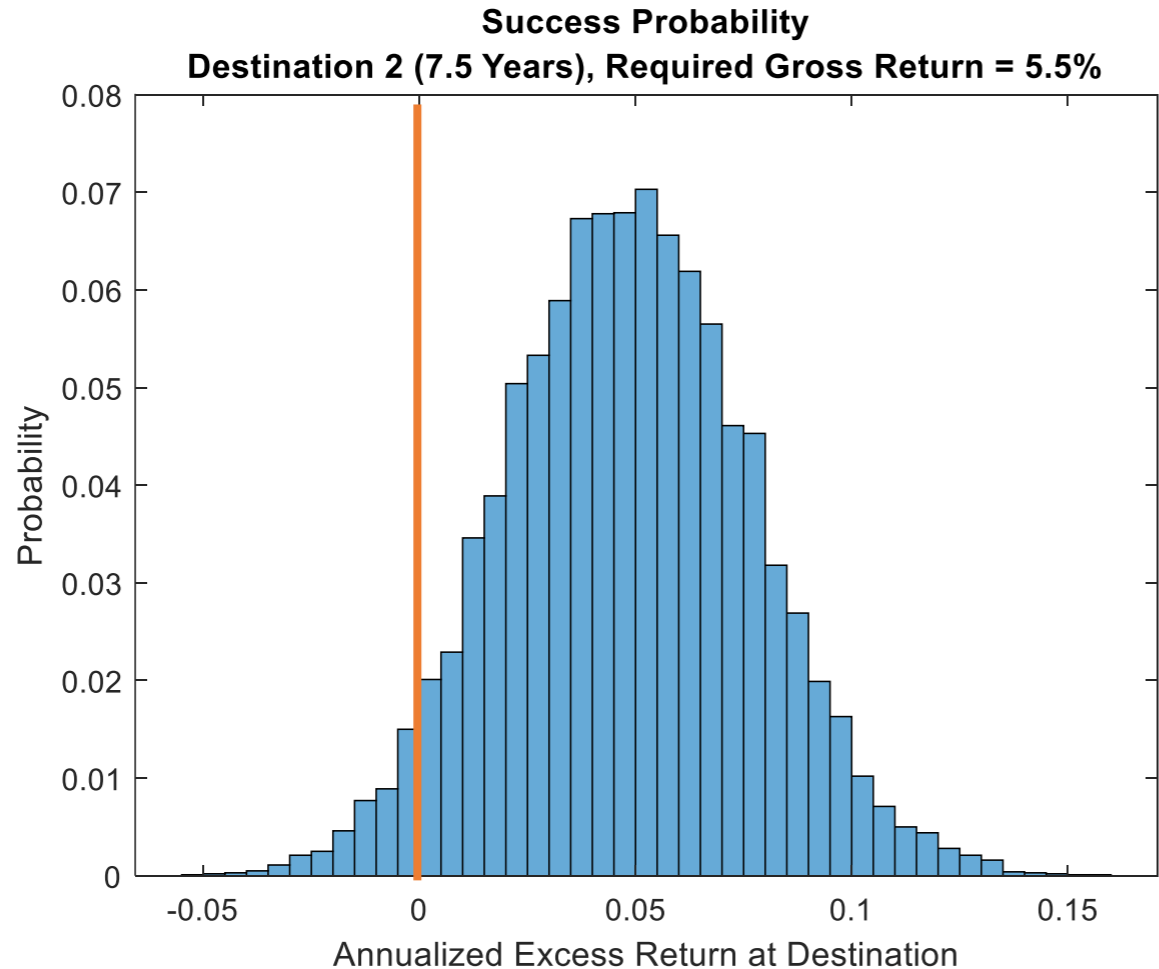
- **Avoid attempting to be all things to all people**
 - Participation and protection
 - Capture the upside, while protecting against loss
- **Versus a index benchmark, very difficult . . . no correlation**
 - 1-, 3-, 5-, 7-years . . . wacko
- **Superior approach**
 - Maximize the probability of earning at least “X%” but measured only at “Y-years”
- **This is not an absolute return solution . . . no such thing**

- Goal-Based Investment Objectives

Destination Number	Investment Horizon (Years)	Destination (Years)	Target Return
2	6-10	7.5	4.0% (Net) 5.5% (Gross)
3	11-15	12.5	5.0% (Net) 6.5% (Gross)
4	16-20	17.5	6.0% (Net) 7.5% (Gross)
5	21+	22.5	7.0% (Net) 8.5% (Gross)

Investment Objective – Seek the highest possible probability of earning at least the target returns at destinations.

- Hypothetical Back Test Results
- Destination 2 – 5.5%



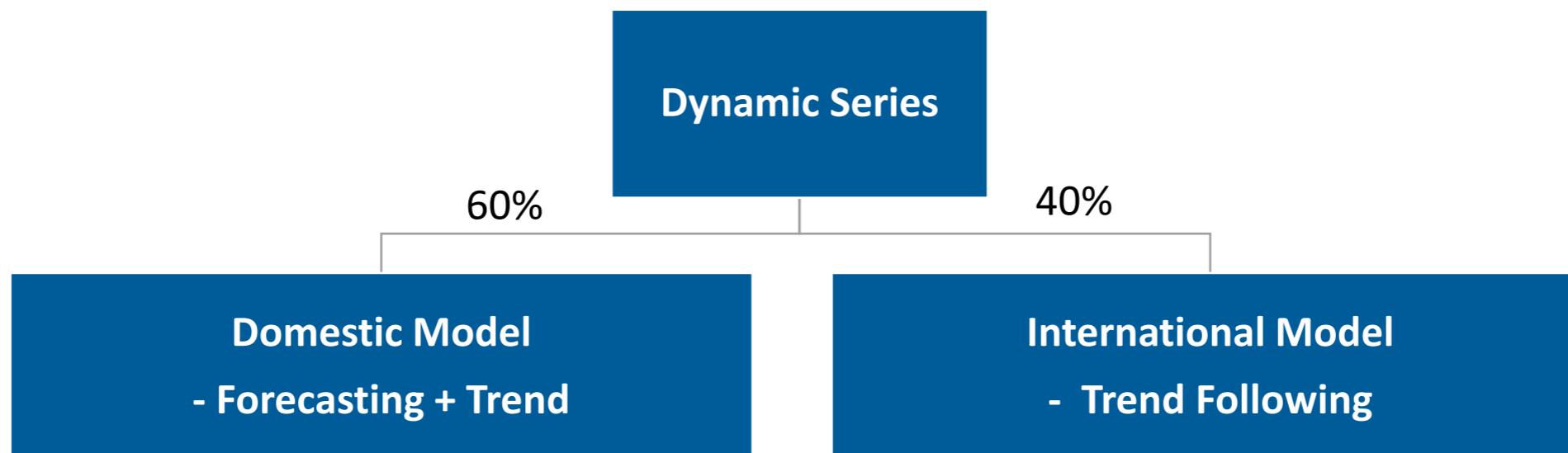
Year	Destination 2	Excess Return
2003 Sept. –Dec.	11.0%	9.6%
2004	11.3%	5.8%
2005	6.0%	0.5%
2006	11.6%	6.1%
2007	13.7%	8.2%
2008	4.3%	-1.2%
2009	16.1%	10.6%
2010	15.1%	9.6%
2011	3.2%	-2.3%
2012	10.6%	5.1%
2013	19.2%	13.7%
2014	5.9%	0.4%
2015	2.5%	-3.0%
2016	10.0%	4.5%
2017	17.1%	11.6%
2018	2.0%	-3.5%

Note: The performance results shown on this slide are HYPOTHETICAL based on modeled results and are gross before investment management fees. Please see Disclosures for more information..

* The success probability is estimated with 100,000 samples created by bootstrapping the back-testing monthly returns.

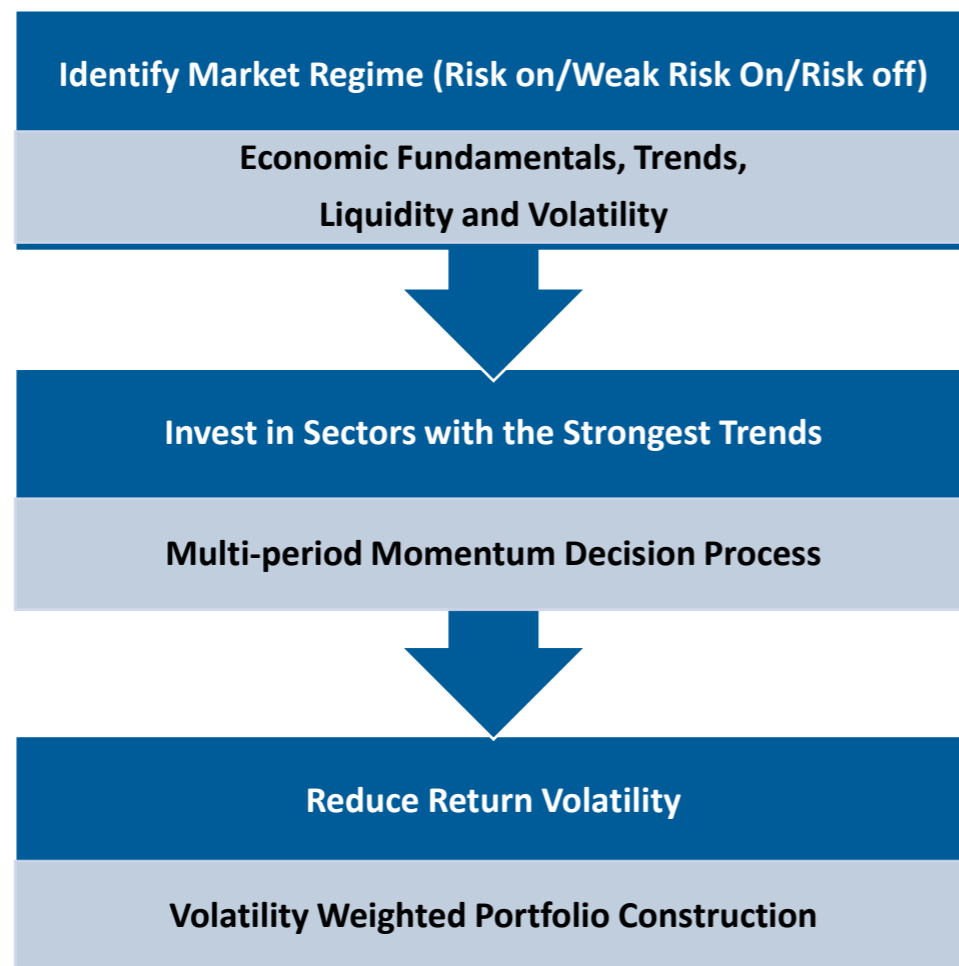
- Frequent portfolio adjustments
- **Benefit**
 - Responsiveness
 - Potentially better mitigate a hyper-short downdraft (only 2 in last 150 years)
- **Cost**
 - Whipsaw
 - Greater trading costs
- **Optimal**
 - Effectiveness . . . trends last for finite windows
 - Maybe monthly
 - Superior approach taken by Julex

- Investment Approach – Multi Strategies

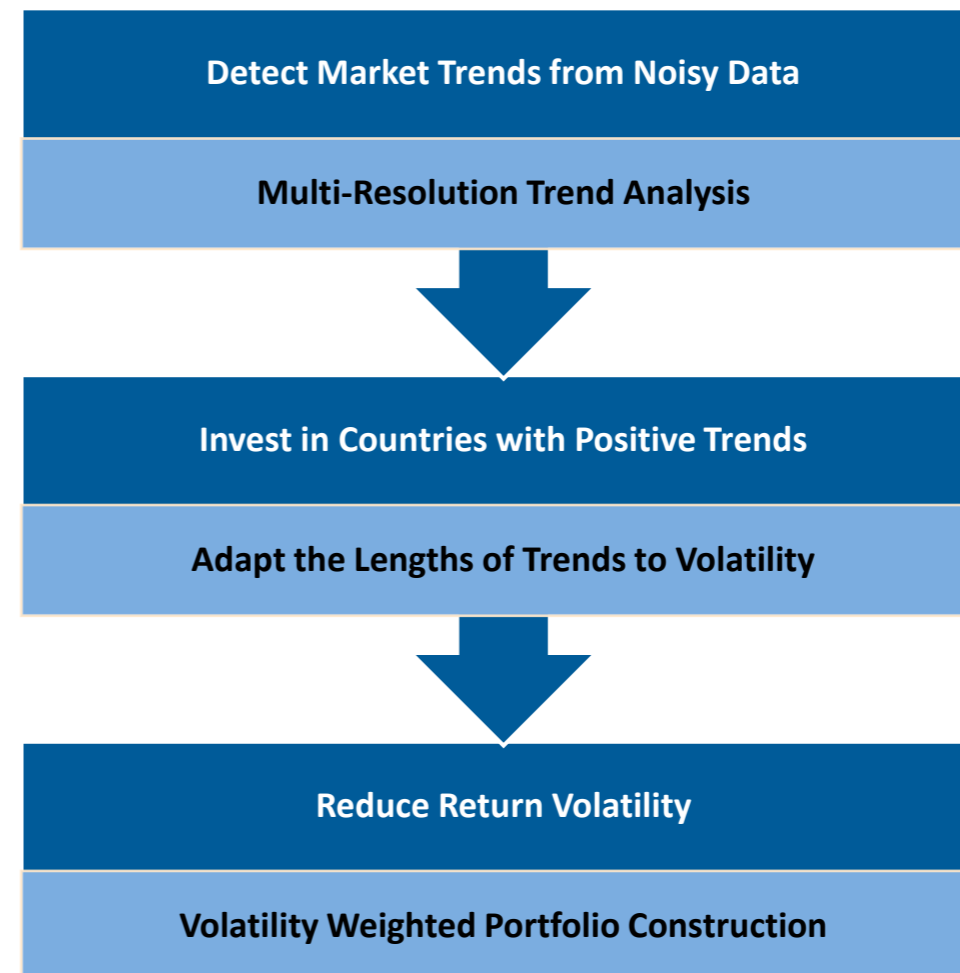
**Benefits of Multi Strategies:**

- Better risk-adjusted return
- Model risk mitigation

Domestic Model



International Model



- **Classic wrong approach**
 - 8 primary US industry sectors
- **Desire**
 - Sources of return, and sources of risk mitigation
 - But for different types of risk: Recession, i-rates, Inflation, US Dollar, Energy prices, Politics, War, Pandemics, Financial crisis
 - Broad range
 - Cost effective exposures
 - Different, low correlation . . . So can always find something that's trending
- **Interaction effects**
 - Absolute trend
 - Relative trend . . . Critical to a well-defined playing field

• Investment Universe



- Personally . . . I don't like cash
- Maybe, it makes no difference today, with interest rates so close to zero
- But why not just use SHY or SHV
- Disagreement about the use or non-use of cash is reasonable

Operation

Trading costs

Exposure limits

Diversification minimums

Operation - Trading costs

- **Rob Arnott critique (and others)**
 - Trading costs are big
 - Large enough to fully neutralize the benefits of TAA
 - Therefore, no net benefit
- **Not what I've seen**
- **But . . . I have seen that trading costs are**
 - Big
 - Important
 - Account for a sizeable deterioration in performance if unattended
- **Solution**
 - Turnover rate
 - Bid/ask spread and market-push

- **Let's return to first principals**
 - Markets trend
 - All markets trend
 - They always have, still do, and always will
 - Winners repeat, and losers repeat . . . For just one additional period
- **How do we harvest this behavioral aspect?**
 - Overweight the recent relative winners
 - Underweight the recent relative losers
 - Rinse, wash, and repeat
- **BUT . . . maintain prudent balance in what is built**
- **OTHERWISE . . . fingers burned, or worse yet, knocked out of the game**

Operation - Diversification minimums

- Requiring a minimal level or nature of diversification
- Forces risk management
- It helps promote a more risk-managed posture during or in preparation for significant market downdrafts

- Portfolio Construction

- **Momentum driven, volatility-weighted portfolio**
- **Position limits:**
 - Total equity exposure: 0-100%.
 - International equity exposure: 0-40%
 - US equity exposure: 0-60%
 - Individual equity ETF exposure: 0 - 15%
 - Total bond exposure: 0-100%
 - Cash: 0-2%
- **Number of positions:** 4 - 20
- **Trading Frequency:** Twice a month
- **Annual Turnover:** 379% (average based on back test)

Dynamic Series 5 Portfolio (9/1/2020)		
Ticker	Name	Weight
XLK	Technology Select Sector SPDR Fund	4.02%
XLY	Consumer Discretionary Select Sector SPDR Fund	4.80%
IBB	iShares NASDAQ Biotechnology ETF	3.52%
FDN	FT Internet	3.28%
IGV	iShares Expanded Tech-Software Sector ETF	3.61%
SOXX	iShares PHLX Semiconductor ETF	3.41%
SPYG	SPDR Portfolio S&P 500 Growth ETF	4.12%
IWO	iShares Russell 2000 Growth ETF	3.24%
EWD	iShares MSCI Sweden ETF	3.94%
EWG	iShares MSCI Germany ETF	4.37%
EWJ	iShares MSCI Japan ETF	7.31%
EWL	iShares MSCI Switzerland ETF	5.70%
EWN	iShares MSCI Netherlands ETF	4.75%
EWT	iShares MSCI Taiwan ETF	5.63%
EWY	iShares MSCI South Korea ETF	3.67%
FXI	iShares China Large-Cap ETF	4.63%
SHV	iShares Short Treasury Bond ETF	20.00%
LQD	iShares IBOXX Investment Grade Corp	10.00%

Evolution

Subjective intervention

Model adaptation

- **Worst**

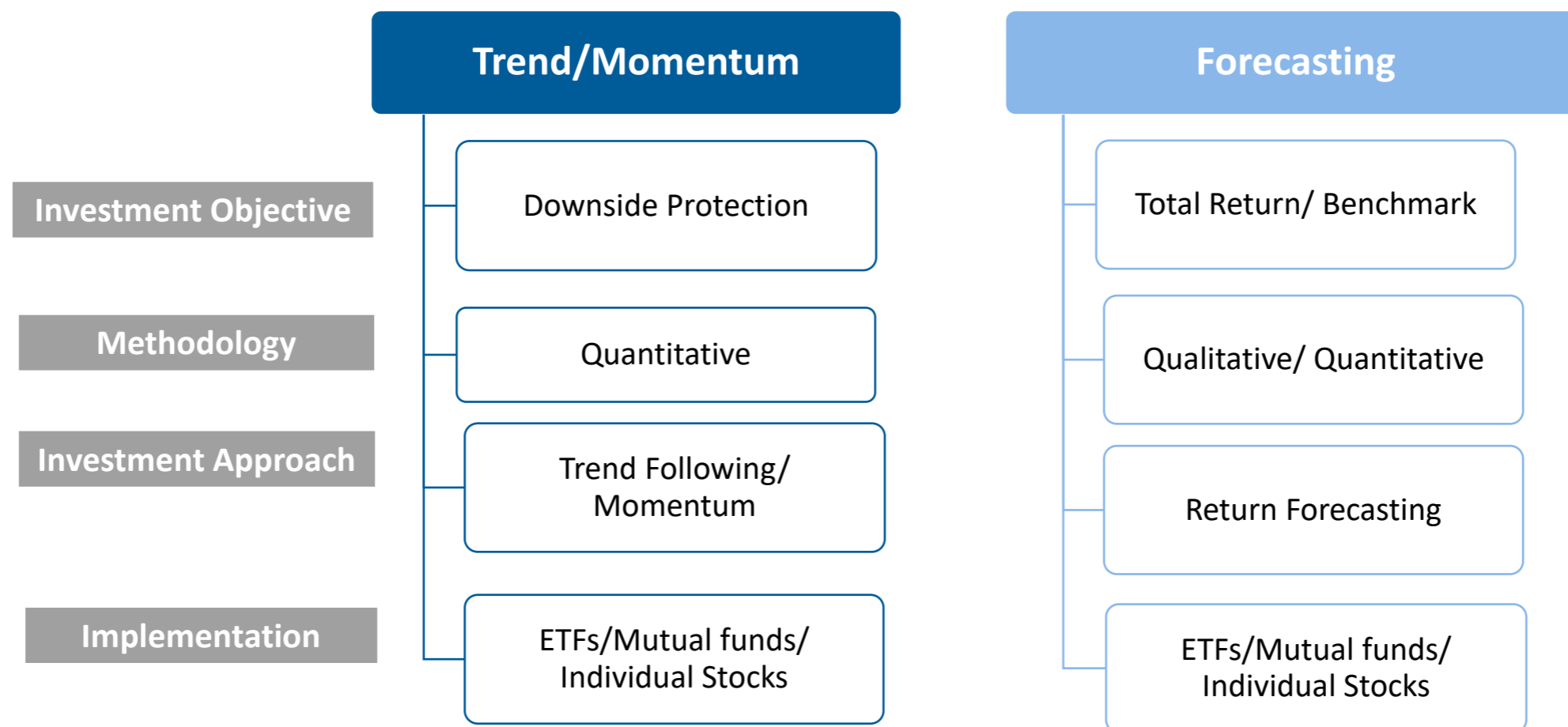
- Investment team overrules the model

- **But**

- Need to have that ability While at the same time never using that right
- Example: Terrorist act or natural disaster closes markets for 7-days need and be willing to override the model in order to accommodate profoundly atypical market behavior

- **99.9% of the time, overriding the model is bad**

• Different Approaches to Tactical Asset Allocation



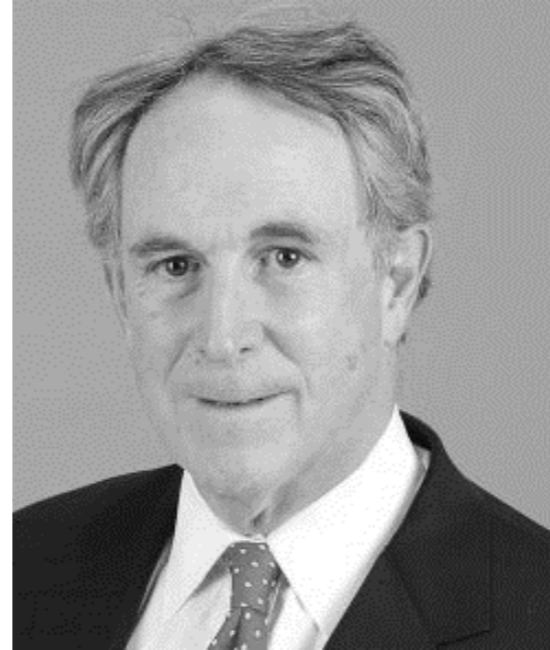
Evolution - Model adaptation

- Nevertheless, quantitative models must evolve
- New data arrives
- Data quality improves
- New products appear . . . new ETFs
- Existing product properties improve, making them more useful
- The challenge is limiting the pace of the model evolution

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Whipsaw in TAA portfolios, why, how bad, and solutions

Fri, Nov 13, 2020 11:00 AM - 11:45 AM (EST)

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