Why doesn't everyone offer TAA?

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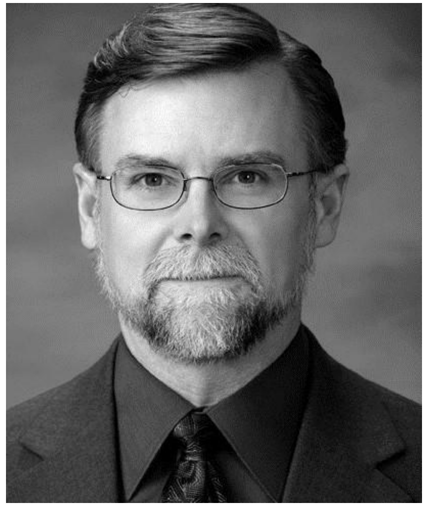

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"The best way to destroy the capitalist system is to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens."

John Maynard Keynes

Available from Julex - A client-facing piece

- Why doesn't BlackRock offer TAA?

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To address this question in a substantive fashion, we must examine a specific example, one that anyone could replicate with ease and simplicity. We'll call our specific example the thought-experiment portfolio. It's a passive portfolio built from the 31 asset categories shown in the graphic below using these weighs: 33.0% US stocks, 39.4% international stocks, 8.9% US Treasury bonds, 4.2% US investment grade corporate bonds, 1.6% international bonds, 2.1% gold, and 10.8% other commodities. Over the last 102 years (ending 1/31/2021) this portfolio would have delivered 14.5% per annum. That's pretty good.

But there's a bit more to the portfolio's construction. Since it's a TAA portfolio, it overweights recent winners and underweights recent losers - that's what TAA does. Specifically, it reconstitutes itself once each month, selecting the seven asset categories (drawn from the 31 shown below) that trended most strongly over that last eleven months (with a slight bias against last month's winners). These seven are then equal-weighted. This portfolio construction technique is the very essence of quite literally all TAA portfolios.

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Ranging from Industrials to Energy	Ranging from the United Kingdom to Japan	Ultra diversified industrial and agricultural commodities	Treasury Inflation-Protected Securities bonds	Ranging from very short-term U.S. Treasury bonds to ultra long-term	Ranging from liquid investment grade corporates to international bonds	Ranging from gold to palladium

Failure to launch

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PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

The short-term - in a sales setting, buyers of investment products have an unrelenting tendency to compare to the S&P 500. Worse, yet, they make this comparison over short time periods. The dysfunction of this behavior is the topic for another day. For the moment, let's just accept it as an unfortunate aspect of consumer behavior. So how does the thought-experiment portfolio perform relative to the S&P 500, in the short-run? The answer is:

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But, as an individual investor, keep your own investment objectives in mind. Don't cave to the investment industry's need to make money from you . . . instead of for you. For example, if your need, your objective, was to earn at least 7% or 8% over the last twelve years, then perhaps the thought-experiment portfolio might just have been the superior solution for your needs.

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Next steps

Your financial advisor has a menu of possible investment solutions. The solution that is most appropriate to your unique needs and circumstances can only grow out of a meaningful discussion with your advisor. Reach out to them, talk with your advisor.

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If TAA is so good, then why doesn't everyone offer it?

- First off . . . They do

- You can find it at
  - BlackRock
  - Invesco
  - Nationwide
  - Voya
  - Fidelity

- But they don't talk about it

- Because, it doesn't sell

Don’t get confused here

- Keep in mind the distinction between

- A product selling well in a commercial sense

- And it being the best possible solution for your client’s needs

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To answer the question, we need to consider a specific example

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- To prevent anyone from being able to honestly accuse of us gaming the answer

- We select an overly simplified TAA model

- It's a passive portfolio built from the 31 asset categories
    - 33.0% US stocks
    - 39.4% international stocks
    - 8.9% US Treasury bonds
    - 4.2% US investment grade corporate bonds
    - 1.6% international bonds
    - 2.1% gold
    - 10.8% other commodities

- But since it's a TAA portfolio . . . we overlay this mix by over-weighting recent winners and under-weighting recent losers

Specifically

- The seven best performing (with the strongest relative trending) are equal-weighted

- RESULT . . . It earned 14.5% per year over the last 102 years

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14.5% per year . . . that's good enough for commercial success !!

- One is tempted to conclude that 14.5% per year is more than adequate for unbelievable commercial success

- No it's not
- No investor can wait 102 years

- There are two big problems
  - The short-term
  - Episodic eras

The short-term - in a sales setting, buyers of investment products have an unrelenting tendency to compare to the S&P 500. Worse, yet, they make this comparison over short time periods. The dysfunction of this behavior is the topic for another day. For the moment, let's just accept it as an unfortunate aspect of consumer behavior. So how does the thought-experiment portfolio perform relative to the S&P 500, in the short-run? The answer is:

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The short-term problem

- All to often
- The measure of commercial sales success is

- Did it beat the S&P 500

- Well . . . We have the data . . . What does it tell us

Time it takes to beat the S&P 500

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The commercial approach

- The practical path taken by the commercial business

- Just sell the small roster of products that just happen to of beaten the S&P . . . after-the-fact

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Episodic eras exist, when TAA lags the S&P (temporarily)

- Consider our simple example
- The thought-experiment TAA model

- Since Feb 2009 . . . The TAA portfolio returned 8.8% . . . Plenty good enough for any client need, especially given its low risk level

- BUT . . . The S&P returned 16.9%

- These episodic eras do arise, not very often . . . but they do

What is the commercial objective??

- It is not to make money for you
- Instead, it is to make money from you

But is it a best possible investment solution?

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Nevertheless, the TAA portfolio might be in your client's best interest

- Over the last 102 years
- The overly-simplified TAA portfolio returned 14.5%
- While the S&P returned 10.3%
- But . . . Your client can't wait 102 years . . . Well, how long can they wait?

Perhaps you have an investment time horizon of just 7½ years. What then? Well, the data provides an answer. If you only have 7½ years, then investing in the S&P 500 would have given you a 98% probability of earning more than **-2.4%** per annum. In contrast, the thought-experiment portfolio would have delivered a 98% probability of generating more than **+5.3%** per annum.

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Maybe their time horizon is 7 ½ years

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- Over 7 ½ years the S&P has delivered a
  - 98% chance of earning more than -2.4% per annum
  - That's not very attractive

- The simple TAA portfolio delivered a
  - 98% chance of earning more than +5.3%
  - That's plenty good enough

- So . . . Which would you rather have? -2.4% or +5.3%
- The answer requires . . . that one is capable of controlling their greed and regret

- Advisors deliver tremendous value . . . when they help investors control these two dysfunctional behaviors

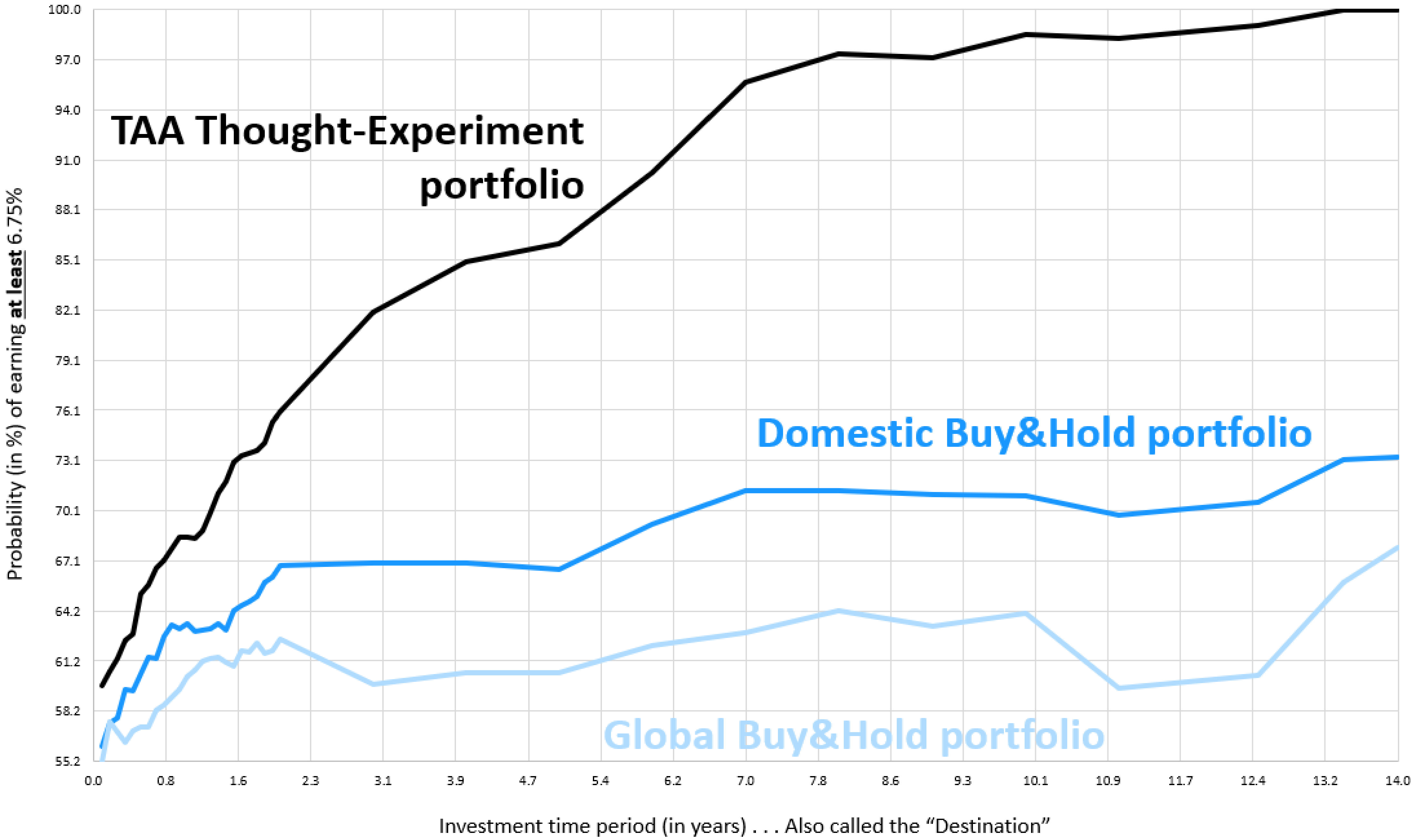
Here's a better way of thinking about the problem

But it requires that you are successful in getting your client to think about their needs

. . . . instead of relative comparisons (regret and greed)

A 2nd thought-experiment TAA portfolio

- This version starts with a slightly more aggressive average asset allocation
- But still takes on the overly-simplified method of
  - Over-weight the recent winners
  - Under-weight the recent losers
- It has a slightly longer investment time horizon
  - 12 ½ years . . . . . since it is intended to serve spending needs during years 10-15
  - Some would suggest that a reasonable/appropriate comparative asset mix would be 50/50 stocks/bonds . . . I agree
- So, what is the probability of earning at least 6 ¾% over various length investment time windows?



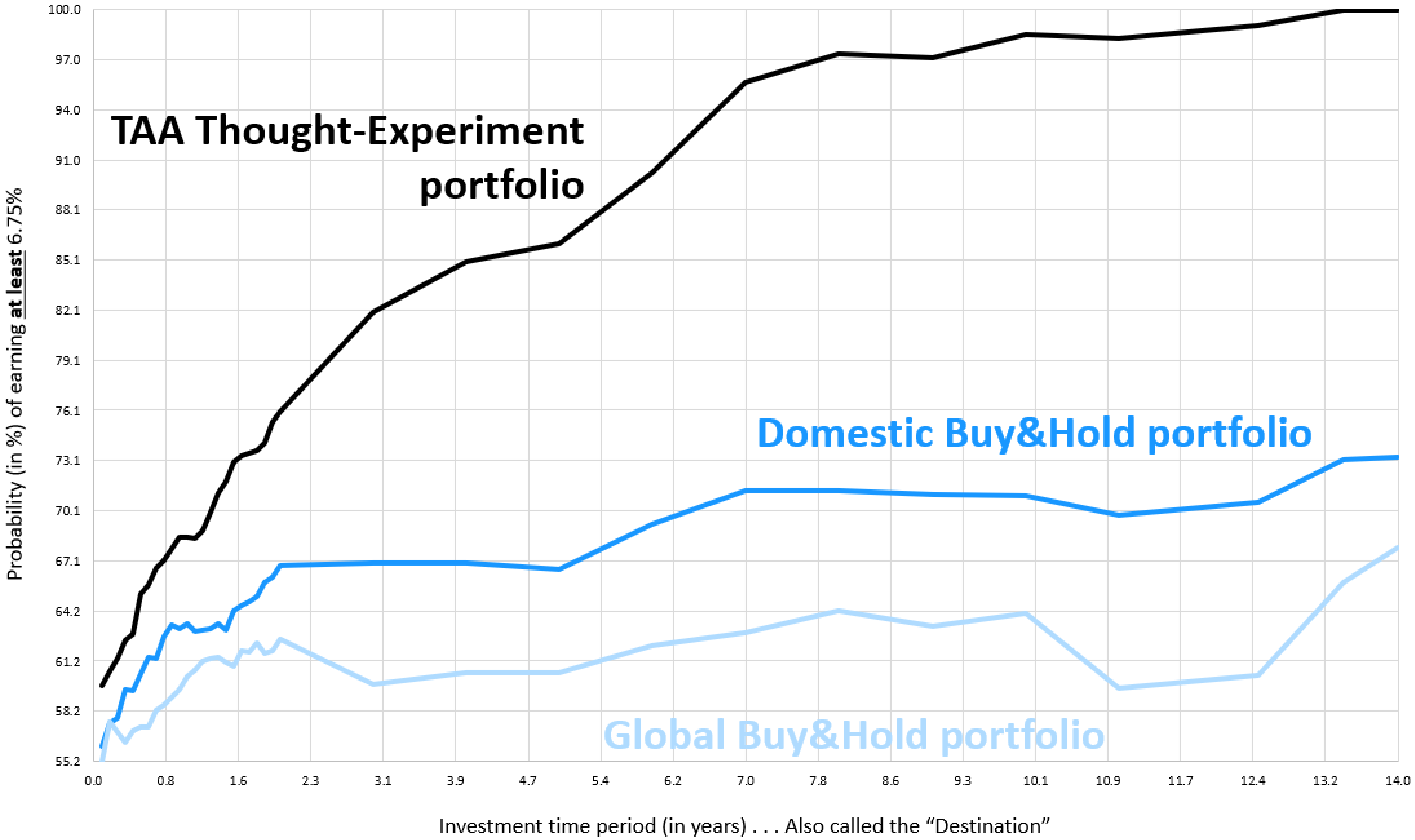
TAA Thought-Experiment portfolio
Domestic Buy&Hold portfolio
Global Buy&Hold portfolio
Probability (in %) of earning **at least** 6.75%
100.0
97.0
94.0
91.0
88.1
85.1
82.1
79.1
76.1
73.1
70.1
67.1
64.2
61.2
58.2
55.2
0.0
0.8
1.6
2.3
3.1
3.9
4.7
5.4
6.2
7.0
7.8
8.6
9.3
10.1
10.9
11.7
12.4
13.2
14.0
Investment time period (in years) . . . Also called the "Destination"

Bottom line

- Which portfolio will more quickly meet your client's objectives?

- Which portfolio has the higher probability of success?

- Look at the graph . . . To answer the question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61.2
58.2
55.2
0.0
0.8
1.6
2.3
3.1
3.9
4.7
5.4
6.2
7.0
7.8
8.6
9.3
10.1
10.9
11.7
12.4
13.2
14.0

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One can respond: "I don't believe it"

- OK

- But we'll give you the data
- And you can check the results yourself

- They are . . . as reported

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You don’t want to use TAA until the perfect environment comes along . . .

What does that ideal environment look like?

Monday, May 3rd

Important Disclosures

All of the data and statistics appearing herein were provided by Global Financial Data, Inc.

The exact specifications for the Thought-Experiment TAA portfolios are provided within the disclosure language of the associated piece of collateral referred to herein and available from Julex

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One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. For example, the ability to withstand losses or adhere to a particular trading program in spite of trading losses are material points which can also adversely affect actual trading results. There are numerous other factors related to the markets in general or to the implementation of any specific trading program which cannot be fully accounted for in the presentation of hypothetical performance results and all of which can adversely affect actual trading results.

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