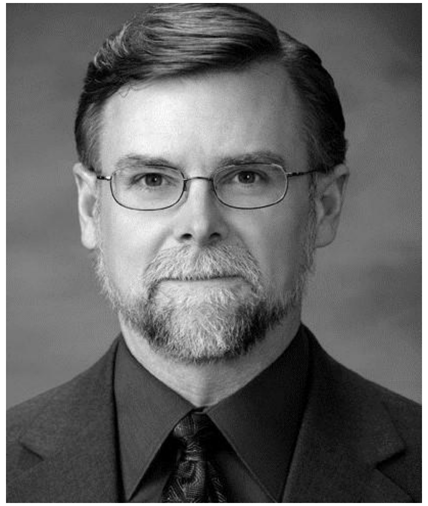
Selling proposition for TAA right this moment

Rob Brown, PhD, CFA

Julex Capital Advisory Board Member, Website www.robbrownonline.com



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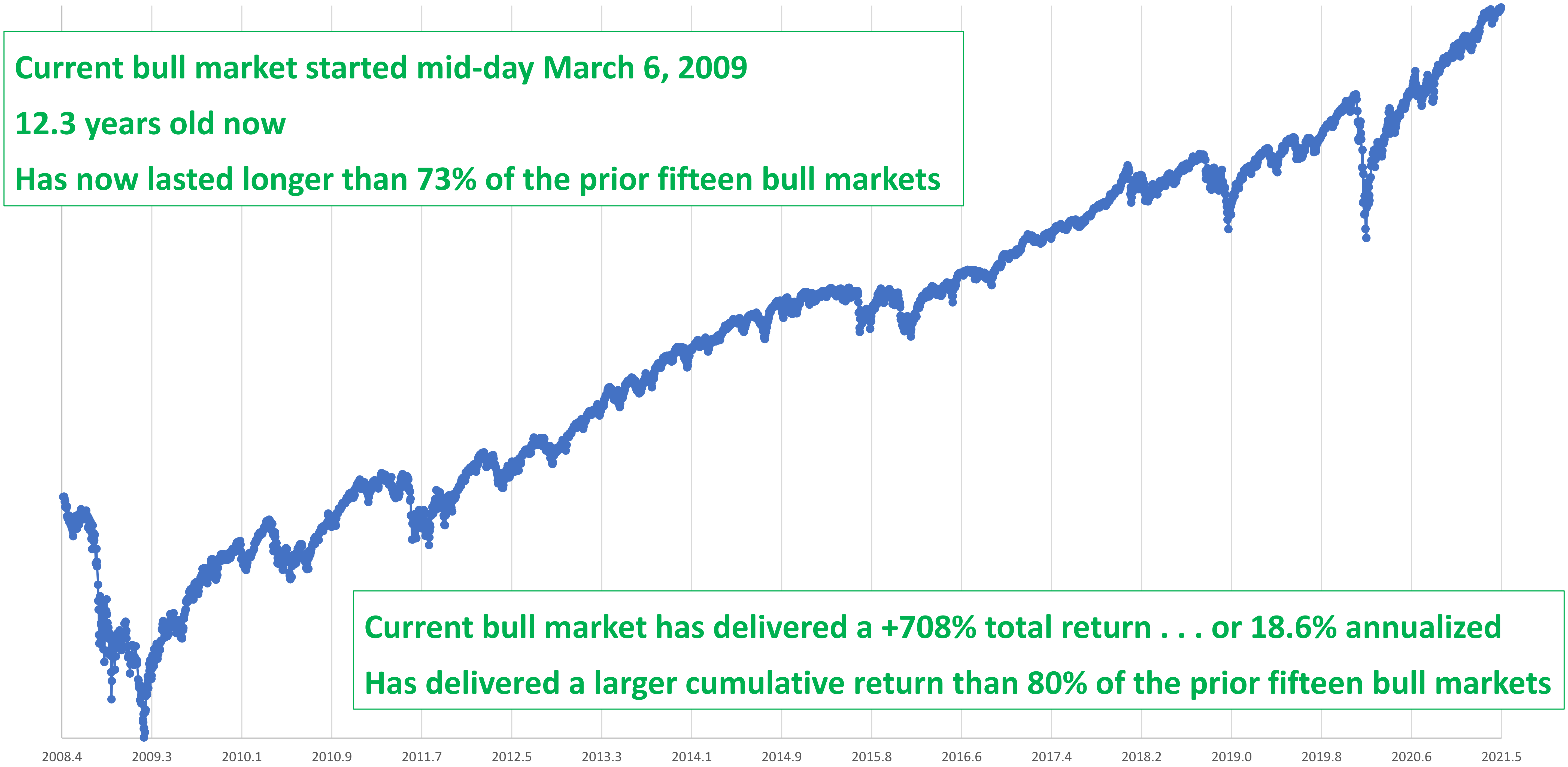
"The best way to think about investments is to be in a room with no one else and to just think. If that doesn't work, nothing else is going to work"

Warren Buffett

The juice ain't worth the squeeze - from staying in the S&P 500



History of all past bear markets - We've always had bears and always will

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History of BEAR markets for inflation-adjusted stocks

	Cumulative percentage loss, unannualized	Duration in months	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were negative	Annualized return during BEAR market
	-30	15	Aug 1853	Nov 1854	26.6	73	-25.1
	-31	10	Dec 1856	Oct 1857	18.3	90	-36.4
	-35	8	Jul 1864	Mar 1865	30.3	63	-47.1
	-32	15	Mar 1876	Jun 1877	7.6	93	-26.2
	-37	14	Sep 1906	Nov 1907	13.3	86	-32.7
	-27	24	Oct 1912	Oct 1914	10.8	63	-14.8
	-48	49	Nov 1916	Dec 1920	15.7	59	-14.8
	-79	33	Aug 1929	May 1932	36.8	64	-43.7
	-50	13	Feb 1937	Mar 1938	30.3	77	-47.1
	-39	31	Sep 1939	Apr 1942	19.0	58	-17.3
	-37	21	May 1946	Feb 1948	14.1	71	-23.4
	-35	19	Nov 1968	Jun 1970	14.4	74	-24.1
	-52	21	Dec 1972	Sep 1974	14.8	86	-34.2
	-30	3	Aug 1987	Nov 1987	27.7	100	-76.3
	-47	25	Aug 2000	Sep 2002	17.4	64	-26.4
	-52	16	Oct 2007	Feb 2009	18.6	75	-42.1
Median BEAR market	**-37.2**	**17.5**			**17.8**	**74**	**-29.6**
Mean BEAR market	**-41.4**	**19.8**			**19.7**	**75**	**-33.2**

The average bear is an ugly thing

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History of BEAR markets fo ks

Recent bear markets have been worse than historic averages

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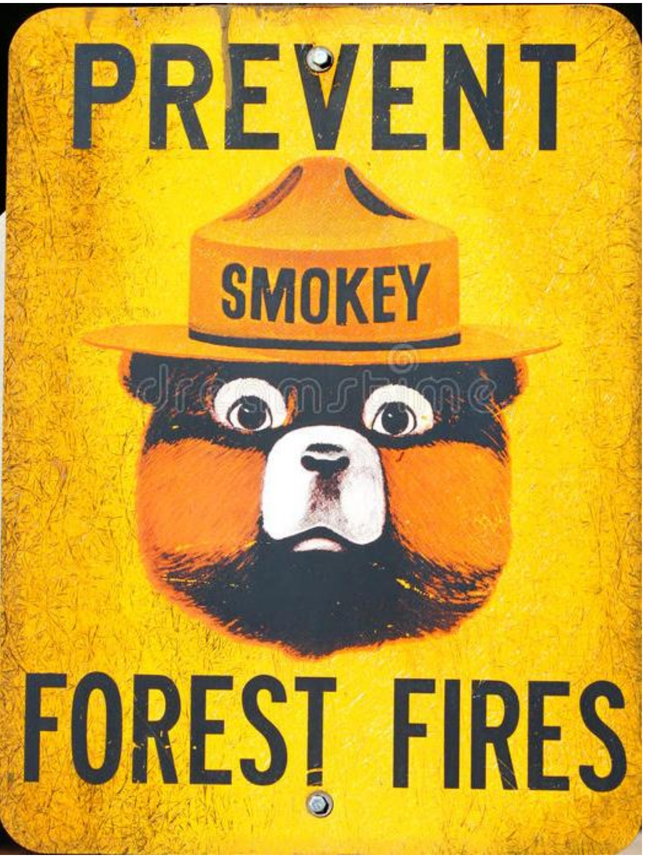
Recent bear markets have been worse than historic averages

But why? Things never happen by pure accident

The consequences of ever more heroic fire suppression efforts



Creative Destruction

Innovation and invention creates:
- New Products
- New Jobs
- New Production Processes

Innovation and invention destroys:
- Existing Markets
- Existing Jobs
- Existing Production Processes

Uncertainty remains at historic highs - Near impossible to understand

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Economics

The Most Important Number of the Week Is $25.6 Trillion

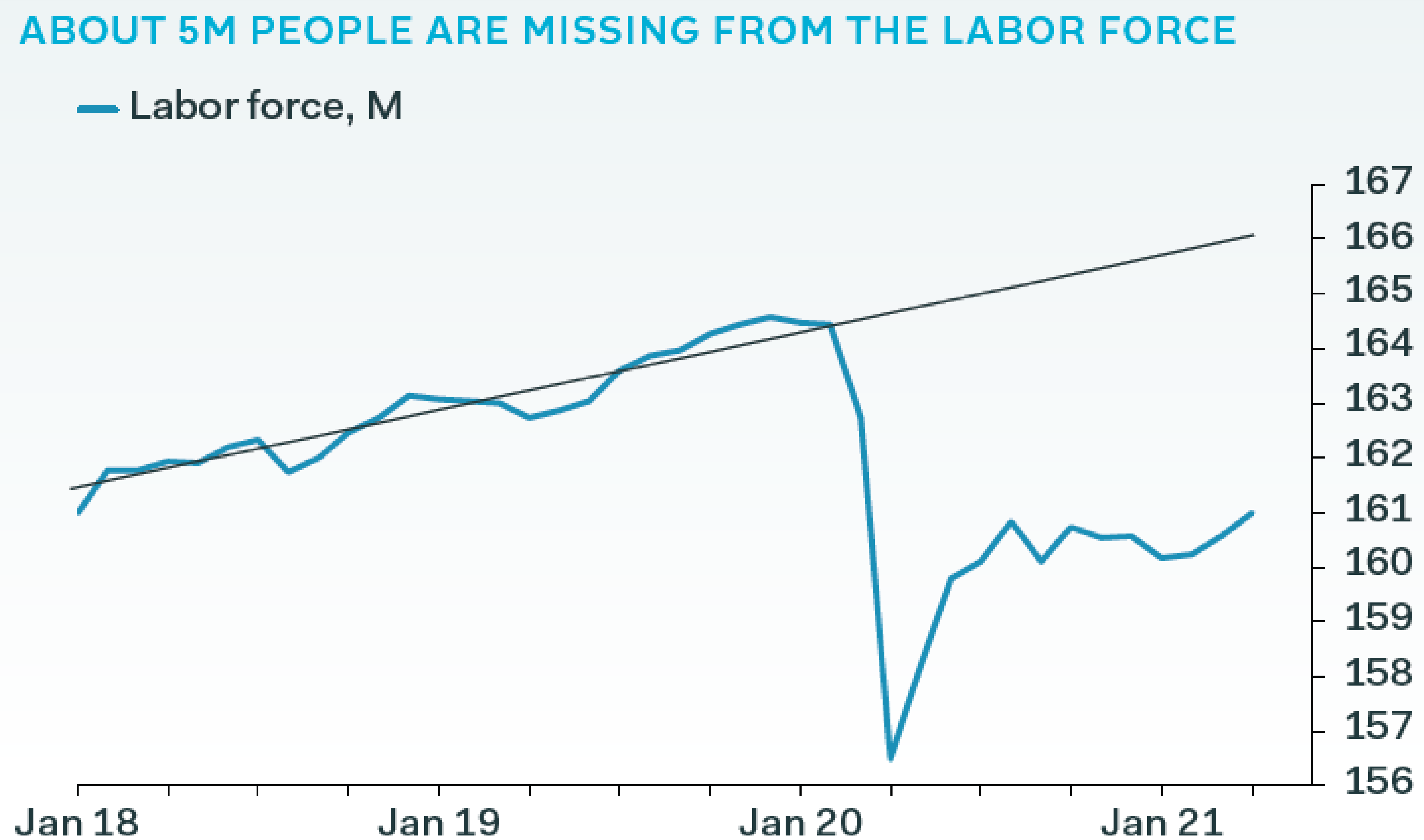
The jump in U.S. household net worth has significant implications for inflation and the economy.

By Robert Burgess
June 12, 2021, 5:00 AM PDT

To say the pandemic has turned traditional economic theory on its head would be an understatement for the ages. No economist can say with a straight face that he or she predicted that the sharpest contraction since the Great Depression would just as quickly turn into boom times not seen since the 1980s. Likewise, no market strategist can say he or she predicted the historic rally in stocks or appreciation in home prices that accompanied the pandemic.

This week brought some more news that no one thought would be possible during a pandemic, which is that U.S. household net worth ballooned by $25.6 trillion in the 12 months ended March 31, bringing the total to $136.9 trillion.

So much uncertainty out there - What is going on?



Economics

Hot U.S. Inflation Could Stir Once-Sleepy Household Expectations

By Craig Torres
June 12, 2021, 5:00 AM PDT

- Consumers have ignored the Fed and inflation for years
- Fed needs simple messages with broad appeal, economists say

U.S. inflation is back in the news after being dormant for years, potentially affecting how Americans think about price pressures after not thinking about them much at all.

The Federal Reserve says expectations that inflation will stay near its 2% target will help to ensure the current surge in consumer prices, which jumped 5% in May, will be temporary. Chair Jerome Powell can expect questions on this at his post-meeting press conference Wednesday.

Business

Out-of-Control Shipping Costs Fire Up Prices From Coffee to Toys

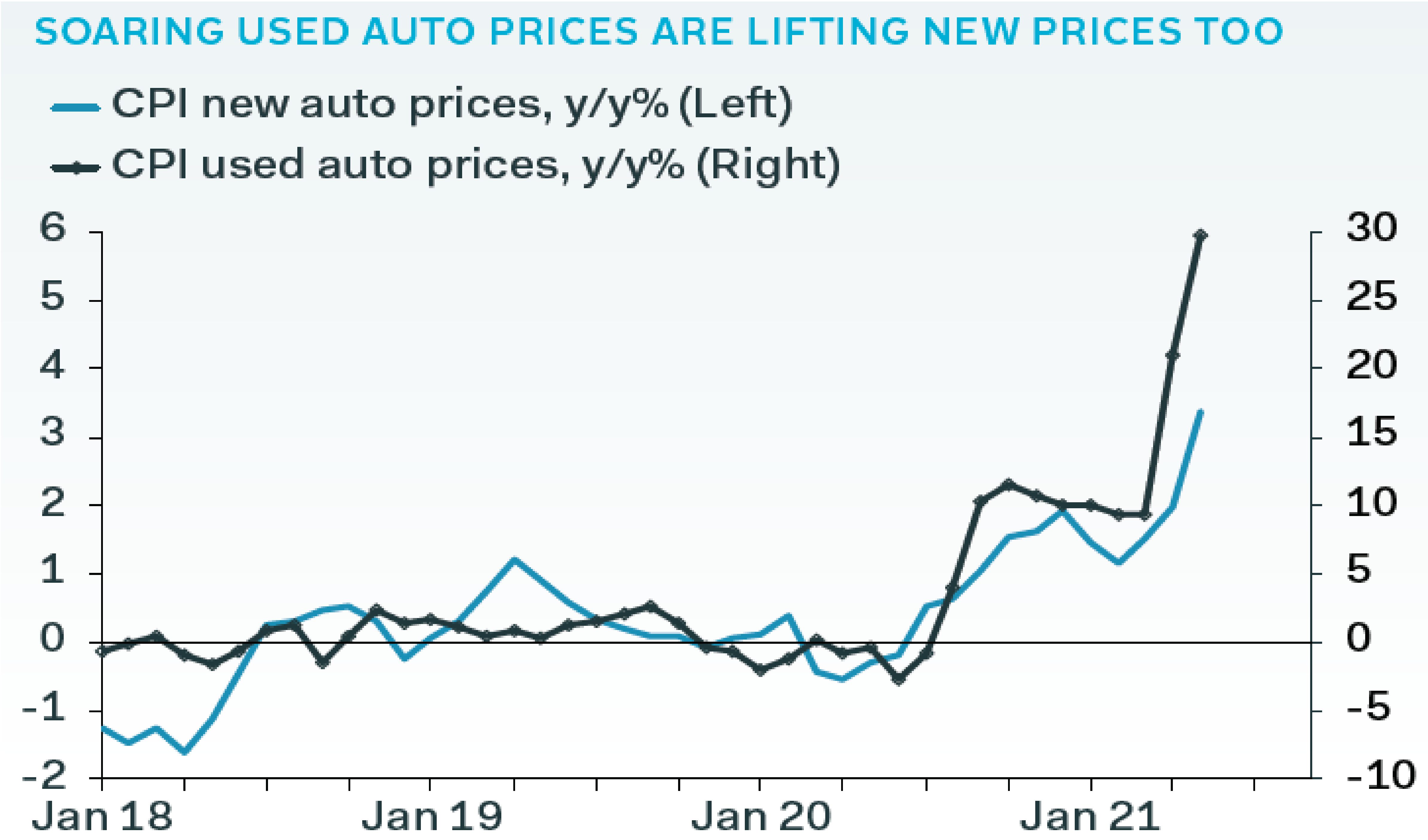
By Alex Longley, Catherine Bosley, and Deirdre Hipwell
June 12, 2021, 4:01 PM PDT

- Zero slack in shipping system to keep freight pricey into 2022
- Economists weigh inflation risk of long period of costly rates

The skyrocketing price of shipping goods across the globe may hit your pocketbook sooner than you think -- from that cup of coffee you get each morning to the toys you were thinking of buying your kids.

Transporting a 40-foot steel container of cargo by sea from Shanghai to Rotterdam now costs a record $10,522, a whopping 547% higher than the seasonal average over the last five years, according to Drewry Shipping. With upwards

Ouch - serious ouch



Munger observes that speculation is “problematic”

"It Must End Badly" - Munger Says Market Resembles Dot Com Bubble, Calls SPACs "Shit"

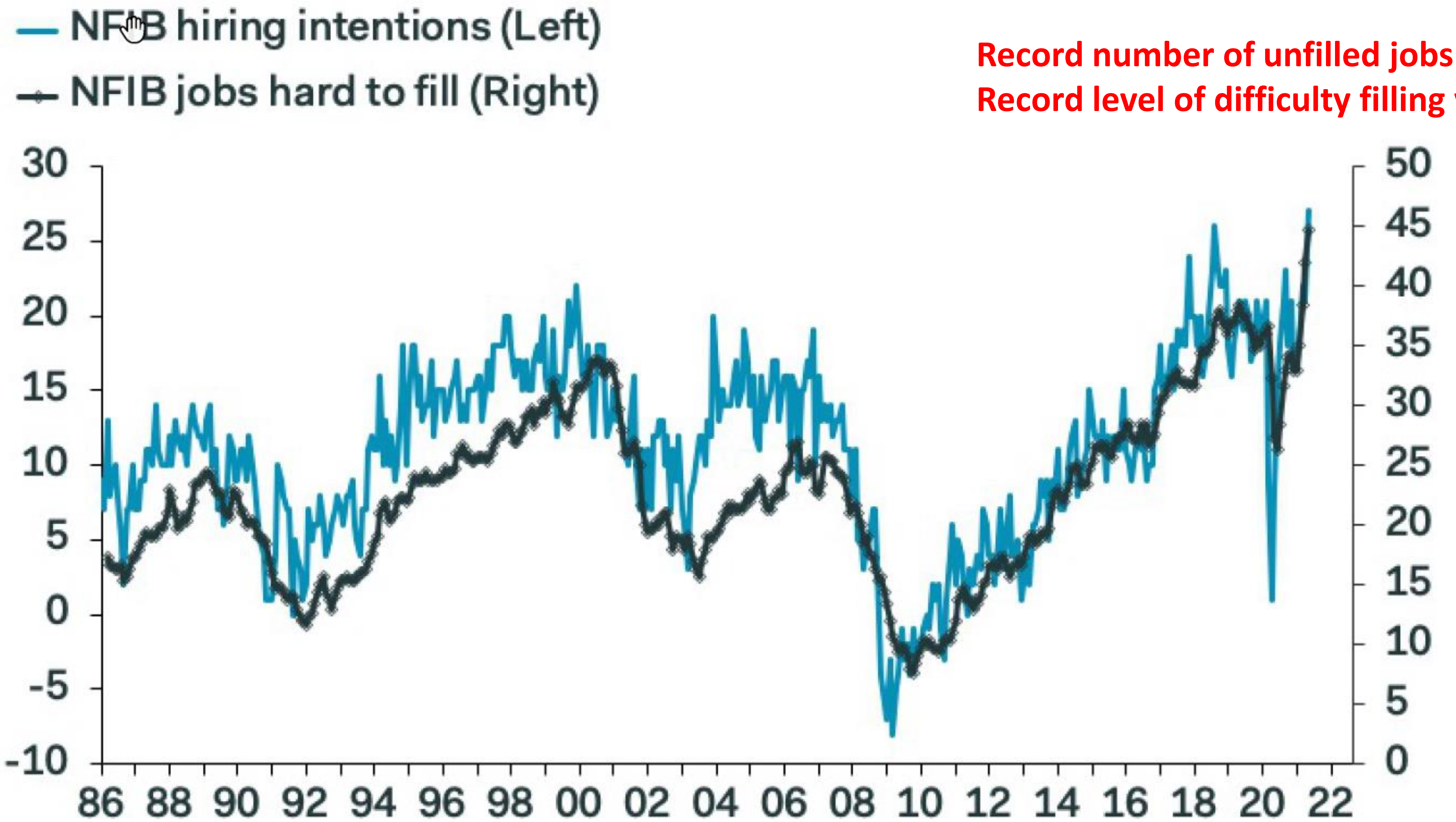
BY TYLER DURDEN

WEDNESDAY, FEB 24, 2021 - 15:29

Warren Buffett's "No. 2" spoke during the annual meeting of the Daily Journal Corporation, the Los Angeles newspaper-publishing company chaired by Munger. The 97-year-old Charlie Munger is best known for his work as Vice Chairman of Berkshire Hathaway, where he has served as Buffett's right hand man for

Wage inflation coming?

Record number of unfilled jobs
Record level of difficulty filling vacant jobs



Wages - it is starting to look “truly serious”

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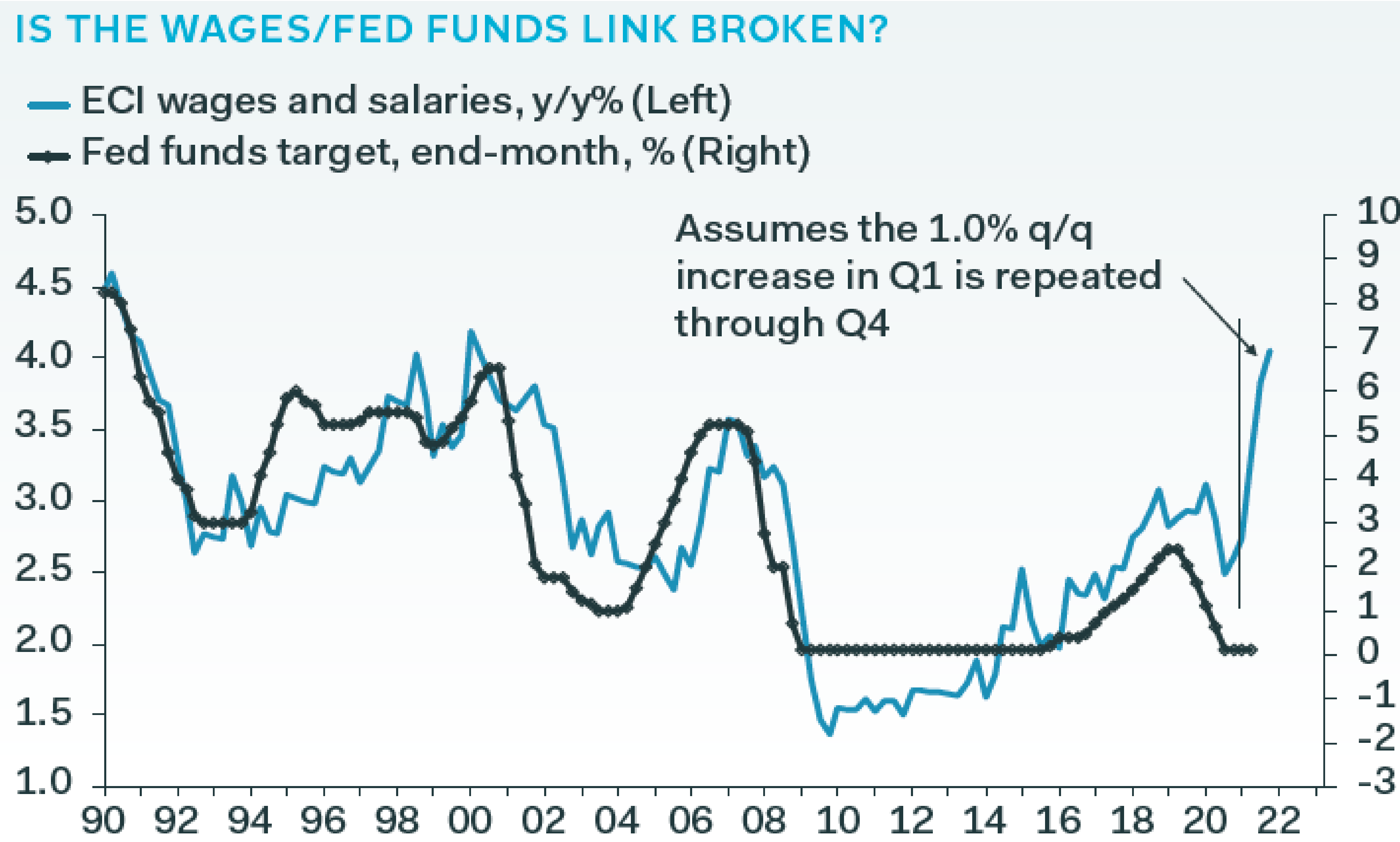

Central bankers around the world are concerned

Economics

ECB Officials Warn of Inflation Risk Despite Extending Stimulus

By Carolynn Look
June 11, 2021, 5:56 AM PDT

- Holzmann says crossing 3% would need a rethink of policy
- Knot sees upside risk, Weidmann sees 4% temporarily in Germany

Some European Central Bank officials issued warnings about higher rates of inflation, just a day after agreeing to keep monetary stimulus flowing at an accelerated pace through the summer.

Austrian Governor Robert Holzmann went so far as to say that if euro-area price growth exceeds 3%, then policy makers would need to consider acting. He said the possibility can't be excluded that temporarily higher prices would drive up wage pressures.

Larry Summers on future inflation - He's worried

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We Can Have Persistent Inflation and Transient Inflation: Summers

Wall Street Week

June 11th, 2021, 5:33 PM PDT

Former U.S. Treasury Secretary Lawrence H. Summers, a Wall Street Week contributor, says that it's a fallacy to think that transient inflation means we cannot have persistent inflation. He points to the labor and housing markets as examples of persistent inflation.

TIPS demand suggests disastrous inflation ahead

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Bloomberg Fixed-Income ETF Tracker

Inflation-Protected Bond ETFs Post Record Inflow

Updated: June 4, 2021

The inflation trade isn't finished yet, judging by exchange-traded fund flows last month.

Investors with one eye on price growth poured almost $3.7 billion into ETFs tracking inflation-protected bonds in May, according to data compiled by Bloomberg. That was the biggest monthly inflow on record. Ultrashort-duration ETFs, tracking securities which are less sensitive to rising rates, added the most since March last year.

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Treasury Inflation Protected Securities (TIPS)

NAME	COUPON	PRICE	YIELD
GTII5:GOV **5 Year**	0.13	109.41	-1.73%
GTII10:GOV **10 Year**	0.13	110.30	-0.90%
GTII20:GOV **20 Year**	2.13	149.09	-0.40%
GTII30:GOV **30 Year**	0.13	109.02	-0.17%

TIPS current yields as of June 13, 2021

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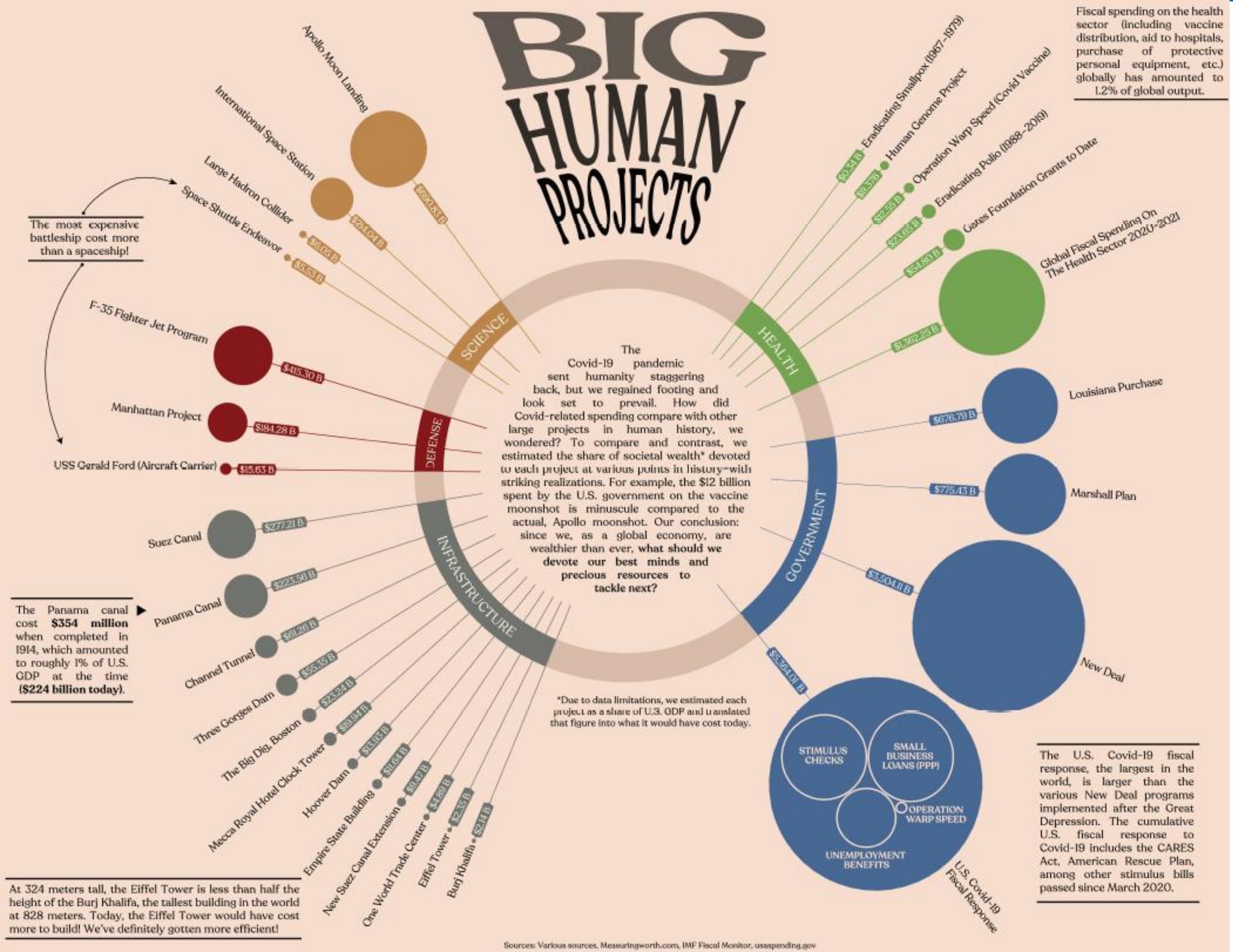
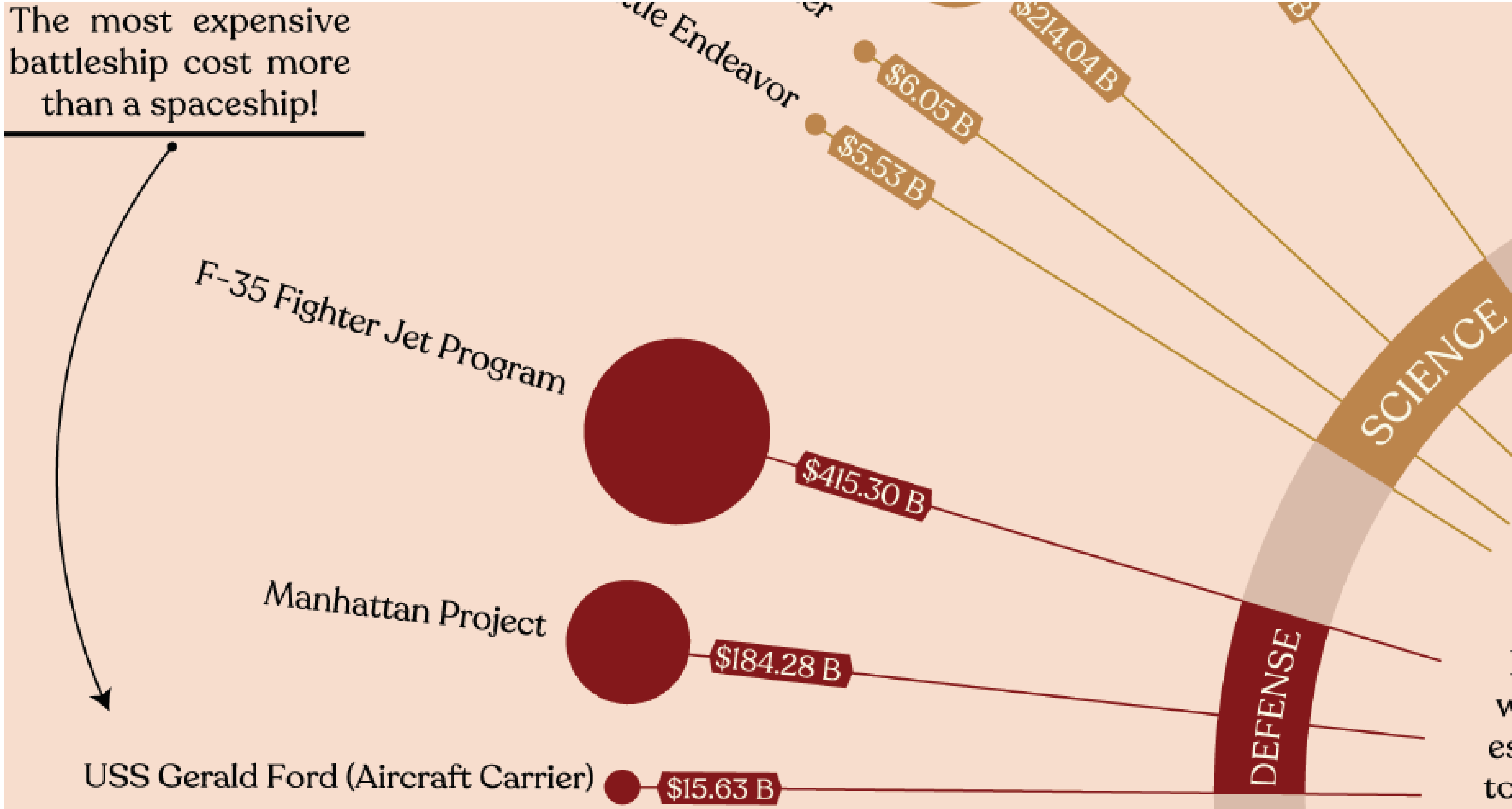
Government response to COVID was a pretty big deal



Government response to COVID was a pretty big deal

The Manhattan Project only cost $184 billion



Government response to COVID was a pretty big deal

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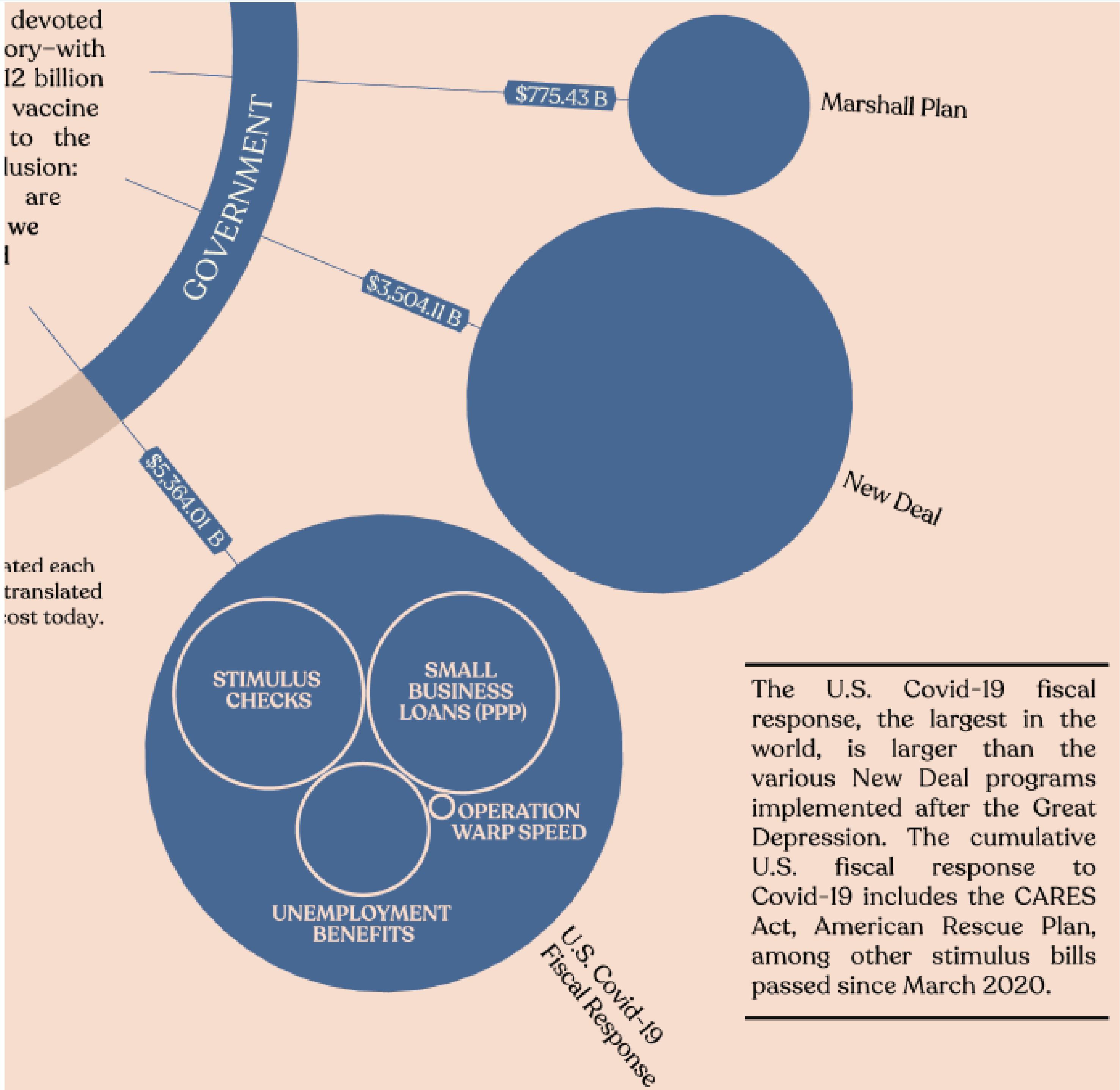
But the U.S. response to COVID cost $5,634 billion

The equivalent of 31 Manhattan Projects all at the exact same time



U.S. monetary/fiscal stimulus has affected relative opportunities/risks

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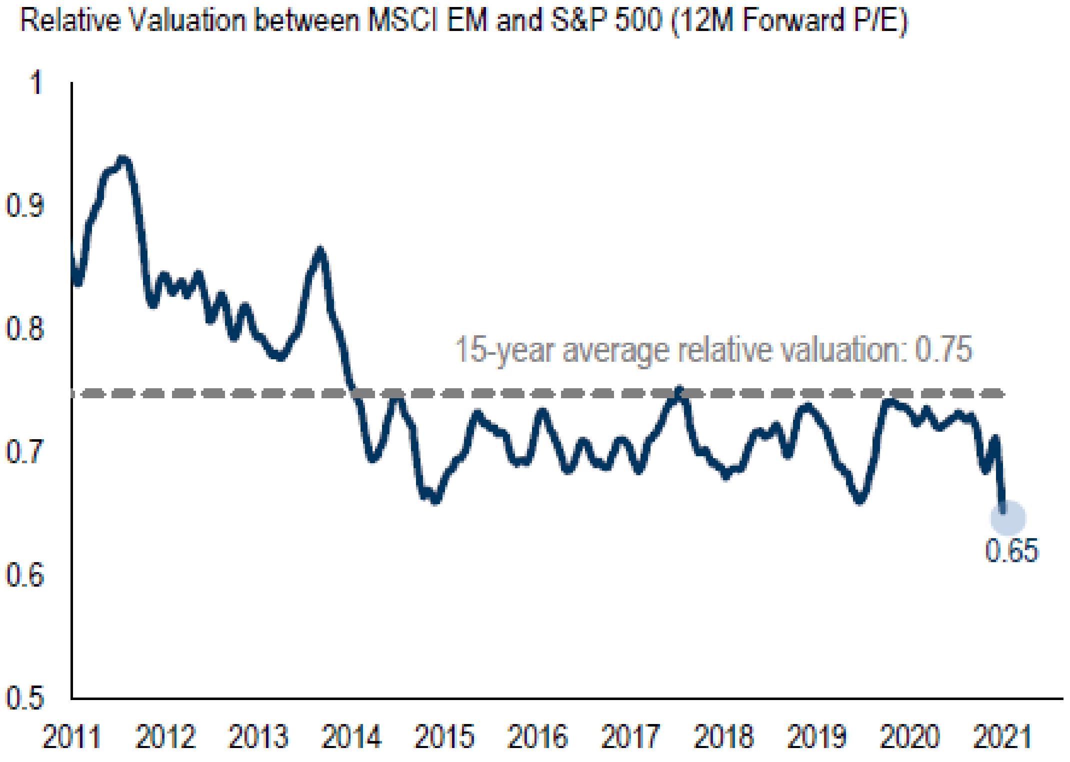
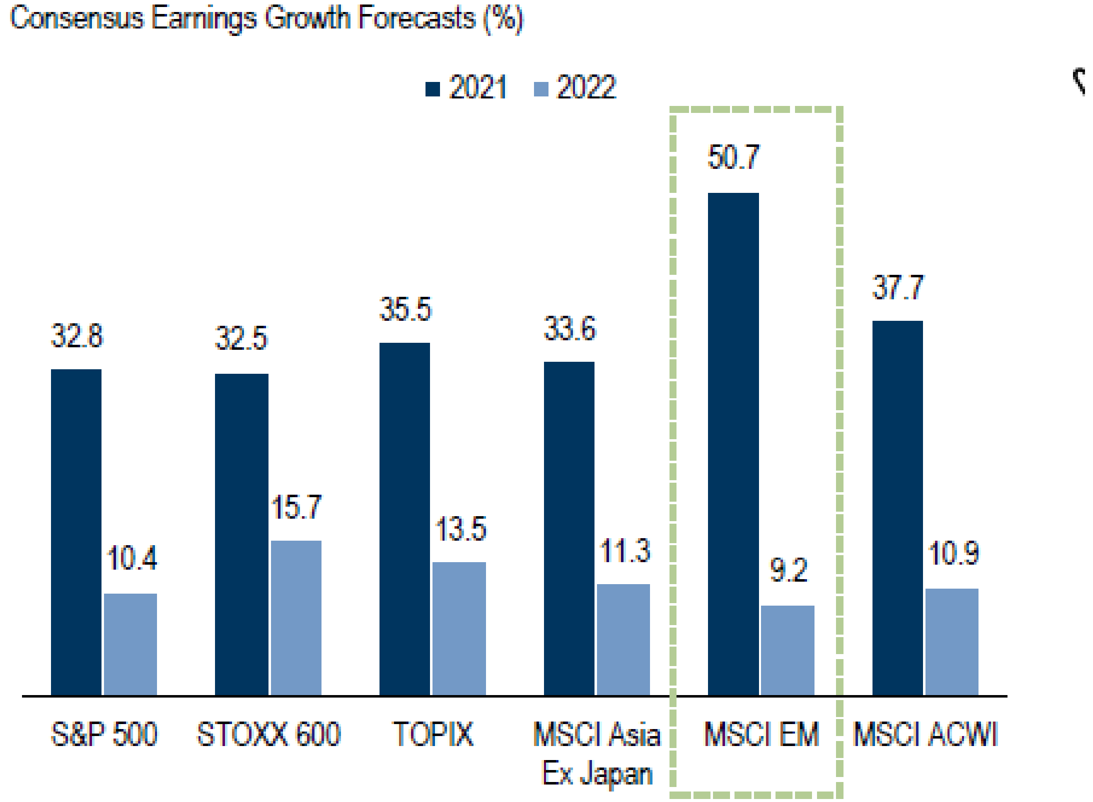
Relatively cheap EM assets paired with strong earnings potential reflect an attractive entry point for investors

Deep discount in relative valuations

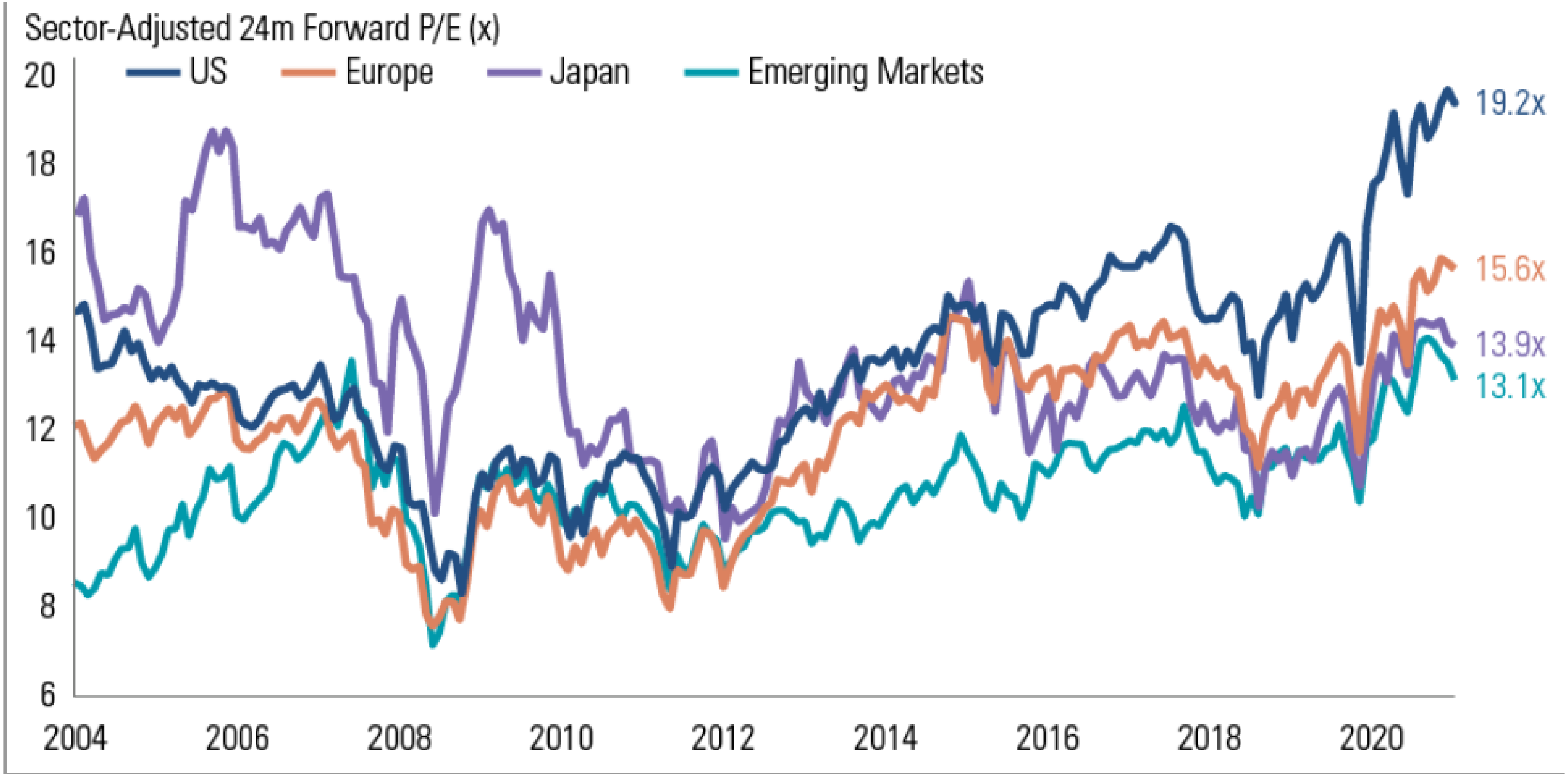


Higher relative earnings expectations



Source: Bloomberg and Goldman Sachs Asset Management. As of May 14, 2021. Left Chart Notes: "MSCI EM" refers to the MSCI Emerging Markets Index. "S&P 500" is the Standard & Poor's 500 Composite Stock Prices Index of 500 stocks. "12M Forward P/E" refers to price to earnings ratio based on projected earnings in the next 12 months. Right Chart Notes: "STOXX 600" refers to the STOXX Europe 600 Index. "TOPIX" refers to the Tokyo Stock Price Index. "MSCI Asia Ex Japan" refers to the MSCI Asia excluding Japan Index. 'MSCI ACWI' refers to the MSCI All Country World Index. Consensus earnings growth forecasts reflect Bloomberg estimates. The economic and market forecasts presented herein are for informational purposes as of the date of this presentation. There can be no assurance that the forecasts will be achieved. Please see additional disclosures at the end of this presentation.

US in unique position, not seen before, defined by relative high-prices



Source: FactSet, Goldman Sachs GIR, and Goldman Sachs Asset Management

MoneyWise

The 60/40 rule of investing is dead, experts say — it's time to get more creative

Sigrid Forberg
Sun, June 13, 2021, 2:00 PM

For decades, investors have put their financial future in the hands of ol’ reliable: the 60/40 rule.

With 60% of your money in stocks, you’ll have enough growth potential to meet your goals. And with 40% in bonds, you’ll have a stable source of income to fall back on in case your stocks don’t perform.

At least, that’s the conventional wisdom. The problem is that the investing landscape today looks completely different compared to 20 years ago, let alone 70 years ago.

Overall Results

Returns over the coming decade are likely to be very disappointing compared to history. Our assumptions suggest a typical global portfolio, consisting of 50% large-cap equities, 30% bonds, and 20% alternatives, will produce an annual nominal return of only 2.9%, compared to an average of 6.3% over the past 20 years. A US-only portfolio with a similar composition is likely to produce only a 2.8% return, compared to 7% in history.

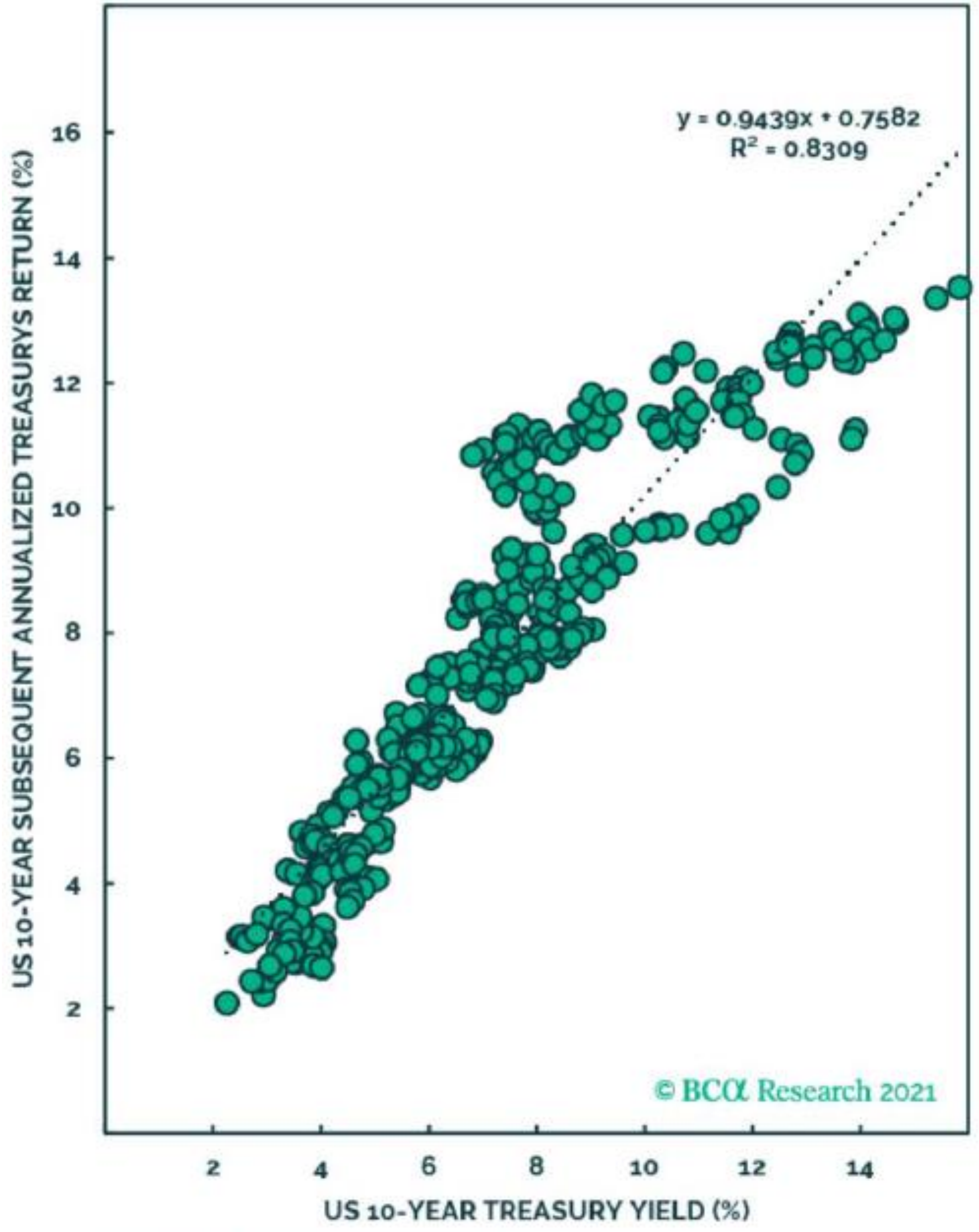
But why? - Why such low returns over the ten years ahead?

The reason is simple: Valuations currently are very stretched in almost every asset class. The risk-free rate (the 10-year government bond yield) in the US is 1.6% (compared to a 20-year average of 3.1%). It is negative in the euro area (in nominal terms) and zero in Japan. These rates are the anchor for the returns of all other asset classes, which are theoretically priced off the risk-free rate plus a risk premium.

We have long argued that valuations are not a good timing tool for investors. An asset can remain very expensive or very cheap for a considerable period. But all the evidence shows that the valuation at the starting point is a very powerful indicator of *long-run* returns. The

True for bonds - Current yield predicts future long-run returns

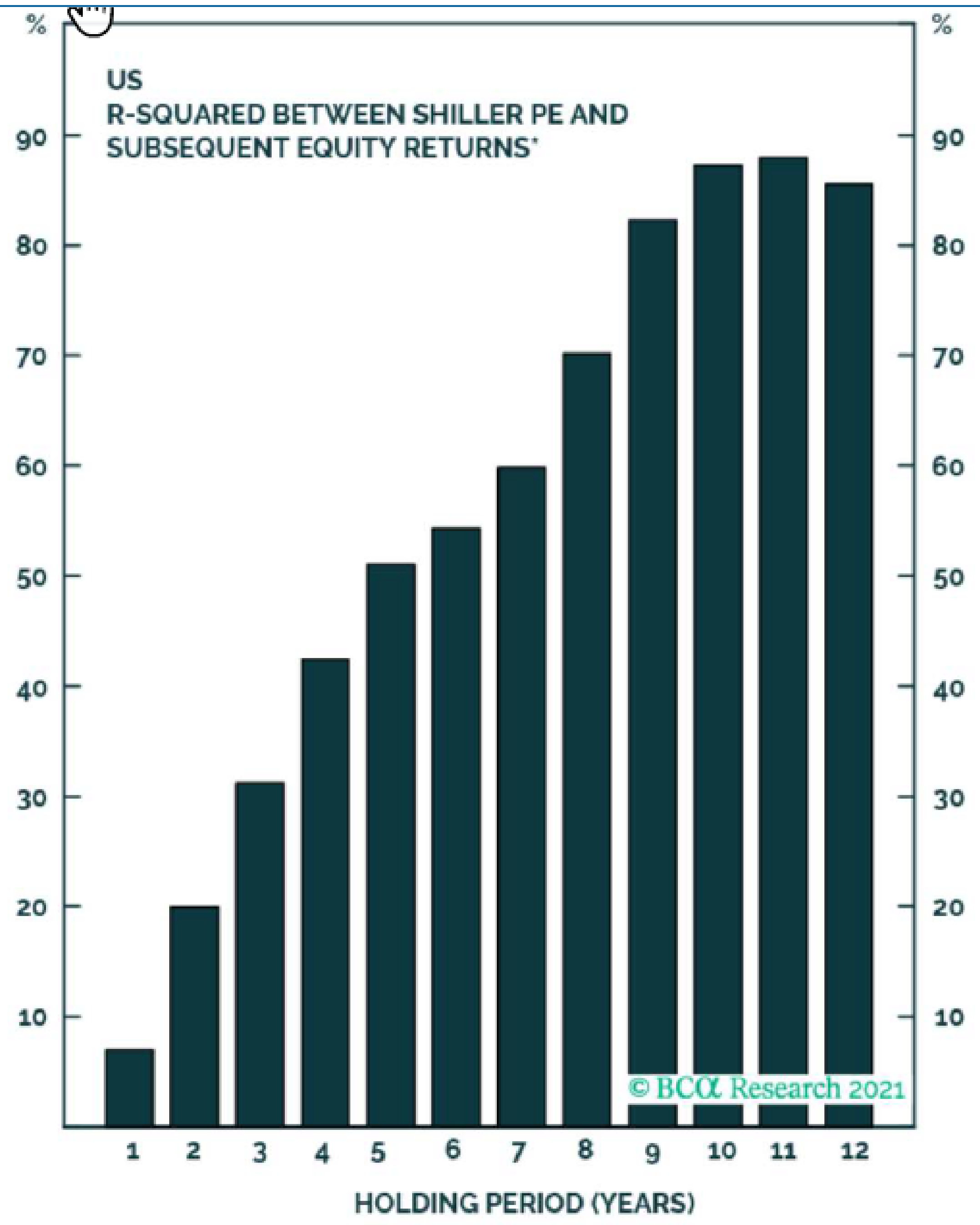
Almost a perfect relationship between a bond's current yield and what you earn on bonds over the next eight or nine years



SOURCE: BLOOMBERG BARCLAYS INDICES.
BASED ON MONTHLY DATA FROM 1973.

True for stocks - P/E predicts long-run returns

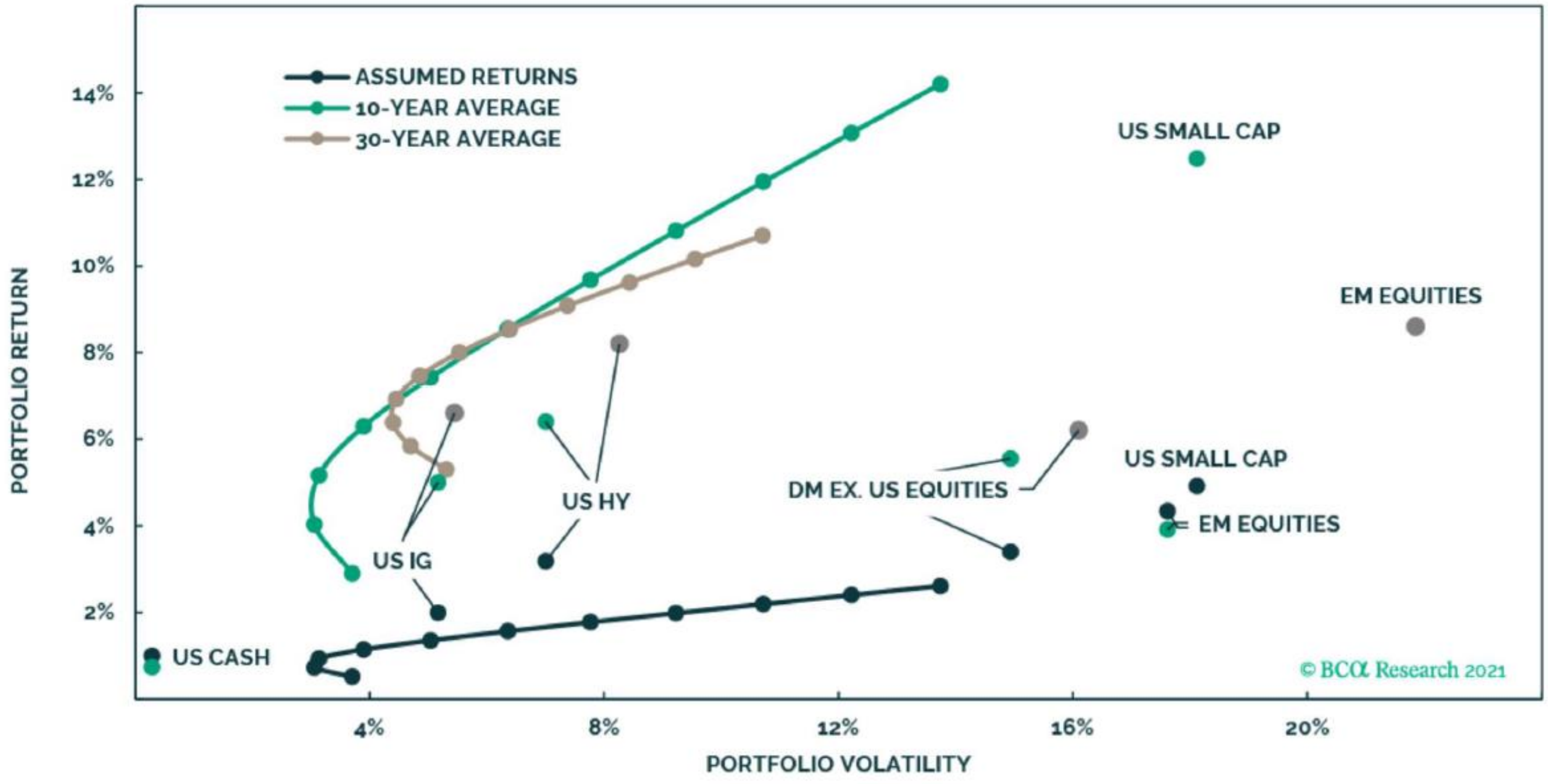
Almost a perfect relationship between stock's Shiller P/E ratio and what you earn on stocks over the next ten or eleven years



* SOURCE: ROBERT SHILLER CAPE AND MSCI INC. (SEE COPYRIGHT DECLARATION). DATA SINCE 1987.

Next 10 years . . . versus prior 10 and 30 years

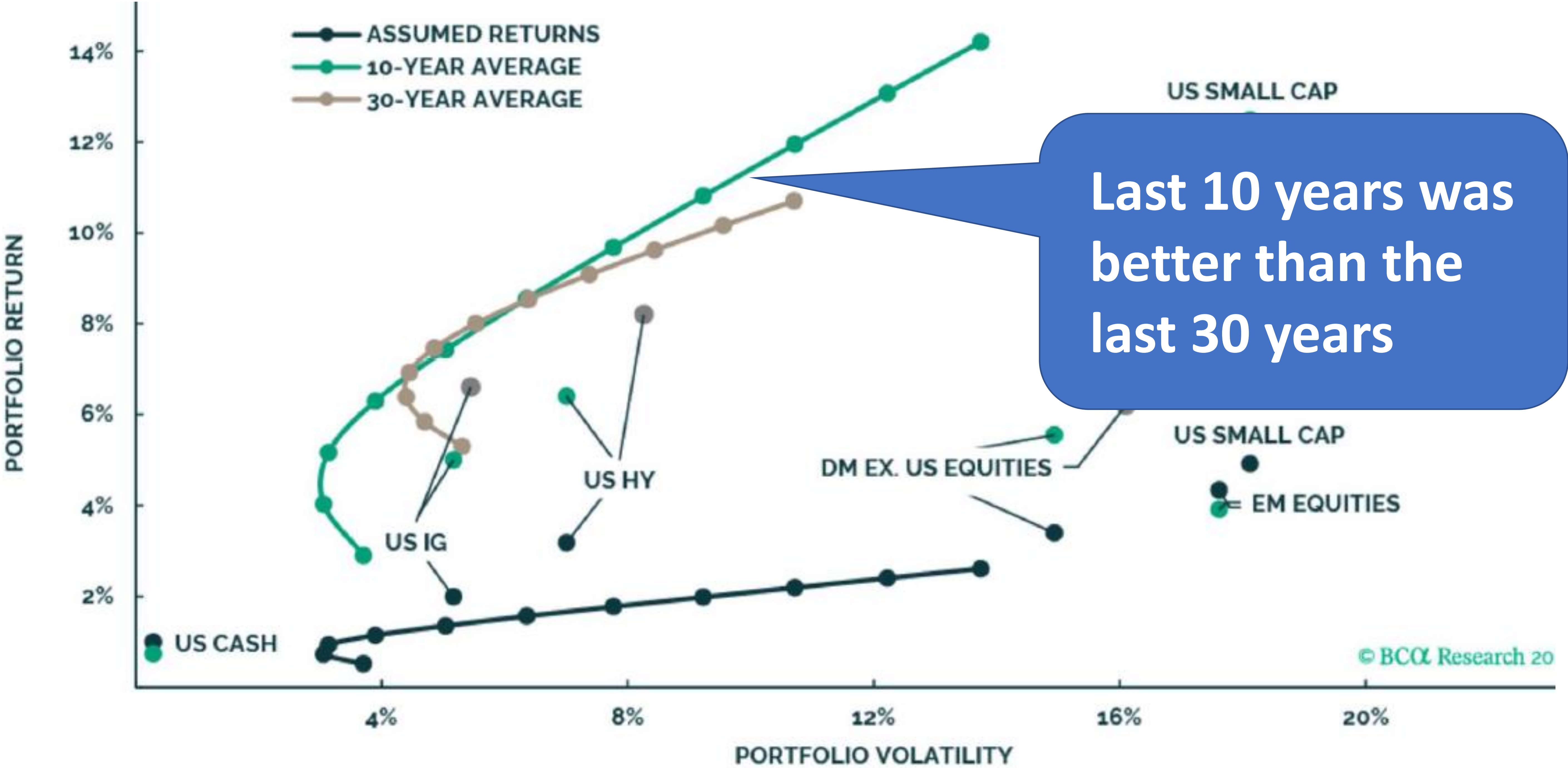
You Need To Take More Risk To Produce Return



SOURCE: MSCI INC. (SEE COPYRIGHT DECLARATION) AND BLOOMBERG BARCLAYS INDICES.

EFFICIENT FRONTIERS ARE CALCULATED BASED ON RETURNS AND VOLATILITY OF A PORTFOLIO CONSISTING OF US LARGE-CAP STOCKS AND US TREASURYS. CURRENT EFFICIENT FRONTIER IS BASED ON OUR CALCULATED ASSUMED RETURNS AND THE 10-YEAR ANNUALIZED HISTORICAL VOLATILITY. THE 10-YEAR AVERAGE AND 30-YEAR AVERAGE EFFICIENT FRONTIERS ARE BASED ON THE 10- AND 30-YEAR ANNUALIZED RETURNS AND THEIR RESPECTIVE VOLATILITIES.

Last 10 years was CRAZY good



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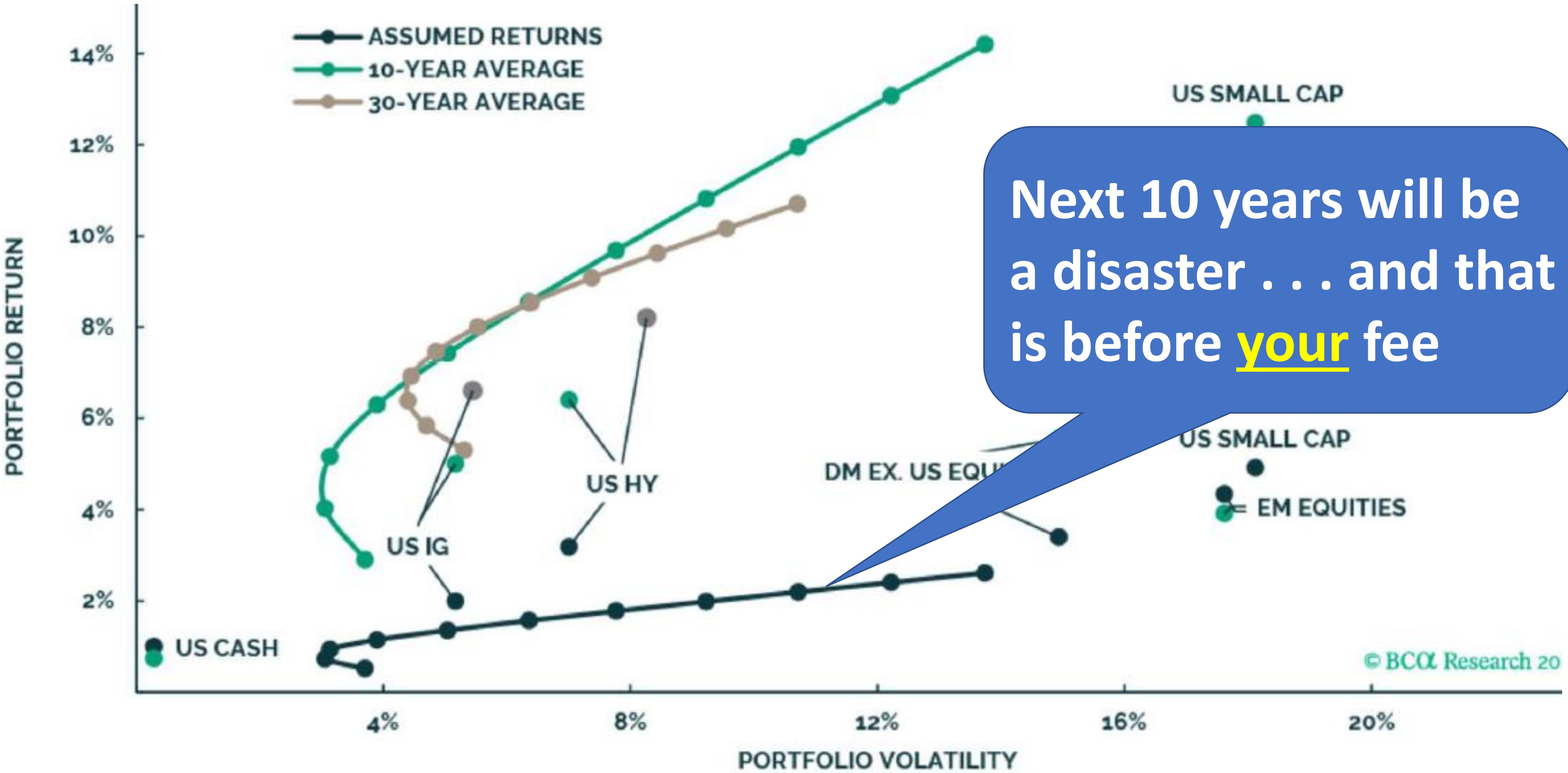

Next 10 years will be a disaster . . . and that is before <u>your</u> fee

Fiscal stimulus . . . largest since WWII

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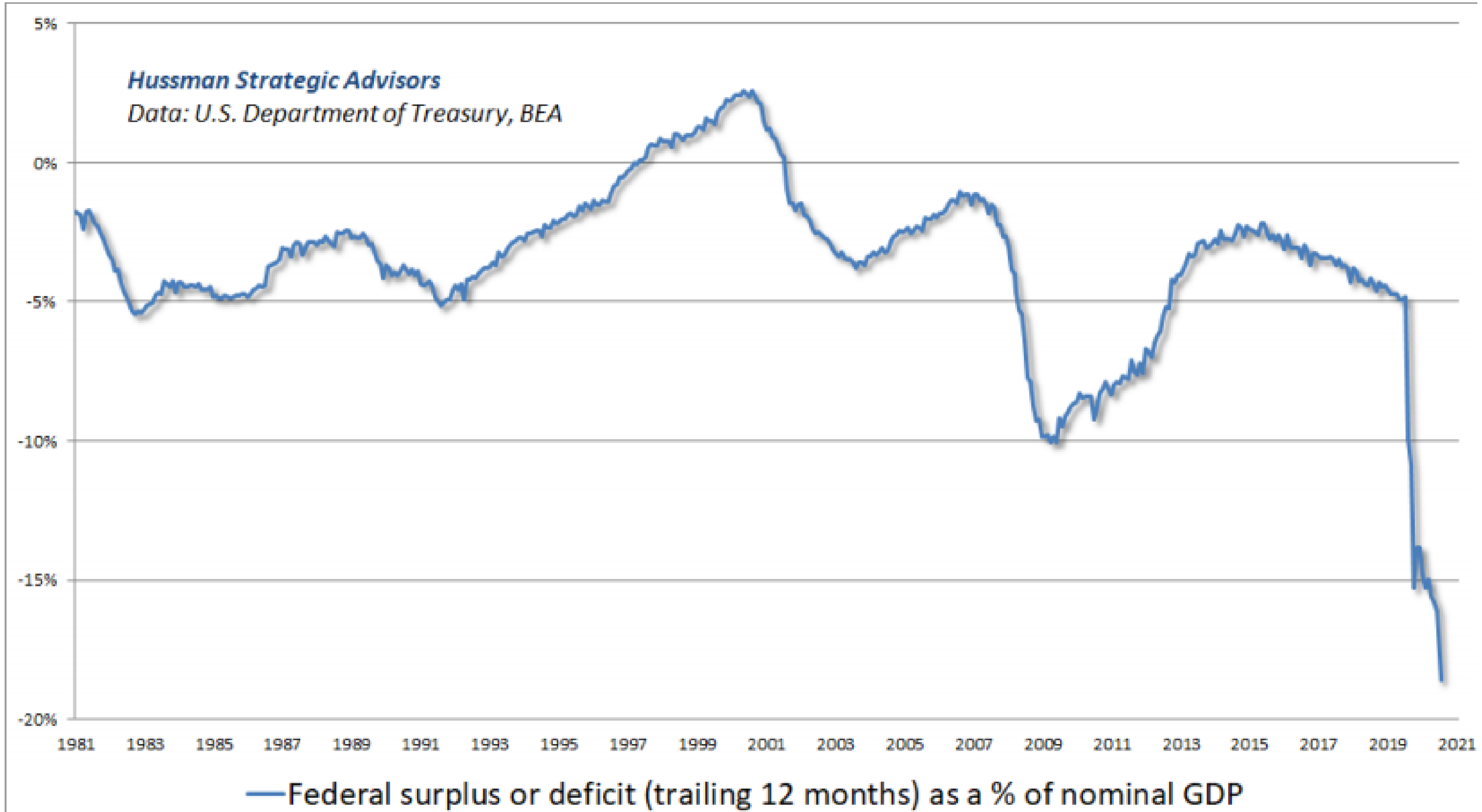
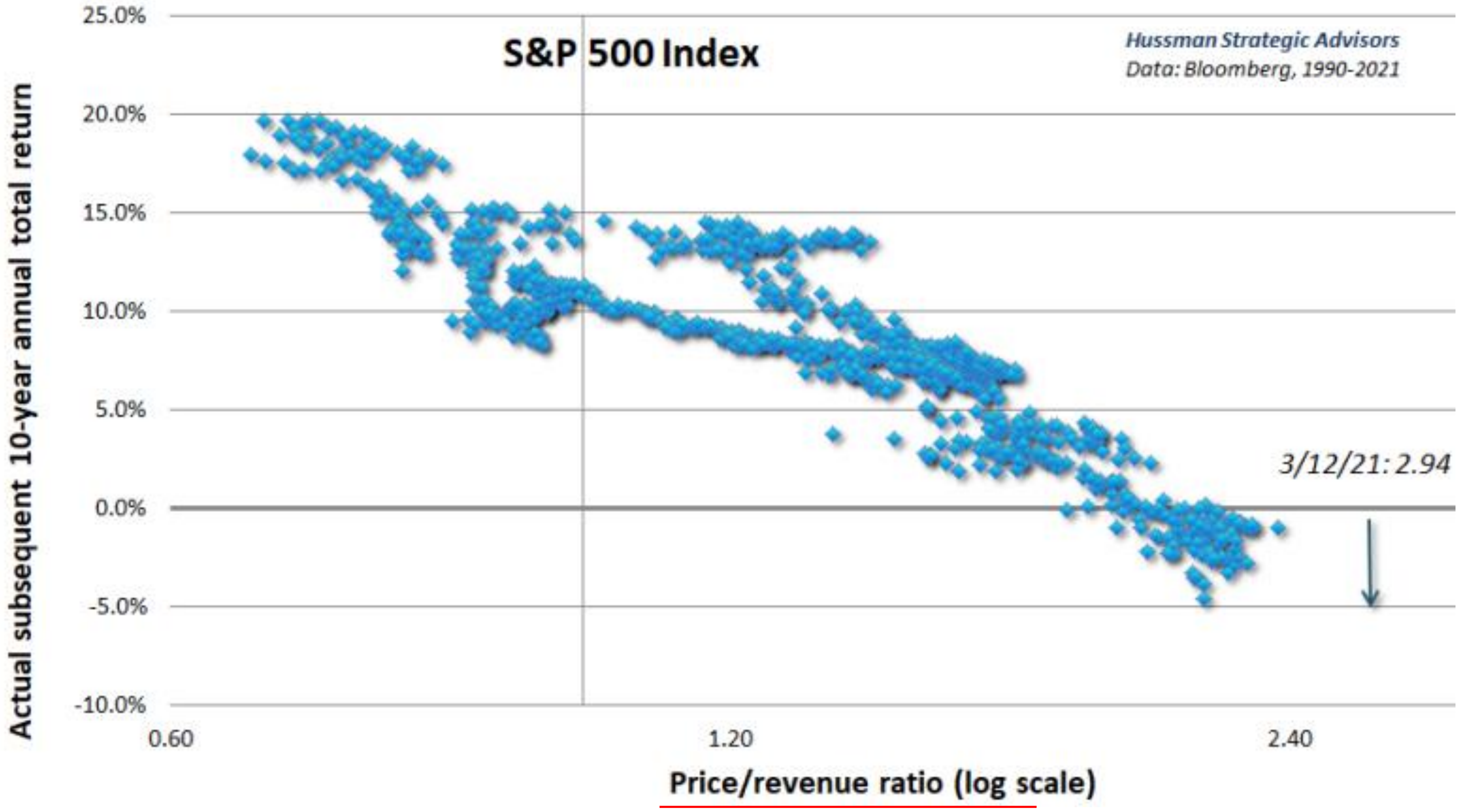
What's going on is simple. Over the past 12 months, the U.S. federal government has run the deepest fiscal deficit since World War II. Investors seem to be vastly underestimating the extent to which a likely economic rebound will *replace* rather than *augment* the effect of trillions of dollars in pandemic relief programs, amounting to close to 20% of GDP, which preserved corporate revenues while subsidizing labor costs.



Relationship hold over time



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Things Have Changed

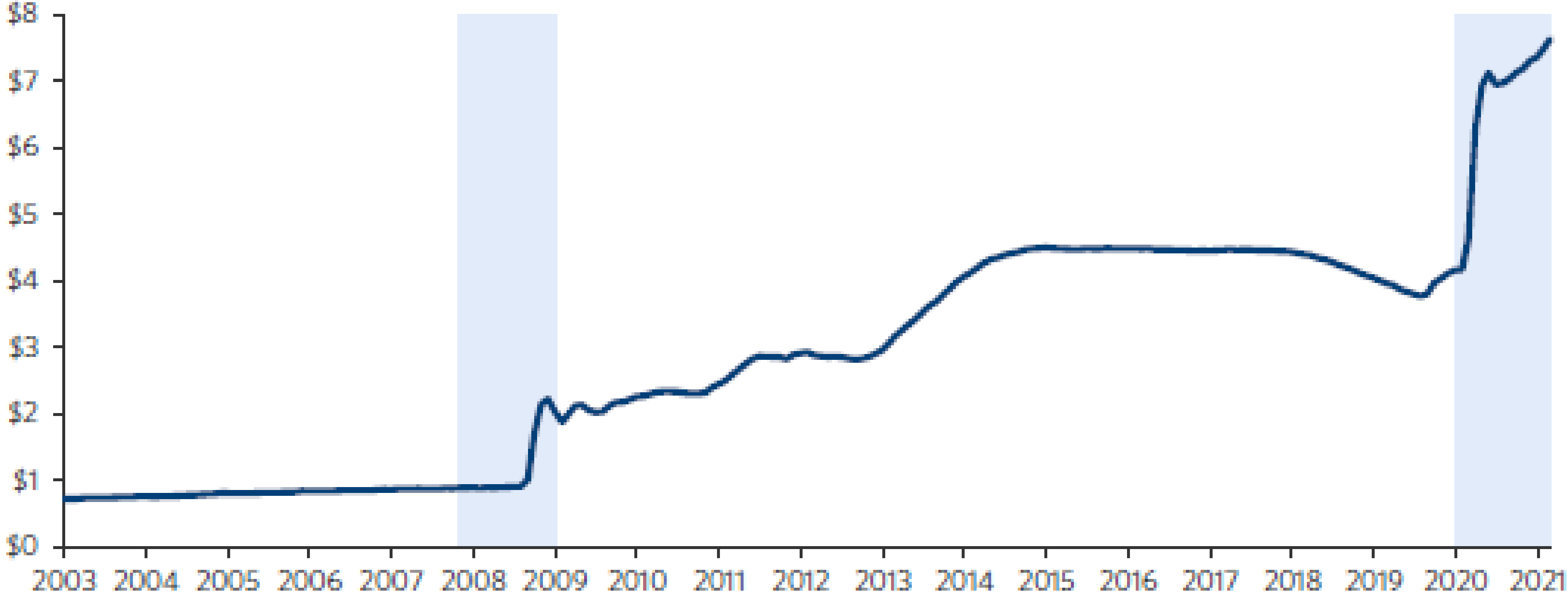
The U.S. stock market was cheaper on the eve of the Roaring '20s than at any time before or since

Source: Robert Shiller

How did we get to this point?

Exhibit 1. Already-Large Fed Balance Sheet Ballooned in Response to Pandemic

Total Assets of the Federal Reserve (Less Eliminations from Consolidations) in Trillions of Dollars, January 2003 through March 2021



Source: Federal Reserve; data as of April 5, 2021.

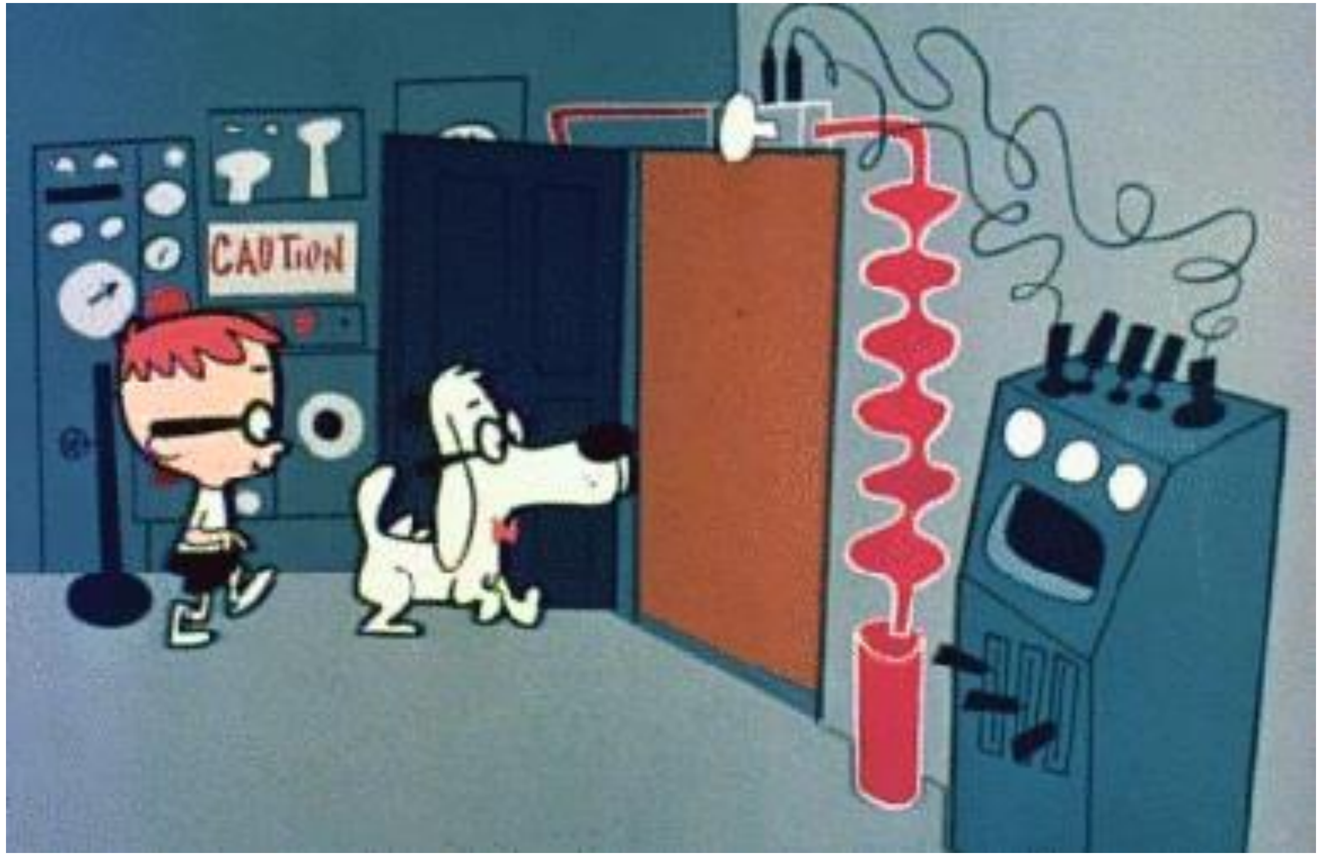
Mr. Peabody and the Wayback machine

Time travel is not possible

Your clients can't invest in the past

Only in the future

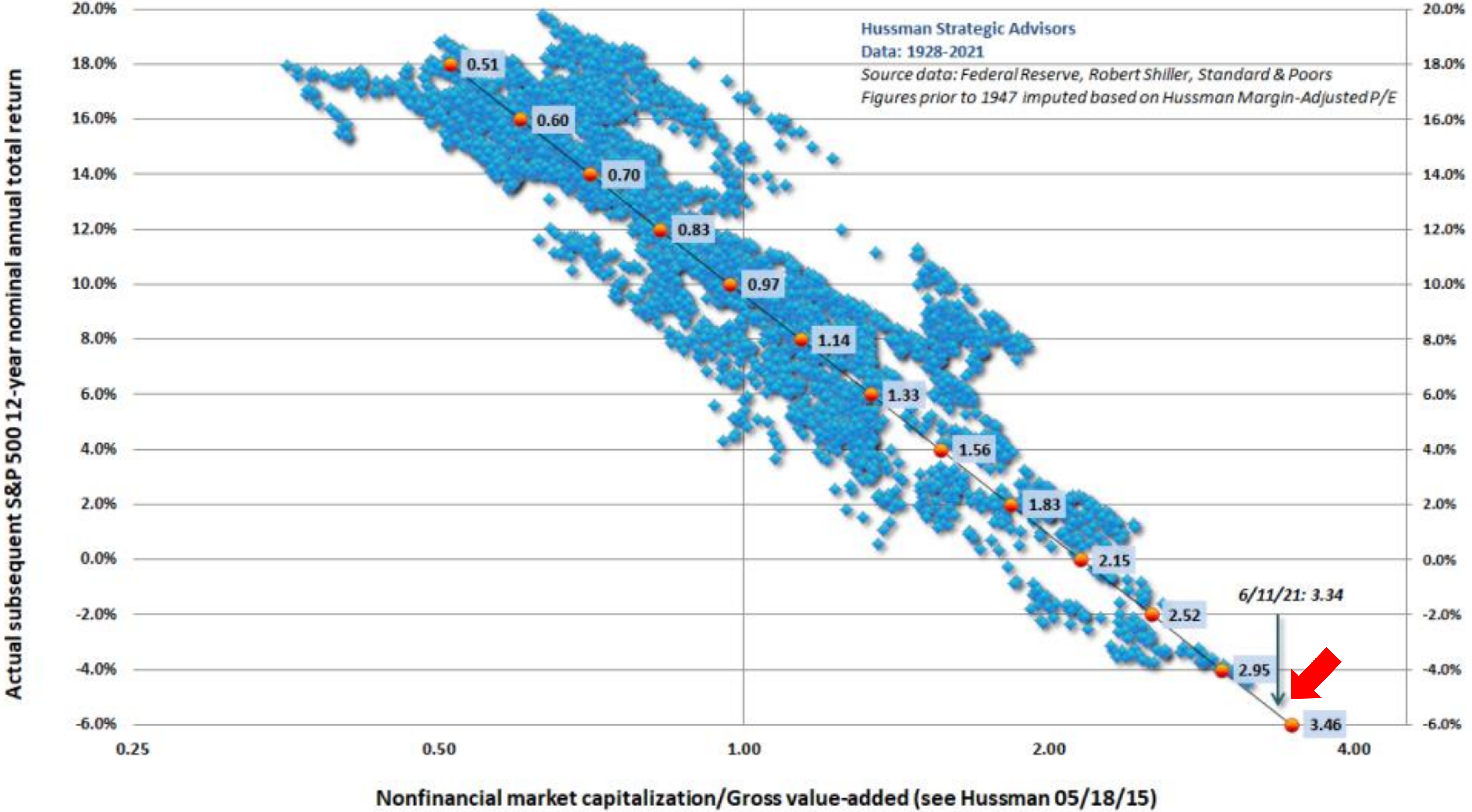
You need to help them embrace this reality



To recap

and drive the point home

Market cap to “GDP” - and the S&P’s return over the next 12 years



Margin-adjusted P/E ratio - and the S&P's return over the next 12 years

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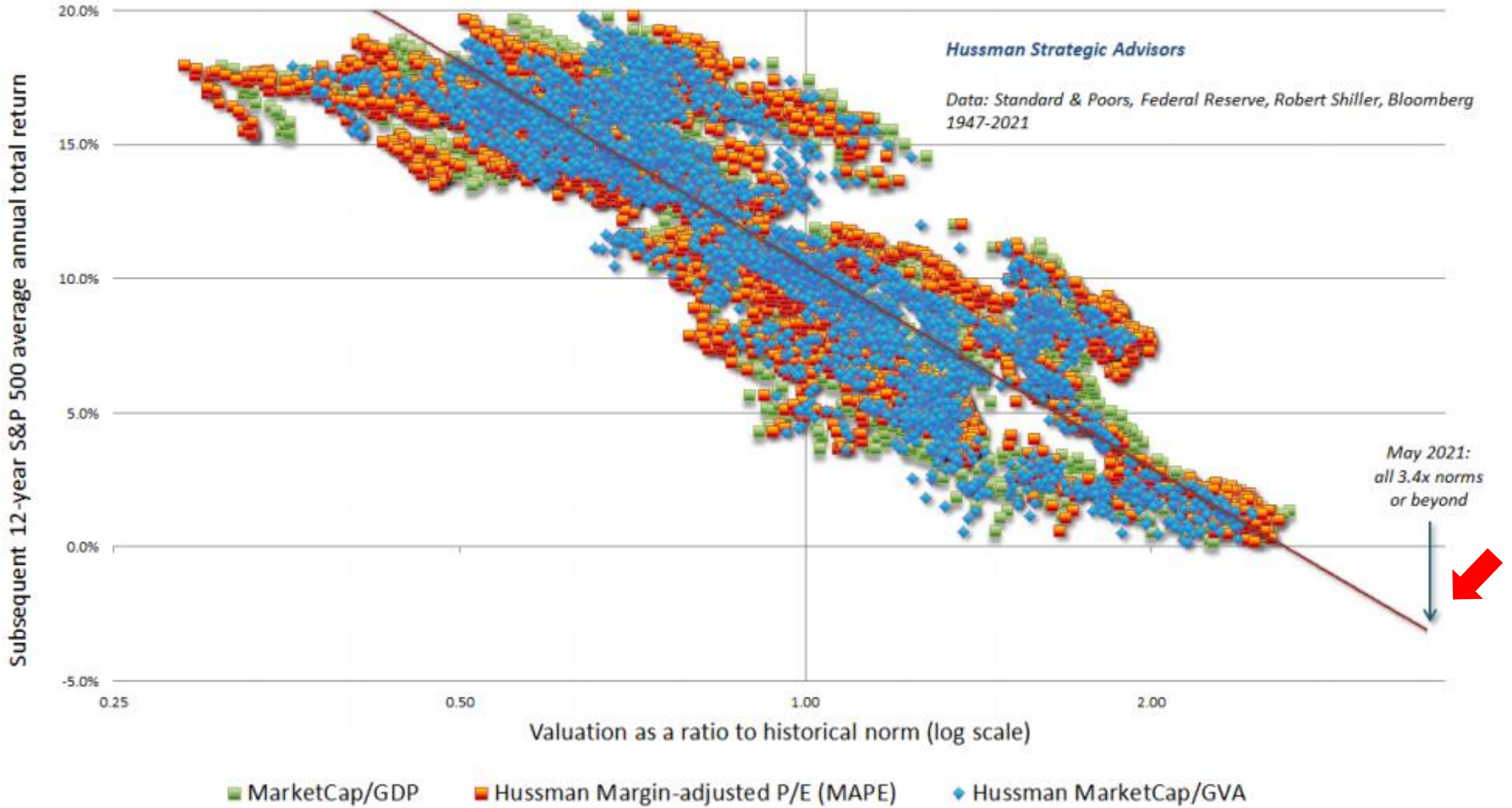

Savings & Retirement

Latest Blow to 60/40 Model Is Exodus of Mom and Pop Pensions

By Ruth Carson and Claire Ballentine

June 15, 2021, 2:00 PM PDT

- Retirees join banks, funds in abandoning stocks/bonds ratio
- Inflation, meme stocks, Bitcoin contribute to dumping of bonds

LISTEN TO ARTICLE

▶ 5:42

SHARE THIS ARTICLE

Peter and Lynette Griffith had two-thirds of their retirement savings in shares during the 2008 financial crisis. By the time they stopped contributing to their pension fund last year, it was 100%.

Versus trendline, the S&P went up too fast in too short a time

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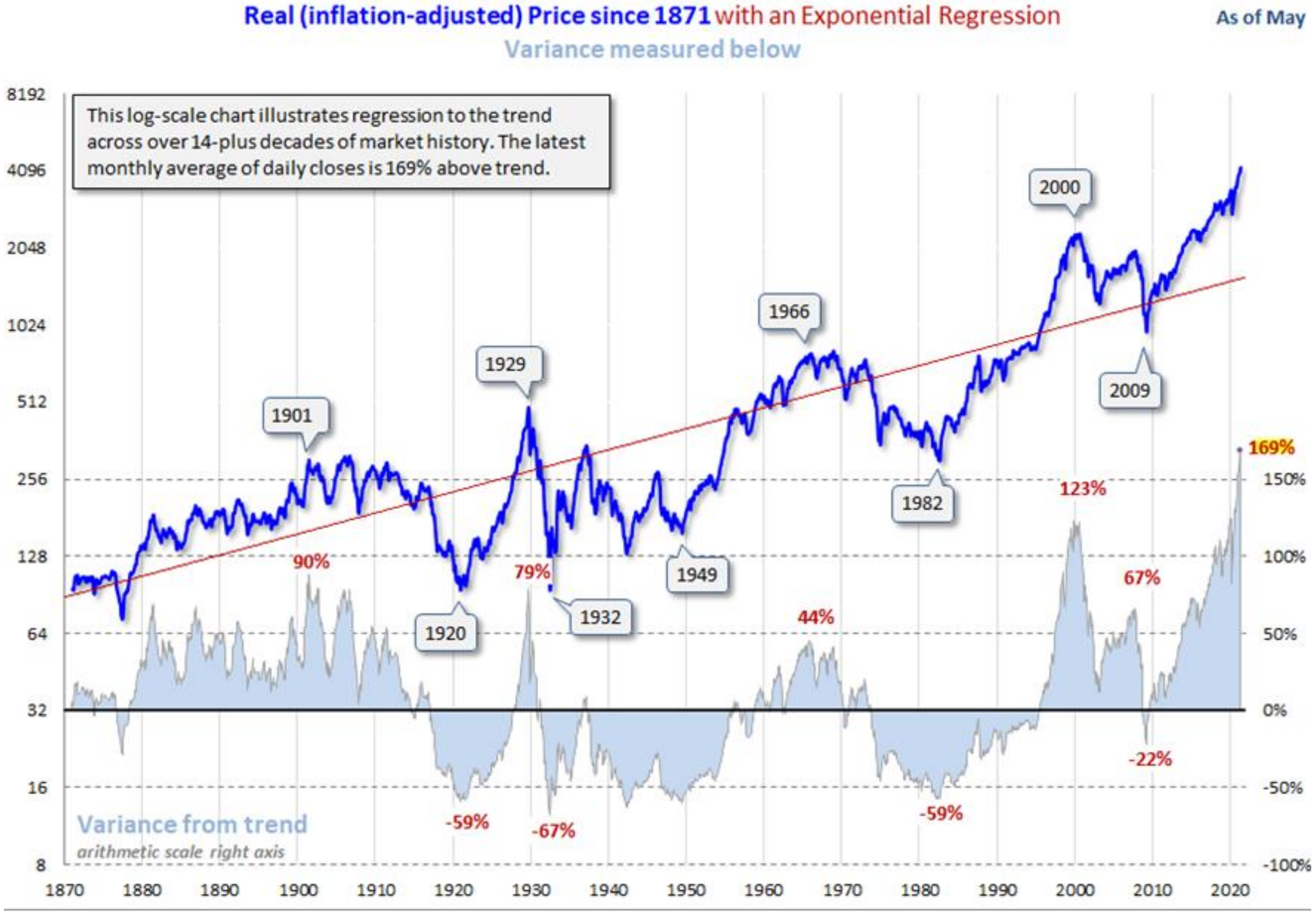
As of May 2021 the S&P 500 price is 169% above its historical trend line, this is the highest level in 140 years.

Last time prices were at a historic high was the Tech Wreck of 2000 (123% above trend).



Recall a bit of history

- For seriously long periods of time

- The S&P 500 does earn LESS than 90-Day U.S. Treasury bills (a money market fund)
  - For **18 years** (1929-1947)
  - For **21 years** (1961-1983)
  - For **13 years** (2000-2013)

- You need to earn your advisory fee
- Maybe that's not possible using a traditional vanilla balanced stock/bond portfolio

Client-facing collateral

Investment Library collateral

Sometimes People Just Don't Fact-Check

Some have falsely claimed that market cycles are getting shorter

Tactical Asset Allocation (TAA) relies on trending or momentum for its success. Some have falsely claimed that market cycles are getting shorter, and therefore TAA no longer has the inherent advantage that it once did. Let's fact-check this claim in order to determine its truth or falsehood.

Read More

Which Portfolio is Lower Risk?

We care most about risk when the sky is falling

When the market is going up, we don't care about risk. But when it's collapsing, we do. Since 1920, there have been nine stock bear markets. Let's compare how four hypothetical portfolios performed during these nine traumatic events.

Read More

But Has TAA Worked Better Than Bonds?

Investment Library collateral

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PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

JULEX CAPITAL

What happens when interest rates rise?

How does TAA perform during rising/falling interest rate environments?

To answer this question, we must:

- Identify a time period to examine,
- Specify how we define rising and falling interest rate environments,
- Identify a simple transparent TAA portfolio that anyone could replicate, and
- Provide comparative passive index benchmarks.

PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

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Time - Can be your best friend

Matching a need - with an investment portfolio

I've determined how much I plan to spend (and gift) during years 10 through 15 (in the future). To support this plan, my portfolio will be invested for 12 ½ years (on average), the midpoint of this interval.

Many would suggest that an appropriate and common-sense asset mix would be 50% stocks and 50% bonds given this investment time horizon. No, not necessarily today, given current market valuations, but certainly as a normal average asset mix when one's investing for 12 ½ years.

PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

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Why doesn't BlackRock offer TAA?

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

First off, BlackRock, Nationwide, Invesco, and Fidelity all offer TAA products. Nevertheless, the investment industry widely appreciates that TAA is not commercially viable, i.e., it won't sell well. How do we understand this seeming contradiction? As we explore this question, keep in mind the distinction between a product selling well in a commercial setting . . . and that same product being the best possible investment solution for an individual investor. The two have little if any overlap. Let's begin.

PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

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A Pretty Good Outcome

Let's try a thought experiment - What if . . .

What if we build a passive portfolio from the 32 asset categories shown in the graphic below using the following weighs: 30.3% US stocks, 29.3% international stocks, 5.0% US Treasury bonds, 31.5% US investment grade corporate bonds, 1.4% international bonds, 1.3% gold, and 1.2% other commodities. Over the last 102 years (ending 1/31/2021) this portfolio would have delivered 11.53% per annum. That's pretty good.

PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

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But has TAA worked better than bonds?

Is TAA versus bonds the right comparison?

Probably not. But to answer this question, we must first identify the all-important investment timeframe. I'm assuming here that the investor is targeting needs arriving between 5 and 20 years in the future. Therefore, their investment holding period or time horizon is 5 to 20 years.

For such an investor, a pure 100% bond portfolio won't work. It won't be able to generate the needed returns. Similarly, a pure 100% stock portfolio won't work. It'll be too volatile, exposing the investor to an undue likelihood of having to liquidate at an unfortunate point in time (when their account value is down).

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A Century of Evidence on Trend-Following Investi

PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

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Which portfolio is lower risk?

We care most about risk when the sky is falling

When the market is going up, we don't care about risk. But when it's collapsing, we do. Since 1920, there have been nine stock bear markets. Let's compare how four hypothetical portfolios performed during these nine traumatic events.

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The way back is closed, only the path forward remains open

There are different types of change

It's a trite phrase to say *"change is the natural order of things,"* sounds too much like an excuse.

Worse yet, it serves to mask the different types of change - and how the best approach for dealing with one type of change is the worst for another.

Different types of change are distinguished by two attributes:

- Speed or pace
- Smoothness or direction

AQR

A Century of Evidence on Trend-Following Investing

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Fall 2014

Executive Summary

We study the performance of tren investing across global markets s extending the existing evidence by mo years. We find that trend following ha

PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

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Sometimes people just don't fact-check

Some have falsely claimed that market cycles are getting shorter

Tactical Asset Allocation (TAA) relies on trending or momentum for its success. Some have falsely claimed that market cycles are getting shorter, and therefore TAA no longer has the inherent advantage that it once did. Let's fact-check this claim in order to determine its truth or falsehood.

But first, let's work to better understand this issue. The following graph shows two different market paths. Each starts and ends at the same spot, and therefore both generate the same total return after many years.

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Important Disclosures

All data and statistics were provided by Global Financial Data, Inc., Hussman Strategic Advisors, Macro Strategy out of London England, and by BCA Research out of Montreal Canada.

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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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