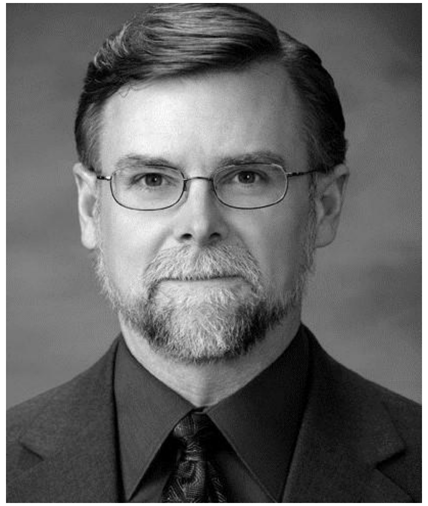
Is it easier to just go traditional/conventional?

Rob Brown, PhD, CFA

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



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"What we do is not beyond anyone else's competence. I feel the same way about managing that I do about investing: It's just not necessary to do extraordinary things to get extraordinary results"

Warren Buffett

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Does it make better business sense . . . to just stay conventional and traditional

Strictly avoiding anything to do with TAA

Why not just ride what worked so well over the last dozen or so years?

Let's break the last 26 years into two equal parts

- Thirteen years ending May 31, 2008
- Thirteen years ending May 31, 2021

- Which eight asset categories performed the BEST during the first period?

- S&P midcap growth
- REITs
- S&P 400 midcap core
- Health Care sector
- S&P smallcap value
- Europe Dow Jones Stoxx 50 index
- S&P 500 equal weighted index
- S&P midcap value

Essentially midcap, healthcare, Europe, and value

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Collectively these eight asset categories did quite well

- An equal-weighted portfolio of these eight asset categories delivered 15.25%
- Versus the S&P 500 at a much lower 11.72%
- An extra 353bp per annum for 13 years running

- But how did these same eight perform in the subsequent 13 years ending 5/31/2021
- They underperformed the S&P 500 by 123bp per year for thirteen years
- That's a lot over thirteen years
  - $100 grows to be $368 in the S&P 500
  - But grows to only $318 in the eight-asset portfolio

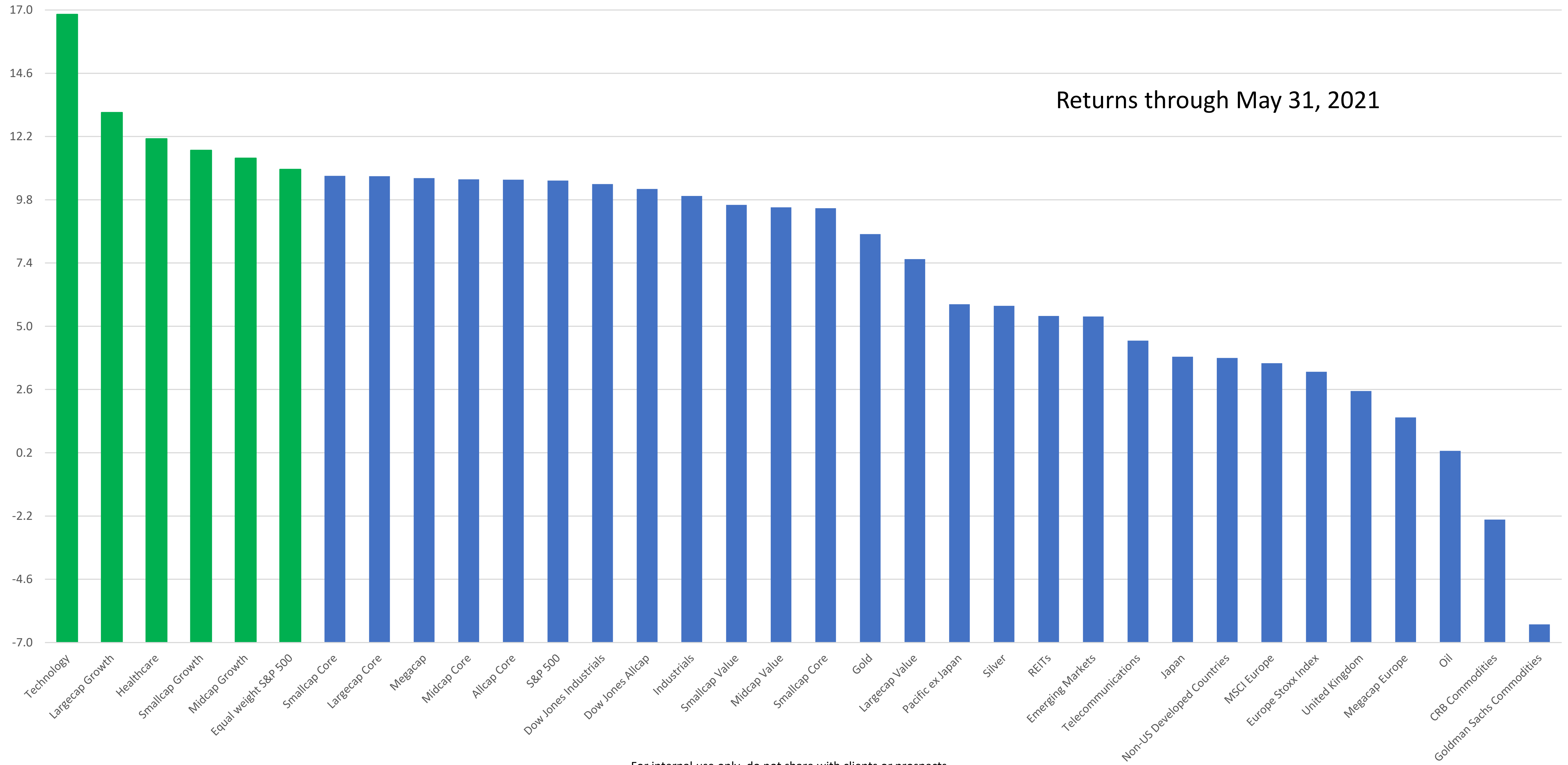
Lesson learned

What did best in one period . . . usually performs poorly in the next

So what has performed best over the last thirteen years

- Information Technology sector
- S&P 500 growth
- Health Care sector
- S&P smallcap growth
- S&P midcap growth
- S&P 500 equal weighted index
- S&P 600 Small Cap Index
- Russell 1000 Large Cap Index

So what has performed best over the last thirteen years



Or more briefly what has walked away with the show

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- Technology
- Growth
- U.S. stocks
- Bring the cap size DOWN . . . but without going all the way to smallcap or midcap

- Worse yet . . . and this is very important . . . . active stock managers have been badly burned by deviating from the benchmark (the S&P 500)
- Today, active stock managers have started hugging the S&P 500 more closely than at any point in the last fifteen years

Looking back . . . the S&P 500 was the place to be

BUT . . . looking forward . . . is the S&P 500 the best place to be or the WORST place?

S&P versus Emerging markets

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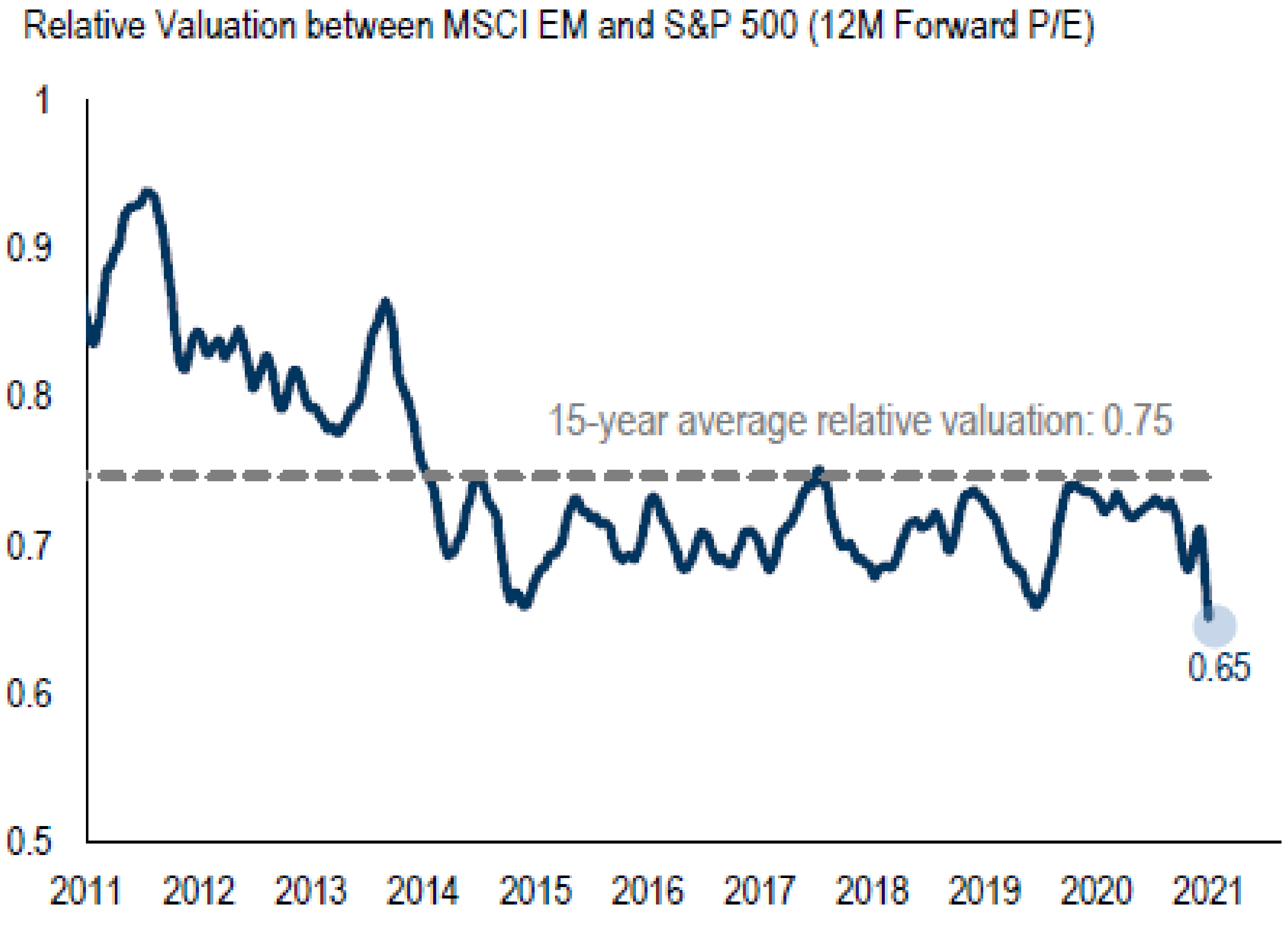
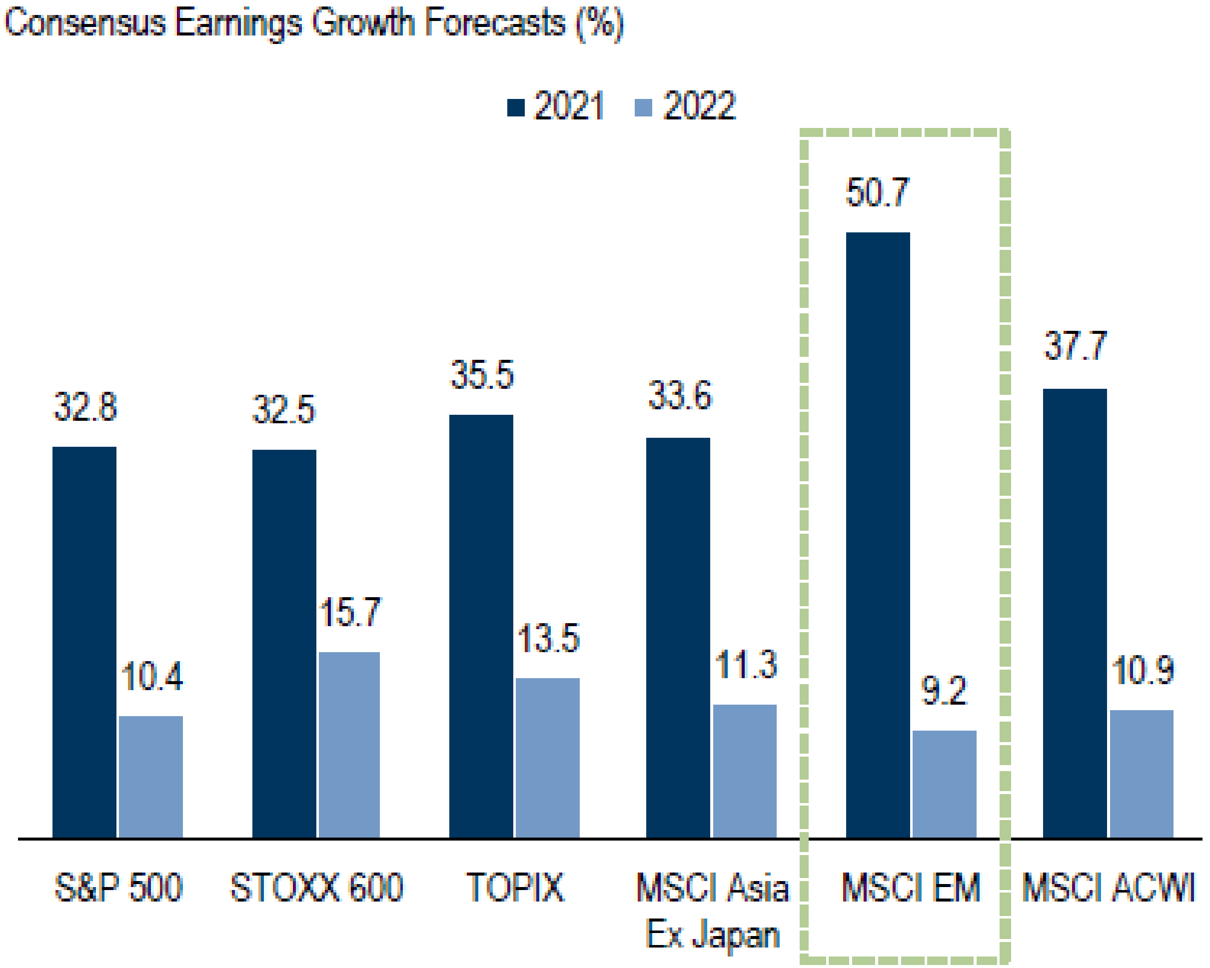
Relatively cheap EM assets paired with strong earnings potential reflect an attractive entry point for investors

Deep discount in relative valuations



Higher relative earnings expectations



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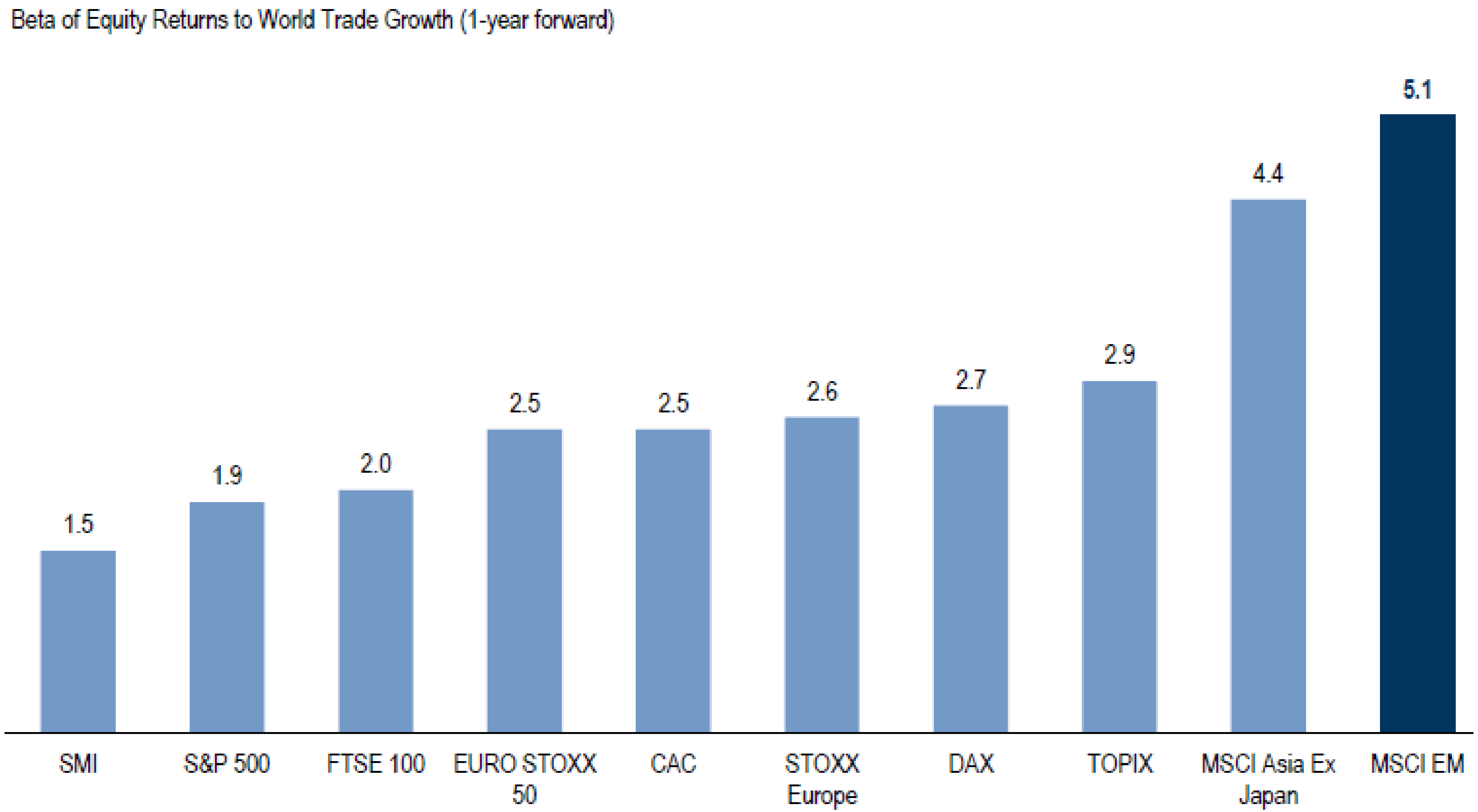
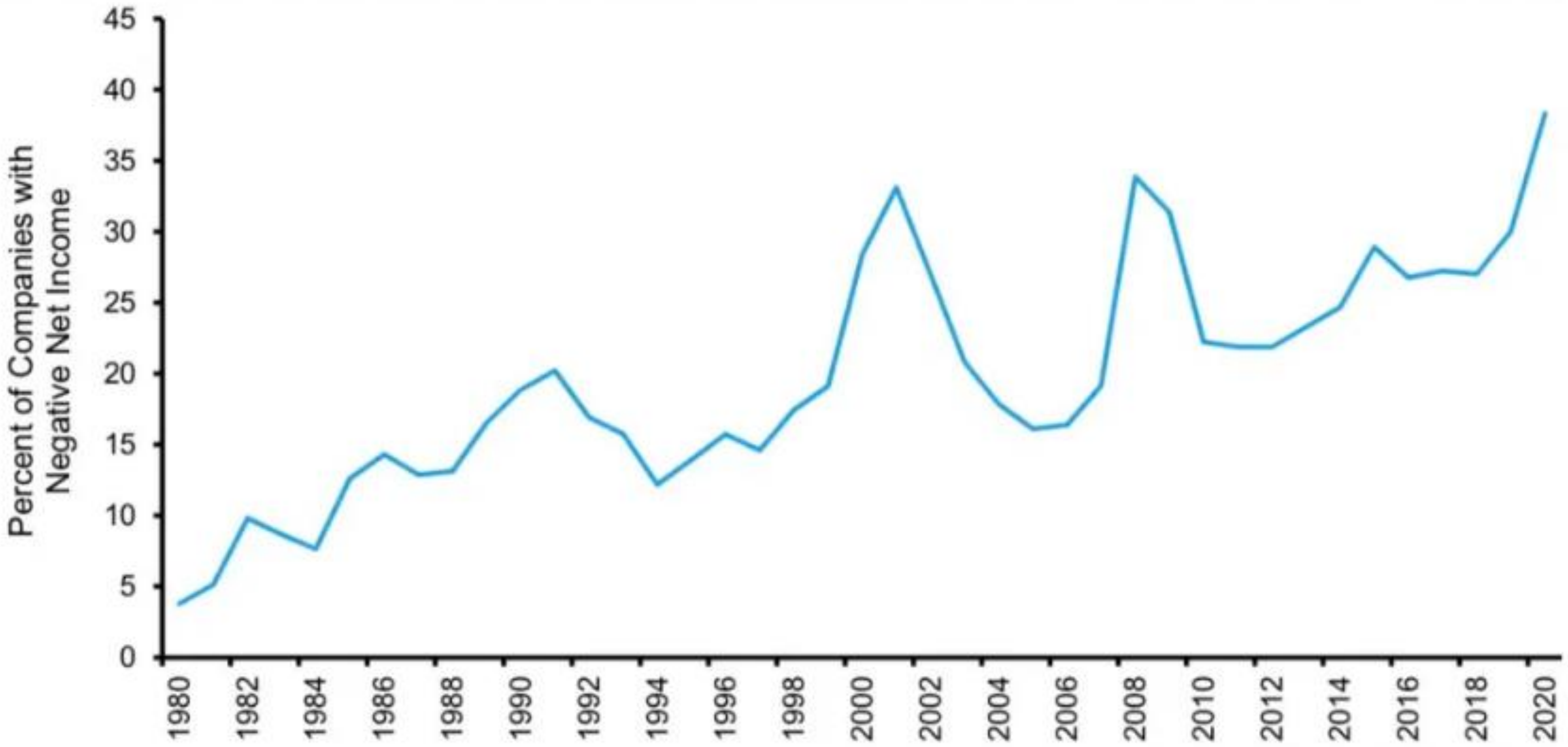
If you believe in a return to global growth . . .

EM's higher beta to global growth may provide a meaningful boost to asset prices



Zombies here in the U.S.

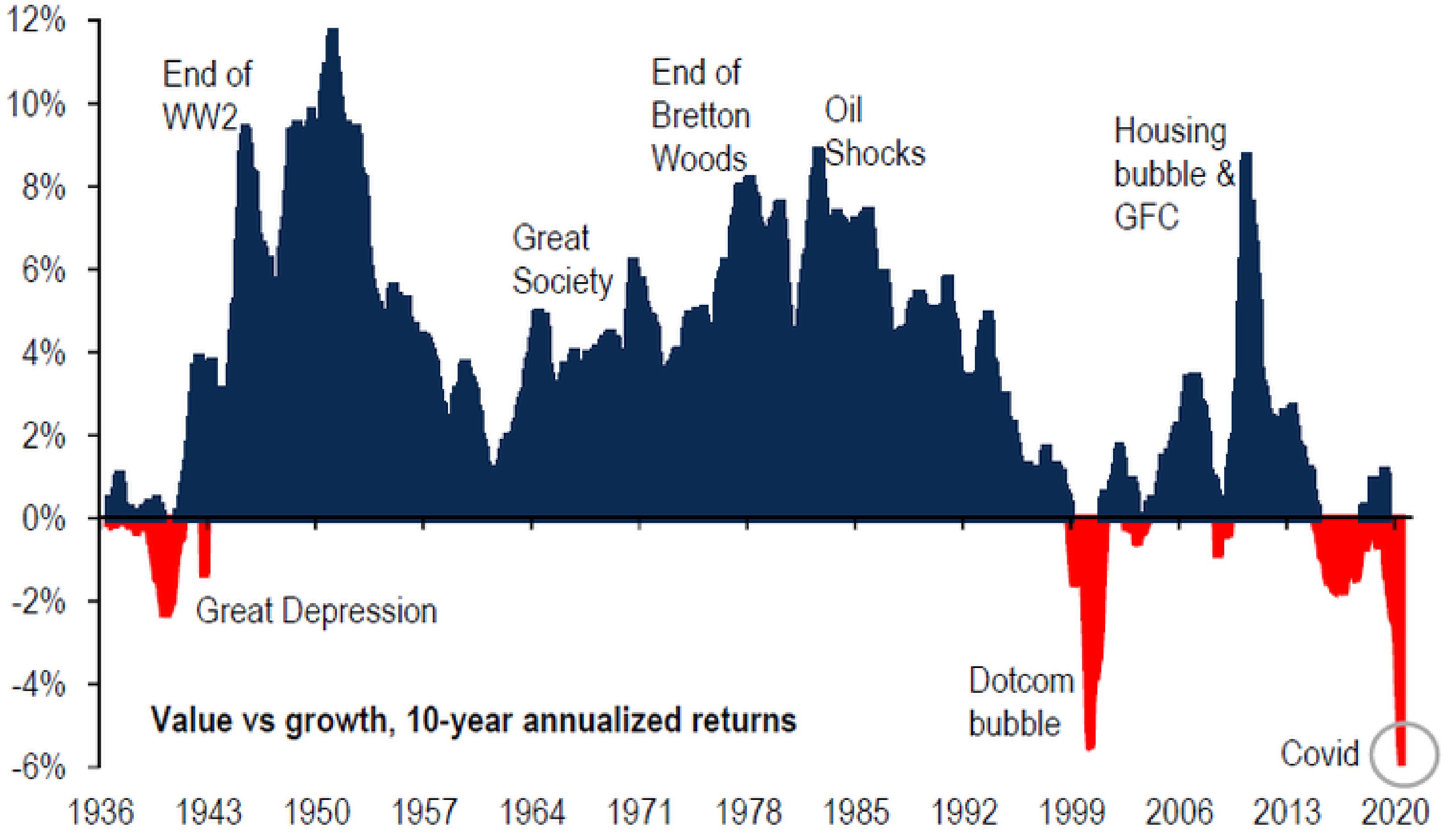
Exhibit 5: Percentage of Companies in the Russell 3000 with Negative Net Income, 1980-2020



Source: FactSet.
Note: Constituents of the Russell 3000 Index as of year-end.

This has been the worst cycle for VALUE in all of history

Chart 1: The worst ever returns to value stocks



Source: BofA Research Investment Committee, Fama & French.

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Always be looking for all-time extremes . . . Value vs growth

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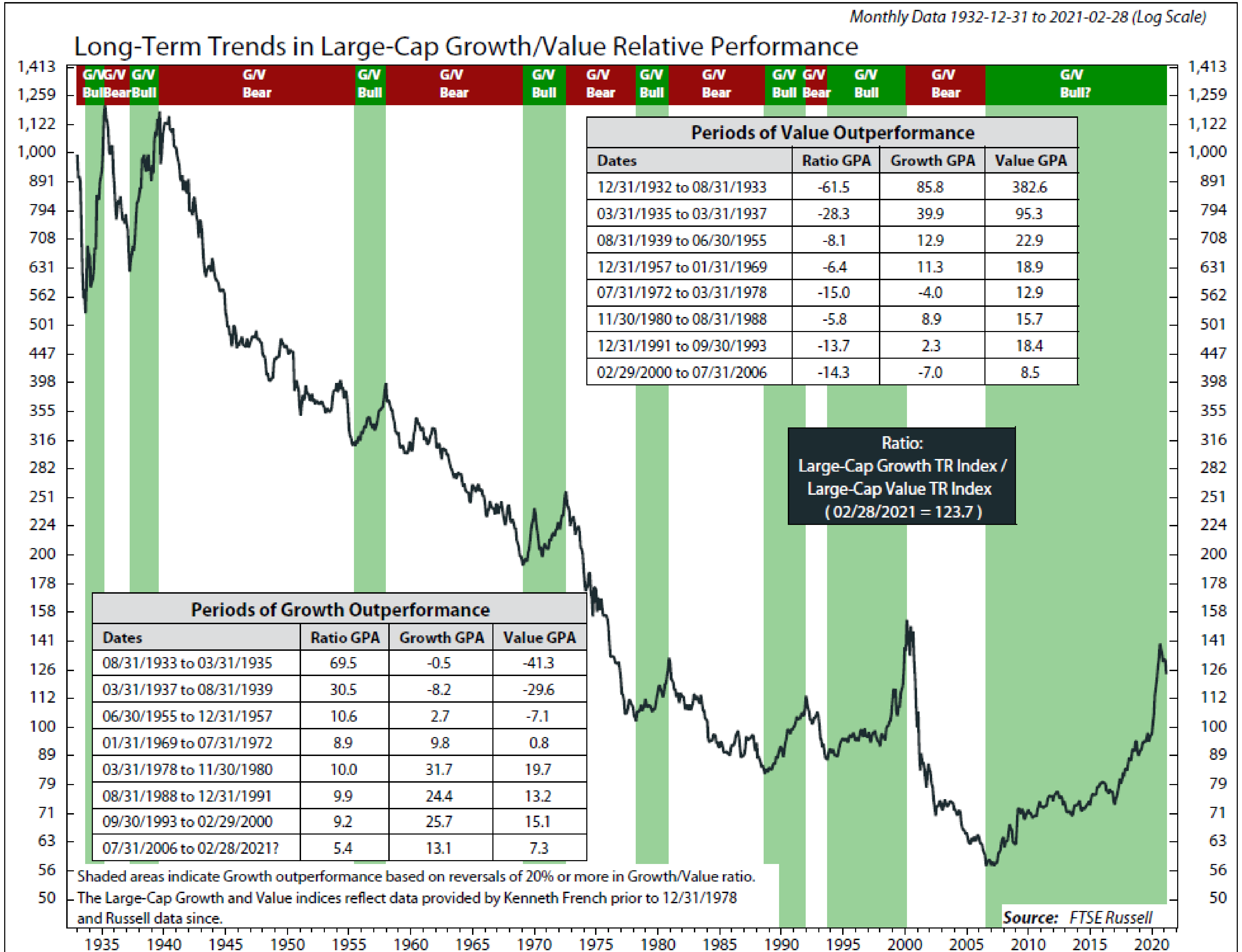
Is Value exiting a 15-year secular bear vs. Growth?



Periods of Value Outperformance			
Dates	Ratio GPA	Growth GPA	Value GPA
12/31/1932 to 08/31/1933	-61.5	85.8	382.6
03/31/1935 to 03/31/1937	-28.3	39.9	95.3
08/31/1939 to 06/30/1955	-8.1	12.9	22.9
12/31/1957 to 01/31/1969	-6.4	11.3	18.9
07/31/1972 to 03/31/1978	-15.0	-4.0	12.9
11/30/1980 to 08/31/1988	-5.8	8.9	15.7
12/31/1991 to 09/30/1993	-13.7	2.3	18.4
02/29/2000 to 07/31/2006	-14.3	-7.0	8.5

Periods of Growth Outperformance			
Dates	Ratio GPA	Growth GPA	Value GPA
08/31/1933 to 03/31/1935	69.5	-0.5	-41.3
03/31/1937 to 08/31/1939	30.5	-8.2	-29.6
06/30/1955 to 12/31/1957	10.6	2.7	-7.1
01/31/1969 to 07/31/1972	8.9	9.8	0.8
03/31/1978 to 11/30/1980	10.0	31.7	19.7
08/31/1988 to 12/31/1991	9.9	24.4	13.2
09/30/1993 to 02/29/2000	9.2	25.7	15.1
07/31/2006 to 02/28/2021?	5.4	13.1	7.3

Shaded areas indicate Growth outperformance based on reversals of 20% or more in Growth/Value ratio.
The Large-Cap Growth and Value indices reflect data provided by Kenneth French prior to 12/31/1978 and Russell data since.

U.S. is no longer even in the top-ten in terms of innovation

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Economics

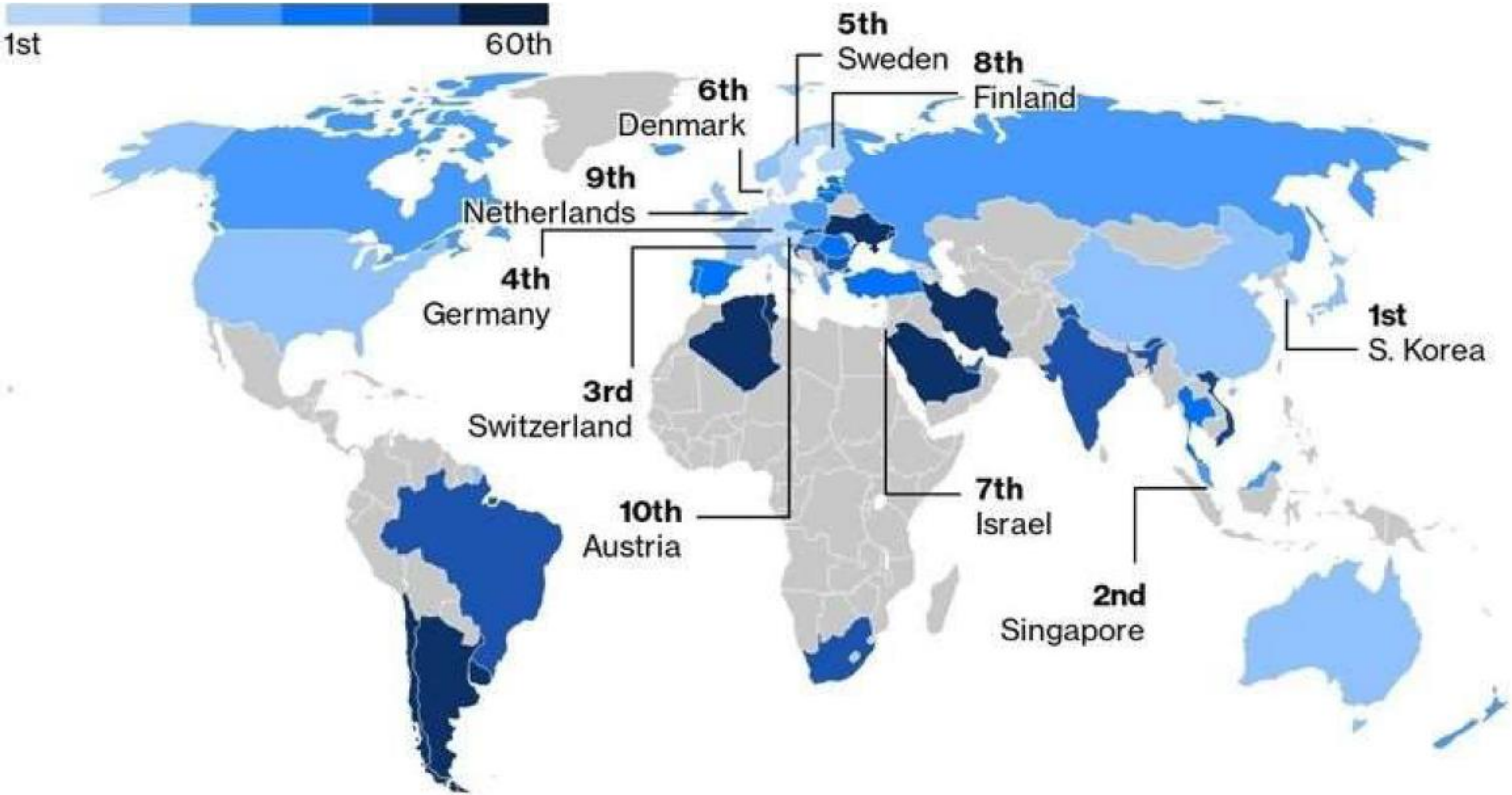
South Korea Leads World in Innovation as U.S. Exits Top Ten

By Michelle Jamrisko, Wei Lu, and Alexandre Tanzi

February 2, 2021, 5:00 PM MST
Updated on February 3, 2021, 8:07 AM MST

- Singapore, Switzerland rank 2nd and 3rd on new Bloomberg Index
- Seven of top 10 places go to European countries; China slips

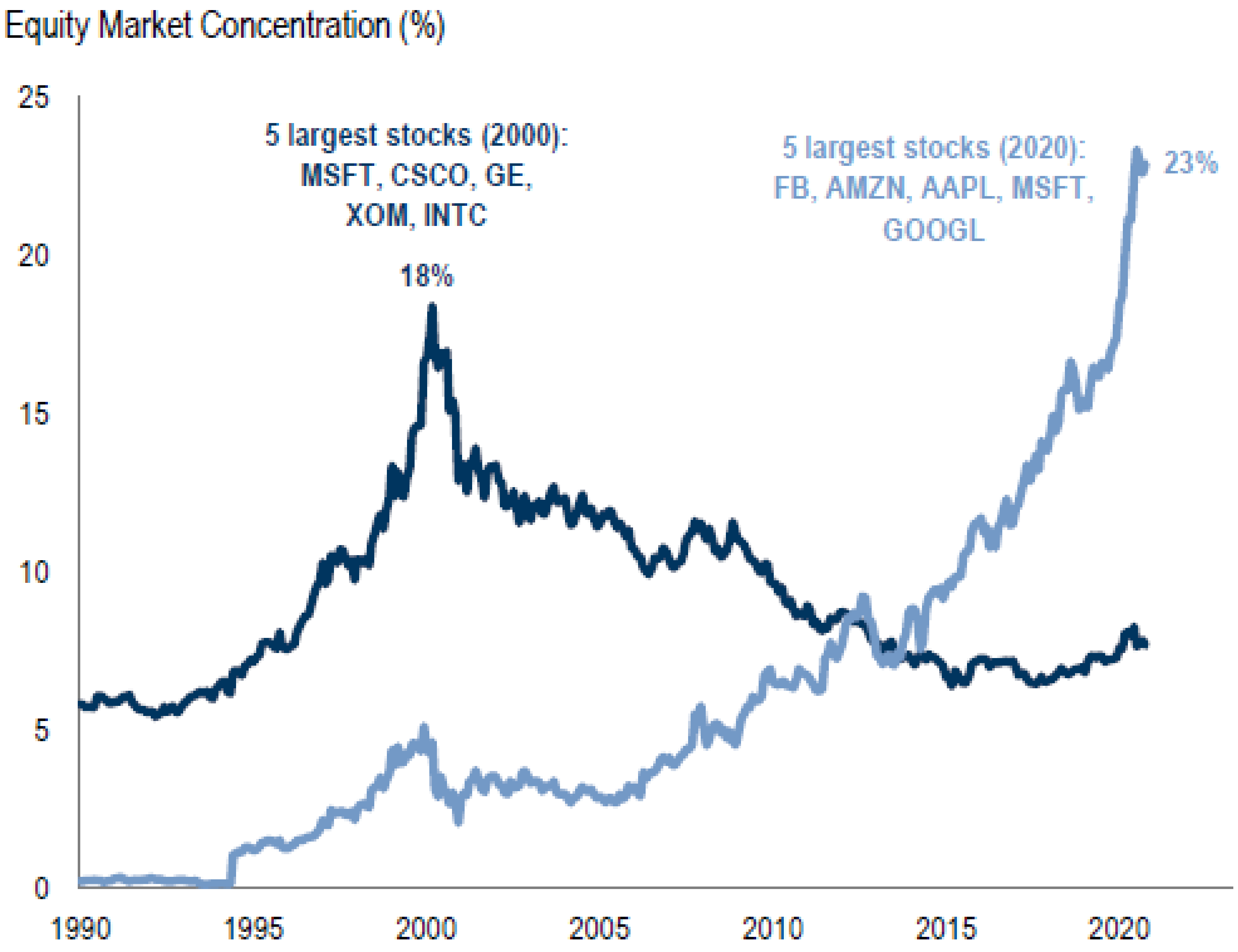
U.S. is no longer even in the top-ten in terms of innovation



Sources: Bloomberg, International Labor Organization, International Monetary Fund, World Bank, Organisation for Economic Cooperation and Development, World Intellectual Property Organization, United Nations Educational, Scientific and Cultural Organization

Bloomberg

S&P 500 Index has become distorted by a few large companies

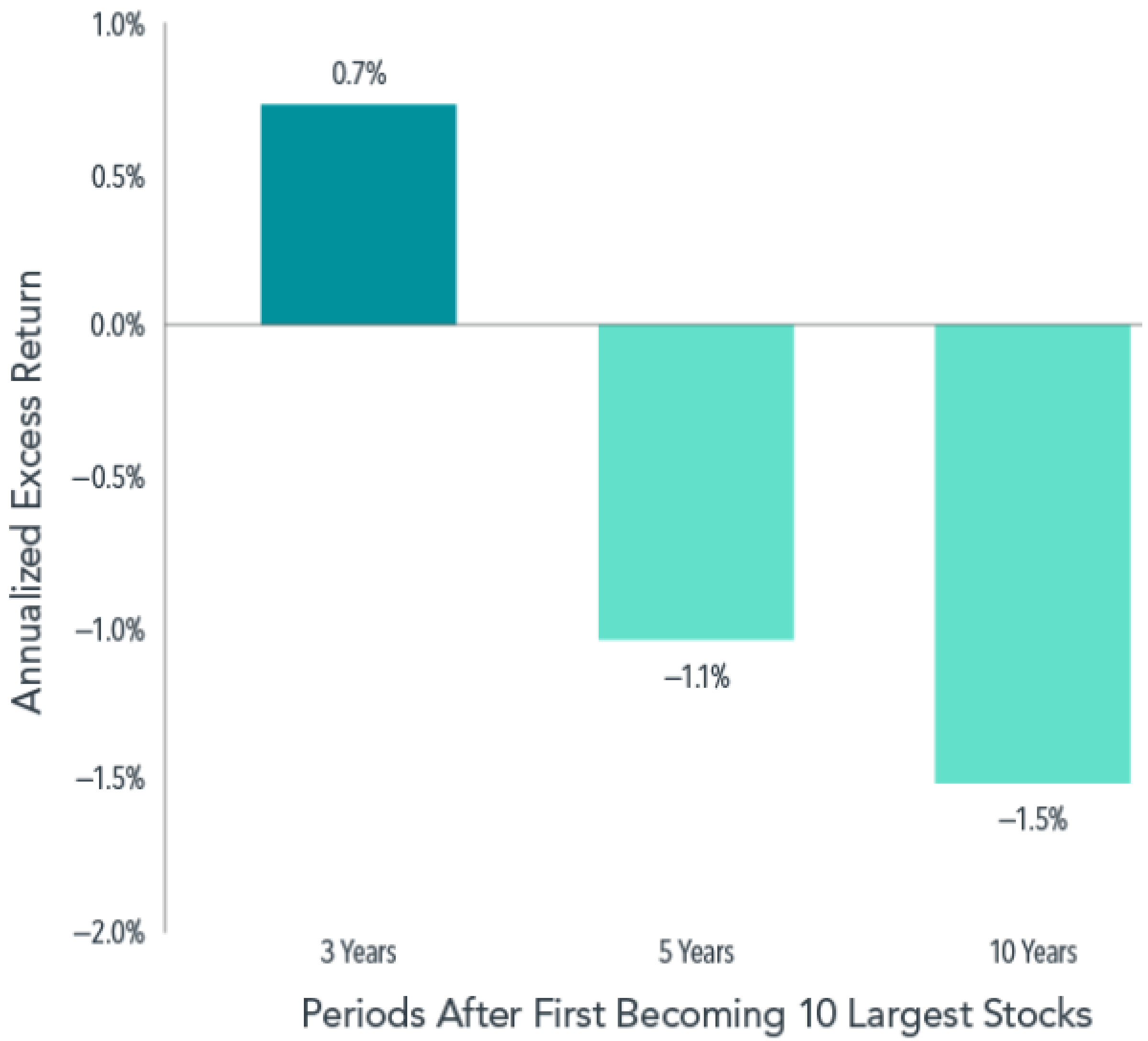


Performance of largest stocks in the S&P 500

Exhibit 3

Power Down

Annualized return in excess of market for stocks after joining list of 10 largest US stocks, 1927–2019



Largest stocks have always failed . . . Throughout history

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Largest ten U.S. stocks at the start of each decade

(companies ranked by market capitalization, size)

1930	1940	1950	1960	1970	1980	1990	2000	2010	2020
AT&T	AT&T	AT&T	AT&T	IBM	IBM	Exxon	Microsoft	Exxon	Apple
General Motors	General Motors	General Motors	General Motors	AT&T	AT&T	General Electric	General Electric	Microsoft	Microsoft
General Electric	DuPont	DuPont	DuPont	General Motors	Exxon	IBM	Cisco	Walmart	Amazon
Exxon	Exxon	Exxon	Exxon	Kodak	General Motors	AT&T	Walmart	Apple	Google
Marathon Oil	General Electric	Union Carbide	General Electric	Exxon	Amoco	Altria	Exxon	Johnson & Johnson	Berkshire Hathaway
DuPont	Union Carbide	General Electric	IBM	Sears	Mobil	Merck	Intel	Procter & Gamble	Facebook
Con Edison	Marathon Oil	Sears	Marathon Oil	Texaco	General Electric	Bristol-Myers Squibb	Lucent	IBM	JP Morgan
Philadelphia Company	Texaco	Chevron	Texaco	Xerox	Chevron	DuPont	IBM	JP Morgan	Johnson & Johnson
NY Central Railroad	Sears	Texaco	Union Carbide	General Electric	Atlantic Richfield	Amoco	Citigroup	AT&T	Walmart
Penn Central Railroad	Coca-Cola	Gulf Oil	Kodak	Gulf Oil	Shell Oil	BellSouth	Time Warner	General Electric	Visa

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What if interest rates rise?

Conventional/traditional versus Tactical Asset Allocation

Client facing piece on the topic of rising interest rates

PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

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.

Identify a time period to examine - Historically, interest rates proceeded through long "40-year" bull and bear markets, i.e., through multi-decade long regimes of rising and then falling interest rates. Therefore, any useful answer must examine the long span of time. Here, we examine the period from 12/31/1919 through the present. This allows use to identify performance during remarkably different interest rate environments. Our definition of "interest rates" is the current yield on the 10-year US Treasury bond.

Specify how we define rising and falling interest rate environments - The time period examined provides monthly returns. We broke these months into four equal-sized groups identifying periods of rapidly rising, moderating rising, moderately falling, and rapidly falling interest rates. Each group covers 25.3 years.

Identify a simple transparent TAA portfolio that anyone could replicate - Our TAA thought-experiment portfolio was constructed from 32 asset categories and had an average asset mix of: 21.7% US stocks, 25.6% international stocks, 13.5% US Treasury bonds, 33.6% US investment grade corporate bonds, 0.6% US high yield corporate bonds, 1.6% international bonds, 1.2% gold, and 2.1% other commodities. The thought-experiment portfolio is passive in that it eschews forecasts, predictions, or estimates of the future. Instead, it makes use of a simple observation, i.e., relative winners have a tendency to repeat for just one more month. And the same is true for relative losers. As a consequence, the thought-experiment portfolio heavily overweights the seven asset categories exhibiting the greatest relative trending over the last eleven months and strongly underweights (or excludes) the rest.

As a consequence, this portfolio has the average asset allocation described above, but at any instant in time, will deviate from this average so as to heavily overweight recent relative winners (and exclude or underweight the rest). The thought-experiment portfolio is continuously reshaping itself so as to remain in strong alignment with what has been working in the recent past.

To make the results more realistic, we assumed transactions costs for each trade - examples include 37 bps (0.37%) for a one-way trade of Palladium or 3½ bps (0.035%) for a one-way trade of generally investment grade international bonds.

Conventional/traditional balanced portfolio vs TAA

When interest rates were . . .		TAA thought-experiment portfolio	Narrow U.S. benchmark 25% S&P 500 Index, 75% 10-year US Treasury bonds	Broad U.S. benchmark 25%/75% mix broadly diversified across all US stocks and bonds	Broad global benchmark 25%/75% mix broadly diversified across all US and int'l stocks and bonds
Rising the fastest	304 months (25% of the time) when interest rates rose the fastest	8.2%	-4.7%	-1.4%	0.2%
Rising a little bit	303 months (25% of the time) when interest rates rose only modestly	10.8%	4.9%	5.5%	4.1%
Falling a little bit	304 months (25% of the time) when interest rates fell only modestly	13.1%	9.7%	9.7%	8.8%
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What if inflation rises?

Conventional/traditional versus Tactical Asset Allocation

Client facing piece on the topic of rising inflation

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What if a bear market comes along?

Conventional/traditional versus Tactical Asset Allocation

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Client facing piece on the topic of bear markets

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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.

Performance for Portfolios A, B, C, and D
During the last nine stock bear markets

Bear market started	8/31/1929	2/28/1937	9/30/1939	5/31/1946	11/30/1968	12/31/1972	8/31/1987	8/31/2000	10/31/2007	Average
Lasted (months)	33	13	31	21	19	21	3	25	16	
U.S. stocks fell (%)	-79	-50	-39	-37	-35	-52	-30	-47	-52	
Portfolio A	-19.9	-11.0	29.9	-2.1	1.9	23.5	-11.2	6.7	-1.6	1.8
Portfolio B	-31.7	-12.0	3.1	-5.7	-10.0	-11.4	-6.0	5.3	-4.1	-8.1
Portfolio C	-36.8	-17.8	0.4	-3.4	-10.2	-10.7	-6.2	1.4	-10.3	-10.4
Portfolio D	-27.1	-11.3	16.3	-2.5	-3.2	-6.3	-2.7	1.5	-14.1	-5.5

In all but one of the declines, Portfolio A delivered a more comfortable ride. Most investors would conclude that Portfolio A was the lower risk portfolio.

If our investment time horizon is 7½ years, how should we define risk?

Defining risk by what happens during the inevitable stock bear market is helpful. But it also provides an incomplete view. What if we're investing for a need located five to ten years in the future (let's take the mid-point of that, 7½ years). This investment objective allows us to define risk as the worst that could happen during any possible 7½ year period.

Four portfolios are examined

Portfolio A	**TAA thought-experiment portfolio**	
Portfolio B	Narrow U.S. benchmark	25% S&P 500 Index, 75% 10-year US Treasury bonds
Portfolio C	Broad U.S. benchmark	25%/75% mix, broadly diversified across all US stocks and bonds
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Portfolio “A” the TAA portfolio did best during the last nine bear markets

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Quick review of where the S&P 500 stands today

OR . . . Where do *the building blocks* of the conventional/traditional portfolio stand?

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

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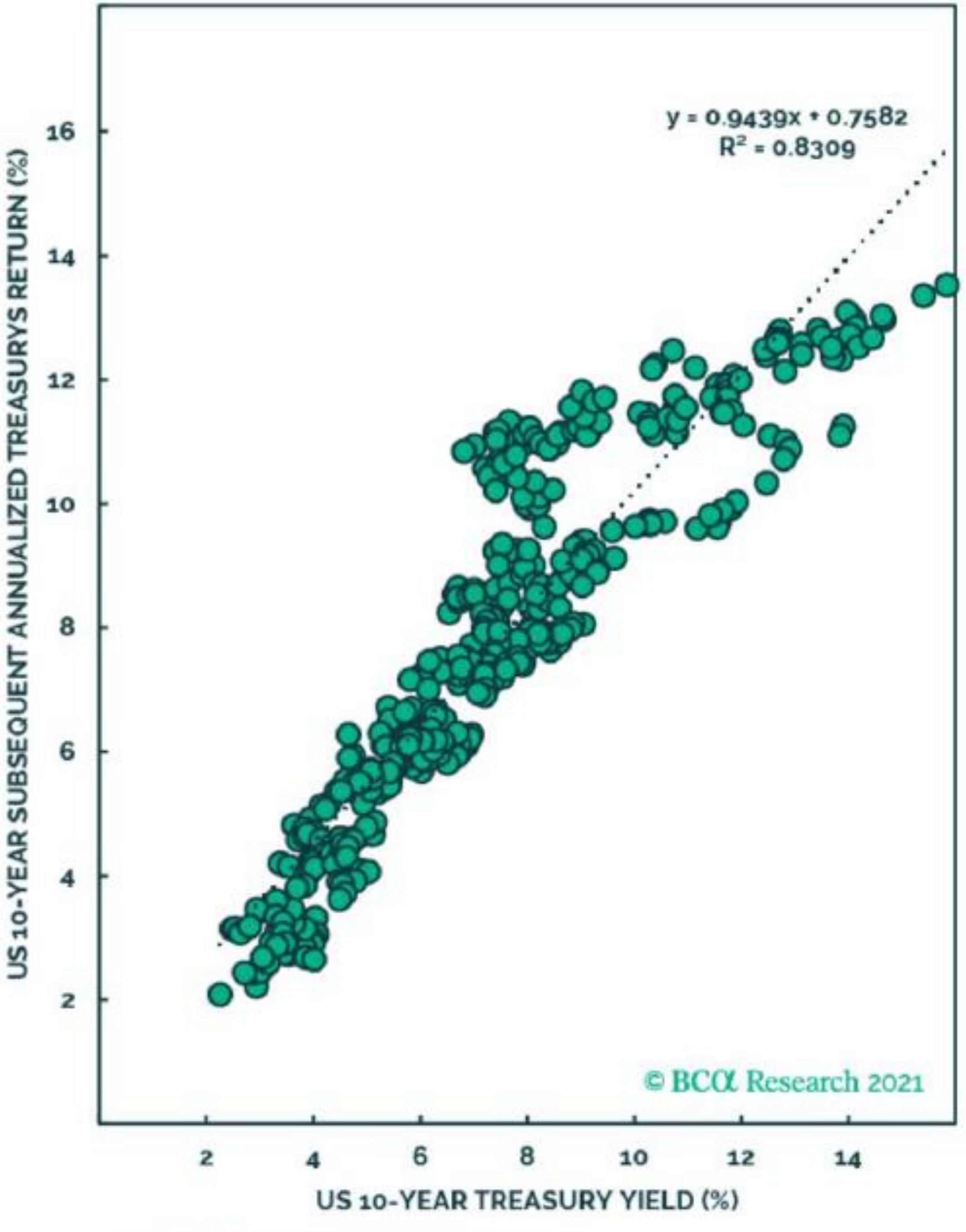
Almost a perfect relationship between a bond's current yield and what you earn on bonds over the next eight or nine years



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

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TIPS current yields as of June 13, 2021

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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%

Treasuries current yields as of June 21, 2021

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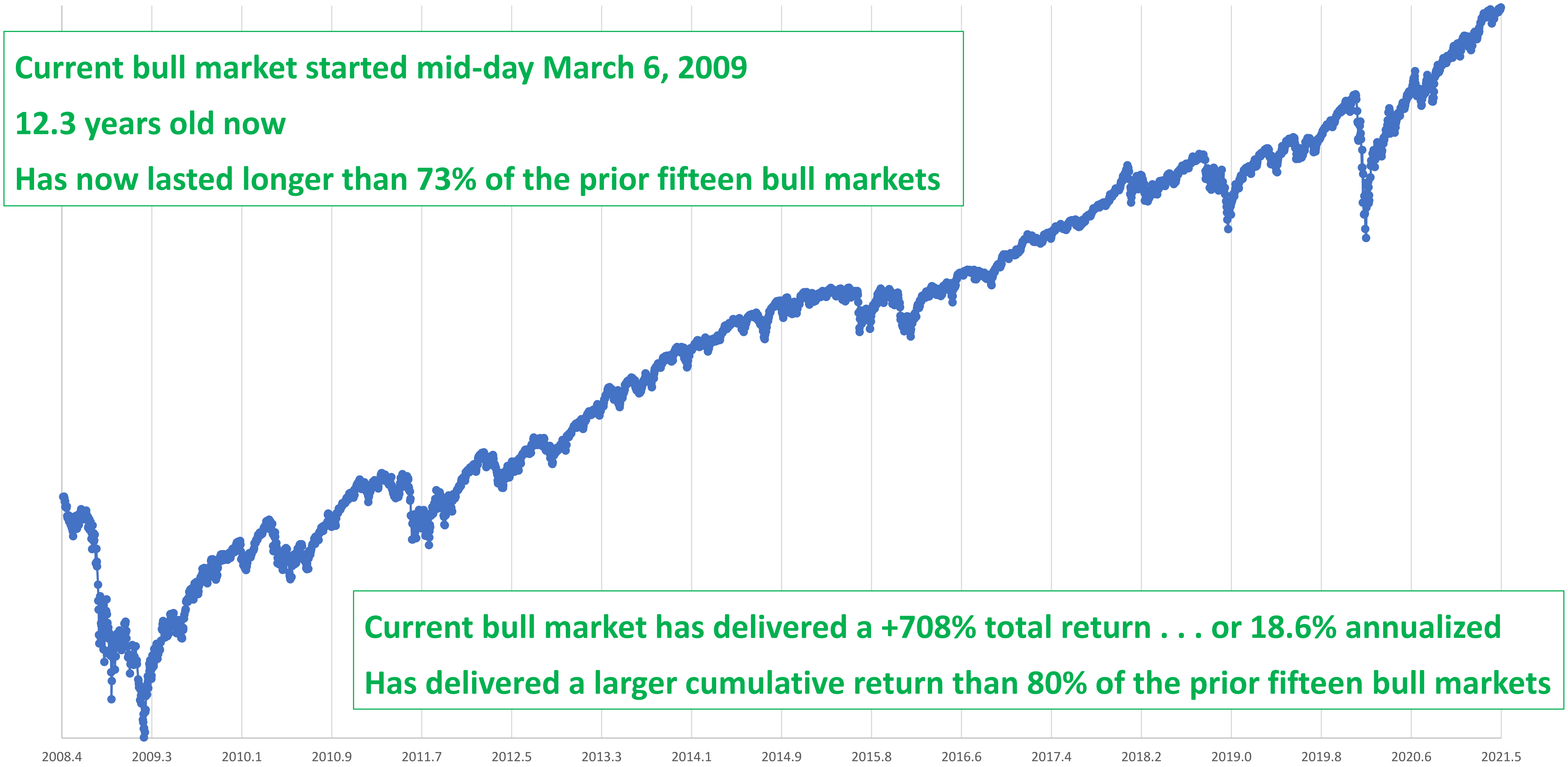
Treasury Yields

NAME	COUPON	PRICE	YIELD
GB3:GOV **3 Month**	0.00	0.03	0.03%
GB6:GOV **6 Month**	0.00	0.05	0.05%
GB12:GOV **12 Month**	0.00	0.09	0.09%
GT2:GOV **2 Year**	0.13	99.73	0.27%
GT5:GOV **5 Year**	0.75	99.23	0.91%
GT10:GOV **10 Year**	1.63	101.36	1.48%
GT30:GOV **30 Year**	2.38	106.63	2.08%

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



Market cap to "GDP" - and the S&P's return over the next 12 years

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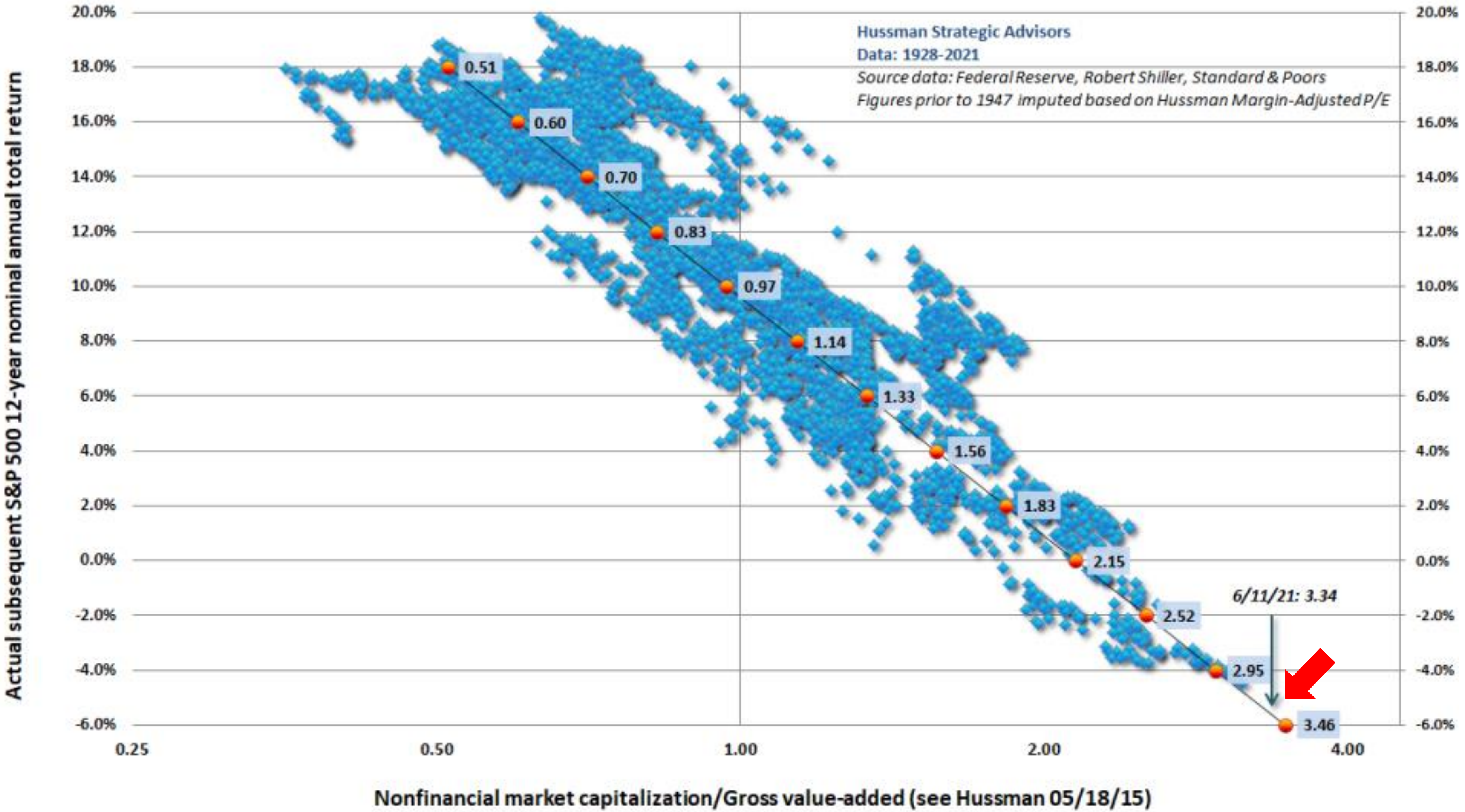
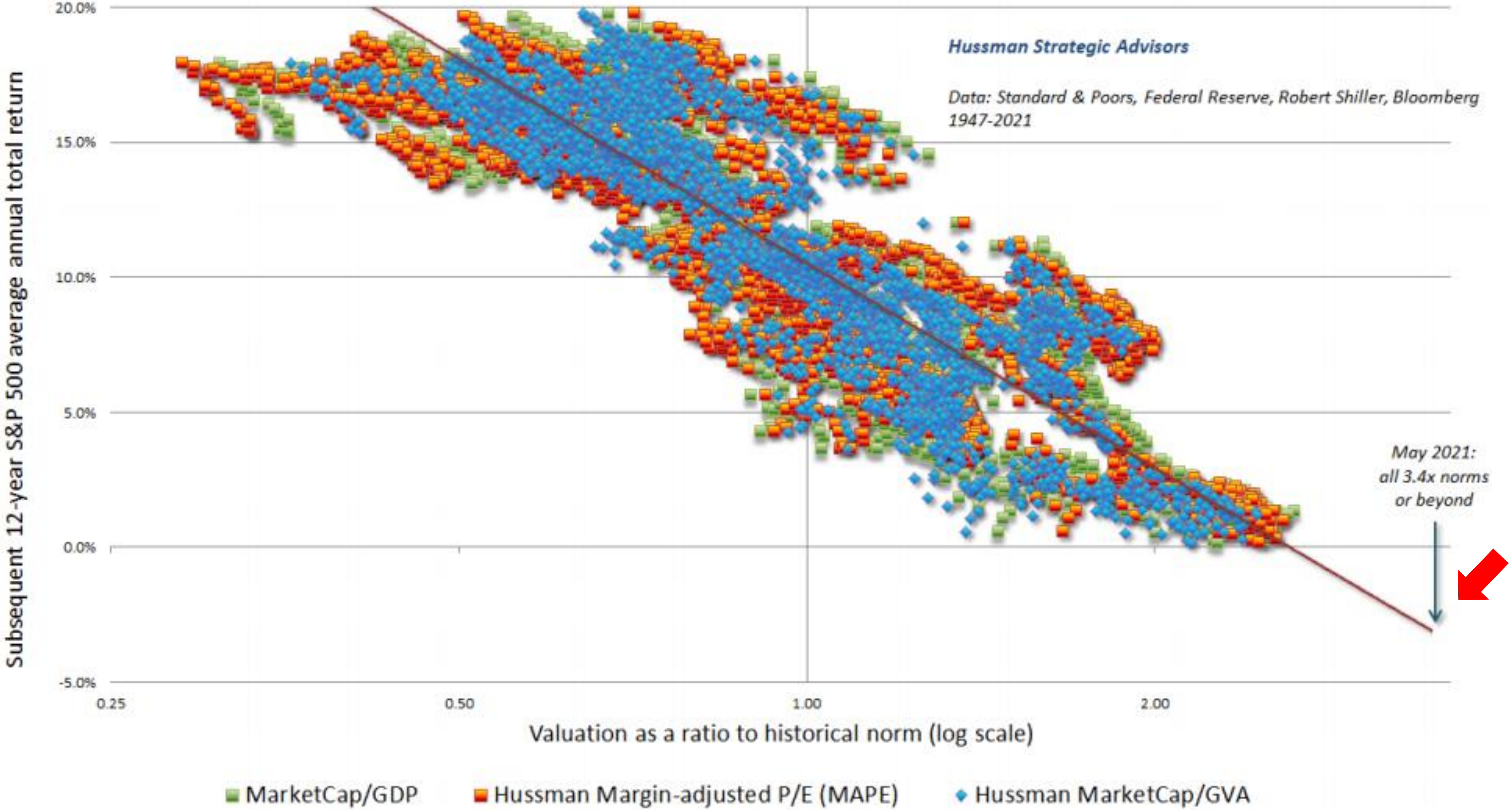


Margin-adjusted P/E ratio - and the S&P's return over the next 12 years



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.

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But Has TAA Worked Better Than Bonds?

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PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

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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).

The Journal of Portfolio Management

VOLUME 44, NUMBER 1 www.iijpm.com FALL 2017

A Century of Evidence on Trend-Following Investir

PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

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AQR

PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

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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

A Century of Evidence on Trend-Following Investing

Brian Hurst
Principal

Yao Hua Ooi
Principal

Lasse H. Pedersen, Ph.D.*
Principal

Fall 2014

Executive Summary

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

PERSPECTIVES ON TACTICAL ASSET ALLOCATION (AKA SECTOR ROTATION)

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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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