



# TAA - when inflation is rising

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Today . . . Right now

- CPI today
- On a year-over-year basis
  - 9.1% June 30<sup>th</sup>
  - 8.5% July 31<sup>st</sup>
  - 8.0% **e** August 31<sup>st</sup>

- Just take the difference between
  - Regular Treasuries
  - TIPS
- Be careful to
  - Use current yield
  - Exactly match the maturities

Treasury Yields

NAME	COUPON	PRICE	YIELD
GB3:GOV 3 Month	0.00	2.79	2.85%
GB6:GOV 6 Month	0.00	3.17	3.27%
GB12:GOV 12 Month	0.00	3.25	3.36%
GT2:GOV 2 Year	3.25	99.69	3.41%
GT5:GOV 5 Year	3.13	99.40	3.26%
GT10:GOV 10 Year	2.75	96.97	3.11%
GT30:GOV 30 Year	3.00	95.17	3.25%

# Treasury Inflation Protected Securities (TIPS)

NAME	COUPON	PRICE	YIELD
GTII5:GOV 5 Year	0.13	98.19	0.52%
GTII10:GOV 10 Year	0.63	100.98	0.52%
GTII20:GOV 20 Year	0.75	95.02	1.03%
GTII30:GOV 30 Year	0.13	79.83	0.91%

Therefore the market expects future inflation to be

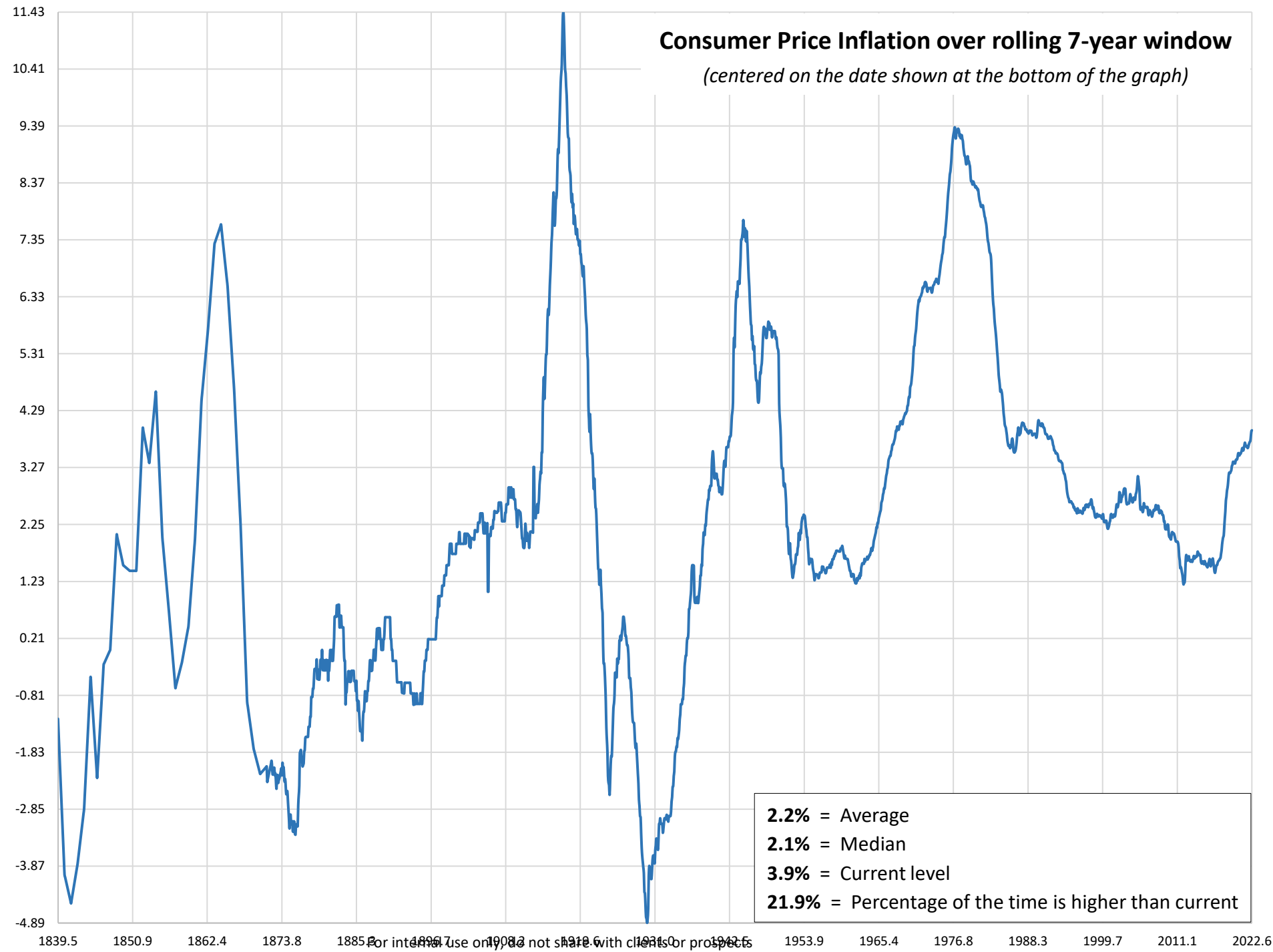
- Average over the next

- 2.7%                      5 years
- 2.6%                      10 years
- 2.2%                      20 years
- 2.3%                      30 years

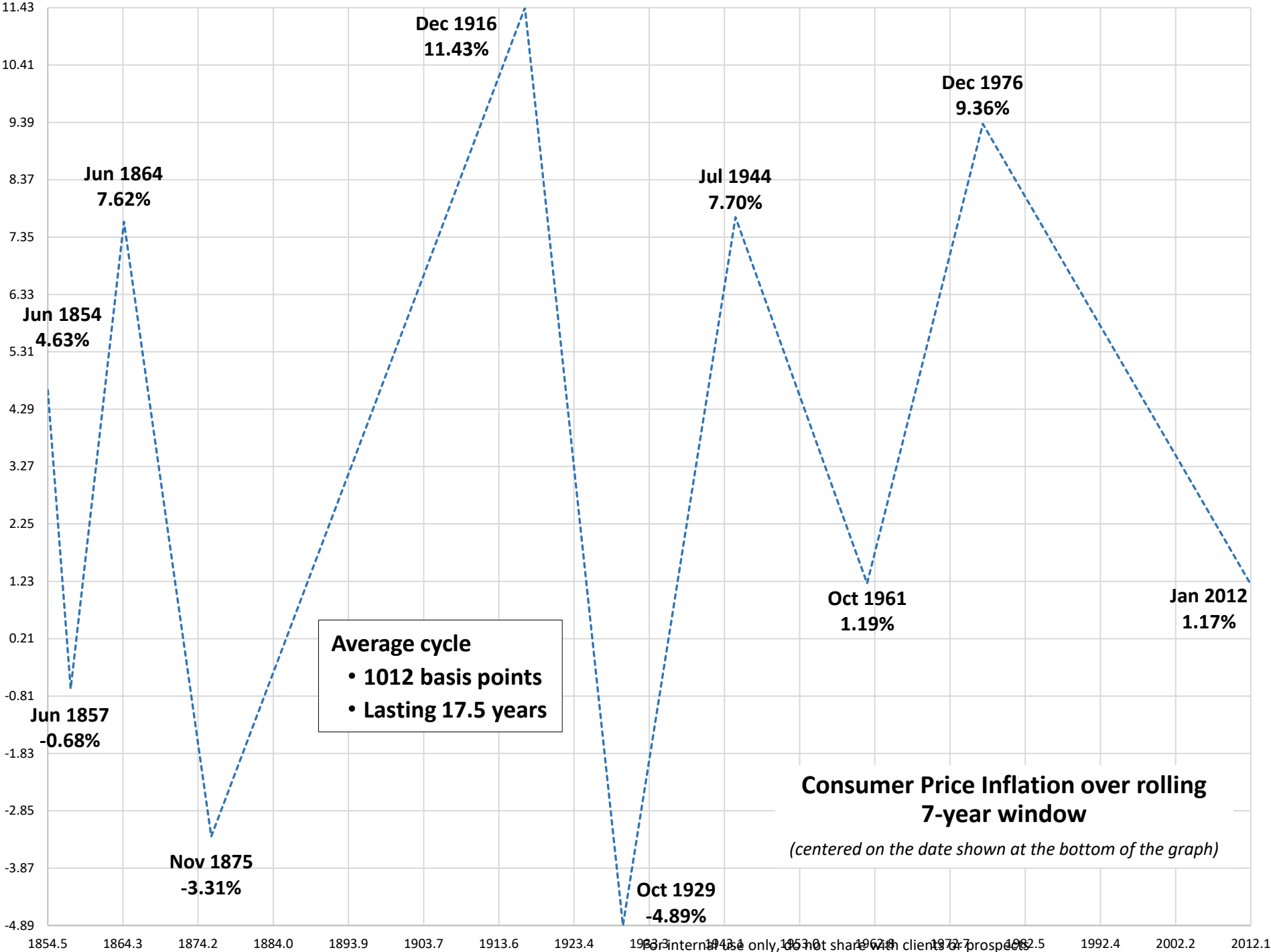
# Context is necessary

Long-run history

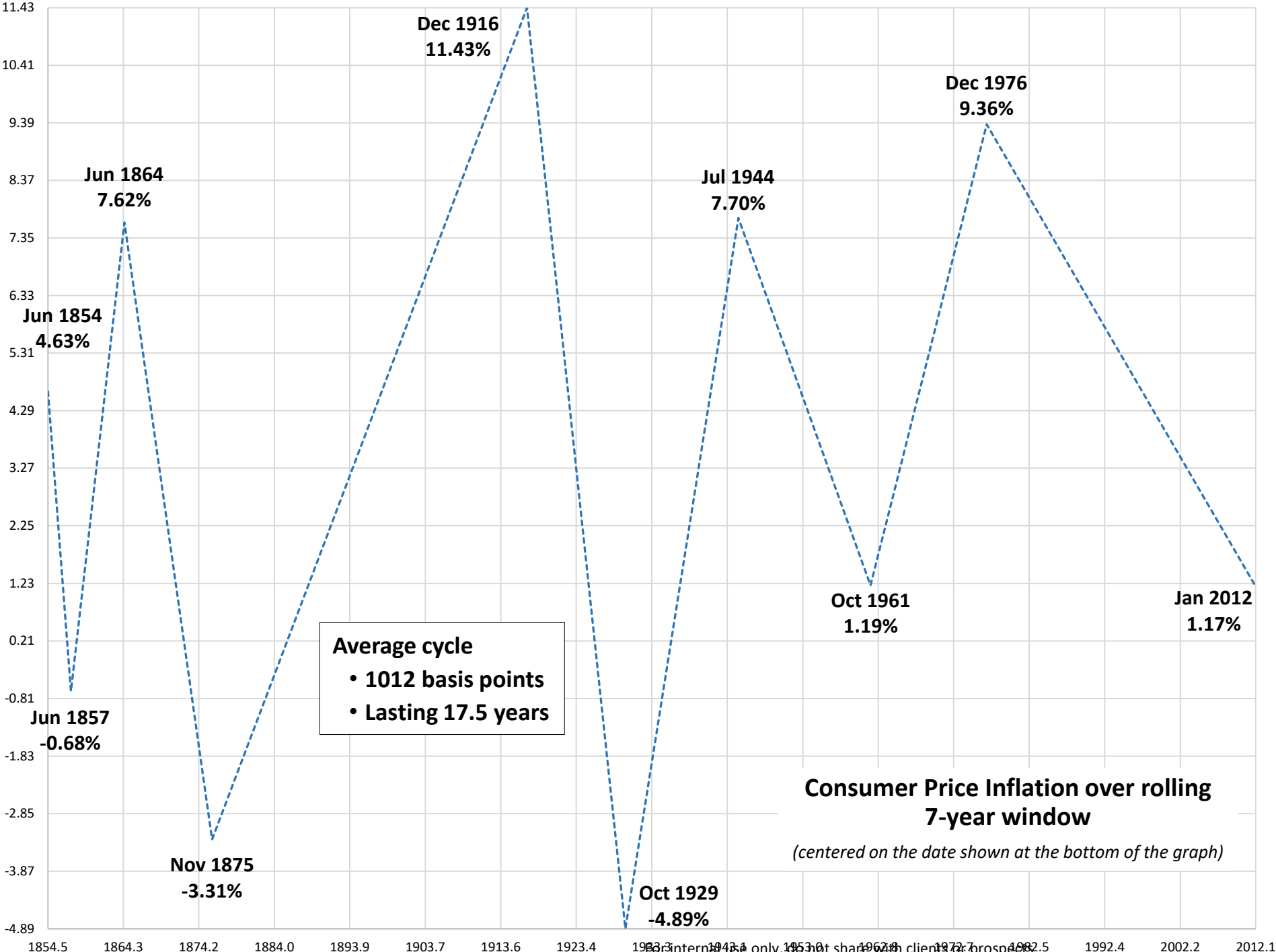




# Inflation - the cycles



# Inflation - the cycles



**Inflation . . . Now  
rises for “17.5  
years”**

**Like its always done**

# If we just “accept” history

Take history as the forward-looking forecast . . . . A good/best starting point

- **Bottomed out**
  - Jan 2012
  - At 1.17%
- **Typical cycle**
  - Runs for 17.5 years
  - Moves inflation YOY by 1012bps
- **If history repeats (the best possible starting point) . . . inflation will peak**
  - On July 2029
  - At 11.29% . . . YOY (year-over-year)
  - Is this “heroic”? . . . . Nope . . . This would be normal, vanilla, boring, and seriously typical
  - **RECALL . . . inflation hit a high of 14.8% on Mar 1980 YOY**

# Important qualifications

Drawn from today's . . . quite serious realities

## Rob's attempt at . . . current-day qualifications

- It's all about COVID
- And the US government's response to COVID
- And many other country's . . . respective responses to COVID
- We seriously need to modify our history-based conclusions for the once-in-a-hundred-year event of COVID
- I struggle to see . . . how this has anything to do with “long-run” interest rates
- BUT . . . It has serious implications for inflation

- Why is inflation happening . . .

- COVID

- Millions left the labor force . . . stopped working
    - The global supply chain broke . . . and it takes years (not months) to reconnect it
    - Consumers got bored . . . and just started buying stuff . . . a lot of stuff

- Federal government stimulus

- Monetary - by Federal Reserve
    - Fiscal - spending by the US Congress

- Ukraine

- Deglobalization



- It goes down . . . Big time
- Security markets are forecasting inflation to AVERAGE just
  - 2.7 % over the next five years
  - 2.6% over the next ten years

# Why is it necessary that inflation falls from today's level

- Why must inflation fall from current levels?

- COVID

- Millions left the labor force . . . stopped working
- The global supply chain broke . . . and it takes years (not months) to reconnect it
- Consumers got bored . . . and just started buying stuff . . . a lot of stuff

- Federal government stimulus

- Monetary - by Federal Reserve
- Fiscal - spending by the US Congress

These five factors are all working in reverse, serving to push inflation back down

- Ukraine

- Deglobalization

These two factors are working hard to drive inflation higher

# But why ?

Why would inflation go back up . . . AFTER COVID fully washes through the system

It may not . . . . .

BUT . . . . .

- It's all about funding (paying for) . . . projects . . . that're at play
- Society and governments have several projects that they're attempting to finance
  - Cold war with Russia
  - Cold war with China
  - Conversion from fossil fuels to renewables
  - Income inequality gap
  - Wealth inequality gap
  - Expanding social welfare programs
  - Transitioning from one political structure . . . To a different structure
- Inflation is a method for both obscuring the cost . . . and dispersing its burden
- My 2 cents . . . The French revolution (reign of terror) of the late 18<sup>th</sup> century . . . Is helpful

# Ultra-simplified TAA model

Used to evaluate the question of how TAA performs when inflation rises/falls

## 28 asset categories (Jan 1919 - present)

- High quality, consistent, uniform data available since Jan 1919
- 7 types of US stocks
- 9 international countries
- 5 types of US Treasuries
  - 90-Day . . . to . . . 30-Years
- 1 type of TIPS
  - Yes, simulated back to 1919
- 1 type of high yield US corporate bonds
  - Yes, simulated back to 1919
- 2 types of precious metals
  - Gold and platinum
- 3 types of generalized commodities
  - Ultra-diversified commodities
  - Agricultural commodities
  - Diversified base metals

- Investment time horizon is specified as
  - 7 ½ years . . . . . The midpoint of 5 years and 10 years
- Pick those asset categories that trended the most strongly
  - Over the last eleven months
- Always pick the top eight
- Because of the short investment time horizon (7 ½ years)
  - Differentiated weighting is applied to the asset categories
  - For example, if Treasuries are “selected,” then they receive an extra weight

- At the low end
  - **1 basis point** to trade stocks . . . . in one direction (a buy or a sale)
- At the high end
  - **108.3 basis points** to trade diversified base metals . . . a buy or a sale
- The assumed transactions costs are far higher than what one to encounter in real life



- All data was provided by
- Global Financial Data, Inc.
- Kenneth R. French data library (Dartmouth College)

# Results

Over the entire time period . . . . 1919 to the present

- **Adjustment for inflation is necessary because**
  - Inflation has varied to such an extent (high to low), that without this adjustment one ends up with noise
  - Investors care about what their portfolio will purchase in goods and services
- **We took the entire time period (1919 – present)**
- **Evaluated for those months when inflation was rising the most rapidly**
  - 20% of the months
  - 25%
  - 33.33%
  - 50%
  - 60%
- **Strictly ignored how high or low inflation was . . . Only looked at how fast it was rising (measured proportionately)**

After inflation, annualized returns . . . . Rising the FASTEST



Percentile (in %)	TAA before all transactions costs	TAA after super high transactions costs	S&P 500	Dow Jones Industrials	10-year Treasury	US Aggregate Bond Index	Gold	25/75 S&P 500 and 10-year Treasury
20	2.7	1.5	-3.3	-4.1	-4.7	-4.2	0.3	-4.1
25	2.3	1.2	-2.7	-3.4	-3.4	-2.8	-1.4	-3.0
33.333	4.4	3.3	-0.5	-0.7	-2.1	-1.6	-0.4	-1.5
50	6.8	5.7	1.7	1.8	-0.4	-0.1	1.1	0.3
60	7.8	6.7	3.0	3.4	0.1	0.5	0.9	1.1

# When inflation was falling the fastest

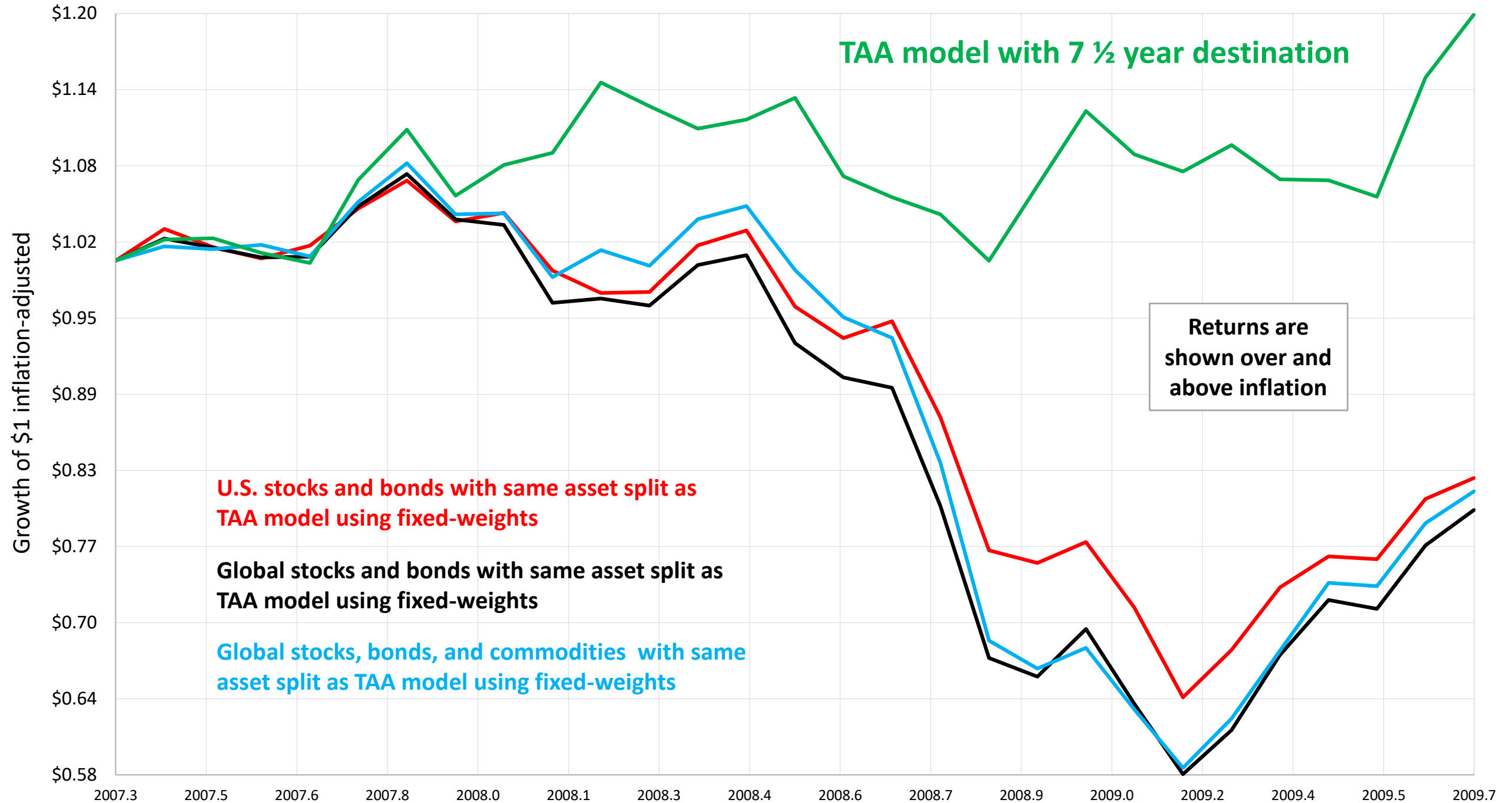
When inflation was falling the fastest

This is when inflation is FALLING the fastest

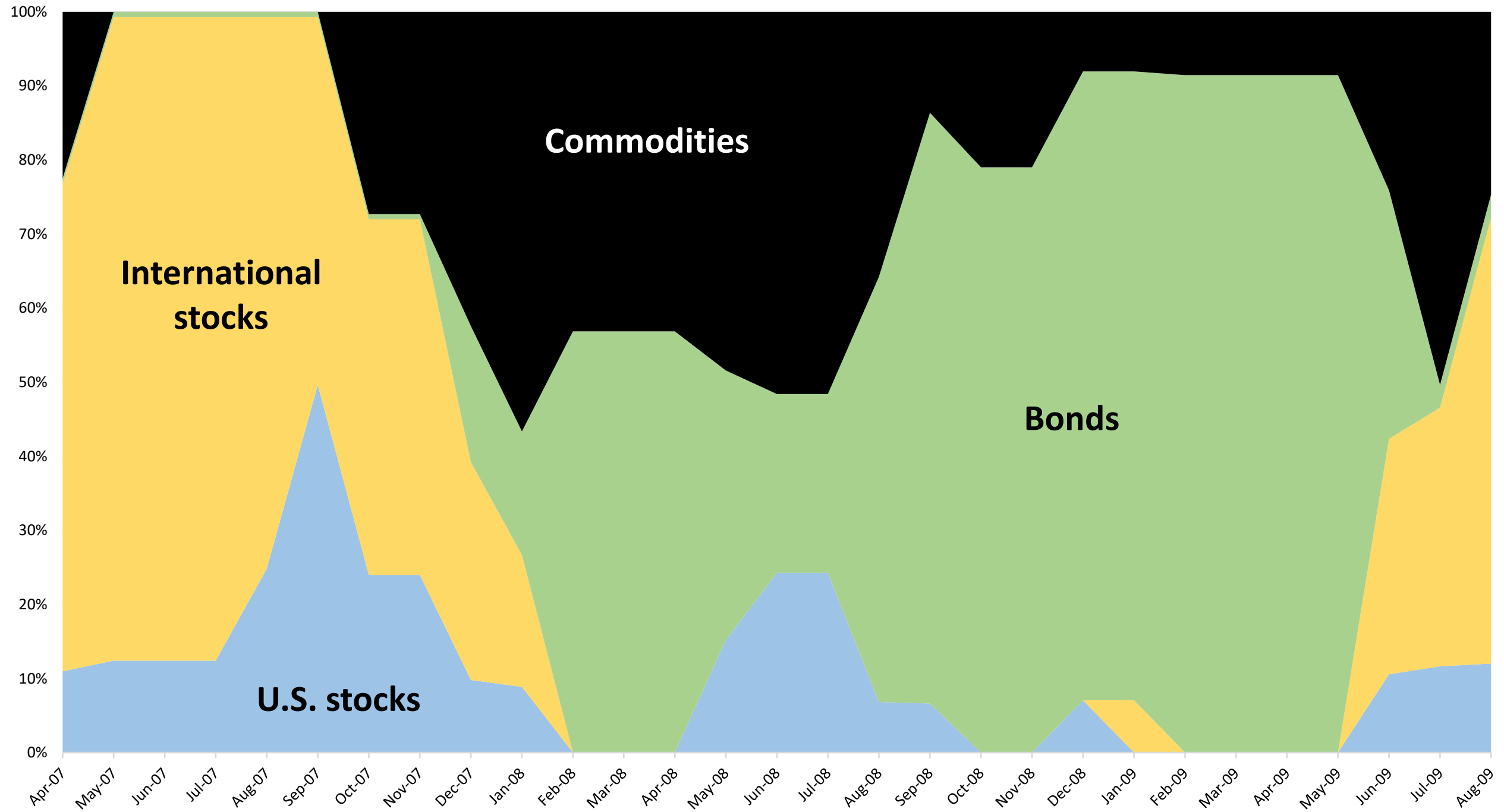
Percentile (in %)	TAA before all transactions costs	TAA after super high transactions costs	S&P 500	Dow Jones Industrials	10-year Treasury	US Aggregate Bond Index	Gold	25/75 S&P 500 and 10-year Treasury
10	16.1	15.7	11.6	9.3	13.9	13.5	10.9	14.6
20	18.5	17.9	18.3	19.1	8.0	8.9	6.5	11.2
25	18.7	18.1	16.6	16.2	7.0	7.8	6.6	10.0
33.33	18.3	17.6	15.9	15.5	6.4	7.0	4.2	9.3

# But why?

Why is the TAA model doing so much better than passive Buy & Hold?







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ROB BROWN



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### Rob Brown

Rob is a senior level investment professional with over 35 years of experience in portfolio management for large, sophisticated foundations, endowments, pensions, and the ultra-high net worth. Today, he serves as Integrated's Chief Investment Officer. Prior to Integrated, he held executive positions with Goldman Sachs, Genworth Financial, SEI, Envestnet, and the CFA Institute. During his tenure with Goldman Sachs, he directed the investment management department, a team that included nine CFA Charterholders who oversaw \$18.6 billion. While at Genworth, Rob served as the Chief Investment Officer directing a \$7.5 billion institutional portfolio of domestic and international securities. At SEI, he worked as the Managing Director of SEI's Research Department that supported the wealth management needs of over \$300 billion of pension, endowment, and foundation assets under advisement. At Envestnet, Rob served as the Chairman - Investment Policy Committee, Executive Vice President, and Senior Managing Director - Consulting Division for PMC International (later acquired by Envestnet), where he led the investment decision-making for a \$3.3 billion portfolio. Rob also worked in the public sector, where he held the position of Chief Investment Officer for one of our nation's larger state public pension plans, the Arizona Public Safety Personnel Retirement System. His publications have appeared in the Journal of Derivatives and Hedge Funds, Journal of Investing, Journal of Investment Consulting, Journal of Beta Investment Strategies, Pensions & Investments, FA Magazine, RIA Central, On Wall Street Magazine, Royal Alliance Associates Sourcebook, Bank Investment Consultant, Investment News Magazine, London Financial Times, Financial Planning, Financial Advisor, Journal of Finance and Market, Journal of Financial Planning, and Journal of Wealth Management.

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# Winners Repeat, Losers Repeat

Rob Brown

## KEY FINDINGS

- The TAA portfolio earned an inflation-adjusted 10.8% over the aggregate period (102.1 years), whereas a comparable passive index earned a lesser 6.7% (one with a similar standard deviation, a 75/25 global stock/bond mix).
- TAA's performance advantage resulted even after subtracting unusually high transaction costs from the TAA portfolio, while assuming that the comparable passive index could rebalance each month cost-free.
- The TAA portfolio's greater relative success in achieving the stated investment objective did not diminish with the passage of time. If anything, it may have improved during the most recent period (14.3% of the cases examined drawn from the data spanning 1919-2021).

## ABSTRACT

I present a tactical asset allocation proof-of-concept portfolio. It is intended to harvest the non-IID statistical attributes of stocks, bonds, commodities, and currencies, both domestic and international. It has as its objective to benefit from markets' propensity to trend from month to month and during both bull and bear market environments. The proof-of-concept portfolio relies on a simple quantitative rule that allows for rigorous evaluation over the past 102.1 years. The results presented herein suggest that Tactical Asset Allocation (TAA) is an approach worthy of consideration. Moreover, the article suggests that a necessary condition for TAA success lies in correctly specifying its rather differentiated investment objective—one that may be unrelated to comparisons with popular fixed-weight index benchmarks. Such fixed-weight benchmarks have correlations with TAA strategies that are so low as to make commonly used statistical comparisons irrelevant (i.e., not statistically significant). This article attempts to correct our industry's mischaracterization and overpromising of all things TAA by focusing on the time required for success.

Tactical Asset Allocation (TAA) earned a poor reputation over the past 13 years (since 3/6/2009, the recent bear market low). My objective is to mitigate a portion of the retail industry's TAA skepticism. This is an interesting topic, given the size of the retail industry, TAA's prominence within it, and forecasted future growth in TAA's market share. Direct and indirect, the retail industry is large and growing, currently estimated to be more than \$16 trillion.<sup>1</sup> TAA first came into existence back in the 1980s and has grown consistently ever since, with occasional faster growth

<sup>1</sup> Sources: ICMA (International Capital Market Association) analysis using Bloomberg Data (August 2020), Ned Davis Research, and The Visual Capitalist (<https://www.visualcapitalist.com>).

# Quick rebuttal

Have bear markets been getting shorter . . . NO !

Has TAA been losing its edge . . . NO !

Bear markets for inflation-adjusted U.S. stocks since 1845

Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BEAR market
-30	1.25	Aug 1853	Nov 1854	27.6	27	-25.1
-31	0.83	Dec 1856	Oct 1857	19.2	10	-36.4
-35	0.67	Jul 1864	Mar 1865	32.4	38	-47.1
-32	1.25	Mar 1876	Jun 1877	7.8	7	-26.2
-37	1.17	Sep 1906	Nov 1907	13.8	14	-32.7
-27	2.00	Oct 1912	Oct 1914	11.0	38	-14.8
-48	4.08	Nov 1916	Dec 1920	15.9	41	-14.8
-79	2.75	Aug 1929	May 1932	37.3	36	-43.7
-50	1.08	Feb 1937	Mar 1938	31.6	23	-47.1
-39	2.58	Sep 1939	Apr 1942	19.3	42	-17.3
-37	1.75	May 1946	Feb 1948	14.5	29	-23.4
-35	1.58	Nov 1968	Jun 1970	14.8	26	-24.1
-52	1.75	Dec 1972	Sep 1974	15.2	14	-34.2
-30	0.25	Aug 1987	Nov 1987	33.9	0	-76.3
-47	2.08	Aug 2000	Sep 2002	17.8	36	-26.4
-52	1.33	Oct 2007	Feb 2009	19.2	25	-42.1
?	?	Dec 2021	?	?	?	?

Cumulative percentage return, unannualized	Duration in years	Start date	End date	Volatility, annualized standard deviation of monthly returns	Percentage of monthly returns that were POSITIVE	Annualized return during BEAR market
-50	1.08	Feb 1937	Mar 1938	31.6	23	-47.1
-39	2.58	Sep 1939	Apr 1942	19.3	42	-17.3
-37	1.75	May 1946	Feb 1948	14.5	29	-23.4
-35	1.58	Nov 1968	Jun 1970	14.8	26	-24.1
-52	1.75	Dec 1972	Sep 1974	15.2	14	-34.2
-30	0.25	Aug 1987	Nov 1987	33.9	0	-76.3
-47	2.08	Aug 2000	Sep 2002	17.8	36	-26.4
-52	1.33	Oct 2007	Feb 2009	19.2	25	-42.1
?	?	Dec 2021	?	?	?	?



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## EXHIBIT 12

## Probability of Earning More Than 4.25% Inflation-Adjusted During a Random 12.5-Year-Long Investment Period

Number of Unique 12.5-Year-Long Investment Periods that End During the Date Range Shown to the Right

	Date Range	TAA Portfolio	65/0/35/0	75/0/25/0	35/30/35/0	40/35/25/0	35/30 26.25/8.75	40/35 18.75/6.25
154	Mar 2009– Dec 2021	100	66	66	64	65	79	77
153	Jun 1996– Feb 2009	100	98	98	98	98	99	98
154	Aug 1983– May 1996	100	81	81	81	81	81	81
154	Oct 1970– Jul 1983	100	18	19	21	24	23	26
154	Dec 1957– Sep 1970	100	99	100	99	100	100	100
153	Mar 1945– Nov 1957	84	63	78	37	43	38	44
154	May 1932– Feb 1945	100	71	69	91	90	90	86

**NOTE:** TAA = Tactical Asset Allocation.



Probability of Earning More Than 4.25% Inflation-Adjusted During a Random 12.5-Year-Long Investment Period

Number of Unique 12.5-Year-Long Investment Periods that End During the Date Range Shown to the Right	Date Range	TAA Portfolio					35/30	40/35
			65/0/35/0	75/0/25/0	35/30/35/0	40/35/25/0	26.25/8.75	18.75/6.25
154	Mar 2009–Dec 2021	100	66	66	64	65	79	77
153	Jun 1996–Feb 2009	100	98	98	98	98	99	98
154	Aug 1983–May 1996	100	81	81	81	81	81	81
154	Oct 1970–Jul 1983	100	18	19	21	24	23	26
154	Dec 1957–Sep 1970	100	99	100	99	100	100	100
153	Mar 1945–Nov 1957	84	63	78	37	43	38	44
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# How to explain Tactical Asset Allocation to a prospect

Friday

Sept 16<sup>th</sup>

11:00 a.m. EASTERN

All data and statistics were provided by Ycharts, Global Financial Data, Inc., and NDR, Inc. (unless otherwise indicated in the exhibit)

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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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