The Active Manager

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Trading Strategies

Practice Management

NAAIM News

OUTLOOK 2019
CONFERENCE

Bigger and Better Than Ever in Dallas/Ft. Worth

NAAIM'S 2019 OUTLOOK CONFERENCE IS coming to the Hyatt Regency Hotel at the Dallas/Ft. Worth Airport November 10-12 with excellent presenters, more member panels, networking, and information exchange than ever before. This year's event kicks off with a revamped NAAIM Shark Tank Sunday evening featuring stock selection and sector rotation strategies. Then it's on with the Outlook agenda Monday through Tuesday.

Among the presenters are technical strategist Katie Stockton, CMT; Ivan Barretto and Draye Redfern. Expert panels feature trading strategies, marketing tactics, effective client communications, and a myriad of ways to make your

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The views and opinions of the authors are not necessarily those of NAAIM, its officers or Board of Directors.

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President's Letter

Matthew Spangler

SUMMER WAS A NICE BREAK from the fast pace of first half of the year, with time for small family trips with the kids. But with fall officially here, school back in session, and clients back from vacations and summer fun, work has ramped up. I am seeing a lot of requests for portfolio reviews as clients worry about market volatility and the uncertainty created by trade tariff issues, interest rate policies and slowing economies around the world.

All of which brings home to me once again the importance of having contacts in this business that you can bounce issues off and find out how they are dealing with markets and clients, and keeping their businesses on track. Creating relationships with other investment advisors through NAAIM has been essential to my business. This is why I want to encourage everyone to set aside time in their lives now to attend NAAIM's OUTLOOK 2019 conference, coming up November 10-12 at the Hyatt Regency DFW at the Dallas Fort Worth Airport.

When it comes to creating friendships and peer groups, nothing beats the opportunity to meet face to face. NAAIM conferences bring you together through working sessions, conference receptions and special events with investment advisors who believe in active management and share your approach to investing. It is also an important opportunity to reconnect with people you don't see throughout the year.

The focus of the NAAIM Board is to make every conference the best one yet with topics that cause people to say – *I really need to be there*. At the OUTLOOK conferences, the goal is to have advisors shape the agenda with more member panels and opportunities for attendees to be part of the conversation. Discussion topics include business growth strategies, effective technology applications and technical perspectives of what may be ahead in the financial markets. We want every attendee to leave OUTLOOK with practical ideas that they can use to make their advisory business more effective.

Some outstanding speakers will bring new ideas to the discussion. Among the headliners for the conference is technical strategist Katie Stockton. Katie's appearances on CNBC, BNN, Fox Business, MarketWatch and Bloomberg, as well as coverage in *The Wall Street Journal, Seeking Alpha* and other business publications make her a familiar market presence for many of the NAAIM members (more about Katie and other speakers on page 2).

Another new aspect of OUTLOOK 2019 is the inclusion of the NAAIM Shark Tank on Sunday evening, prior to the conference. This is the start of a revamped, more focused approach to Shark Tank where managers compete based on

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Bigger and Better Than Ever in Dallas/Ft. Worth

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investment advisory practice more successful, all with the peer-to-peer collaboration unique to NAAIM.

Make your reservations now to assure you have a room onsite by contacting the Hyatt Regency DFW at 972-453-1234 – and mention NAAIM to receive the group room rate. Or book ONLINE HOTEL RESERVATIONS: Hyatt Regency DFW at https://www.hyatt.com/en-US/group-booking/DFWAP/G-NAAI.

For OUTLOOK 2019 registration visit: https://naaimevents.org/outlook-2019.

Read more about the featured presenters and the new look and feel of the NAAIM Shark Tank on page 3.

Using Market Internals and Technical Outlook with presenter Katie Stockton, CMT

Explore ways to leverage the market's internal measures, specifically breadth, sentiment, and volume, to help identify inflection points in equity market in real time with Technical Strategist Katie Stockton. Katie will share the current status of her preferred indicators and impart how best to analyze them within the current market framework. She will address misconceptions regarding the most popular indicators, which she believes are often misused and applied incorrectly, and contextualize the current technical outlook by referencing past extremes in breadth and sentiment, emphasizing support and resistance, trend-following gauges, and overbought/oversold measures.

Katie is Founder and Managing Partner of Fairlead Strategies, LLC, an independent research provider of technical analysis. Her technical strategy research adheres to a top-down approach, employing multiple indicators to help clients identify opportunities and manage risk. Prior to forming Fairlead Strategies, Katie served as Chief Technical Strategist for BTIG for four years and was Chief Market Technician at MKM Partners for nine years. Previously, she was a technical analyst for Morgan Stanley and Wit Soundview. Katie received her CMT designation in 2001, and later joined the board of the CMT Association, serving as Vice President from 2012 to 2016. In 2017, she was honored by The Technical Analyst, which awarded BTIG the Best Institutional Brokerage for Equity Research for her technical research. Katie graduated magna cum laude with a BSBA from the University of Richmond and is currently a member of the Executive Advisory Council for the Robins School of Business.

Proven Systems, Automations & Infrastructure to Unleash Your Firm's Ultimate Potential with presenter Draye Redfern

In this incredibly unique session, you'll get a behind the scenes look at some of the most profitable marketing campaigns that elite financial advisors have used in the past year. By the end of the session you will have a clear action-plan on how you can radically differentiate your business, automate your marketing, and create even more "WOW" moments for your prospects and clients.

Draye is the founder and Ambassador of Buzz of Redfern Media, a marketing and consulting agency that helps business owners redefine their traditional approach to marketing with a series of systematized, automated and efficient processes to dramatically improve rapport with prospects and turn clients into "Raving Fans." Draye is one of the most sought after direct-response marketers serving clientele that have included elite financial advisors, *New York Times* best-selling authors, Sharks from ABC's hit TV Show "Shark Tank" and many others.

You Get an Audit, and You Get an Audit! Everybody Gets an Audit! with presenter Ivan Barretto

So, you have received a call from a state or SEC regulator letting you know that you have been selected for a routine regulatory examination. Now what? This presentation will cover the tips and tricks to assist you in preparing for an examination or audit. Learn about the common examination deficiencies and findings found during routine examinations via hypothetical examples.

Ivan Barretto is the Founder and Managing Director of RIA Compliance Concepts. Founded in 2017, RIA Compliance Concepts is a boutique consulting firm offering affordable solutions to state and SEC-registered investment advisory firms. Prior to starting RIA Compliance Concepts, Ivan was a Financial Examiner with the Texas State Securities Board Inspection and Compliance Division from 2006 to 2013 and worked as a compliance consultant from 2013 to 2016. He holds a Bachelor of Business Administration in Management degree from Texas Tech University and Master of Public Administration degree from the College of Charleston.

NAAIM Shark Tank Debuts a New Strategy-Focused Format

Sunday, November 10, just prior to the 2019 OUTLOOK Conference

EACH YEAR, THE NATIONAL ASSOCIATION OF Active Investment Managers (NAAIM) hosts competitions to seek out the best actively managed investment strategies. Launched in 2013, NAAIM's Shark Tank Active Investing Strategy Competition provides an opportunity for managers to showcase their active investment strategies, models, and signals and to provide membership with opportunities to develop relationships with other active managers.

New for 2019/2020: Category Competitions

Beginning November 10, 2019, NAAIM's Shark Tank Investing Competitions will be strategy category specific. Stock selection strategies will compete directly with other stock selection strategies, and asset allocation, tactical, fixed income, and alternative strategies will all compete against like strategies.

Next NAAIM Shark Tank Competition: November 10, 2019 – Dallas, TX

The next NAAIM Shark Tank Active Investing Strategy Competitions will be held on Sunday, November 10, 2019 at the Hyatt Regency DFW in Dallas, TX. The two strategy category competitions will be:

Stock Selection Strategies
Tactical Stock Market Strategies

Stock Selection Strategies. Attention all Stock pickers: Here's your chance to show your stuff. Stock selection strategies are defined as investing strategies that apply "selection alpha" to a portfolio of individual equities. All managers with verifiable, live track records for their stock picking strategies are welcome to compete.

Tactical Stock Market Strategies. Traders, timers, and risk managers: This competition category is for you. Tactical Stock Market Strategies are defined as investing strategies that utilize a tactical approach to the management of the U.S. stock market. All managers with verifiable, live track records for their tactical strategies are welcome to compete. Note that leverage is limited to 2X for this competition.

Grand Prize Packages:

Live Distribution and Promotion on TAMP Offering
Promotion to NAAIM Membership
Live Meetings with Manager-of-Managers Firms
$1,000 Cash Prize

The biggest NAAIM Shark Tank news is **the 2019/2020 winners will receive a distribution slot on Global View Capital Management's TAMP offering**, which focuses on active investment managers. Pending due diligence approval by Global View, the winning strategy will be promoted to Global View's advisor base and the manager will receive an invitation to the firm's annual conference. Global View currently hosts three recent Shark Tank managers and **has raised more than $100 million in AUM for previous Shark Tank winners over the past two years.**

Who May Participate: The NAAIM Shark Tank strategy competitions are open to all trading and investing practitioners who have developed strategies with live, verifiable, real money track records. Note that NAAIM Membership is required to participate in the live NAAIM Shark Tank Finals at OUTLOOK.

How to Apply: Managers wishing to participate in the upcoming event are requested to complete an outline application to the committee by 9 pm ET on Monday September 30, 2019**. Links to the application can be found at** https://www.naaim.org/programs/naaim-shark-tank/

Finalists will be announced by October 20, 2019.

November 2019 NAAIM Shark Tank Finals: The finalists will compete in front of a live audience at NAAIM's OUTLOOK conference on November 10, 2019 at the Hyatt Regency DFW in Dallas, TX.

Past Winners On Their Shark Tank Experience:

"I can't say enough about the NAAIM Shark Tank Strategy Competition or the NAAIM community in general. Having recently left a CIO position at a large RIA firm, I was looking for an opportunity to showcase my new consulting service. The strategy I presented to the Shark Tank was very well received and within 6 months of the competition, I had acquired 8 new business relationships. I am pleased to report that my services are now promoted on 4 multi-manager platforms and I have a multitude of advisors to work with. I would encourage anyone looking to promote their business to participate in the NAAIM Shark Tank Strategy Competition."

David Moenning – 1st Place Winner – 2018
Chief Investment Officer, Heritage Capital Research

"I entered the Shark Tank for the 2015 competition. I had sold my prior company years earlier but had a non-compete until 2014 when I sold my remaining shares and decided to take my 12-year EVO trading system and track record to the Shark Tank challenge. After placing third, my assets began to grow substantially, even before winning the competition last year. Today our assets primarily through licensing, using just the EVO strategy, have grown to $370m. I have to credit my participation in the Shark Tank for the exposure in getting to this level."

Rich Paul – 1st place winner – 2017
President, Potomac Advisors

"Winning NAAIM's Shark Tank strategy competition has been invaluable on many levels. As a manager previously immersed solely in the hedge fund world, joining NAAIM opened several new avenues of opportunity I simply hadn't been aware of before.

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OUTLOOK 2019
CONFERENCE

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Relativity – If Einstein Had Been a Market Analyst

DAVE WAGNER

EINSTEIN HAD HIS TROUBLES CONVINCING THE world that his theory of general relativity was correct. As a matter of fact, it took several years and several failed attempts by others trying to prove (or disprove) before it was finally accomplished. After all, you can't measure the position of a star as the sun is totally eclipsed by the moon any day you wish.

He would have had a much easier time with the markets had he had the inclination, patience and willingness to work with something that wasn't subject to the physical laws of nature. However, I'm sure he would have had the ability to look at the financial system as a whole and break down the individual components in a number of ways to examine the relationships (or lack thereof) between a variety of varying subsets. Looking at country to country dynamics, region to region and continental comparisons, I'm sure he would have come up with some complex yet logical (at least to some) explanations as to why what happened should have been expected and that something specific can be expected in the future given a specific set of circumstances. In the end, he might have called it the Theory of Market Relatively.

The US markets have done very well in the last several years, (11? With a few short disruptions). Mainly, one could argue, due to a friendly Fed. Arguments can rage on and on around this point, but one can be pretty certain that with high interest rates, a lack of any reasonable semblance of a housing market, continued unemployment, and runaway federal spending, the markets' performance would have been much worse. And one can be just as surprised that the markets haven't (as yet) had the bubble burst ala 2008 and 2001 and 1987. Many had predicted the end of the world with the sharp rise in the federal deficit. Throw in a few more plausible scenarios and it would have been expected by most reasonable people. But it didn't happen. And maybe it won't happen.

Why? Ah, the $20 trillion question. The answer? Market Relativity. S+D=C Think about it. You have money, you aren't an idiot, so you want your money to make money. Savings accounts are paying close to 0%, short term CD's are better than last year but with recent Fed decisions might fall again. Ten-year US Treasury Notes are a whopping 2.5% (or so) and a good Corporate bond is maybe 3%. Fixed Income doesn't look too good. Kinda makes a 6% 30-year treasury from 1992 look pretty good; but back then you could get a one-year CD for 6%, so it was an easy choice. (Pardon the lack of consideration for the investment time horizon question). Real estate is still pretty scary for some investors, precious metals, meh, (and maybe it is time to add some??), and alternatives, hedge funds and commodities are like Chinese Algebra to most folks, just too hard to comprehend. What is left? Equities!

So you are sitting on a pile of money, wondering which countries' equities you should choose for your portfolio. Fortunately for you, Einstein had this theory of Market Relativity and, more fortunately, you remember hearing about it at some point. So you think - Which equity market is going to do better relative to the other markets in the world? On a relative basis, which market is the most solid? Russia? Maybe someday definitely a long way off. China? Still a communist influence that scares free people. India? No. Europe? Possibly, but too many unsure components that can rock the boat. Individual European countries? The lack of size and diversity add unnecessary risk. That leaves a whole bunch of emerging and pseudo emerging countries that while possibly appropriate for a small amount in some portfolios, not so for a sizable equity position. Canada? Eh? The US? We have a winner.

Seriously, relative to any other markets and in some part as long as the dollar remains the world currency standard, the US equity markets are more diverse, better funded, more stable and more liquid than any other. RELATIVE to any other markets. S+D=C. Strength +Diversity = Capital. Strength and diversity have their own components, and together they attract capital. Now it is fairly certain that if (when) there is another country (region) that can rival the US, and that country (region) has better federal fiscal management, a more favorable business climate, and a better standard of living (ie: lower taxes, better health care, better education, etc.) then the US market would not look as good, RELATIVELY.

Why didn't (don't) the US markets burst? Relative to everywhere else, there is not a better choice.

Dave Wagner is President of Active Investment and a Member of NAAIM since 2008. Mr. Wagner has been in the securities business since 1987 and has developed and managed many active management strategies over the past 25 years. He is also a Managing Partner of Numetrix Capital, LLP.

NAAIM Shark Tank

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Additionally, the community of fellow tactically-oriented managers willing to share ideas and resources was a truly welcome surprise. Without question, the Shark Tank victory has helped my business grow, and I believe that my continued association with NAAIM will only help further the future growth of my business."

David Bush – 1st place winner – 2016
Managing Member, Alphatative LLC

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Semiconductors at the Center of the Trade War – Trading Opportunities

LEKS GERLAK, CFA

SEMICONDUCTORS ARE AT THE CENTER OF THE trade war with China, as President Trump has taken a hard stance against China's questionable technology and intellectual property practices. This industry is essentially the "brain" of the digital economy. It's a critical core component in everyday consumer electronics, computing, and communication devices (TVs, laptops, mobile phones, tablets, etc.).

Semiconductors, or "chips," are increasingly being used in advanced equipment in nearly every area of the economy, from the aerospace industry, to financial markets, and to national security. This subsector deserves investors' attention, as its place in the trade war may be here to stay for a while, creating opportunities to capitalize on its performance – both up and down.

The Importance of the U.S. Semiconductor Industry – By the Numbers[1]

Here are a few stats that not only highlight its importance, but also offer perspective into why the industry plays a critical role in trade relations.

#4 – Semiconductors are America's fourth-largest export after airplanes, refined oil, and crude oil.

82% – The percentage of U.S. semiconductor sales to overseas customers.

$44 billion – The U.S. exported $44 billion in semiconductors in 2018 and maintains a consistent trade surplus in semiconductors

45% – The U.S. semiconductor industry is the worldwide leader with about ha.lf of global market share.

President Trump's Trade War – Addressing Questionable Trade Practices for Technology, IP

The tech and IP battle with China started in late 2017 and continues to evolve. On August 18, 2017, U.S. Trade Representative Robert Lighthizer self-initiated an investigation of China after President Trump instructed him to consider whether to investigate any of "China's laws, policies, practices, or actions that may be unreasonable or discriminatory and that may be harming American intellectual property rights, innovation, or technology development."[2] The report from this investigation was released in March 2018, and from there, barely a day has gone by without a news headline related to U.S-China trade tensions and tariffs.

Over the past few months, the U.S. has increased pressure on Chinese telecom giant Huawei, the world's #1 telecom supplier and #2 phone manufacturer. There are serious concerns about Huawei's ability to spy on countries and companies and its friendly relationship with the Chinese government.[3] In May, Huawei was effectively banned from U.S. communications networks and added to the U.S. Department of Commerce's Bureau of Industry and Security Entity List. The ban impacts major chip makers, including Intel and Qualcomm, which both took steps to cease working with Huawei. Recently, at the G20 summit, President Trump agreed to restart trade talks with China and allow Huawei to buy U.S. products.

These events, along with others, have sparked periods of volatility in semiconductor indexes, illustrated in the chart below:

With the development of 5G technology, the semiconductor industry is entering a new phase of incredible growth opportunities. 5G is poised to be the fastest, most robust technology we've ever seen, with the potential to power autonomous cars, smart communication devices, and industrial Internet of Things, for example. The 5G race is on, and the competitive positioning between the U.S. and China is, and will likely continue to be, fierce.

Source: Bloomberg, as of 8/20/2019

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Semiconductors at the Center of the Trade War

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Investing in Semiconductors – Consider Leveraged and Inverse ETFs

There are a number of investment vehicles available to capitalize on movement in the Semiconductor industry. In addition to traditional unleveraged ETFs, investors can consider leveraged and inverse ETF options. These types of funds provide magnified exposure and can be used in a variety of ways: to implement a high-conviction directional trade, to overweight or underweight the segment of the market, or as a hedge. Leveraged and inverse ETFs have a "one-day" investment objective and offer multiple levels of daily exposure (i.e. +/- 2x).

Remember the Impact of Compounding

Leveraged and inverse ETFs are designed for short-term use. If you intend to use them for periods longer than a day, it is critical to understand how compounding affects the performance of leveraged and inverse ETFs. Because of the daily objective and the results of compounding, it's unlikely an investor will receive a leveraged or inverse ETF's multiple times the benchmark's return for periods longer than a single day. In trending periods, compounding may enhance returns, and in volatile periods, compounding may hurt returns. Generally speaking, the greater the multiple or more volatile an ETF's benchmark, the more pronounced the effects of compounding are likely to be.

Conclusions

The semiconductor industry is likely to feel the impact of the trade war for some time. The industry plays a critical role in the economy and is a driver of many forms of technological advancement. Existing leveraged and inverse ETFs cover a wide range of market segments potentially affected by trade conditions: broad-market domestic and international equities, single countries, sectors, currencies, commodities and fixed income. As with any leveraged or inverse strategy, it's important to closely monitor your position, as frequently as daily.

[1] https://www.semiconductors.org/wp-content/uploads/2018/08/SIA_One_Pager_May_2018.pdf

[2] Peterson Institute for International Economics https://piie.com/blogs/trade-investment-policy- watch/trump-trade-war-china-date-guide

[3] https://www.cnet.com/news/huawei-ban-full-timeline-on-how-and-why-its-phones-are-under-fire/

Leks Gerlak joined ProShares in 2015 as an Investment Strategist. His responsibilities include portfolio analysis, education, product research and development, and the presentation of investment strategies using the company's leveraged and inverse (tactical) ETFs. Prior to joining ProShares, Mr. Gerlak served as an Analyst at J.P. Morgan Private Bank, managing money for wealthy families, endowments and foundations. Before that, he served as a Fixed Income Trader with Vanguard where he was responsible for trading corporate bonds and managing Vanguard's fixed income ETFs. Mr. Gerlak earned a bachelor's degree in economics from Haverford College, holds Series 7 and 63 FINRA registrations, and holds the Chartered Financial Analyst (CFA) designation.

A Note About Risk

Investing involves risk, including the possible loss of principal. Most leveraged and inverse funds seek returns that are a multiple of (e.g., 2x or -2x) the return of a benchmark (target) for a single day, as measured from one NAV calculation to the next. Due to the compounding of daily returns, leveraged and inverse fund returns over periods other than one day will likely differ in amount and possibly direction from the target return for the same period. These effects may be more pronounced in funds with larger or inverse multiples and in funds with volatile benchmarks. Investors should monitor their holdings as frequently as daily. Most leveraged and inverse funds are non-diversified and each entails certain risks, which may include risk associated with the use of derivatives (swap agreements, futures contracts and similar instruments), imperfect benchmark correlation, leverage and market price variance, all of which can increase volatility and decrease performance. Inverse funds should lose money when their benchmarks or indexes rise. Please see their summary and full prospectuses for a more complete description of risks.

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What Does an RIA Claim Look Like?

CHAD RAMBERG

WE OFTEN GET THIS QUESTION WHEN A prospective client is purchasing E&O insurance for the first time, and any short answer will typically be unsatisfying because there is no "normal" claim scenario. The other challenge is that we can't really look to any upcoming or pending claims as examples, for obvious reasons. Today we have the unique opportunity to look under the hood of an RIA claim. Here are the details:

A Registered Investment Advisor and affiliated Broker Dealer collectively known as Allegis executed a put credit spread in August of 2015. This spread was based on the Russell 2000 index with a maximum potential gain of $313,600 and maximum potential loss of over $38 million. The trade resulted in the maximum loss which affected multiple clients where the firm had full discretionary authority. From the clients' perspective they lost half of the aggregated value in their accounts. This generated multiple arbitrations and threatened lawsuits.

Initially, there were eight clients that filed arbitration and threatened suits. By 2017, the count expanded to more than 20. The clients claimed the RIA "made misrepresentations, mismanaged their funds, breached fiduciary duties, engaged in securities fraud, was negligent, etc." The clients did not refer to the types of investments or trades. All of the clients' allegations were brought into one claim because the root cause of the claim had to do with the event of the August 2015 trades.

The RIA requested defense council and the carrier chose a different attorney to defend against the client allegations. Once the claim was active, the RIA leadership reviewed the insurance contract and believed the activities to be covered because the policy stated coverage for "fully covered put or call options." The carrier took the opposite position that coverage did not apply because "this insurance does not apply to any claim or defense expenses: … Arising out of the actual or alleged purchase, sale, attempted sale, solicitation or servicing of any of the following: … Commodities, any type of futures contracts, any type of options contract or derivative. However, this exclusion shall not apply to fully covered put or call options."

From Very Bad to Even Worse

Not only was this a big claim, the carrier had denied coverage and defense of the claim. The single biggest mistake made by the firm leadership was that they did not appear to review or read the insurance contract prior to placement of the coverage. They could have purchased coverage for broad options trading strategies. The firm member in charge of placing the coverage stated they had no personal knowledge of the options trading strategies. The broker who placed the coverage stated the focus was to find appropriate coverage at a competitive price for its customers. This gives us a second big mistake - if the primary focus is price you have lost the battle. Price is important but ultimately, in a claim scenario, nobody remembers that they saved a few thousand dollars.

The Final Resolution

The financial firm sued its carrier seeking payment for defense of the claims. That suit was denied in March of 2019. From start to finish it took over three years to close the book on this case. You may remember the volatility in the market back in the fall of 2015. I would not be surprised if the trader who initiated the put spread felt like it was a black swan event that led to the losses. The point being that individual actions done with the best of intentions did not go as expected.

There are many more twists and turns in the story of this claim. Others have written compelling reviews of this case but here I have focused on issues that can help you think more proactively about your RIA business insurance purchase decisions. In this case, it is my opinion, not enough attention was paid to the technical aspects of the insurance contracts by the leadership of the financial firm nor the insurance broker. This is why you must first choose an insurance professional who understands both the technical aspects of your advisory business as well as the technicalities of the insurance contract.

We never know what will be alleged in a claim. The question you should be asking yourself is, "What is the plan if someone accuses our firm of breaching its fiduciary duty?" Having insurance is not the right answer. Knowing "what" you have is key.

Chad Ramberg is President of Box Professional Insurance, Built by Advisors for Advisors. Chad spent the first decades of his career in leadership positions on the claims side of insurance services. When that season of his career was wrapping up, he decided to use his financial acumen to become a Registered Investment Advisor. He worked as an advisor just long enough to gain a healthy respect for the day-to-day challenges RIAs face every day. Shifting gears a bit, Chad found he could add more value to the financial services community by being an insurance advisor to advisors. Today Chad talks with advisors across the country, meeting their needs so they can focus on what they do best.

Indexing Big Oil: A Fresh Take on Energy Investing

SCOTT ACHEYCHEK

THE OIL INDUSTRY ISN'T GOING AWAY ANY TIME soon, even if the world continues to move towards clean energy. The U.S. has never been as energy self-sufficient as it is today, thanks to the rapid increase of domestic oil and natural gas production. And that trend does not seem to have an end in sight - with bidding wars over the Permian Basin and high-flying acquisition prices for oil companies making news in the sector.

The oil and gas industry can be divided into three segments, with each segment creating energy market gyrations and moments of opportunity for traders and investors. These segments are referred to as *upstream, midstream,* and *downstream.*

Upstream is associated with the exploration and production of crude oil. This includes the drilling of wells, research into new drilling sites, and all other aspects of the exploration & production process for crude oil.

Midstream is associated with companies involved in the transportation, storage and wholesale distribution of crude petroleum products. This includes many aspects of transporting crude oil or natural gas from the field to its final destination such as pipelines, barges, trucks and trains.

Downstream is associated with the process of refining, marketing and distributing the byproducts such as gasoline down to the retail or consumer level.

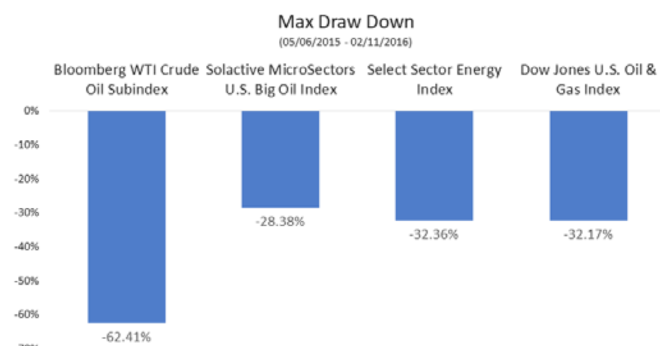
Energy Sector Index landscape: know before you trade

The Select Sector Energy Index and the Dow Jones U.S. Oil & Gas Index are typically known as the energy benchmark indices. Due to a market cap weighted approach, however, two companies, Exxon and Chevron, make up 43% of those indices. The indices may seem diverse because they have 30 or more names in each index, but you're really making a large bet on those two names and then lesser allocations to many smaller players in the energy industry.

In addition to increased diversity, equal weighting of positions can outperform a market capitalization weighted distribution. The Solactive MicroSectors U.S. Big Oil Index was introduced in 2019 as an alternative to the Select Sector Energy Index and the Dow Jones U.S. Oil & Gas Index. This equal-weighted index is comprised of the 10 largest energy companies in the U.S. As a result, Exxon and Chevron make up only 20% (10% each) of the MicroSectors U.S. Big Oil Index. Application of the index methodology in hindsight shows the Solactive MicroSectors U.S. Big Oil outperformed its competitor benchmarks since March 2013.

Max Drawdown Analysis During Oil Sell-off

During the crude sell off in late 2015 and early 2016, the MicroSectors U.S. Big Oil index had the least amount of drawdown relative to the primary benchmark indices. OPEC could not come to an agreement oil production, which, when combined with the surging U.S. output, resulted in an oversupply of oil and downward pressure on crude prices. The price of a barrel of oil was cut by more than 50% in less than a year, and the benchmark indices declined during this sell off.



Source: Bloomberg

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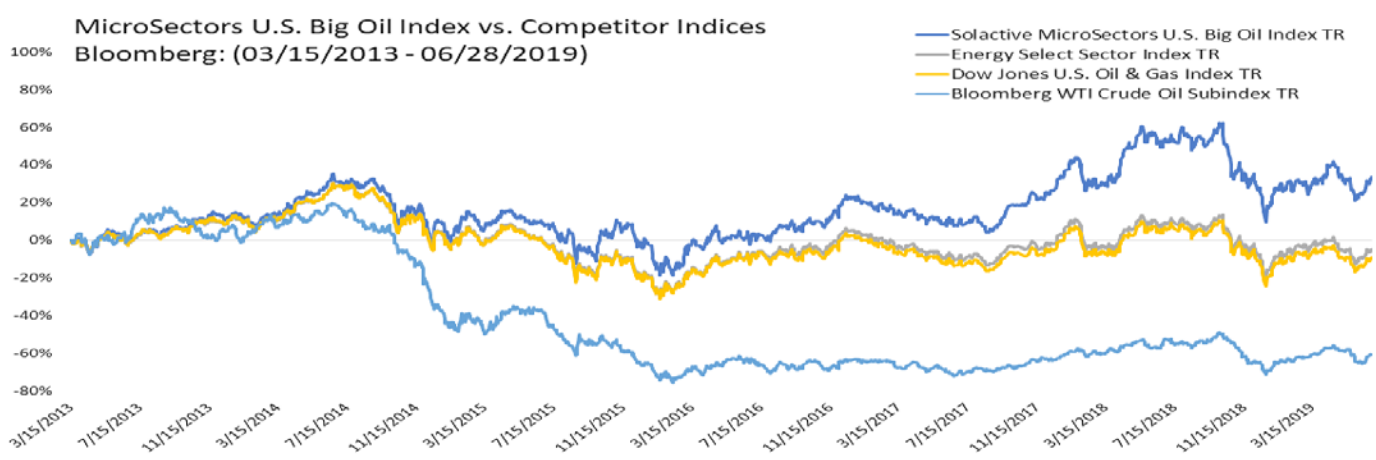


Source: Bloomberg, index data as of 6/30/2019.

Indexing Big Oil: A Fresh Take on Energy Investing

CONTINUED FROM PAGE 10

Solactive MicroSectors U.S. Big Oil Index Holdings:

Ticker	Company Name	Index Weight	Market Cap ($b)
APC US EQUITY	Anadarko Petroleum	10%	36.87
COP US EQUITY	Conocophillips	10%	68.18
CVX US EQUITY	Chevron	10%	238.17
EOG US EQUITY	EOG Resources	10%	50.51
MPC US EQUITY	Marathon Petroleum	10%	36.60
OXY US EQUITY	Occidental Petroleum	10%	39.16
PSX US EQUITY	Phillips 66	10%	46.24
PXD US EQUITY	Pioneer Natural Resources	10%	23.25
VLO US EQUITY	Valero Energy	10%	34.90
XOM US EQUITY	Exxon Mobil	10%	317.29

Source: Bloomberg, market cap & weighting data as of 7/19/2019. Index rebalances monthly to equal weight.

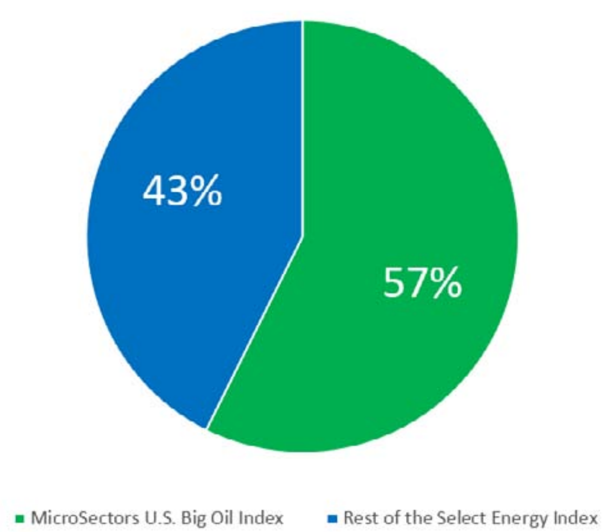
Laser focus on the names that lead the sector

Energy stock prices can be driven by numerous factors such as OPEC decisions, demand for oil, geopolitics, domestic legislation, and advancements in clean energy alternatives.

Investors and traders may face uncertainty when trying to pick which oil companies survive or perform the best due to outside factors or even company specific factors like oil spills. But if you do want to participate in this trade, the biggest, most highly traded names in the energy/oil sector may give you the play you're looking for.

While the 10-stock basket in the Solactive MicroSectors U.S. Big Oil Index constitutes roughly one-third of the Select Energy Index composition, they make up 57% of the social media velocity for that entire index. Social media velocity tracks the number of followers for each constituent across news and social media channels, such as Stocktwits, indicating both awareness and interest in the companies.

Social Media Velocity Comparison: MicroSectors U.S. Big Oil Index vs the Select Energy Index



Index constituents per Bloomberg 07/18/19. REX Social Velocity score based on number of followers for each constituent across news and social media channels such as Stocktwits.

Bottom Line

With the proposed merger between Anadarko and Occidental Petroleum, will there be more M&A activity in the space? Will oil prices continue to fluctuate? How will the current state of the geopolitical sphere affect how these companies move forward? Whether you have strong bullish or bearish view on the oil sector, the MicroSectors U.S. Big Oil Index provides an alternative tool for playing the energy sector.

This information is not intended to be investment advice. Past historical or hypothetical data is not a guarantee of future index performance. Please visit the MicroSectors website for guidance on available products linked to the Solactive MicroSectors U.S. Big Oil Index: www.microsectors.com/bigoil

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Scott Acheychek is President of REX Shares, LLC, distributor of MicroSectors™ exchange traded notes (ETNs) issued by Bank of Montreal. MicroSectors ETNs provide concentrated exposure to investable market segments that heavily influence many investor portfolios. Scott joined REX Shares in 2016 after holding senior sales and leadership positions at several large global investment banks. Scott covered hedge funds, asset managers, and financial advisors for multi-asset and commodity specific solutions. Since 2006, he has worked on the launch of 30+ ETNs and ETFs.

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[1]Beta is a measure of price variability relative to the market. [2]The Solactive High Yield Beta Index is a rules-based, systematic strategy index that provides exposure to a weighted portfolio of three different ETFs. The allocation to each US High Yield Corporate Bond ETF is changed every month to an equal weighting of all ETFs. The Index is calculated and distributed by Solactive AG and is calculated and published in US Dollars. One cannot directly invest in an index.

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Risks An investment in the Funds involve risk, including the possible loss of principal. The Funds are non-diversified and include risks associated with concentration which results from the Funds' investments in a particular industry or sector and can increase volatility over time. The Fund will invest a significant portion of its assets in securities rated below investment grade bonds that generally involve significantly greater risk of loss of your money than an investment in investment grade bonds. High yield bonds are considered more speculative than investment grade bonds and have a higher risk of default. Active and frequent trading associated with a regular rebalance of the fund can cause the price to fluctuate, therefore impacting its performance compared to other investment vehicles. For other risks including correlation, leverage, compounding, market volatility and specific risks regarding each sector, please read the prospectus.

Distributor for Direxion Funds: Rafferty Capital Markets LLC.

I don't want to lose half my money!

BEN REPPOND

LAST YEAR, WARREN BUFFETT TOLD BERKSHIRE Hathaway shareholders that "losses of 50% or more are not only possible, but inevitable in the future." Based on the context of the letter, his warnings seem to imply that he was looking at 2019 to 2020 as a period of high risk. He was not specific, but there was a reason he wrote this when he did.

Further, Scott Minerd, Guggenheim's Global Chief Investment Officer, also warned that the market is on a "collision course with disaster," and expects the worst of the damage to start in late 2019 and into 2020. His prediction is that we are in store for a wave of corporate debt defaults and a precipitous fall in equity prices – perhaps as much as 40% or more.

The US Treasuries just developed an "inverted yield curve." That is when yields on short-term Treasury bills, notes, and bonds are higher than long-term yields. Every time this has happened during the past 50 years, a recession has always followed, according to The Balance. This is not an encouraging sign for investors without a strategy to deal with it.

Further, Central Banks in Europe are now worried that Germany is headed into a recession. Since Germany is the leading economic force in Europe, and because of how intertwined Germany and Europe are with the United States, this is another indicator that there is likely trouble ahead for US investors.

I don't want to lose half my money. Nobody does. This is not only a personal statement, but also the echo from my clients about their money.

If any of this is true, how do I protect my money? Of course, I could just sell equities (and bonds) and put my money in money market funds for a while. The problem with this is that it is a knee-jerk reaction and then, when would I know to get back into the market to take advantage of potential gains, which usually follow crashes. This involves a level of clairvoyance that I do not have. I call it dart-throwing. If I am fortunate enough to be right on the exit, am I also fortunate enough to be right on when to re-enter the market? Likely not.

So, what is the answer? I believe that the answer is active investment management. Active investment management is not perfect on when to reduce or eliminate market exposure and it is not perfect on when to get back into the market. But each active manager seeks to do this to the best of their ability.

I suggest that the key is to be part of an active management methodology that you believe will minimize downside market risk and participate as much as possible in market advances when the market again resumes an upward climb. To measure the effectiveness of any investment strategy, one needs to look at the complete market cycle and ask these questions:

- How much risk am I taking to get the returns I expect to receive?
- How much loss (drawdown) will I likely experience?
- How long will it likely be until my money returns to where it started?
- Am I satisfied with my answers to the above questions?

These questions are designed to give the investor a starting place to ask about risk vs. return.

Perhaps a look at an active investment manager's historical patterns during previous periods of market risk will be instructive about how risk was handled in the past.

Multi-manager approach

Another way to minimize downside stock market risk is to diversify one's assets among multiple managers who provide many active management strategies. Rather than rely on a single manager's style, why not utilize a multiple manager approach? **Global View Capital Management** has a multi-manager platform that allows their advisors to design a custom allocation of multiple active managers whose combined strategies are used to manage client assets.

To the best of my knowledge, the Global View platform is perhaps the most comprehensive and technologically advanced platform of active investment management strategies in the investment industry. A multi-manager platform allows the advisor to help his or her client to diversify strategies – all of which can be designed to minimize downside market risk.

While Global View has a comprehensive approach, there are other multi-manager platforms that one can consider, such as **Atlas Capital Management** and **Portfolio Strategies, Inc.**

Back to dart-throwing

I am aware that many investment professionals worry that there is real economic and investment risk ahead – and perhaps closer than we know. Friends of mine who manage money for clients using a more conventional approach often ask me, "What do you think of the market?" This question gets asked in a nervous and anxious kind of way. What I think they are really saying is that "I don't know what is happening to the

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I don't want to lose half my money!

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market, but I am out there gathering opinions so I can get a sense about what others are doing."

I would be concerned if I had an investment advisor who was out there nervously asking for opinions about the direction of the market. If an advisor does not have a solid strategy on how to deal with serious market risk, the winds of the market will wreak havoc on them and their clients when the next serious stock market decline occurs. I call subjective decision making dart-throwing.

Conclusion

I know that active management is not the perfect solution in all situations to market risk. However, it is the best way I know to minimize stock market risk.

Ben Reppond is owner and founder of Reppond Investments, Inc., a registered investment advisor located in the Flathead Valley of Montana. Ben spent his career in the insurance business in Seattle, where he started and sold three businesses to public companies. After he sold his last company, he had money to invest. The financial advisors he spoke with all wanted him to put his money in the stock market. This felt too risky to Ben, and he did not take their advice. That decision sent him on a journey to find a way to manage money in such a way that he would not have to take unnecessary risk – a journey that included more than 15,000 hours of reading and research, to develop an active investment approach that minimized stock market risk. He enjoys helping clients grow their assets while protecting them as much as possible in all market conditions.

Trading the $VIX Futures Term Structure

LAWRENCE G. MCMILLAN

THE CBOE INTRODUCED THE VOLATILITY INDEX ($VIX) in 1993. The calculation of $VIX has changed a couple of times over the years, and due to the complexity of those calculations, $VIX itself cannot be traded. However, in 2004, $VIX futures were listed, followed in 2006 by $VIX options. $VIX futures are the underlying instrument for all of the Volatility ETN's and ETF's that exist today (VXX, for example).

There is a lot of information in the $VIX futures – primarily in their relationship to $VIX (discounts or premiums) and in their relationship to each other (the term structure). We use those two things to determine the "construct" of volatility derivatives – a stock market indicator that we track in our general Market Commentary in our newsletters. But in this article, we're not concerned with stock market *predicting* as much as we are in *trading* the market.

What is The Term Structure and Why Does It Slope?

The term structure of the $VIX futures refers to the price relationship that the futures have with one another. For example, an upward-sloping term structure generally occurs during a bullish stock market. The nearest-term futures would be the lowest-priced, then the second month futures would be slightly higher-priced, and the third month higher than both, etc.

The reason that the term structure slopes upward in bullish times has nothing to do with the futures market attempting to predict implied volatility. In fact, it's really just the opposite: due to the vagaries of attempting to predict where long-term volatility is going to be, market makers will price longest-term $VIX futures somewhere near the average of long-term volatility. But in a bullish market, volatility is low, so the near-term futures will be trading with a volatility that is below average.

This is an exceptional article from Larry McMillan, but too long for the Active Manager format. To make certain readers have access to the full article, it can be downloaded as a pdf by clicking Download Article to Continue

Understanding the Nuances of Sector Fund Exposure

GUGGENHEIM INVESTMENTS | UPCLOSE

NOT ALL SECTOR ETFS AND FUNDS ARE THE same. They can differ substantially in their market-cap breakdown, international exposure, style exposure, and weighting. These important factors can have a significant impact on portfolio construction and performance.

Sector investing can be a powerful tool in providing investors with opportunities to fine-tune or manage risk in their portfolios. It is rare for any single sector to be a consistent top or bottom performer year-over-year because different sectors tend to perform differently in various market conditions. Investors may choose to invest in certain sectors that they believe will outperform the market or choose to avoid certain sectors that they believe will underperform the market. Figure 1 shows how sectors have performed relative to the S&P 500® since 2013.

vary significantly. These different sector classifications, inclusion strategies, and weighting approaches may cause performance among sector funds to vary substantially. That is why, before investing in a sector fund, it is important to understand the methodology employed.

Not All Sectors Are the Same

Market sectors are a way to classify different stocks into common groups that may perform similarly in certain economic conditions. There are a number of different sector classification systems, which classify companies based on different criteria such as the markets served, revenue sources, or the products/services offered. GICS is one of the most well-known sector classifications, but a few other popular ones

FIGURE 1: GICS SECTOR PERFORMANCE VS. S&P 500® (2013–6.30.2019)

Source: Bloomberg, 6.30.2019. **Performance displayed is past performance and is no guarantee of future results.** Returns shown are subindex performance of the S&P 500®, representing the GICS sectors. Real estate was added as GICS sector on 8/31/2016. The referenced indices are unmanaged and not available for direct investment.

1 In September 2018, GICS created a new communication services sector, which combined the now defunct telecommunication services sector with parts of the information technology and consumer discretionary sectors.

Understanding sector exposure and construction has perhaps never been more important given the major sector changes that were introduced by the Global Industry Classification Standard (GICS) in September 2018—changes that resulted in 1,000 companies being reclassified globally. According to Morningstar, there are approximately 830 available sector funds and ETFs (as of June 30, 2019), so it may be a challenge to choose a sector fund that matches the needs of specific portfolios. Sector fund construction can vary significantly based on how companies are classified, whether they include global and/or domestic stocks, and which capitalization ranges might be included (large, mid, and/or small). With the emergence of smart beta and alternative weighting approaches, the weighting of stocks within a sector fund can

include the Industry Classification Benchmark, Bloomberg, and FactSet Revere Business Industry Classification System.

As Table 1 illustrates, a company's classification can vary depending on the sector methodology used.

TABLE 1: SECTOR CLASSIFICATION VARIATIONS

	Target	Walmart	Amazon.com	CVS Health	Netflix
GICS Sector	Consumer Discretionary	Consumer Staples	Consumer Discretionary	Health Care	Consumer Discretionary
ICB Industry	Consumer Services	Consumer Services	Consumer Services	Consumer Services	Consumer Services
Bloomberg	Consumer Staples	Consumer Staples	Consumer Discretionary	Health Care	Communications
FactSet RBICS	Consumer Non-Cyclical	Consumer Non-Cyclical	Consumer Non-Cyclical	Health Care	Technology
Guggenheim/ Rydex Proprietary Classification	Retailing	Retailing	Retailing, Internet	Health Care	Leisure, Internet

Source: Guggenheim, FactSet, Bloomberg, ICB, GICS 6.30.2019

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While sector classifications typically remain constant, recently there have been two significant changes in the popular GICS classifications. In 2016, real estate was carved out of the financials sector to reflect its increased importance. In September 2018, GICS made more substantial changes by creating a new communication services sector, which combined the now-defunct telecommunication services sector with parts of the information technology and consumer discretionary sectors. The new sector was created to demonstrate the changes in the way consumers communicate and access entertainment content and other information. Among the more notable changes:

- Facebook and Alphabet moved to communication services from information technology.
- Netflix and Walt Disney moved to communication services from consumer discretionary.
- EBay moved to consumer discretionary from information technology.

These sector changes underscore the need to understand how a sector strategy classifies companies. Certain companies, particularly ones with well-diversified lines of business or ones in emerging technologies or industries, can be difficult to pin down.

Guggenheim's philosophy on classification is that sector portfolios should be reflective of the broad economic performance of specific sectors. If a company is integral to the economic performance of more than one sector, then it should be included in all the relevant sectors.

For example, Amazon.com has a significant impact on retail, a strong online presence, and offers internet hosting services and web-based data and services. The case can be made for including Amazon.com in both retailing and internet sector funds, as Guggenheim does. GICS classifies Walmart and Target in different sectors (Walmart in consumer staples and Target in consumer discretionary). However, both of these companies compete directly in retail, and, accordingly, Guggenheim includes both Walmart and Target in the Rydex Retailing Fund.

Domestic or Global?

Sector categorization is the broadest way to deconstruct sectors, but there are many other considerations, such as geographic exposure (global, domestic, region-specific) or capitalization factors (large-, mid-, small-cap stocks). In today's globalized economy, as firms grow larger, it's not uncommon for them to become more and more exposed to markets outside of the United States. A case in point is the S&P 500® Index, one of the most common benchmarks for U.S. equities. The average stock in this index generates 32% of its revenues from outside the U.S. (as of June 30, 2019), according to FactSet. FactSet also reports that more than a quarter of index members earn less than 50% of their revenue domestically, demonstrating that even this well-known benchmark composed of U.S. stocks has a considerable global footprint and exposes investors to international markets.

Guggenheim believes it makes sense to look at sectors in holistic terms and include global exposures through international stocks that trade on U.S. stock market exchanges, such as American Depositary Receipts. For example, including Unilever in the consumer products sector and Novartis in the health care sector may provide a truer sector exposure than excluding them.

Guggenheim includes international stocks in its sector classifications because it believes that a global frame of reference can be beneficial to help create a purer sector definition.

Does Company Size— Large, Mid, Or Small—Matter?

A sector index's starting universe can have a significant effect on composition and performance. For example, if the sector is solely selected from the S&P 500, it will be dominated by large-cap stocks and may miss opportunities in smaller stocks or international stocks. Guggenheim believes a more inclusive approach is appropriate and includes companies from various cap ranges in its sector strategies. Table 2 shows the market capitalization and international exposure composition of Rydex Health Care Fund compared to two popular health care indices (percentages indicate the relative composition of stocks from each category).

TABLE 2: Health Care Capitalization and International Exposure Comparison

	Rydex Health Care Fund	S&P 500® Health Care Select Sector Index	MSCI US IMI Health Care 25-50 Index
S&P 500®	55%	100%	16%
S&P MidCap 400	16%	0%	9%
S&P SmallCap 600	1%	0%	17%
Other U.S.	22%	0%	55%
International	6%	0%	2%

Source: Guggenheim, Bloomberg, 6.30.2019

Watch Your Weight

In traditional sector portfolios, stocks are weighted by market capitalization, which can result in overweighting or dominance by the largest stocks. In the past decade, smart beta has become a popular way to create investment strategies for many areas of the market, including sectors. Smart beta generally refers to any strategy that differs from a conventional market-cap-based weighting. Some sector funds use equal weighting to limit the size bias. Others may use factor weighting techniques, such as dividend yield or momentum scores, to weight stocks.

Cap-weighting provides a representation from a business landscape perspective, with larger stocks getting larger

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weights, whereas equal weighting provides a good representation of an investor's opportunity set with all stocks equally able to contribute to performance. Guggenheim's modified cap-weighted approach, which, in general, takes the square root of each company's market capitalization, acts as a midpoint between these two perspectives, allowing the market leaders to retain the most influence without unduly dominating the sector and negatively impacting diversification. For more than 15 years, Guggenheim has used this approach as a basis for its Rydex sector funds because we believe it reduces stock-specific risk and broadens sector exposure.

Table 3 shows a hypothetical example of the differences in weights between the top 10 S&P 500 Energy Index allocations, based on market capitalization, equal weight, and modified market-capitalization methodologies.

TABLE 3: Energy Sector Weighting Comparison

	Weighting Scheme		
Stock	Market Cap	Modified Cap	Equal
Exxon Mobil Corp	25.71%	11.02%	3.45%
Chevron Corp	18.80%	9.42%	3.45%
ConocoPhillips	5.47%	5.08%	3.45%
EOG Resources Inc	4.37%	4.54%	3.45%
Schlumberger Ltd	4.29%	4.50%	3.45%
Occidental Petroleum Corp	3.75%	4.21%	3.45%
Marathon Petroleum Corp	3.36%	3.99%	3.45%
Phillips 66	2.98%	3.75%	3.45%
Valero Energy Corp	2.94%	3.72%	3.45%
Kinder Morgan Inc/DE	2.83%	3.66%	3.45%
Weight in the Top 10 Stocks	**74.50%**	**53.88%**	**34.48%**
Weight in Remaining 20 Stocks	**25.50%**	**46.12%**	**65.52%**

Source: Guggenheim, Bloomberg, 6.30.2019

Bottom Line: No Two Sector Funds Are Alike

Not all sector ETFs and funds are the same and they can differ substantially in their market-cap breakdown, international exposure, style exposure, and weighting. All of these factors impact performance and how the sector strategy will be integrated into the overall client portfolio. Understanding the nuances of a sector fund's security selection process can result in a better outcome for meeting portfolio risk-return objectives.

Ryan Harder, CFA, is a Managing Director and Portfolio Manager at Guggenheim Investments. He leads a team of portfolio managers responsible for managing tradable Rydex funds, as well as select alternative funds. He is a member of the investment leadership team and sits on the credit review committee.

Adrian Bachman, CFA, is a Portfolio Manager at Guggenheim Investments. In addition to managing portfolios, Mr. Bachman conducts research on various quantitative equity strategies.

President's Letter

CONTINUED FROM PAGE 1

their investment style – with stock selection approaches and sector rotation strategies in the spotlight on Sunday.

In addition to holding a great conference for existing members, NAAIM is focused on growing attendance at our conferences. NAAIM is a great resource for active managers and we need to get the word out. And it's not just because of the conferences. If you are not active on the NAAIM members-only forum board, you need to take some time to follow the conversations and ask your own questions. It's a great tool for feedback. There is also the NAAIM Indicator Wall, the NAAIM Exposure Index, NAAIM Speaks with blog postings from the membership, and much more. If you are not familiar with these benefits, visit the NAAIM website at www.naaim.org. To get a password for the Forums Board, contact our administrator – Susan Truesdale – at info@naaim.org.

This is a very challenging time to be an investment advisor. Clients watch the market going up and they want market performance. But at the same time, they don't want the risk. Managing expectations is critical. What have other members found to be effective ways to do so? You can't get the answer unless you are active in the association. Attend the conferences. Participate in the bulletin boards. Utilize the NAAIM online resources. Develop personal relationships with fellow members. NAAIM is my business' most influential resource. I hope you will make it yours as well.

Have a great fall and I look forward to seeing you at Dallas/Fort Worth for the 2019 NAAIM OUTLOOK Conference.

Matthew Spangler
2019-2020 NAAIM President

Platinum Sponsor ProFunds and NAAIM to Host October Webinar

Tuesday, October 15 at 4:15pm EST

Leveraged Funds with Insights and Applications from Nasdaq Dorsey Wright

LEKS GERLAK, CFA, TACTICAL INVESTMENT Strategist, ProShares | ProFunds and Ben Jones, Senior Analyst, Nasdaq Dorsey Wright will review fundamentals of leveraged funds, including the one-day investment objective, impact of compounding, and rebalancing considerations over time as well as relative strength methodology and how it can be used to analyze funds, such as the ProFunds sector lineup. They will also explore ways in which relative strength can be used to construct sector rotation strategies with ProFunds and how to incorporate these strategies in tactical portfolios.

Register for the Webinar:
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