The Active Manager

Quarterly Journal of the National Association of Active Investment Managers

Vol. 17 Issue 1, Feb. 2020

INDEX

Uncommon Knowledge CONFERENCE 2020

Uncommon Knowledge 2020 Comes to Tampa, Florida, Sun., May 3–Wed., May 6

Plan to arrive early for NAAIM's 2020 Uncommon Knowledge Conference to take advantage of pre-conference activities on Sunday, May 3, including:

- The annual NAAIM Classic Golf Tournament
- NAAIM Solo Advisor's Meeting
- Sunday evening Welcome Reception
- Followed by the NAAIM Active Investing Strategy Competition Finals (see more about the competition on page 3)

On Monday, May 4, it's full speed ahead with conference activities and an outstanding line-up of presenters with insights essential to the success of investment advisors taking an active approach to investment management.

It's all happening at The Westin Tampa Waterside in Tampa, Florida. For more information on speakers, agenda highlights, hotel accommodations and what to do in Tampa, keep reading this issue of *Active Manager* and watch out for email updates from NAAIM.

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

NAAIM
6732 W. Coal Mine Ave., #446
Littleton, CO 80123
888-261-0787
info@naaim.org
www.naaim.org

President's Letter


Matthew Spangler

HAVE YOU EVER BEEN ASKED, what was the best NAAIM conference you have attended? My answer is inevitably, the last one.

At every NAAIM conference you meet more people and build more relationships with like-minded advisors. Then when the next conference rolls around, there's more friends to greet, new people to add to your resource file and information to build on from prior conferences. I think that is why many of the attendees at the November NAAIM OUTLOOK conference said it was one of the best conferences they have been to.

I thought we also had some remarkable speakers at OUTLOOK. Katie Stockton's presentation, Using Market Internals and Technical Outlook, was exceptional. Doug Ramsey, Chief Investment Officer and Portfolio Manager with The Leuthold Group, LLC, always has great information to share, as did Michael Wheater with Splicer Technology, LLC, Draye Redfern of Buzz and other speakers. The core of the OUTLOOK agenda, however, is the exchange of information among members through panel discussions, round tables and audience participation. That really makes OUTLOOK an incredible experience.

The 2019 OUTLOOK Conference also introduced a new approach to the NAAIM Active Investing Strategy Competition – i.e. Shark Tank. The competition featured two strategy categories and was held Sunday evening prior to the conference. It really set the stage for ongoing discussions of investment strategies throughout the two days.

We are going to try the Sunday time slot again at the NAAIM 2020 Uncommon Knowledge Conference coming up Sunday, May 3 through Wednesday, May 6 in Tampa, Florida. The NAAIM Active Investing Strategy Competition will be held Sunday evening at 6:30 pm at The Westin Tampa Waterside in Tampa. The competition will again feature strategy categories to create a fairer playing field for the participants.

NAAIM also has a new sponsor for the Shark Tank competition – Hidden Levers. We will be able to utilize their software to scorecard the presentations and dig a little deeper into the numbers of the strategies. Guest judges will be part of the event this year, bringing outside input to the competition.

Sunday's schedule also includes the NAAIM Golf Classic, the Solo Advisors Meeting from 4 to 6 p.m. and an evening reception. So make certain you plan your schedule to be in Tampa on Sunday, May 3 and start off the Uncommon Knowledge Conference at top speed.

The agenda for Uncommon Knowledge 2020 is shaping up to be a very strong one. You'll find introductions to a

continued on page 9

On the Uncommon Knowledge Agenda

Greg Morris is Welcomed Back to the Uncommon Knowledge Podium

Gregory L. Morris has been a technical market analyst for 45 years and a long-time member of NAAIM. At one point, he oversaw the management of more than $5.5 billion in assets in six mutual funds, separate accounts and retirement plans. After a short-lived attempt at retiring in 2014, during which he completed his fourth book, Investing with the Trend – A Rules-based Approach to Money Management, published by John Wiley under the Bloomberg Press label, he returned to the working world as a consultant in the field of technical analysis and money management. Greg is a Senior Advisor to McElhenny Sheffield Capital Management and Chairman of Stadion Money Management, LLC's Board of Trustees. He also writes a blog for StockCharts.com called *Dancing with the Trend* and plays lots of golf.

Greg is a noted spokesman on the merits of technical analysis and utilizing a technical rules-based trend-following model. Among his published works are three books with McGraw-Hill; The Complete Guide to Market Breadth Indicators, a third edition (original edition in 1992) to his best-selling and vastly expanded "Candlestick Charting Explained, released in March 2006, and Candlestick Charting Explained Workbook, which was published in December 2011. His latest book, Investing with the Trend – A Rules-based Approach to Money Management, explores the flaws of modern finance, research on risk and trend analysis, and how to build a rules-based trend-following model. Greg also produced Japanese Candlestick Pattern Recognition software for MetaStock, an add-on package that not only offers automatic identification of real patterns but provides a sophisticated trend analysis measure and automatic support and resistance identification.

Managing risk in high stakes ventures has been a part of Greg's life since he first earned his pilot's license in 1967. Greg was a "Top Gun" Navy pilot for seven years, flying the T2-C Buckeye, A-4J Skyhawk, and his favorite military jet, the F-4J Phantom. While in the Navy, he logged over 240 carrier landings (103 at night) and exceeded two times the speed of sound. From 1978 to his retirement in 2004, Greg was a Captain for Delta Air Lines flying the Boeing 727, Lockheed L-1011, McDonald Douglas MD-88, MD-90, Boeing 757, Boeing 767, and his favorite airliner, the McDonald Douglas MD-11 (maximum takeoff weight = 625,000 pounds). Over 37 years of flying, he accumulated 21,000 hours of flying time, and as he likes to say, never put a scratch on an airplane.

Julie Littlechild – Creating a Compelling Client Experience

Julie Littlechild has been identified twice as one of the 25 Most Influential People in Financial Planning by *Investment Advisor Magazine* and won the Influencer Award in Practice Management from *Financial Planning Magazine*. Her expertise as a speaker, writer and researcher, is helping advisors, teams and enterprises gather client feedback and design a compelling client experience that will drive significant engagement, revenue and referrals.

Julie has worked with and studied successful financial advisors and their clients for more than 25 years. Prior to founding her firm, Absolute Engagement, she launched and ran one of the industry's leading research firms, focused on client engagement. Julie is the author of a popular blog, the co-host of the Becoming Referable podcast, author of The Pursuit of Absolute Engagement and a former member of the national board of the Financial Planning Association.

Rob Hanna Offers Quantifiable Edges for Active Investing

Since Rob Hanna began utilizing quantitative analysis in 2004, he has published thousands of studies related to market action and indicators. At Uncommon Knowledge 2020, he will share many of his favorite studies from his years of research, and his favorite indicators, including some that he developed. You'll learn the concepts Rob finds most important for the strategies he employs, and he'll demonstrate the power of combining strategies when attempting to make more efficient use of capital, increase profits, and contain drawdowns.

In 2001, Rob founded Hanna Capital Management, LLC, where he has served as president since that time. In 2003, Rob began publishing market and trading ideas in one form or another and in 2008, founded Quantifiable Edges, where much of his research can be found. There he shares research related to breadth, volume, sentiment, volatility, Fed-induced liquidity, seasonality, price action and anything else he observes that could provide a trading edge. Rob is also active on Twitter under the handle @QuantEdges. In 2019 Hanna Capital Management teamed up with Eastsound Capital Advisors, LLC to offer many of Rob's short-term trading models to clients through separately managed accounts.

continued next page

On the Uncommon Knowledge Agenda

CONTINUED

Tom Giachetti Presents the Latest Compliance Traps for Financial Advisors

For many years, Thomas D. Giachetti, chair of the Investment Management and Securities Practice Group of Stark & Stark Attorneys at Law, has been a frequent speaker at Uncommon Knowledge and his presentations never disappoint. A former investment banker and NASD registered representative, Tom's legal practice is devoted to investment-related matters, including the representation of investment advisors, financial planners, broker-dealers, public and private investment companies, CPA firms and registered representatives throughout the U.S.

Tom spotlights the latest hot buttons for the SEC and FINRA compliance reviews, legislative and regulatory changes industry trends and steps to stay out of compliance trouble. His daily contact with legal issues faced by the investment advisory industry gives him unique access to the latest trends and the people impacting the industry.

WELCOME - UNCOMMON KNOWLEDGE 2020 SPONSORS

GUGGENHEIM

Direxion
ETFs | Funds

Bridge

ThetaResearch
...because nothing beats actual verified performance.

Founders Award Winning Paper Presentation

Among the closing programs on Wednesday will be a presentation of the winner of the 2020 Founders Award for Advances in Active Investment Management white paper competition. Now in its 11th year, the competition has resulted in both novel and break-through papers.

Look for more great presenters and more fun on tap at Uncommon Knowledge 2020 in upcoming emails and newsletters. For more information on pricing and options, see the registration form at the end of the *Active Manager*.

Save Your Spot at The Westin for Uncommon Knowledge 2020

NAAIM'S UNCOMMON KNOWLEDGE 2020 conference will be held at The Westin Tampa Waterside, 725 South Harbour Island Boulevard, Tampa, Florida. Located within steps of the Tampa Convention Center near the Florida Aquarium, Sparkman Wharf, Amalie Arena, Tampa Riverwalk and Raymond James Stadium, the hotel offers newly renovated accommodations with residential-inspired floorplans, modern essentials, plush furnishings and signature amenities.

Reserve your room online today at The Westin Tampa Waterside.

10 Macro Themes to Watch in 2020

Guggenheim's Macroeconomic and Investment Research Group analyze the 10 macroeconomic trends likely to shape monetary policy and investment performance this year.

To access the full report, visit GuggenheimInvestments.com/10-macro-themes-to-watch-in-2020

Preliminary Rounds are Underway for the 2020 NAAIM Active Investing Strategy Competition

DO YOU HAVE A PROVEN INVESTMENT STRATEGY IN one of the following categories?

- **Active Bond/Fixed Income Strategies** - Investing strategies utilizing an actively managed approach to the Bond/ Fixed Income markets.
- **Active Stock Selection Strategies** - Investing strategies that apply active "selection alpha" to a portfolio of individual equities.
- **Strategic Allocation Strategies** - Investing strategies employing an actively managed, strategic approach to asset allocation.
- **Tactical Stock Market Strategies** - Investing strategies utilizing a tactical approach to the management of the U.S. stock market. Note that leverage is limited to 2X for this competition.
- **Alternatives Strategies** - Investing strategies applying active management techniques to alternative asset classes or utilize an alternative approach to managing traditional asset classes.

If your answer is "Yes" and you have not entered the 2020 NAAIM Active Investing Strategy Competition (i.e. the NAAIM Shark Tank) you could be passing up an opportunity to have your strategy receive live distribution and promotion on a TAMP platform* and win $1,000 along with other benefits.

There's still time to enter the preliminary competition to be a finalist and compete in front of a live audience at the NAAIM Uncommon Knowledge Conference - Sunday, May 3, 2020, 6:30 p.m. at The Westin Tampa Waterside in Tampa, FL.

How to Apply:

ASAP - Submit NAAIM Investing Strategy Preliminary Competition Application

February-March 2020 – Complete an online GoToWebinar 7-minute presentation (this is a hard deadline) to the NAAIM Investing Strategy Committee - will be recorded. Q&A session with committee members may be conducted during presentation or at a later date. Download application and rules from the NAAIM.org website.

https://www.naaim.org/programs/naaim-shark-tank/

Note: NAAIM Membership is required to participate in the live NAAIM Active Investing Strategy Competition Finals.

* 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.

Strategy Categories for the November 2019 Shark Tank Competition – Stock Selection and Sector Rotation

FIRST PLACE WINNERS FOR THE NOVEMBER 2019 NAAIM Shark Tank Competition were Bill Davis, Managing Director, Stance Capital LLC and John Worthington with Dauble+Worthington Equity Portfolios. Bill took top place in the Stock Selection Strategy category with his firm's Stance Equity ESG Large Cap Core, while John's D+W Sector Rotation was named the top Tactical Stock Market Strategy at the competition held in Dallas, Texas, on Sunday, November 10, 2019.

The November 2019 event marked the first competition in which strategies competed based on investment approach. "When we looked at the active investment strategies that have competed in the Shark Tank over the last five years, there were distinctly different approaches and performance goals, which made judging a bit like comparing apples to oranges," explained Dave Moenning, chair of the Shark Tank Committee and winner for the 2018 Shark Tank Competition. "By grouping investment strategies by type of approach, the competition drills down to superior strategies within specific investment niches."

The winning Stock Selection Strategy - **Stance Equity ESG Large Cap Core** - is an actively managed quant strategy focused on members of S&P 500 that offer compelling financial fundamentals and off balance sheet outperformance relative to industry group peers on material risk factors relating to environmental, social, and governance risk factors. Stance Equity's objective is to outperform benchmarks on both absolute and risk-adjusted returns, while at the same time demonstrating significant impact with respect to lower carbon profile and higher "green" product and service revenues. Notably, the strategy does not hold fossil fuel, tobacco, and weapons. Stance **Capital** is a Massachusetts-based Registered Investment Advisor, serving individuals, families, endowments, and institutions. The firm also builds products for other investment firms under research and sub-advisory agreements.

First place in the Tactical Stock Market Strategy category - **D+W Sector Rotation** - is an aggressive growth focused tactical sector rotation strategy. It seeks capital appreciation in rising markets as well as capital preservation during

continued on page 10

OUT OF LEFT FIELD: Market Risk vs. Business Risk

TIM PARKER

WE'VE ALL HEARD THE SAYING "OUT OF LEFT field," meaning 'unexpected' or 'surprising.' It's an idiom from the sport of baseball, where it refers to a play in which the left fielder throws the baseball all the way to first base, or home plate, surprising the runner. In our business, we're used to things coming out of left field—uncertainty is the underlying reality of all markets, and it's something we all must manage as market participants. This article will highlight the key difference between the kinds of risk that you manage for clients (market risks), and risks to the advisory business model itself (RIA business risks).

As an advisor, you help your clients manage and navigate uncertainty in the markets. When things come out of left field, as they always do (and will) in markets, it's you that's responsible for stepping up to the plate with sage counsel in the face of threatening uncertainty. **Market risk** takes many forms, and you are expected to have antidotes and answers for all of them as you design client portfolios with painstaking rigor in the face of the unexpected. That task is your responsibility, your passion, and your livelihood.

But **business risk**—fiduciary risk—is a separate form of risk. Fiduciary risk is that risk transferred from clients to the fiduciary that stewards their capital. Fiduciary risks are threats to the RIA entity itself. The most significant and severe form this can take is a lawsuit from a client claiming that there has been a breach of fiduciary duty.

Many people believe that the greatest drivers of fiduciary risks are mistakes made by advisors themselves, or by defects in process or practice. **In fact, fiduciary risk is much more closely correlated with the market environment than errors or negligence.** There is a lot of data on this (we know, because we've been tracking it for years), and the data is indisputable. What it indelibly illustrates is that there is a clear and direct inverse correlation between equity markets and breach of fiduciary duty lawsuits. These fiduciary breach lawsuits spike when the market becomes corrective, and subside when it is tranquil.

The interesting thing about this relationship from a fiduciary risk perspective is that this is an independent variable from of the quality of the advice you give clients on a day to day basis. In other words, we know and trust that you know how your clients' portfolios will do in an adverse market environment. The question becomes, how can you make sure your *business* will thrive in an adverse market environment?

Now, it's important to say that speaking broadly, we could divide money managers into two camps. The first, and more traditional camp, is positioned opportunistically for an appreciation of the major asset classes (primarily equities) and must thoughtfully "endure" volatility events on the path to these rewards. The second, and more tactical camp, takes some version of the inverse stance—positioned opportunistically for a volatility event, but prepared to underperform the market in the event of a slow, stubborn grind up. If you are one of these managers, volatility is your opportunity to shine, while others are fearful.

The salient question for the first camp is obvious—what is your plan for the kinds of volatility events we can almost certainly expect from a late-stage bull market? If a volatility event will be a setback (and it stands to be a setback if you have participated in the last two years' gains) then the question is—how will you protect the last two years' gains? How do you *keep* them?

The question for the latter camp is more subtle, but just as salient—if you are or have been positioned for a volatility event, and you stand to benefit from it, that's great—but how did you navigate the last two big up years? What is your plan moving forward?

Here is the most important thing to know about the source of fiduciary risk with your clients: **capital is not the only casualty of a drawdown—communication suffers too.** This is a reality of behavioral finance that is too frequently overlooked. Client communication is often the first casualty of a pressurized financial reality, like volatility, underperformance, or a drawdown. Communication warps under the pressure and urgency of threats, and assumptions that seemed foundational are questioned. The weakest links of your clients' understanding of your roles and responsibilities will be tested in these situations, and these communication breakdowns and misunderstandings can take many forms. Interestingly, one of the most frequent forms they take isn't a client claiming their advisor is guilty of some gross negligence, but something more subtle, such as that they were underprepared for opportunity, or failed to capture gains or avoid turbulence in the market. Perhaps a third party, that doesn't know the advisor and the advisor can't communicate with, is whispering in the client's ear that they received bad advice, or that an opportunity was squandered.

In summary—breach of fiduciary claims are infrequent, but very severe. These claims are tied to the overall market environment (specifically volatility) and *not* the quality of your advice or stewardship of client assets. You have a plan for market risk, and that risk management drives every portfolio and plan you design for your clients. How do you manage fiduciary business risks?

Things come out of left field. Your portfolios are built to handle them.

Is your business?

Tim Parker is the Relationship Manager at Box Professional Insurance. He spent years as an investment advisor in a diverse array of capacities and has a keen understanding of the advisory space. Tim can be reached at Tim.Parker@BoxProInsurance.com

Tech Stock and Index Trading Has Changed

SCOTT ACHEYCHEK

TWO DECADES AGO, DURING THE "DOT-COM" bubble, traders craved the volatility of high-flying speculative tech startups like Amazon, boo.com, and pets.com. Unlike many pre-Y2K internet-enabled companies, Amazon survived and became a global behemoth of e-commerce, cloud computing and entertainment that traders still flock towards.

As the tech sector has matured, so have traders. They want a combination of growth and stability, not just speculative fervor about the future. Unlike tech companies of the past, the modern technology titans offer stability in their current business segments while simultaneously innovating and disrupting new markets to stoke future growth.

Facebook, Amazon, Netflix, and Google (now Alphabet) make up the infamous "FANG" acronym which serves as a representation for today's biggest innovators and leaders in the market. Many add a second 'A' in FANG to make it "FAANG" in order to include fellow technology titan, Apple. The five companies dominate industries like cloud computing, e-commerce, online search, mobile phones, advertising, streaming, social media and have entered spaces like autonomous driving and artificial intelligence. These companies are the biggest and best at what they do.

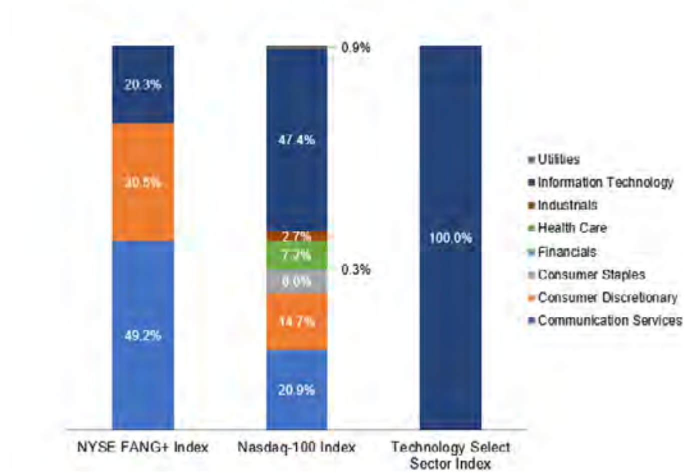
Tech Sector Index landscape: Know before you trade

The Nasdaq-100 Index and the Tech Select Sector Index are popular technology indices that many consider to be benchmarks of tech. However, if you do a deep dive on both indices, we argue that neither fully represent the tech landscape.

Companies like Pepsi, Comcast, Starbucks, Costco, and Charter are all top 25 holdings of the Nasdaq-100 Index. When you think of technology innovation, things like coffee, potato chips, and cable boxes don't really come to mind. Over the years, bigger and more established companies have left other exchanges or have listed directly on the Nasdaq, which in the early 2000's was predominately home for technology companies. As a result, the Nasdaq-100 Index now looks quite different than in years past. In the chart below you'll see the Nasdaq-100 Index includes sectors such as Consumer Staples, Financials, Health Care, and Industrials.

NYSE FANG+ versus Benchmark Indices

GICS sector weightings as of 12/31/2019



Source: Bloomberg, index data as of 12/31/2019.

Based on the above Global Industry Classification Standard (GICS) weighting, the Tech Select Sector Index may seem like a great alternative to the Nasdaq-100. However, that may not necessarily be the case. Facebook and Alphabet, two of the largest tech companies in the world, aren't in the Tech Select Sector Index, but Visa and Mastercard are top 4 holdings.

continued next page

Technology Select Sector Index

Company Name	Wgt %
Apple	19.7%
Microsoft	19.3%
Visa	5.2%
Mastercard	4.3%
Intel	4.2%
Cisco	3.3%
Adobe	2.6%
Nvidia	2.3%
Accenture	2.2%
Paypal	2.0%

Communications Select Sector Index

Company Name	Wgt %
Facebook	19.3%
Alphabet Cl A	11.2%
Alphabet Cl C	11.1%
Netflix	4.8%
Comcast	4.5%
AT&T	4.5%
Charter Communications	4.5%
Activision Blizzard	4.5%
Verizon	4.4%
Walt Disney	4.3%

Source: Bloomberg, data as of 12/31/2019. Top 10 names of Technology Select Sector Index and Communications Services Select Sector Index on 12/31/2019. Highlighted companies are members of NYSE FANG+ Index.

CONTINUED FROM PAGE 7

To understand, you need to go back to the creation of the GICS: September 28th, 2018. GICS is a structure launched by MSCI and S&P Global which impacted technology classifications. After reviewing the landscape of the market, GICS extended the telecommunications services sector to include media and entertainment firms from the consumer discretionary sector and internet companies from the information technology sector. This new telecommunications sector was renamed to the communication services sector. As a result, Facebook, and Alphabet exist within the communication services sector instead of the information technology sector.

Further, it is worth noting that Amazon and Alibaba, global leaders in e-commerce and cloud computing, also don't exist in either the Tech Select Sector Index or Communications Services Select Sector index.

The Technology Select Sector index, which some would consider a benchmark for technology, is missing the world's largest companies involved in social media, online search engines, advertising and streaming services. The Technology Select Sector index does not include Facebook, Alphabet, Amazon, or Alibaba but it does have allocations to Visa, Mastercard, Accenture and Fidelity National Information Services, Inc due to their Information Technology classification. The NYSE FANG+ index has the most innovative firms from the Nasdaq 100 and from both 'Select' indices mentioned in the charts on the previous page.

NYSE FANG+ Index versus Benchmark Indices since September 2014

Source: Bloomberg, index data as of 12/31/2019.

NYSE FANG+ Index Description & Holdings:

NYSE FANG+ Index

Company Name	% Wgt
Apple	10.0%
Amazon	10.0%
Alibaba	10.0%
Baidu	10.0%
Facebook	10.0%
Alphabet	10.0%
Netflix	10.0%
Nvidia	10.0%
Tesla	10.0%
Twitter	10.0%

Source: Bloomberg, index holdings, & weighting data as of the close of 12/20/2019 (last rebalance date). Index rebalances quarterly to equal weight.

The NYSE® FANG+™ Index includes 10 highly liquid stocks that represent the top innovators across today's technology and internet/media companies. The index's underlying composition is equally weighted across all stocks, providing a unique performance benchmark that allows for a value-driven approach to investing.

A new Benchmark Index for Technology?

The NYSE® FANG+™ Index represents the most innovative names in the present day that many know and use, as well as the names that are trying to drive the new economy of the future. It features the names that many know and follow in the technology sector. They are some of the most traded and followed names in U.S. equity markets.

Scott Acheychek 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 over 50 ETNs and ETFs. Scott graduated from Sacred Heart University with a B.S. in Mathematics.

President's Letter

CONTINUED FROM PAGE 1

number of our speakers on pages 2 and 3 of this newsletter, with more to come as we finalize the agenda.

An important part of every NAAIM conference is our sponsors. These companies bring new products, services and ideas to every conference and through their sponsorship fees help keep costs down for attendees. I would like to encourage everyone to help us bring in new sponsors. If there is a firm you are working with that you believe is a good fit for the membership, sponsorship materials are available from Susan Truesdale and board members are available to help you sell the value of a NAAIM relationship.

Another change for NAAIM is a new association management system that will make it easier for the association to communicate with members, register attendees for events and make resources available to the membership. We are transitioning into the new system and should have it fully up in the coming months.

In our continuing effort to grow awareness within the investment advisory community, we will have NAAAIM representatives at the CMT 2020 Symposium in April in New York City. Over the years, NAAIM has built a great relationship with the CMT and we want to continue to foster that synergy. The theme of the 2020 CMT conference is *Navigating the GAP: Applying Technical Analysis to Modern Challenges*. The conference will explore the impact of applying technical data to solve today's biggest market questions. For more information on the event, click on the conference ad and it will take you to the landing page.

2019 ended up being a decent year for the market and I am hopeful we will see another good year in 2020, although it will continue to have its up and downs, particularly with the election and geopolitical issues ahead. I have been amazed by the resiliency of the market and how it continues to go up. The challenge is capturing that strong upward movement yet keeping an eye on potential corrections. Active management provides the framework to be ready to be defensive but still capture as much upside as you can. I really can't imagine managing client assets without that structure to manage risk.

May is going to be here before we realize it, so let me close by saying how much I look forward to seeing everyone again in just a few months, reconnecting with old friends, meeting new members, networking and learning from our speakers.

Have a great close to winter and a very good spring ahead.

Sincerely,

Matt Spangler

Sponsors Sought for Uncommon Knowledge 2020

NAAIM OFFERS A WIDE RANGE OF SPONSORSHIP opportunities from one-day Innovation Sponsorships for small firms to our top Platinum Sponsorship opportunity, which includes sponsorship of the fall NAAIM OUTLOOK Conference. Uncommon Knowledge sponsorship is a unique opportunity for firms to offer products to and create visibility in the active investment community, as well as learn from our members how to best serve this growing marketplace.

A matrix of sponsorship levels and benefits is available in the attachments at the end of this newsletter. If you work with companies you believe will benefit from exposure to the NAAIM membership, please share our Sponsorship brochure with them and encourage their participation. For more information or sales support, contact NAAIM administrator Susan Truesdale or any of the NAAIM Board members.

Hallmarks of a Good Backtest

PJ DUWORS

Introduction

Backtesting involves applying an investment approach to past data and seeing how it would have performed. Despite legal disclaimers about past performance not being indicative of future performance, that is exactly the point. You are trying to find something that would have worked and will continue to work. And whether you are developing your own systematic strategy or evaluating another's, it is critical to make sure the backtest is legitimate. Even the best-intentioned managers can find themselves in a bind (financially or legally if they have been marketing a flawed backtest) by falling into some common traps. Mistakes are unavoidable for the novice though, so ideally you should paper trade strategies until you have several attempts under your belt. For those that don't have to learn the hard way, here are some tips.

Keep it Simple

You should always start with an intuitive theory that you want to test. It could be based on some observation of investor behavior or even academic research about corporate earnings. You should be open to making new discoveries along the way but be careful not to create too many exceptions to the rules. The mistake you are trying to avoid is called "overfitting". Anyone can find a strategy that would have worked in the past if they use enough variables and "fit" the strategy to the data. There is very little chance such a strategy will work going forward. Simplify your approach as much as possible and avoid a lot of bells and whistles.

Don't Cheat

Another common mistake is called "peeking". It involves assuming you would have been able to trade in the past with information that wasn't available at the time. Earnings data, for instance, has a lag to it. Also, a strategy that attempts to trade at a turning point has to predict that turning point without the benefit of hindsight. Similarly, running a regression over a certain timeframe and then using the results to test a strategy over that same timeframe is a form of peeking called "in-sample testing."

Data

This is pretty obvious, but make sure you have a quality data source and enough data to test your strategy over multiple market cycles (if possible). Given the length of the current bull market, that means you need a backtest that goes back 20+ years. You also need to consider trading costs, financing, liquidity, bid-ask spread, and market impact of your trading.

Check Yourself

It is very easy to get excited when you think you've developed a strategy that beats the market. Take a step back and give yourself a reality check. Ask yourself, "why does this work?" Too many researchers don't care. They just want to make money. It is vital to understand why your strategy works for a few reasons: 1) you need to deeply believe in your strategy, 2) you need to explain it to potential investors, and 3) you need to know what developments could make the strategy obsolete. In addition to understanding the "why", you need to make sure the strategy is robust. Small tweaks to variables should not break it. There should be a range of settings that result in similar performance.

Validation

Of course, paper trading and, even better, live returns are helpful in validating your backtest, but returns are usually pretty volatile. Just because the strategy has a rough first year, doesn't mean mistakes were made. Yes, a large unexpected drawdown or a multiple standard deviation move is a red flag. However, absent those, the best indicator that a backtest was done properly is actually volatility. Volatility tends to be pretty stable, so if you expect 6% volatility from the backtest but are realizing 10% after several months, something is wrong.

Conclusion

A strong backtest is step #1 in developing a high-performing quantitative strategy, but it doesn't end there. Investors don't want a black box and managers don't want to give away the secret sauce. That's where discussions around backtesting can bridge the gap. A manager that can speak to the above issues can earn trust and alleviate concerns. Best of luck!

PJ DuWors is a former engineer who has worked in quantitative finance at several investment banks since 2006. In 2015, PJ founded Q32 Capital Management to put into practice quantitative strategies he had been developing for a decade. PJ holds a BS in Mechanical Engineering from the University of Notre Dame and an MBA from UCLA Anderson.

Strategy Categories for the November Shark Tank Competition CONTINUED FROM PAGE 5

extreme market losses. The model follows proprietary trend and relative strength indicators and seeks to achieve its investment objective by investing in specific mutual funds in the ProFunds Ultra Sector series which include leverage. It may invest in and may shift frequently among these funds and money markets. Manager Dauble+Worthington Equity Portfolios (D+WEP) is a Registered Investment Advisory firm (RIA) located in Evansville, IN. The firm specializes in tactically allocated, trend-following investment programs that focus on risk control while striving for absolute and relative price performance.

NAAIM Active Investing Strategy Competition Rules

The Premiere Active Investing Strategy Competition

Who May Participate:

All financial professionals managing one of the following investment strategies:

- Active Bond/Fixed Income Strategies
- Active Stock Selection Strategies
- Strategic Allocation Strategies
- Tactical Stock Market Strategies
- Alternatives Strategies

Note: The NAAIM Investing Strategy Competition is designed for non-institutional firms managing less than $5 billion.

Active Bond/Fixed Income Strategies - Investing strategies utilizing an actively managed approach to the Bond/Fixed Income markets.

Active Stock Selection Strategies - Investing strategies that apply active "selection alpha" to a portfolio of individual equities.

Strategic Allocation Strategies - Investing strategies employing an actively managed, strategic approach to asset allocation.

Tactical Stock Market Strategies - Investing strategies utilizing a tactical approach to the management of the U.S. stock market. Note that leverage is limited to 2X for this competition.

Alternatives Strategies - Investing strategies applying active management techniques to alternative asset classes or utilize an alternative approach to managing traditional asset classes.

How to Apply:

Complete the NAAIM Investing Strategy Preliminary Competition Application and return to NAAIM:

2020 Uncommon Knowledge ~ NAAIM Investing Strategy Competition