The Active Manager

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INDEX

Choosing Frustration Over Devastation

GREG MORRIS AND GRANT MORRIS

TREND FOLLOWING CAN OFFER BENEFITS AS AN investing approach even when not generating positive returns. Sometimes the benefit comes from not losing, or not losing as much as other investment approaches; other times the benefit comes from allowing you to sleep more soundly at night, as selling out of equity positions before the stock market goes into a correction or a bear market is much more comfortable and will reduce an investor's stress and anxiety.

While being defensive during market selloffs can be comfortable, a frustrating part of trend following is that you often have many small loss trades or miss out on some potential upside while being defensive. This must be tolerated to realize the long-term benefits of the approach. Investors who focus on every trade and very short-term results tend to not be good at trend following – they're usually the same investors that are not good at sticking with other approaches either.

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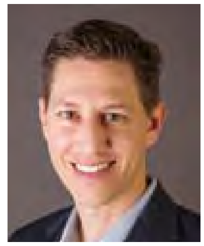
The views and opinions of the authors are not necessarily those of NAAIM, its officers or Board of Directors.

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

President's Letter



Matthew Spangler

THE DECISION IS IN – OUTLOOK 2021 will be an in-person conference at the Marriott Chicago O'Hare, Monday-Tuesday, October 11-12.

When we asked the membership "do you want a digital or in-person conference," the response was overwhelmingly ***in person***. We are working to make certain OUTLOOK is as safe as possible for attendees, but it is going to be so good to see old friends in person, make new friends and talk about everything we have learned over the last year.

Networking needs person-to-person to build great relationships. When I look back at past NAAIM conferences, it is fascinating to see how many business ventures and work relationships got their start at a NAAIM conference. Building a relationship based on trust of the other's character, intelligence and openness to ideas is difficult at best on a Zoom screen.

At the same time, I hope you have found value in NAAIM's digital outreach over the last year. Between the NAAIM exchanges and webinars, we tried to provide members with two to three opportunities a month to learn, discuss issues of concern to their business and interact with each other. That outreach and sharing of ideas throughout the year is something we don't intend to lose once we get back to in-person conferences. We can't go to a NAAIM conference every month, but we can learn from one another and from experts throughout our industry through webinars and digital exchanges on a regular basis. In fact, NAAIM now has a wealth of information available through recordings of the webinars over the last 12 months.

If you weren't on the webinar, definitely make certain you listen to **NEW ADVERTISING RULES: Tread Carefully!** presented by Thomas Giachetti, Esq. and Max Schatzow, Esq., Stark & Stark Attorneys-at-Law; Danielle DiMartino Booth with **Janet Yellen from Fed to Treasury – You Ain't Seen Nothin' Yet!** and many others. You can find the full list of pandemic webinars on page 4. They are available to members on the NAAIM Info Hub.

The monthly NAAIM Exchange networking and open forum calls were a great way to connect with peers during the pandemic months and make certain members were still getting some of that peer-to-peer networking. Complemented by in-person conferences, I think they will be an even more effective way of sharing ideas and staying connected in the future.

The pandemic did not stop a number of NAAIM programs from moving ahead.

Preliminary interviews for **NAAIM's Active Investment Strategy Competition** were completed virtually and we will

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OUTLOOK 2021 CONFERENCE

IS BACK and HEADING TO CHICAGO!
OCTOBER 11 & 12, 2021
at the

MARRIOTT CHICAGO O'HARE
8355 West Higgins Rd., Chicago, IL 60631

Meet your peers in person this fall!

Market forecasts from renowned financial analysts.
Solutions for investment advisory firms in the pandemic warp zone.
Interactive Networking with active management peers.
IDEAS with the potential to drive your advisory practice to greater success!

Join A Virtual Audience at the NAAIM Active Investing Strategy Competition

JUNE 23 AND 24, NAAIM MEMBERS AND FINANCIAL professionals worldwide are invited to watch the NAAIM Active Investing Strategy Competition final presentations digitally. 2021 marks the eighth year of the competition and features an international cast of money managers seeking to win the Grand Prize Package.

This year's competition includes five categories –

- Stock selection
- Tactical allocation
- Asset allocation
- Fixed income
- Alternatives

The Grand Prize Package includes an opportunity for live distribution and promotion on two TAMP platforms - **Global View Capital Management** and **Tactical Fund Advisors**, Promotion to the NAAIM Membership, Live Meetings with Manager-of-Managers Firms and a $1,000 Cash Prize.

To reach the finals, each manager participated in a preliminary round of 9-minute online presentations to the NAAIM Active Investing Strategy Committee followed by a Q&A session. A key requirement to compete is **live, verifiable, real money track records.**

The Competition Finals will begin Wednesday afternoon, June 23 and wrap up on Thursday morning, June 24, with the announcement of winners at the conclusion of Thursday's session. Look for email announcements with meeting information or contact **info@naaim.org** to request your access link.

President's Letter – CONTINUED FROM PAGE 1

be announcing competitors for the final virtual showdown - split between the afternoon of Wednesday, June 23rd and the morning of Thursday June 24th. The 2021 competitions will be held virtually with a live audience. While most of our competitors have been from the U.S., this year's competition features a firm from Indonesia.

A number of good papers were submitted to the **NAAIM Founders Award for Advances in Active Investment Management** and judging is underway. I am looking forward to finding out which ideas the judges select.

So far this has been an unusual year, but a good year in terms of financial performance. I find my clients are split between those a bit nervous, waiting for the next drop, and others who want to get more aggressive. I haven't really seen such a divergence in outlooks before, with clients on both extremes. A lot of my job has been to help them work through their emotions, avoid rash decisions and maintain the course – you can't let fear take you out of the market and miss opportunities but you can't be so aggressive that the account really suffers if there is a downturn. And of course, there are lots of questions about cryptocurrency. We've started doing more in-person meetings in response to client requests. I find a big desire among my clients to be able to meet face-to-face.

I am looking forward to getting back into normality this summer with the return of in-person meetings. We are planning a couple of small family trips starting with Memorial Day. Not too crazy, but a chance to reconnect with family. It's a summer reset and a march forward to new changes. I've learned a lot over the pandemic shutdown that I intend to carry forward in my family relationships and my business, but this has been a time I will be much happier to view in hindsight.

I hope everyone is looking forward to the summer and events to come and I look forward to reporting more to you on OUTLOOK, the Investment Strategy Competition, the Founders Award and future webinars and events.

Have a great summer. Live well, be happy and prosper.

Sincerely,

Matt Spangler
NAAIM President

NAAIM UNCOMMON KNOWLEDGE Is Postponed until 2022

Given the uncertainty of the coronavirus pandemic in early 2021, NAAIM opted to postpone its annual Uncommon Knowledge conference, now scheduled for April 25-27, 2022. We will be meeting in Tampa, Florida at the Westin Tampa Waterside and encourage you to save the date on your calendar and get your hotel reservations in early. Until then, join our webinar series, promoted through email, and NAAIM online member exchanges. We look forward to seeing you in person at OUTLOOK 2021 or in Tampa in 2022.

Meet you at the Waterside - 725 South Harbour Island Blvd., Tampa, Florida

Past NAAIM Webinar Series Recordings

The following digital sessions are available on NAAIM's member Info Hub. For information on how you can access the recordings, contact NAAIM Administrator Susan Truesdale at info@naaim.org.

Managing 401(k) Portfolios – Don Creech, Investor Resources

Recorded June 9, 2021

Trend-following Investment Strategies with GoNoGo Charts – featuring Alex Cole and Tyler Wood

Recorded May 19, 2021

Technical Analysis for Active Investment Managers– featuring Walter Deemer

Recorded May 12, 2021

Best & Worst Days Study: Active Management Delivers More Dependable Returns – featuring Will Hepburn

Recorded April 14, 2021

What's Coming Next – Tom McClellan, Editor, The McClellan Market Report and Daily Edition

Recorded March 18, 2021

NEW ADVERTISING RULES: Tread Carefully! Presented by Thomas Giachetti, Esq. and Max Schatzow, Esq., Stark & Stark Attorneys-at-Law.

Recorded March 10, 2021

Janet Yellen from Fed to Treasury – You Ain't Seen Nothin' Yet! – Presented by Danielle DiMartino Booth

Recorded February 17, 2021

Pitfalls, Traps and Opportunities for 2021 – A Look Ahead in the Financial Markets with Tony Dwyer

Recorded January 20, 2021

2020 Founders Award Winning Paper Presentation | Actively Using Passive Sectors: Generating Alpha Using the VIX – *Michael A. Gayed, CFA, Toroso Investments*

Recorded December 9, 2020

How Government Policy Drives Markets: *Ben Phillips, Chief Investment Officer, EventShares*

Recorded September 23, 2020

What Option Indicators Are Saying About This Market — Now! *Larry McMillan, Founder and President, McMillan Analysis Corp.*

Recorded September 9, 2020

Navigating Covid and the Election with Data-Driven Investing – *John Kosar, Asbury Research LLC*

Recorded August 19, 2020

Values-aligned Investing: What it is and why it is here to stay – *Bill Davis, Stance Capital, LLC*

Recorded August 12, 2020

Quantifiable Edges for Active Investing – *Rob Hanna, Quantifiable Edges & Hanna Capital Management, LLC*

Recorded July 16, 2020

What You Own in this Market Matters – A Lot! Learn How to Stay on the Leader Bandwagon – *John Worthington, Dauble+Worthington Equity Portfolios*

Recorded July 8, 2020

Demonstrating Client Leadership – *Julie Littlechild, Absolute Engagement*

Recorded June 16, 2020

Before It's Too Late: Using Lumber, and Gold to Actively Manage Stocks & Bonds – *Michael Gayed, Lead-Lag Publishing, LLC*

Recorded June 10, 2020

Plumbing for a Stock Market Low – *Doug Ramsey, The Leuthold Group, LLC*

Recorded May 13, 2020

Beating Benchmarks and Passive Investing with Advanced Analytics

ROCCO PELLEGRINELLI

IN THIS CURRENT INVESTMENT ENVIRONMENT OF volatility, uncertainty, complexity, huge institutional asset flows, sentiment, and social media, it has become important to pay more attention to and have respect for price trends. Evaluating and measuring today's price trends though requires sophisticated analytical models versus relying solely on traditional technical analysis approaches.

Asset and wealth management industries need to evolve toward higher standards of value to clients, in an efficient and cost-effective manner. Adopting new data and sophisticated tools is now a necessity.

The greatest opportunity for active managers to deliver alpha

Active managers have a great opportunity to deliver alpha profiting from the fact that equity markets display a huge dispersion of performance all the time. In 2020, if you look at the S&P 500 constituents, the differential between the top 25% performers and the bottom 25% performers was massive. The average return of the top 100 stocks was 105% while the bottom 100 was -18%. This is enough to provide an opportunity for prepared, active stock pickers to beat the 16% return of the index. It is clear that if an active manager can capture a part of the top performers and avoid most of the bottom performers, they will have a high probability to beat the benchmark.

What active investment managers should be focusing on

All indices contain securities in a bull trend and securities in a bear trend with a well-defined distribution or allocation. In order to outperform, active managers need to make sure that the "*trend allocation*" of their portfolios is better than the one of the chosen benchmark to beat.

The key is to develop strategies that overweight the exposure to rising stocks, while limiting positions on falling issues. We call it "*trend allocation analysis and management*" vs. the index. We developed a sophisticated multi-factor model to provide a way to rate the trends of individual stocks and enable an aggregated "rating" for portfolios. For example, a portfolio rating of A-, higher than the benchmark rating of B+, increases the probability to outperform.

Incorporate in an active managers' existing investment processes

For active managers, every strategy should incorporate an element of trend valuation. It is about acknowledging, respecting and profiting from actual, observable price trends at the heart of performance dispersion, rather than strictly believing in subjective forecasts or price objectives based on whatever approach. To put it simply, all it takes is to incorporate some trend valuation metrics into the defined investment strategy. This leverages the profit potential of the manager's existing methodology by adding a layer of objective, unbiased trend assessment.

Price trends are more extreme and last longer than in the past as they are impacted by several factors of which company fundamentals are only a small part. Money flow caused by major firms, analyst sentiment, social media sentiment, momentum players, and an economic landscape full of uncertainty and fast changing scenarios all contribute to creating and accelerating price trends in either direction that fundamental-driven methodologies cannot capture.

Trendrating is taking on the challenge to prove that active managers can beat their benchmarks and passive fund performance with the right tools and market intelligence added to their investment methodologies.

Rocco Pellegrinelli, CEO of Trendrating, began his career as a portfolio manager and has been a successful entrepreneur in the technology sector for the past 20 years. He created Brainpower in 1996 and as Chairman and CEO, established it as one of the top portfolio management systems globally. After going public on the Frankfurt Stock Exchange in 2000, Brainpower was acquired by Bloomberg in 2006.

Rocco's conviction is "Many analytical tools make sense, but do they also make money? It is time to bring real value to fund managers." He launched Trendrating with the mission to provide innovative analytics and technology that deliver alpha, and are measurable, actionable, and repeatable. **www.trendrating.com** *or contact* **j.coulter@trendrating.com**.

Is a Real Estate Crash Coming?

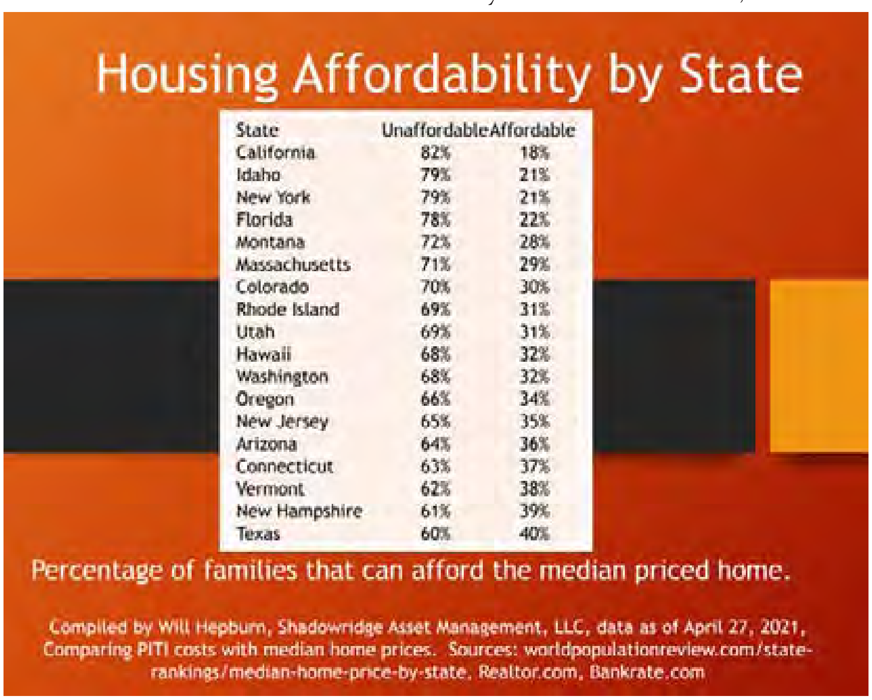
WILL HEPBURN

AS PRICES AND MORTGAGE RATES CREEP UP, homes become less and less affordable, increasing the likelihood that the real estate market will run out of qualified buyers and turn down. This study shows the affordability of house prices by state.

In 1989, while visiting relatives in California, someone asked me what I thought of their red-hot real estate market. I cited an affordability study showing that only 10% of Californians could afford a median priced home – one right in the middle of the price range.

In that environment, much of the buying was being done for investment or on speculation rather than for use as a primary residence. Foreign money from Japanese investors was coming to California in waves back then.

I told the family, I thought that the lack of affordability for homeowners made the market rise unsustainable and to get ready for lower prices. Since two of the family members had recently bought homes, my comments were followed by an awkward silence. Then the 1990 recession came along, causing the real estate market to get so soft it became a big factor in the Savings and Loan crisis. As it turned out, I was correct.



State	Unaffordable	Affordable
California	82%	18%
Idaho	79%	21%
New York	79%	21%
Florida	78%	22%
Montana	72%	28%
Massachusetts	71%	29%
Colorado	70%	30%
Rhode Island	69%	31%
Utah	69%	31%
Hawaii	68%	32%
Washington	68%	32%
Oregon	66%	34%
New Jersey	65%	35%
Arizona	64%	36%
Connecticut	63%	37%
Vermont	62%	38%
New Hampshire	61%	39%
Texas	60%	40%

With our current hot, hot, hot real estate market, I am getting the same questions about how long this strong trend can continue, so I took a look at housing affordability.

The premise of this study is that all markets, whether we are discussing stocks, bonds, or real estate, are a reflection of the balance between the buyers and sellers. An affordability measure like this study can give us an estimate of the number of potential buyers in the real estate market.

In today's strong real estate market, buyers are outnumbering sellers and are clearly bidding up prices. This can be seen in nationwide pricing trends showing almost a 20% rise in prices over the past year (Source: Redfin analysis of MLS data and public records) as well as inventory reports on the numbers of homes listed for sale.

Since real estate markets vary quite a bit by region, I did a state-by-state analysis, using median household income vs median house listing prices, using payments required (Principal, Interest, Taxes and Insurance combined) as a proxy for affordability.

The average interest rate for a 30-year, fixed-rate loan was 3.06% on April 27, 2021 (Source Bankrate.com), so that is the rate I started with.

Mortgage lenders prefer PITI payments to be below 28% of a buyer's household income, PITI was compared to the median household income in each of the states to gauge affordability.

It is no surprise that the state with the least affordable market is California, where only 18% of households can afford today's median priced home. 82% of households are priced out of their market. As we saw back in 1989, this imbalance is difficult to maintain for long.

In Arizona, where I live, only 36% of households can afford the median priced home, and Texas, where Shadowridge has many clients, has a 40% affordability level. Although better than California, both states are still imbalanced, which suggests that if there is a real estate crash in our future, these states will feel it, but perhaps not as strongly as California.

If you were wondering, the most affordable states are West Virginia, Kansas and Indiana, with up to 63% affordability.

These percentiles indicate what is affordable with interest rates as of 4/27/21. But what if interest rates keep rising?

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Is a Real Estate Crash Coming?

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4% average loan rates will mean that only 15% of Californians will qualify for a loan, 32% in Arizona and 35% in Texas.

Mortgage rates are just coming off historic lows and the average historic loan rate is somewhere above 6%. What will 6% rates do to affordability? Only 10% of Californians would be able to qualify for a mortgage, 22% in Arizona and 28% in Texas. How can a market sustain itself if 90%, 78% or 72% of buyers, respectively, are priced out?

As long as investor money flows in, sales can keep going as we saw in the late 1980s. Back then, Japanese investors bought at the top of the market. Today, I hear about Chinese money and investment groups in this market. Chinese investors are anxious to get money out of China, and buying at the top is a small price to pay to get their money out from under Beijing's control. Investors often get blinded by FOMO, Fear of Missing Out. Real estate investment promoters, who often get large commissions up front, can rationalize away the risks of buying in a too-hot market.

Both of these factors are hard to quantify, adding uncertainty to the question of "how sustainable is the price rise?". Could the participation of these groups mark another top in real estate prices? Possibly, although we will have to wait and see.

Sources: worldpopulationreview.com/state-rankings/median-home-price-by-state, www.Realtor.com, www.Bankrate.com, www.insurance.com/home-and-renters-insurance/home-insurance-basics/average-homeowners-insurance-rates-by-state, www.nar.realtor

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Will Hepburn is a private investment manager with Hepburn Capital Management, LLC and Vice President of Investment Research for Shadowridge Asset Management, LLC. He published the 2018 book ***Why Bad Things Happen to Good Investments****, available on Amazon.* **www.HepburnCapital.com**
Invest@HepburnCapital.com

Welcome to New Regular and Associate Members

New Regular Members:

Malcolm Clissold
SCC Capital Group, LLC
1916 Harpeth River Drive
Brentwood, TN 37027
Phone: (615) 370-1770

Christine Ely
Shadowridge Asset Management, LLC
1001 S Capital of Texas Hwy, M-100
Austin, TX 78746
Phone: (888) 434-1427

Gary Erickson A
Wyndfall Financial Inc
1591 N 1st St, Ste 3
Hamilton, MT 59840
Phone: (303) 745-7530

Robert Hanna
Capital Advisors 360
10 Boyden Rd,
Medfield, MA 02052
Phone: (781) 956-6952

Rob Isbitts
Sungarden Investment Management LLC
480 Alexandra Circle
Weston, FL 33326
Phone: (866) 800-9300

Stephen Lu
Dawn Capital LLC
146 Hargrove,
Irvine, CA 92620
Phone: (949) 331-6822

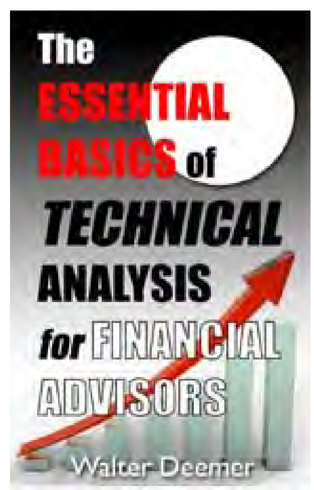
Charles Rice II
Rice Money Managers, Inc.
19 Pointer Lane
Saint Louis, MO 63124
Phone: (314) 569-4087

Perry Sikes
Investor Resources Inc.
1922 Pottery Avenue, Suite 110
Port Orchard, WA 98366
Phone: (425) 673.5000

Vivek Verma
American Alpha Partners LLC
10 West 33rd St., Ste. 802
New York, NY 10001
Phone: (312) 901-7503

New Associate Member:

John Coulter
Trendrating
6 Liberty Square, #6100
Boston, MA 02109
Phone: (508) 315-6313



Webinar guest speaker Walter Deemer has a new book for financial Advisors available on Amazon.com. Use the following links to purchase the book, or other publications by Walter.

https://www.amazon.com/dp/B00HUAKO4A

https://www.amazon.com/When-Time-Comes-Wont-Want-ebook/dp/B07PX38D2V/ref=tmm_kin_swatch_0?_encoding=UTF8&qid=&sr

What are APIs and How Do They Shape the Future of WealthTech?

BRAD KELLOGG

FINANCIAL ADVISORS AND WEALTHTECH FIRMS can both benefit from a deeper understanding of how APIs improve the ability to meet the technology daily needs of advisors.

But there's no WealthTech 101 course for financial advisors to take—even if they do heavily rely on their technology every single day to carry out their fiduciary duties. Whether you're an advisor who's using a best-of-breed technology stack, or you prefer a single unified wealth management platform, understanding APIs can help you understand the benefits of integrations.

Over the rest of this article, we'll go deeper into exactly what an API is, and how they're shaping the future of WealthTech for financial advisors and their technology partners.

What is an API?

API stands for **application programming interface**. Software talks to other software using an API, a set of rules that allows software to talk to each other by sending a request and receiving the corresponding response.

This is important as businesses become more encoded in software requiring software to work directly with other software. Here's a simple way that APIs power interactions between financial institutions and the apps you know and use every day.

> The VISA network connects storefronts and apps with banking institutions through its API to process payments and record transactions.
>
> If you load your VISA credit card into the Venmo app, the person you sent money to doesn't have a direct relationship with banks. They need an intermediary to deliver information about how much money you're exchanging, and check to be sure that the funds are available.
>
> In this case, the intermediary is VISA's API, which uses the internet to connect your app with your bank.

The API's job is to deliver instructions and connect two systems that wouldn't otherwise talk directly with each other. It stands between the app and the banks to route information to the right places and make an interaction like transferring money from one person to another seem as simple as tapping a button.

These are the main terms to know for understanding APIs:

Front end: The front end is what you, the user, interacts with the software to make requests and view the responses and results. For example: You are searching for a flight using a travel website like Expedia or Orbitz. The front end is the search box you use to type in your dates and cities and also the search results page.

Back end: The back end is where the requested information is processed. Using the example above, when you hit "search" on the travel website, the back end kicks into gear to look at the information held by all the different airlines by using the airline ticketing systems' APIs and then sends it to the front end, which interprets that information into something you can read on the results page.

API: A REST API is an API built by web developers using an agreed-upon set of standards that allows for easier "talking" and compatibility between two systems. This is like an agreed-upon style, such as writing dates in M/D/Y format instead of D/M/Y or using a 12-hour clock instead of a 24-hour clock for telling time.

From booking travel to using Venmo to pay back a friend, there are endless everyday use cases for APIs.

4 Ways Advisors and Technology Firms Benefit from APIs

There are also endless everyday uses for APIs for financial advisors and wealth management firms. Here are four main benefits of APIs:

More Efficiencies: You have a lot on your plate already. Any time and energy you would normally put into having to use separate software or siloed systems could be saved and put toward building your client relationships.

For example, when your trading system uses API, it can deliver your trade orders directly to your custodian. Without a connected API, you're left downloading trades into a spreadsheet and then manually uploading that trade file to your custodian's website.

It's not efficient and it leaves room for errors. An API eliminates those manual tasks and connects your trading to your custodian to transmit your orders seamlessly.

That process then gives you more time to spend in a one-on-one meeting with the client to discuss their goals and progress.

Real-Time Automation: In addition to cutting down on duplicated data entry, APIs open up the possibility of creating automated processes for tasks you do on a regular basis. The automation, with help from APIs, provides data and information that you need in real time to make the best decisions for your clients.

Without APIs, your reaction time to market changes is significantly reduced.

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What are APIs and How Do They Shape the Future of WealthTech?

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WealthTech Features: APIs also beef up your wealth stack, whether you are using different pieces of software, an all-in-one solution, or a proprietary system. As noted above, APIs can extend an all-in-one solution or tie different systems together.

With APIs, tech companies can build products or features that you are requesting because they may have access to information and features outside of the current provider or organization.

The end result is that advisor technology systems can directly encode efficient user workflows into their systems, which creates a better user experience for the advisors who use those solutions.

Client Access: Even your clients can benefit from APIs. With all systems connected, they can access a comprehensive financial snapshot or plan that pulls in all of their bank, insurance, and investment information in one place.

You could also use such systems to send out important notifications when changes are made to their account or friendly reminders about portfolio drift or tax season tips.

In this way, APIs create a broader ecosystem of software by integrating them into a single contact point for a user. The APIs talk to other software to exchange data, but the user only has to use a single system to access that data which is stored in multiple systems.

APIs and Flyer

Flyer has developed strategic partnerships with all major custodians and the most popular WealthTech companies to help financial advisors get access to our leading portfolio trading tools and APIs.

The WealthTech partners who build their portfolio trade order management workflows on Flyer's API and network are able to give advisors like yourself a more intuitive and faster way to rebalance and trade while eliminating manual tasks like uploading and downloading files between different systems.

Portfolios can be automatically rebalanced and orders automatically staged for approval or sent to a custodian, giving advisors time back in their day and ensuring investors get a premium investment experience from their wealth manager.

COO Bradley Kellogg is focused on revenue growth including strategy development and partnerships. Previously, he held positions at Barclays and New York Stock Exchange in electronic trading and worked as a software engineer in the defense industry. He holds a M.B.A. from New York University Stern School of Business and a B.S. in Computer Engineering from The George Washington University. To learn more about Flyer **wealth management products** *visit fixflyer.com/wealth-management or schedule a call to* **Flyer** *to talk about improving your tech stack with Flyer's API.*

Choosing Frustration Over Devastation

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There is no such thing as a strategy that is going to be positive every day or in every trade. There is also no way to reliably "call" market tops and bottoms – many try to guess that certain days are a top or bottom, and sometimes are shown to be correct in hindsight, but they're really just guessing.

The last few months have been one of the frustrating periods in our trend following strategies, which focus specifically on the Nasdaq market (some of our reasons for focusing on the Nasdaq have been discussed in previous articles, like: **Building a Rules-Based Trend Following Model - 6 | Dancing with the Trend | StockCharts.com.** The Nasdaq Composite had a strong uptrend from early November to mid-February then rolled over and went into a correction in March, as investors were rotating out of tech and growth stocks and into value stocks. Investors watching only the S&P 500 Index or Dow Jones Industrials Average might not have noticed the correction since those indices were never down more than 5% while the Nasdaq Composite was down 10.54% on March 8th (and has yet to fully recover, although the closing value on 4/16 was close).

The purpose of our trend following approach is to participate in as much market upside as we can, but to avoid the devastation of large losses. Below is a graph of how our model handled this time period.

We participated in the uptrend from mid-November to mid-February and got stopped out of equity positions in late February as the Nasdaq was selling off. We were defensive (and sleeping comfortably at night) as the Nasdaq continued to sell off into correction territory in March. The Nasdaq began trending up on March 10th, but it took until April 5th for our model to indicate a buy signal, whereby we got back invested in equities just above the level at which we went defensive in February. While selling out of the equity ETFs to protect capital prior to the Nasdaq moving into a correction was beneficial to our sleep and our investor psyche, it ultimately did not boost returns. The defensive positions that we use in Trend Plus did not go up while we owned them since we never saw panic selling in equities or the flight-to-safety trade that usually causes those defensive positions to pay off. We also bought back into the equity ETFs at a higher level then

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we sold, so now, and ONLY with the benefit of hindsight, can we say we would have been better off not selling at all.

Why then do we move defensive during times when it often doesn't increase our returns?

A bit too obvious to state but we'll do it anyway. Every bear market starts first as a correction, and every correction starts first as a 5% pullback. If you want to run a tactical rules-based strategy, you must decide what size decline you are willing to withstand in an effort to deliver the results you want. This is a balancing act between selling early to avoid further losses and not selling too soon to allow participation in potential upside. The tighter your stops, the more whipsaw trades you will have but you'll also be getting out sooner when the 5% drawdown does turn into a 10% correction or a 20% or more bear market. Wider stops keep you invested longer with fewer whipsaw trades, but you move to protect your capital more slowly when the big pullbacks come.

Deciding what stop level is best for you to use is as much about testing what worked in the markets historically as it is about making a behavioral assessment on what you (or clients) can tolerate. Our Trend strategies have stop levels that fluctuate between 1.25% and 6% and are dependent on our model readings of the strength of the uptrend.

Be careful about trying to calculate an "optimal" stop level based only on how it performed historically. This can be problematic because as soon as you start using it in live trading, it likely won't perform as optimally as your backtest and after a few painful whipsaw trades, you may decide a new "optimal" stop level is needed. Constantly tweaking your rules based on recent trades is the same as not having rules to begin with.

While sometimes our trend following approach can be frustrating, we'll take frustration over devastation every day of the week. Devastation is what you experience in a bear market. Riding the market down 20%, 30%, or 50% is not something we or many other investors can handle. Investors that use a buy & hold approach, or that always maintain a certain level of equity exposure, will be faced with significant drawdowns at some point, and maybe many times during their investment horizon. When the pain of those large losses is too great, investors always sell out of their equity positions. They are then too gun-shy to get back invested after a recovery takes hold, and their investment portfolios never recover. That is the devastation we aim to avoid.

The frustration that we accept in our approach, in place of this type of devastation, is having whipsaw trades, negative trades, accruing losses in defensive positions waiting for a new uptrend, and sometimes missing out on upside when benchmarks are making new highs (e.g., the S&P 500 made a new high on March 11th when we were still defensive). While never fun, the frustrating times in our Trend strategies are more than worth it based on the long-term results. Portfolios compound at a higher rate of return when you have good upside participation and can avoid large losses. We like those better long-term results and can sleep easier with avoiding panic selling in bear markets, not worrying about making money on every trade, and not focusing too much on short-term results.

Grant Morris **(grant@mscm.net)** *manages various tactical and trend following strategies at McElhenny Sheffield Capital Management for individual investors and other registered investment advisors. Greg Morrison is a senior advisor to the firm. Additional trading perspectives by Greg and Grant Morris can be found at* **stockcharts.com/articles/dancing/**.