Trend-Following Strategies

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Innovative ALTERNATIVE INVESTMENT STRATEGIES

Using Non-Correlated Assets To Diversify and Improve Alpha

Trend-Following Strategies: A Primer

Presented by Alan Lordi

Vice President, Investor Solutions, Aequitas Capital Partners

Trend Following Strategies: A Primer

- Trend following strategies purchase assets that are rising in value and sell assets that are declining.
- There exist behavioral biases that slow price discovery and perpetuate trends.
- Prices tend to initially under-react to news (good or bad) and trends continue as prices slowly move to fully reflect changes in fundamental value.
- Trends have a tendency to continue even further as investors chase trends (herding).
- Herding causes prices to over-react and move beyond fundamentals after the initial under-reaction.

Anchor and Under-Reaction

Investors tend to anchor their views to historical data and adjust their views insufficiently to new information, causing prices to under-react to news.

Psychological Effects

Investors tend to sell their winners too early and ride losers too long.

- Investors sell winners too early because they like to realize gains. This selling creates downward price pressure which slows down the upward price movement to the new fundamental level.
- People hang onto losers too long since realizing losses is painful. Investors try to “make back” what they lost. In this case, the absence of willing sellers keeps prices from adjusting downward as fast as they should.

Outside Influencers of Price

Central Banks operate in the fixed income and currency markets to manage inflation expectations, stimulate economic activity and reduce exchange rate volatility. This slows down price adjustments to events and/or creates trends in and of itself (Don’t fight the Fed).

Hedging activity in commodity markets can also slow down price discovery.

Herding and Feedback Trading

When prices move up or down for a while, investors have a tendency to jump on the bandwagon and this herding effect feeds on itself.

Herding has been documented among equity analysts in their recommendations and earnings forecasts.

Mutual Fund investors often move from funds with recent poor performance and herd into funds that have recently performed well.

Confirmation Bias

People tend to look for information that confirms what they already believe to be true and thus, look at recent price movements as representative of the future.

This leads investors to move money into investments that have recently made money and conversely, out of investments that have recently declined, causing trends to continue

Risk Management Influences

Many risk management techniques involve selling in down markets and buying in up markets, in line with the trend.

- Stop Losses get triggered causing selling in the same direction as the price movement. In the case of short positions, stop losses create buying in the direction of the up-trend.

- A drop in price is often associated with higher volatility (Value at Risk), leading traders to reduce positions to reduce VaR.

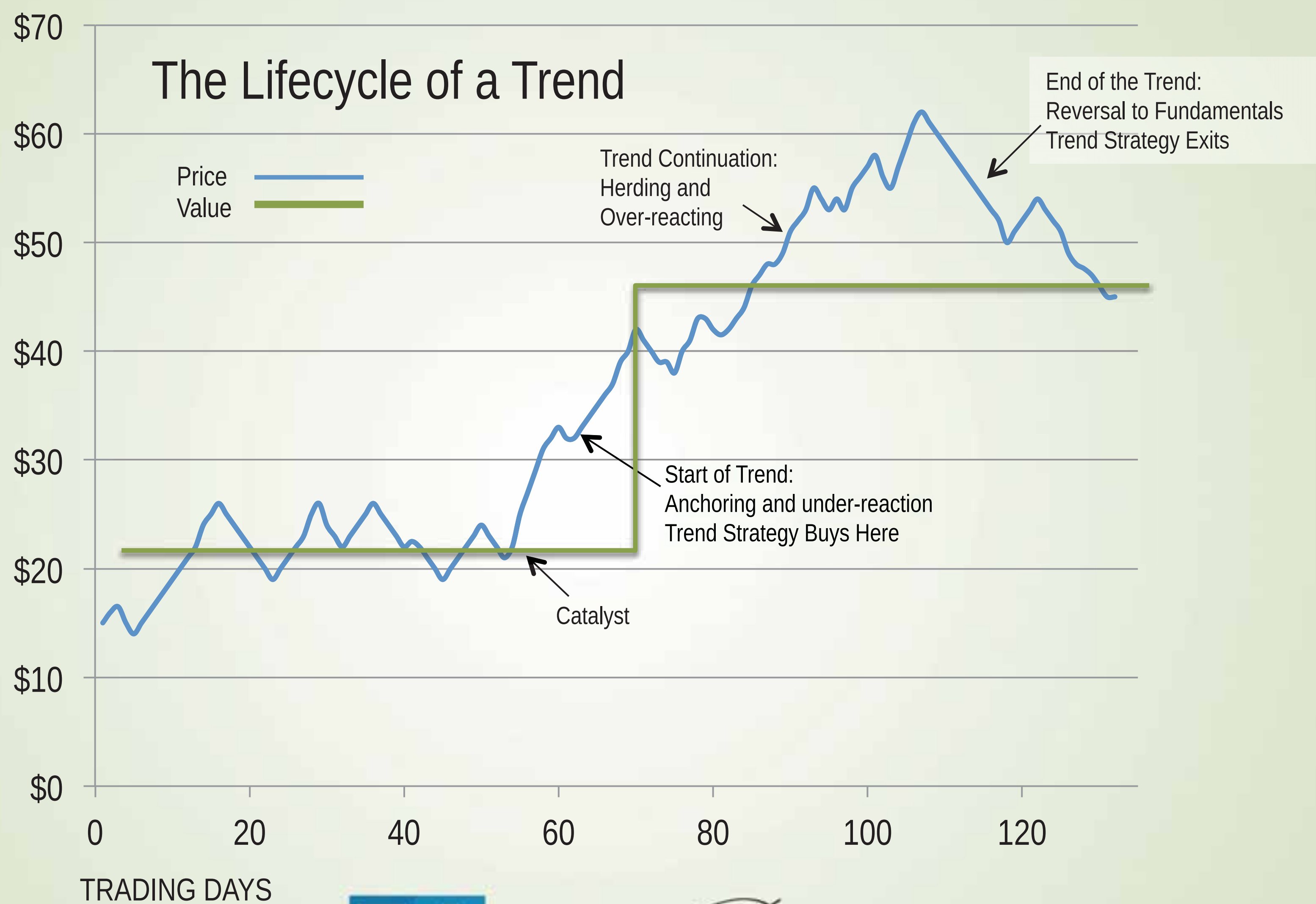
End of the Trend

Ultimately, the markets are efficient and prices correct back toward fundamental value.

As investors realize that prices have gone too far, they revert towards fundamental value and the trend dies out.

The market may then become range-bound until new news cause price movements that set off new trends

One of the main challenges for trend-following strategies is to minimize losses associated with the ending of trends and to preserve capital in range-bound markets that do not exhibit trends.



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Stocks vs Managed Futures: Gain/Loss During Stress Periods

Source: Mgd Fut. = CSFB/Tremont Managed Futures Index, US Stocks = S&P 500, Int'l Stocks = MCSI World Index

The Skinny on Trend Following Strategies

Trend following strategies can benefit a portfolio by providing a non-correlated source of return. In a down-trend, strategies, like managed futures, can perform well providing significant diversification benefits.

Correlation of managed futures index to stocks = -0.04
Correlation of managed futures index to Bonds = 0.13
(Source PerTrac Data 1987 – 2013 Indices = Barclays Systematic Trader's Index, S&P 500, Barclay's Agg. Bond Index.)

Trend following strategies perform poorly in range-bound markets. They also suffer when trends reverse abruptly.

Trend following strategies require high turnover, incurring substantial trading costs. These strategies are also not tax-efficient for taxable accounts.

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Background:

- Creator and manager of the Meidell Tactical Advantage ETF (Arca: MATH) launched 6/23/2011.
- Chartered Market Technician.
- Began studying technical analysis in 2001 because I didn't like how the bear market was affecting my clients emotionally and financially.
- Started experimenting with quantitative trend following of equity mutual funds in 2005 to identifying early changes in market trends.
- In Mach of 2008 incorporated fixed income into our quantitative equity models with favorable results.

It Just Might Work!

Trend Following Strategies May Be Right For Your Clients Portfolios If:

- Clients expect you to keep portions of their portfolios up to date with changes in the market place.
- Clients expect you to keep them from experiencing large losses in their portfolio.
- Your client’s investment personality requires a less volatile experience.

What to consider when using a Trend Following Strategy

- Can represent a core or satellite portion of your clients portfolio depending on your clients needs.
- Trend following strategies are typically less tax efficient and may be more appropriate in retirement accounts.
- Don’t wait for the market to peak before incorporating a trend following strategy into your accounts.

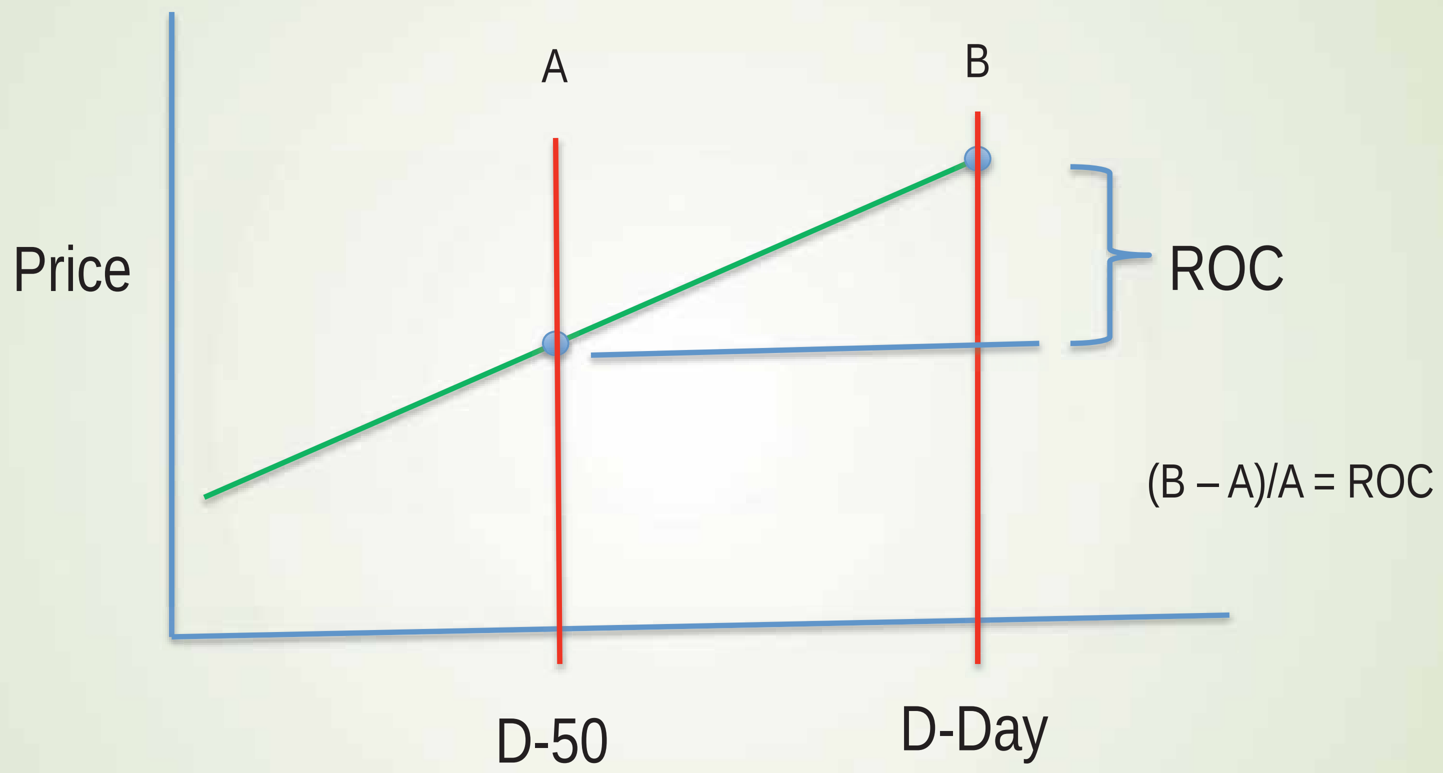
Lifting the Veil on Tactical Strategies

- 9 Sector ETFs
  - XLB – Materials
  - XLE – Energy
  - XLF – Financial
  - XLI – Industrial
  - XLK – Technology

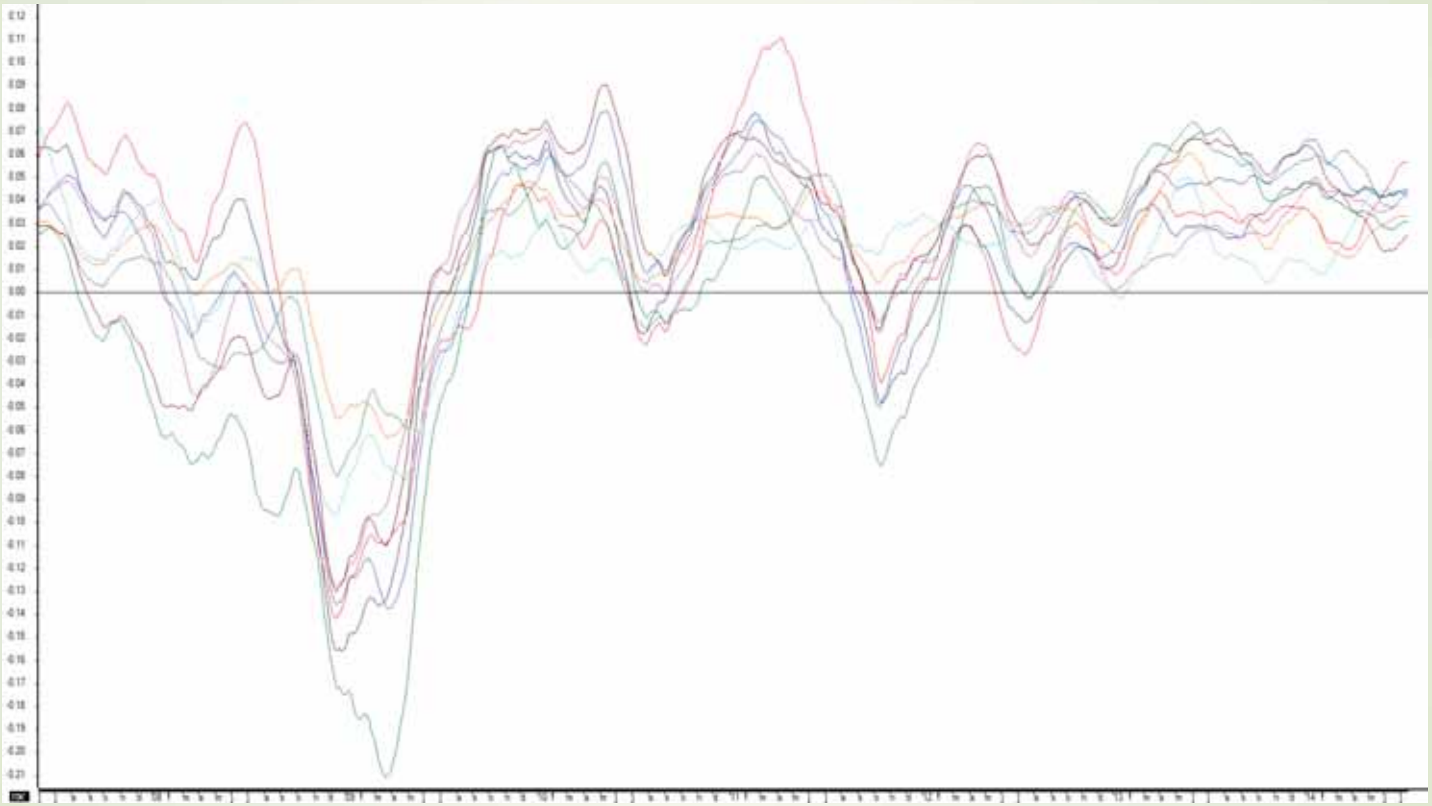
  XLP - Consumer Staples
  XLU - Utilities
  XLV – Health Care
  XLY – Consumer Discretionary

- Calculate the 50 Day Rate of Change of the 200 day exponential moving average for each fund daily
- Rank and own the top 3 ETFs

What is Rate of Change (ROC)?



The 50 Day ROC of the 200 Day Moving Avg. – Slow Velocity




Assets indexed at 1000 (Monthly close)
2400
2300
2200
2100
2000
1900
1800
1700
1600
1500
1400
1300
1200
1100
1000
900
800
700
FDC
'99 's '00 '01 '02 '03 '04 '05 '06 '07 '08 '09 '10 '11 '12 '13 '14
Top 3 Funds
SP-500
SP-500

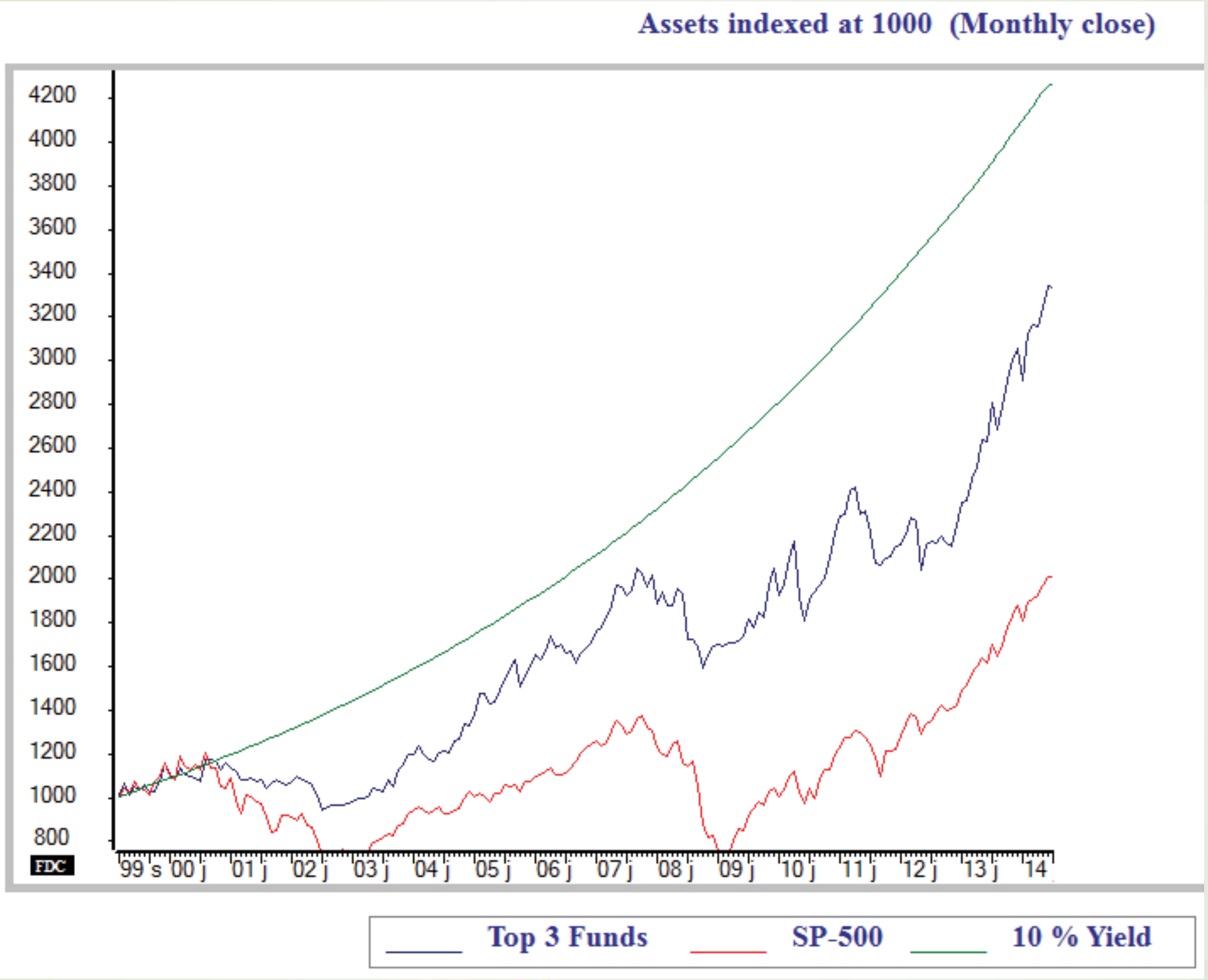
Performance from 03/08/1999 to 07/17/2014

Overall Performance	
Comp. Ann. ROR (%)	5.96
Ave 12Mo ROR (%)	6.89
Ave. Monthly ROR (%)	0.58
Stdv Monthly ROR (%)	4.5
Max Drawdown (%)	49.68
Profitable Months (%)	58

Overall Performance	
Reward/risk	0.12
Sharpe Ratio	0.26
Sortino Ratio	1.25
Alpha (Ann. %)	2.54
Beta	0.79
Information Ratio	0.12
T-Statistic	0.42

What if You Add Three Bond Mutual Funds to the List?

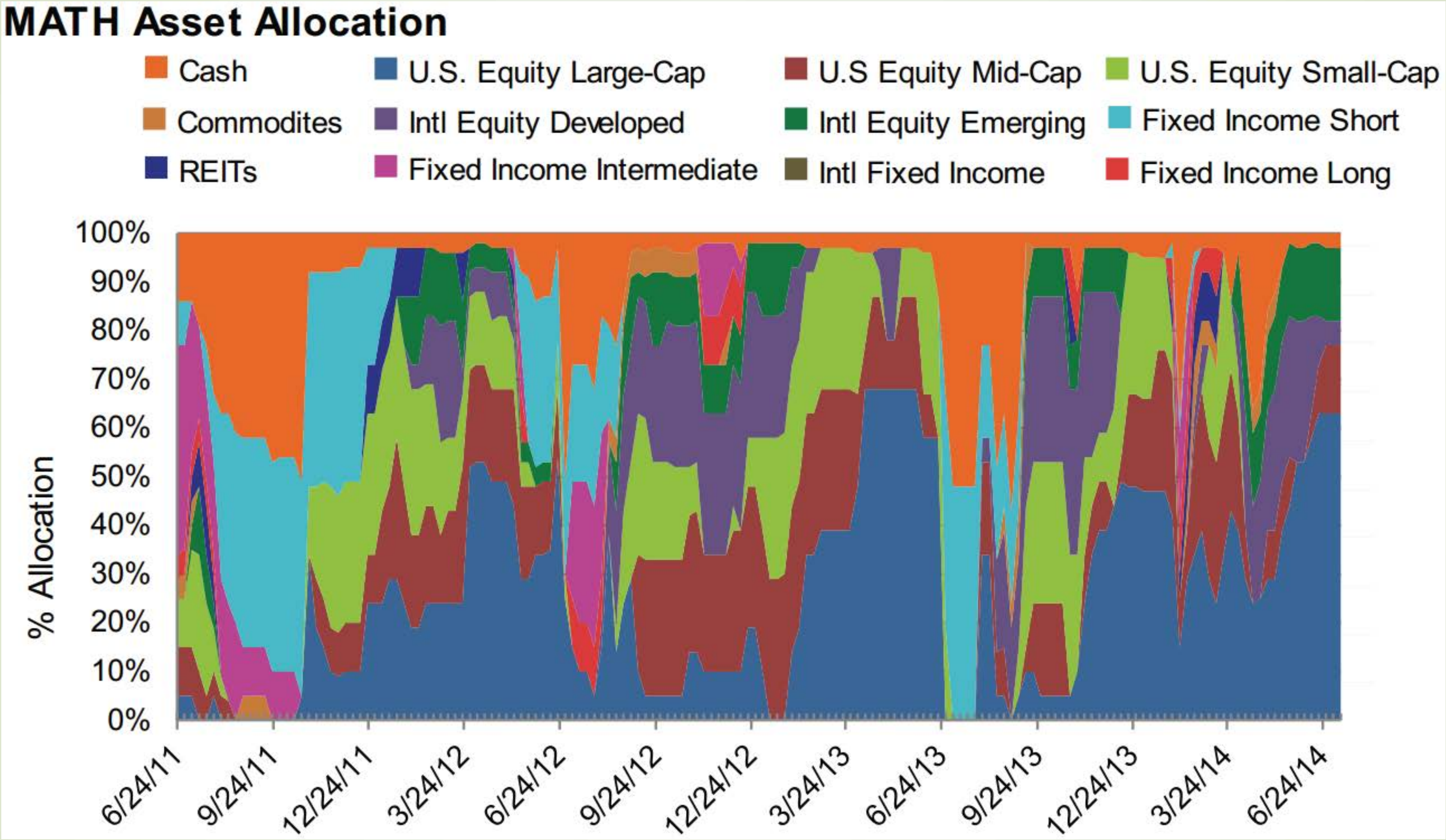
- 9 Sector ETFs
  - XLB – Materials
  - XLE – Energy
  - XLF – Financial
  - XLI – Industrial
  - XLK – Technology
  - XLP - Consumer Staples
  - XLU - Utilities
  - XLV – Health Care
  - XLY – Consumer Discretionary
- 3 Bond Mutual Funds
  - VBISX – Vanguard Short Term Bond Index
  - VBIIX – Vanguard Interm-Term Bond Index
  - VBMFX – Vanguard Total Bond Market Index
- Calculate the 50 Day Rate of Change of the 200 day exponential moving average for each fund daily
- Rank and own the top 3 ETFs


Assets indexed at 1000 (Monthly close)
4200
4000
3800
3600
3400
3200
3000
2800
2600
2400
2200
2000
1800
1600
1400
1200
1000
800
FDC
99 s 00 j 01 j 02 j 03 j 04 j 05 j 06 j 07 j 08 j 09 j 10 j 11 j 12 j 13 j 14
Top 3 Funds
SP-500
10 % Yield

Performance from 03/08/1999 to 07/17/2014

Overall Performance	
Comp. Ann. ROR (%)	8.22
Ave 12Mo ROR (%)	8.41
Ave. Monthly ROR (%)	0.71
Stdv Monthly ROR (%)	3.53
Max Drawdown (%)	24.1
Profitable Months (%)	60

Overall Performance	
Reward/risk	0.34
Sharpe Ratio	0.52
Sortino Ratio	2.65
Alpha (Ann. %)	6.22
Beta	0.44
Information Ratio	0.27
T-Statistic	0.94


MATH Asset Allocation
Cash
U.S. Equity Large-Cap
U.S Equity Mid-Cap
U.S. Equity Small-Cap
Commodities
Intl Equity Developed
Intl Equity Emerging
Fixed Income Short
REITs
Fixed Income Intermediate
Intl Fixed Income
Fixed Income Long
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
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6/24/14

Thank you!

See me after panel or AdvisorShares booth for additional questions.

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Innovative Alternative Strategies Conference

Panelist: Jim Welsh, Forward

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July 2014

Forward Markets: Macro Strategy Review

Macro Factors and Their Impact on Monetary Policy, the Economy and Financial Markets

U.S. Economy

U.S. GDP (Quarter-on-Quarter)

@JimWelshMacro

Our Philosophy

"One of the best ways to make money is to lose less."

Trend-Following Tip #1: Listen

The market is a discounting mechanism, so listen to the market's message

Market tends to be wrong at every major top and bottom

Philosophy: One of the best ways to make money is to lose less.

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Trend-Following Tip #2: Question Everything

Contrary Opinion – Investor's Intelligence

October 2007: 62.0% Bulls, 19.3% Bears

March 2009: 26.4% Bulls, 47.2% Bears

January 2014: 61.2% Bulls, 15.3% Bears

Very helpful, but shift in buying and selling pressure must follow

Philosophy: One of the best ways to make money is to lose less.

Trend-Following Tip #3: Fundamental Analysis

Fundamental analysis helps to protect your portfolio

- Monetary policy
- Gross domestic product, earnings growth and price/earnings ratio
- Portfolio managers: mostly buy and hold, while invested 95% all the time
- Bottoms-up approach: focusing on sectors and balance sheets may result in being blindsided by macro events

Driving a car while looking in the rearview mirror – OK until the first curve

Philosophy: One of the best ways to make money is to lose less.

Trend-Following Tip #4: Technical Analysis

Technical analysis is vital to risk management

- Discipline risk management when the first curve appears
- Importance of knowing when we're wrong
- Different technical indicators provide the ability to layer time frames
- Chart analysis, advance/decline line and moving averages
- Major Trend Indicator: proprietary tool reviewed in Macro Strategy Review

Potential whipsaws, but a well thought-out technical approach can capture the big moves

Philosophy: One of the best ways to make money is to lose less.

Disclosures

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