

San Diego Chapter AAI – Risk Management SIG

September 28, 2022

Presented by

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and

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Upcoming Events

Current calendar can be found at www.aaiisandiego.com

Upcoming Meeting Dates



Webinar Only Event

October 8, 2022 – “Welcome to the Sweet Spot of the 4-Year Cycle”
presented by Jeffrey Hirsch, Editor-in-Chief, Stock Trader’s Almanac



In Person with Live Stream Option

November 12, 2022 – “What We Got Wrong In our Market Outlook for 2022 and Its Impact on 2023” presented by Nick Atkeson, Delta Investment Management LLC



In Person with Live Stream Option

January 14, 2023 – “2023 Economic Update” presented by Andrew Reilly, Market Director, Principal Global Investors



Agenda

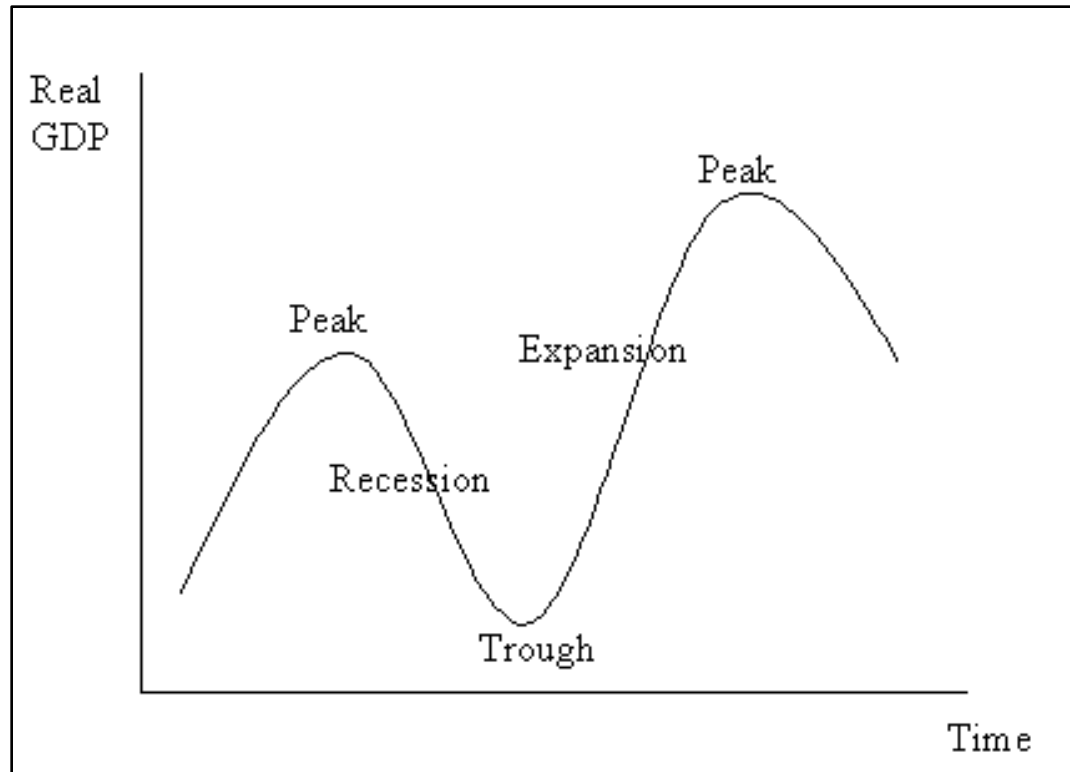
- Current Market Environment
 - Business Cycle
 - Junk Bond Strategy
 - An Opportunity in the Making
- FTCloud
 - A Daily Routine
 - Quick Reference Guide
 - Tip of the Week
- Risk Management SIG Discussion Group

The Current Market Environment

- The current market environment is uncertain and risk is elevated.
- Rising prices and higher inflation expectations are unresolved issues.
- The Fed has clearly indicated they will continue to raise rates until inflation is under control.
- Rising rates will slow the economy and likely result in a recession.
- This is not a time to despair; it is a time to prepare.

The Typical Business Cycle

Economic history shows that there is a repeating pattern of prosperity and recession. This repeating cycle is known as the business cycle.



The Progression of the Typical Business Cycle

▪ Expansion

- a) Gross Domestic Product is increasing and consumer confidence is high.
- b) As the economy expands, demand for capital, labor resources and raw materials result in inflationary pressures.
- c) Inflationary pressures eventually cause yields to rise (bond prices to fall) as bond investors require higher yields to hold longer dated bonds.

▪ Peak

- a) The Fed begins to increase short-term rates in attempt to control inflation.
- b) As interest rates rise, stocks peak on the anticipation of declining earnings in the future.
- c) Although stocks peak, commodity prices continue to rise, at least temporarily, but will eventually decline with the rest of the economy.
- d) Eventually the economy slows as the business environment adapts to the new environment.

▪ Recession/Contraction

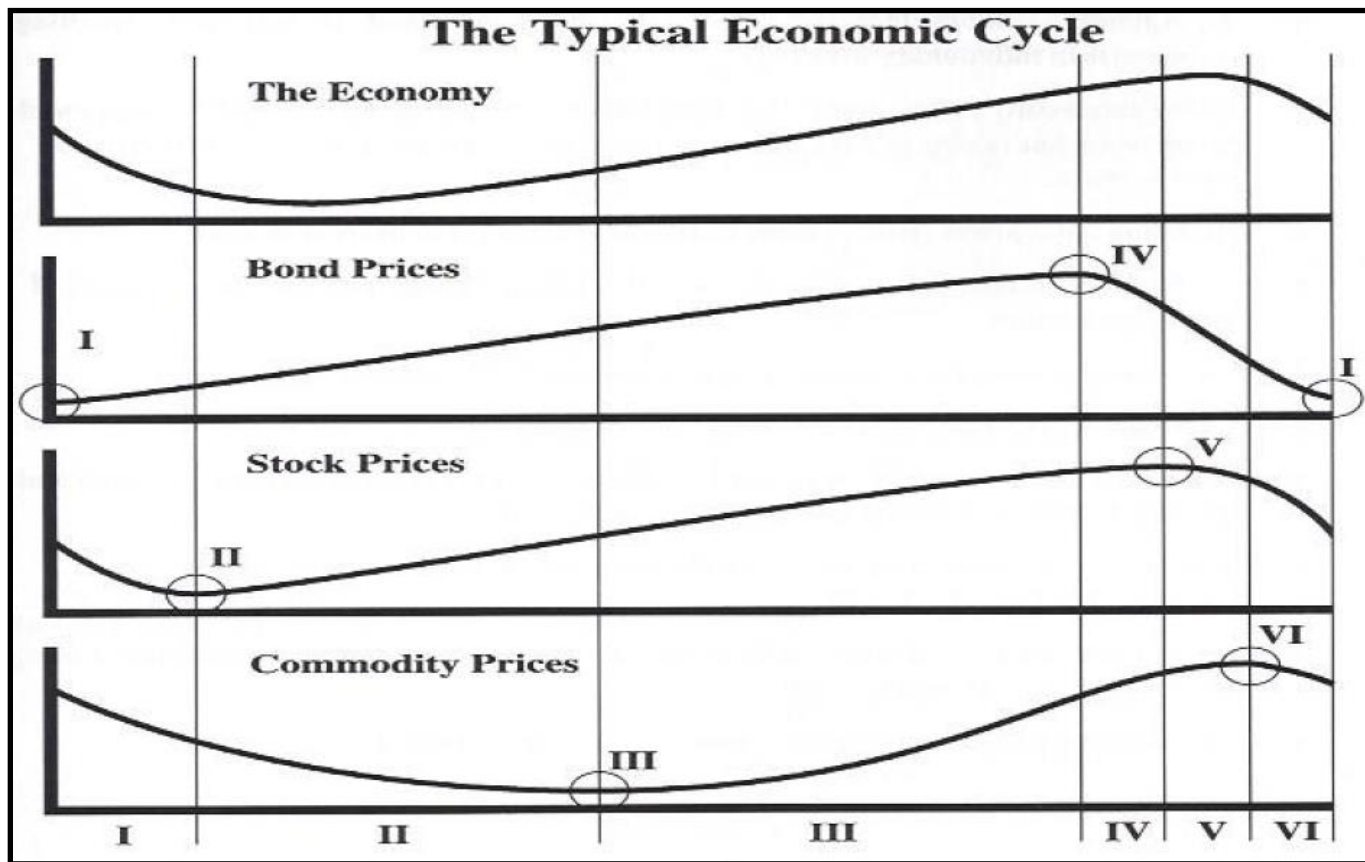
- a) GDP growth rate slows and consumer confidence is low.
- b) Bond prices bottom (yields, top) as the market anticipates that the Fed will begin to lower short-term rates.
- c) Typically, the Fed will keep short-term rates high for too long and the yield curve becomes inverted (an indication that a recession is likely).
- d) GDP may turn negative -- an indication of a recession.

▪ Trough

- a) Declining bond yields increase the supply of credit and spur economic growth.
- b) Stock prices bottom and begin to trend up in anticipation of higher growth and earnings in the future.
- c) As the economy gains traction, the cycle starts over again.

The Typical Business Cycle

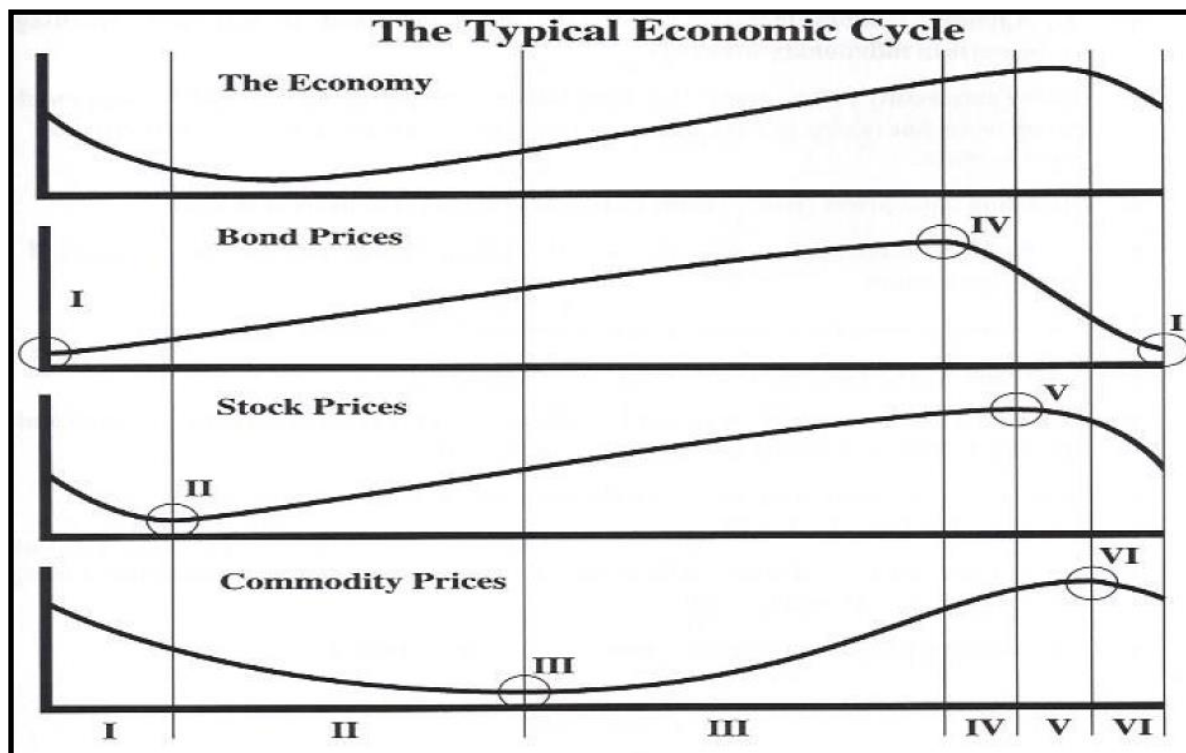
As Described by Martin Pring in *The All-Season Investor*



Source: Michael Price

- An understanding of how different asset classes behave during different stages of the business cycle can provide additional support for tactical investment decision making.

Business Cycle – Impact on Different Asset Classes



Source: Michael Price

Stage I – Bonds Bottom

- Bullish for bonds
- Bearish for stocks
- Bearish for commodities

Stage III – Commodities Bottom

- Bullish for bonds
- Bullish for stocks
- Bullish for commodities

Stage V – Stocks Top

- Bearish for bonds
- Bearish for Stocks
- Bullish for commodities

Stage II – Stocks Bottom

- Bullish for bonds
- Bullish for stocks
- Bearish for commodities

Stage IV – Bond Prices Top

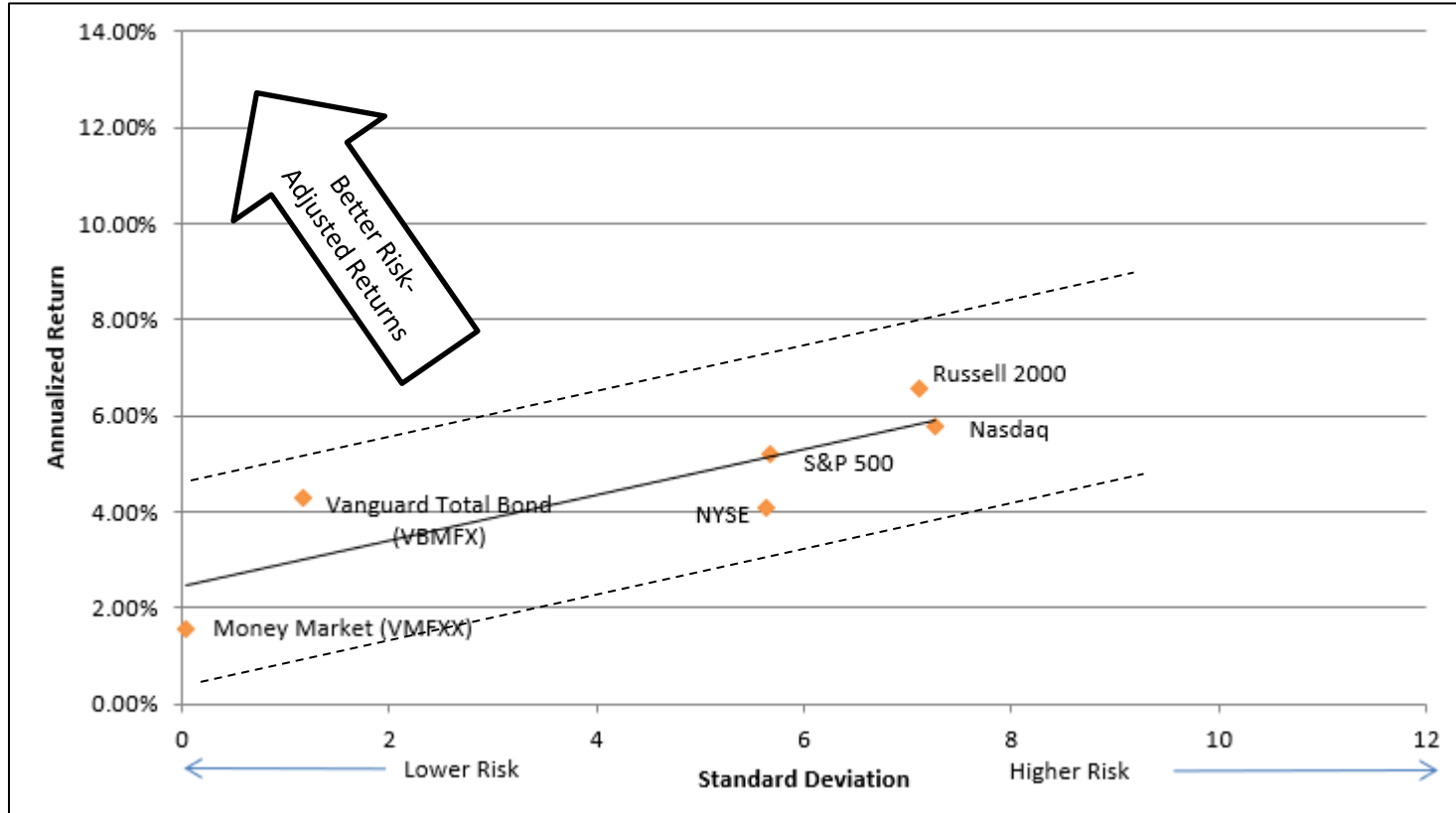
- Bearish for bonds
- Bullish for stocks
- Bullish for commodities

Stage VI – Commodities Top

- Bearish for bonds
- Bearish for stocks
- Bearish for commodities

Risk vs. Reward

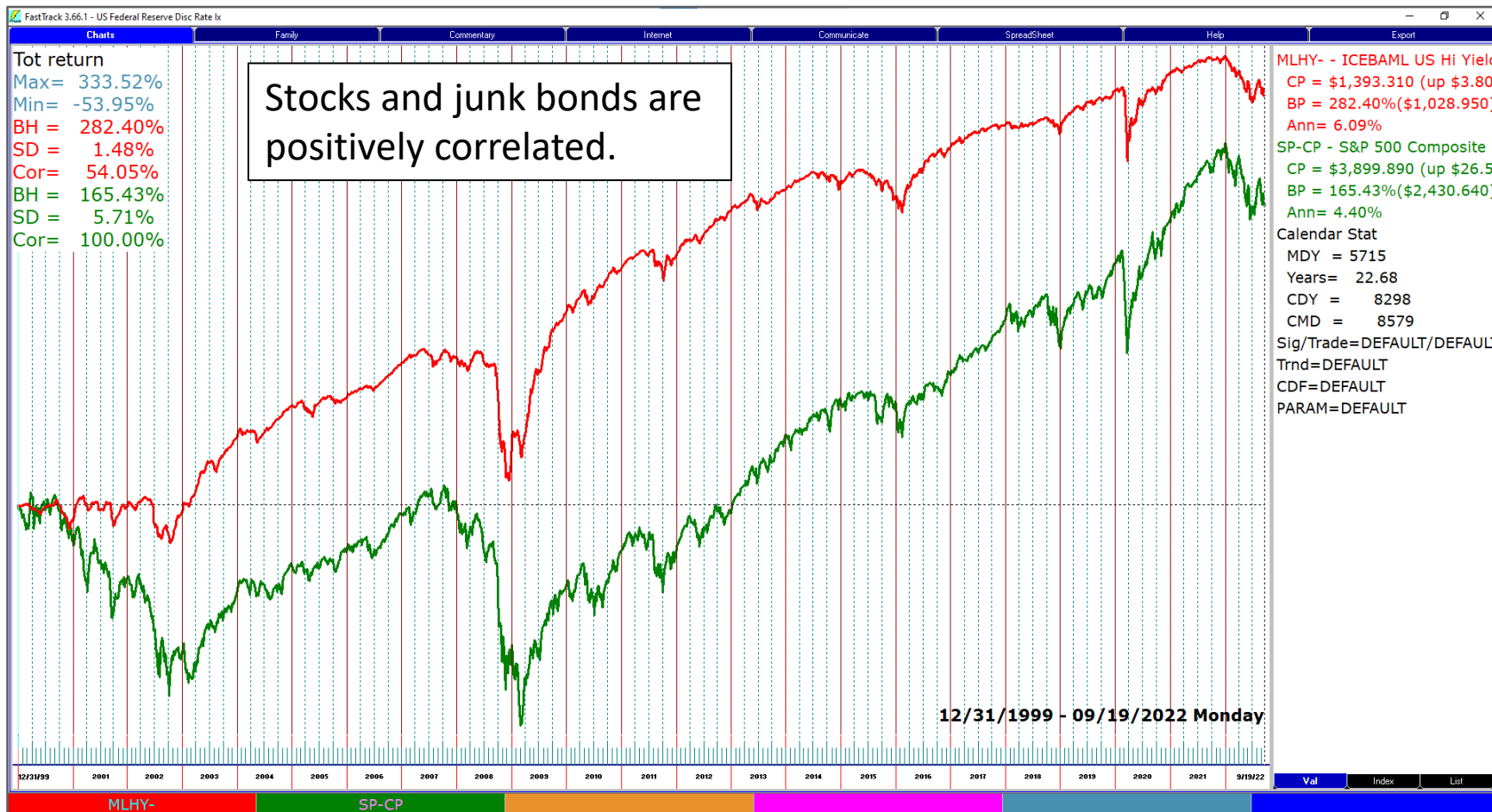
12/31/1999 – 3/31/2022



Our goal as investors is to achieve returns outside the long-term, expected return channel by striving for better risk-adjusted returns (i.e. upper left-hand quadrant).

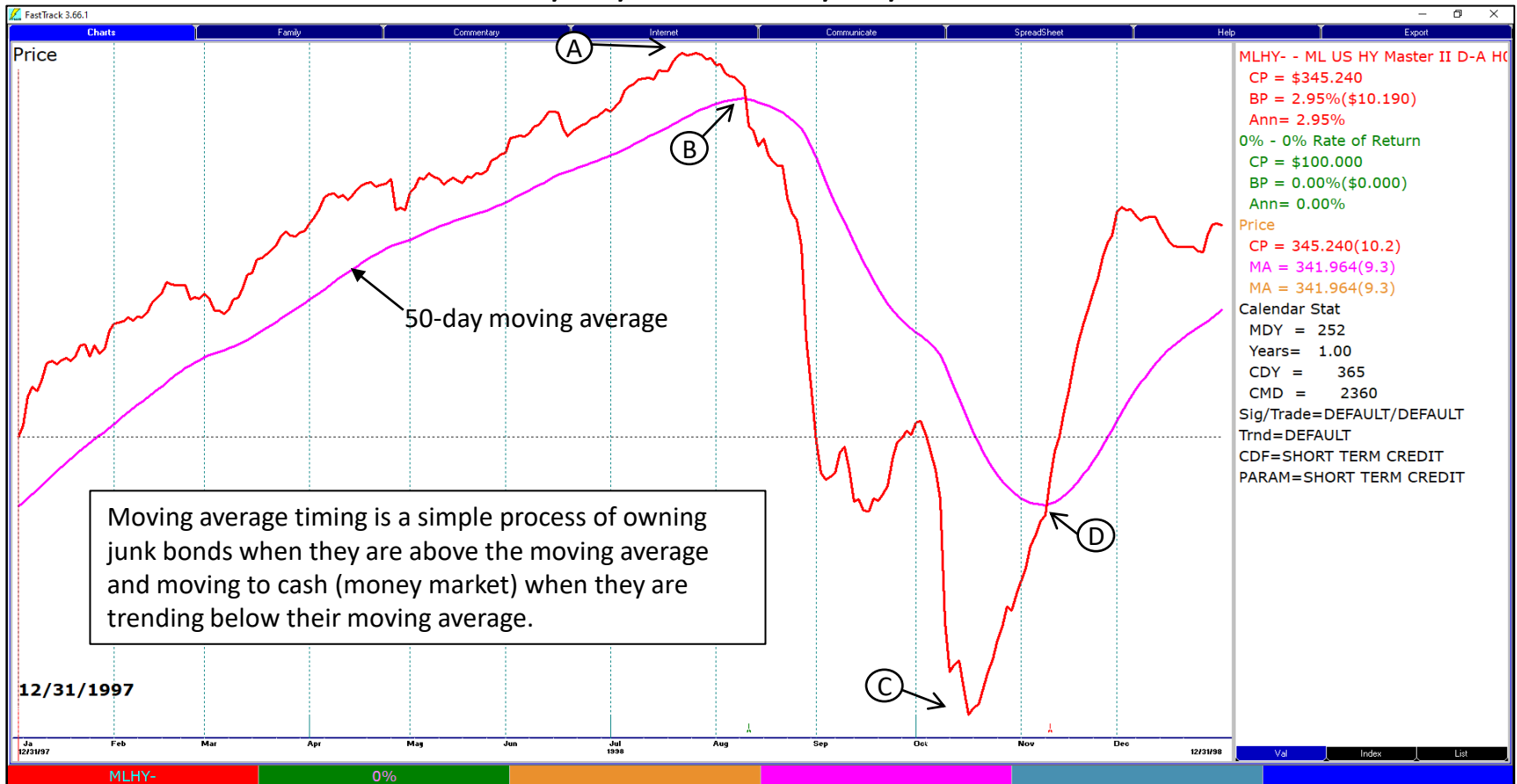
Junk Bonds vs. S&P 500 Index

12/31/1996 – 9/19/2022



MLHY- Timed with a 50-day Moving Average

12/31/1997 – 12/31/1998

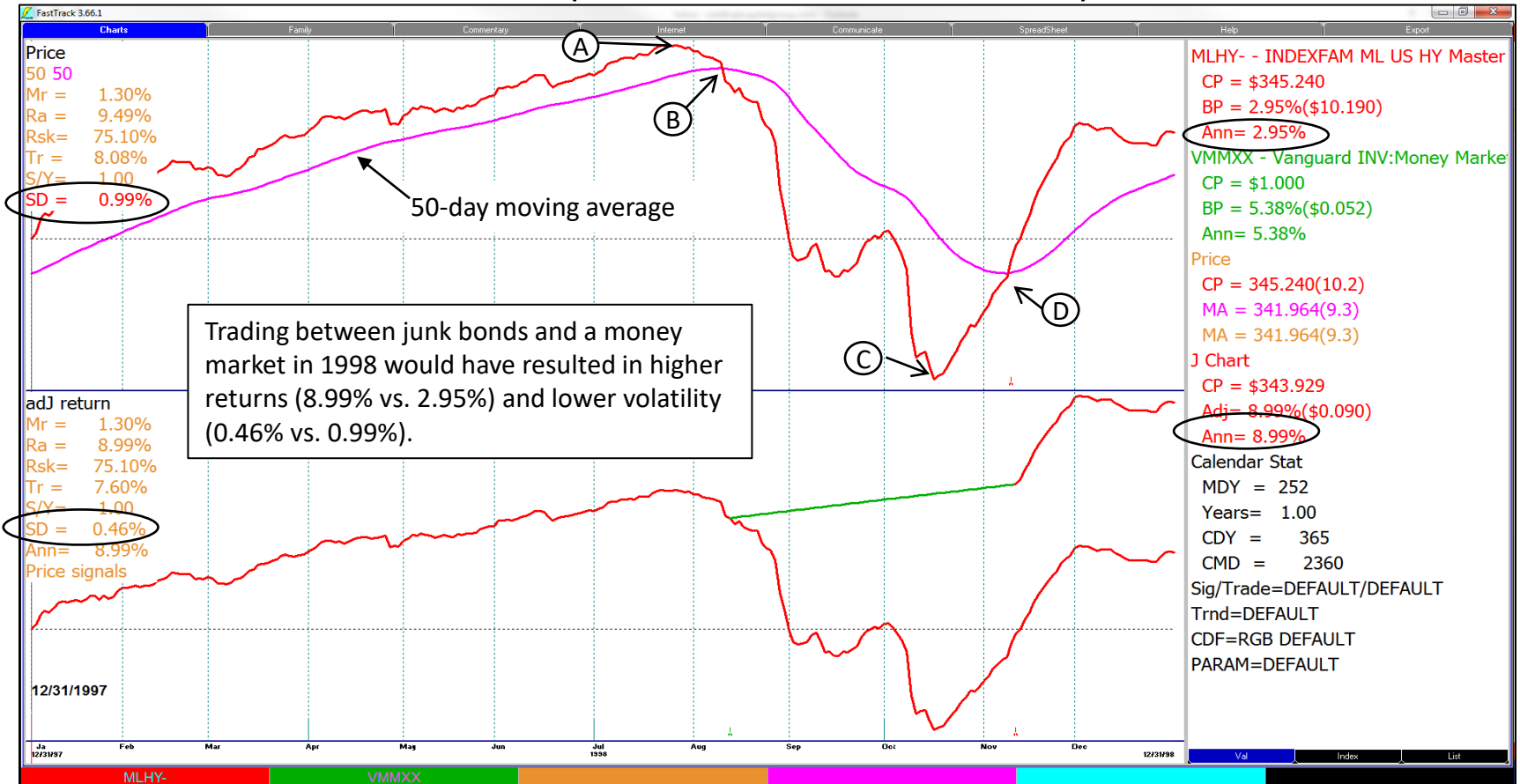


- A: Peak in junk bond index
- B: Junk bond index crosses below moving average
- C: Bottom (trough)
- D: Junk bond index moves above moving average

Timed drawdown (A→B) is very predictable.
 Total drawdown (A→C) is not predictable.

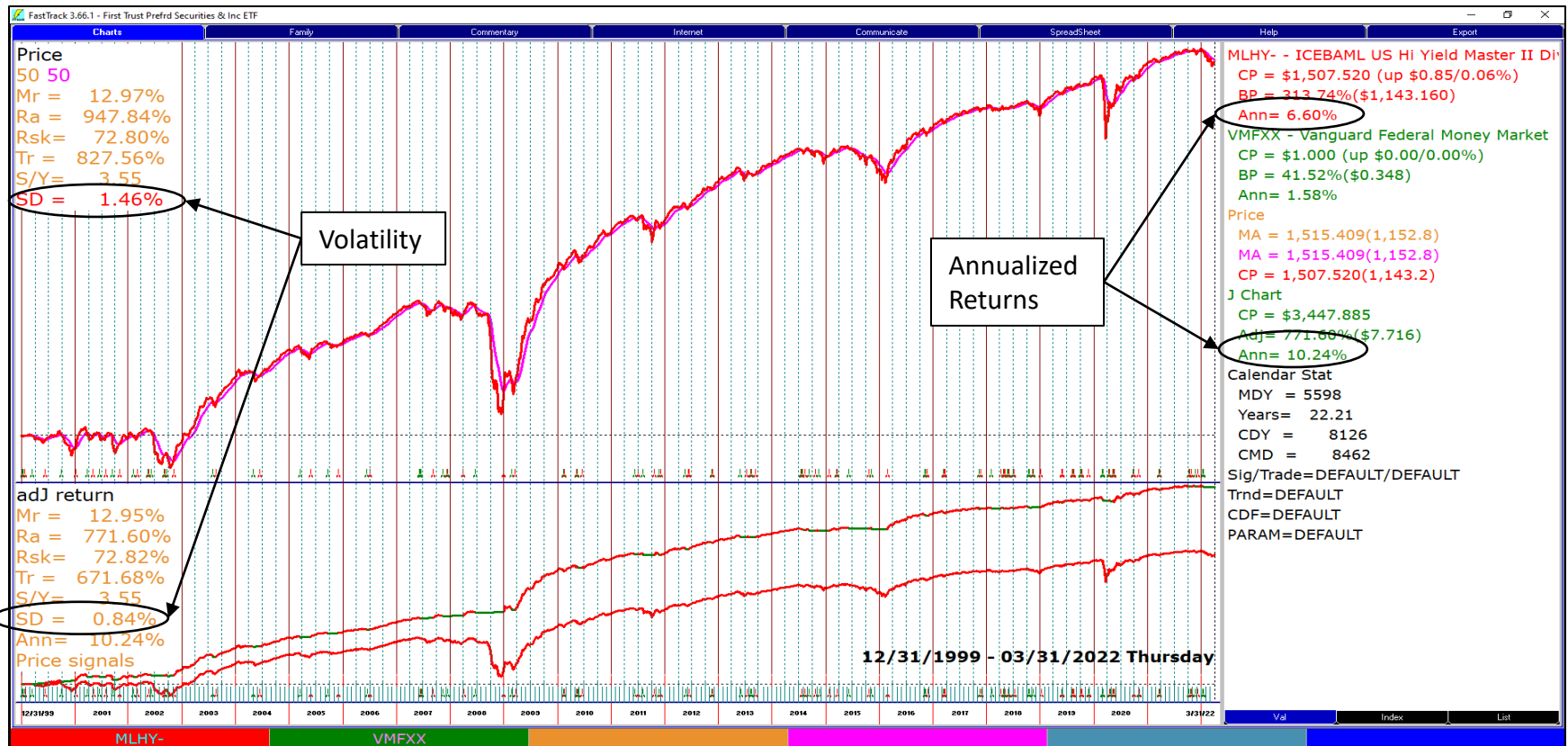
Moving Average Timing

MLHY- (12/31/1997 – 12/31/1998)



- Moving average timing can provide appropriate entry and exit points when investing in junk bonds.
- The timed drawdown (A→B) was -1.0%; the total drawdown (A→C) was -8.7%.
- During 1998, a 50-day moving average would have increased returns and reduced overall volatility/drawdown.

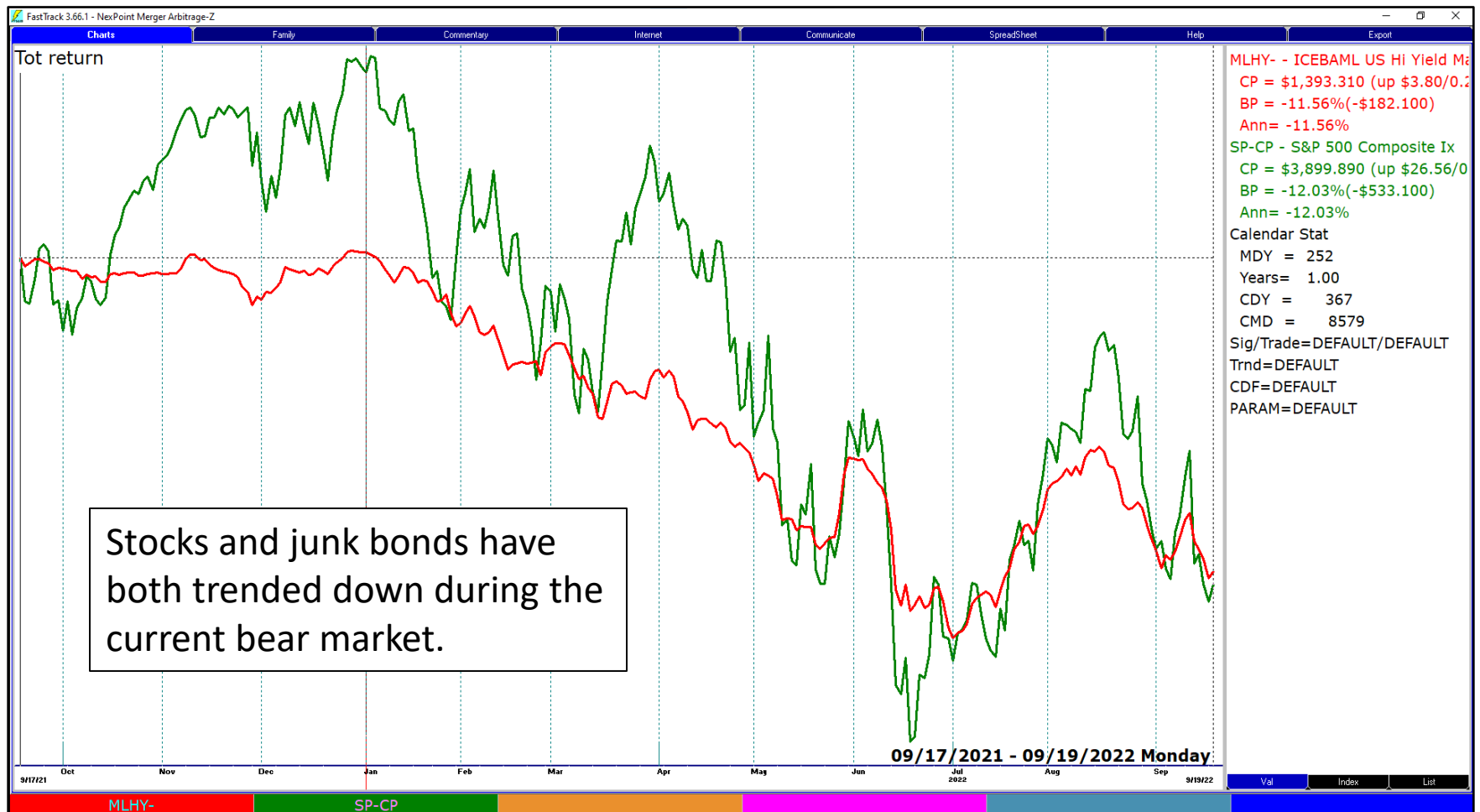
Moving Average Timing 12/31/1999 – 3/31/2022



- Over the 22-year history of MLHY-, using a 50-day moving average has resulted in higher annualized returns and lower volatility.
- The maximum drawdown for the timed strategy is less than 6%.

Current Market Environment

Junk Bonds vs. S&P 500 Index



Current Market Environment

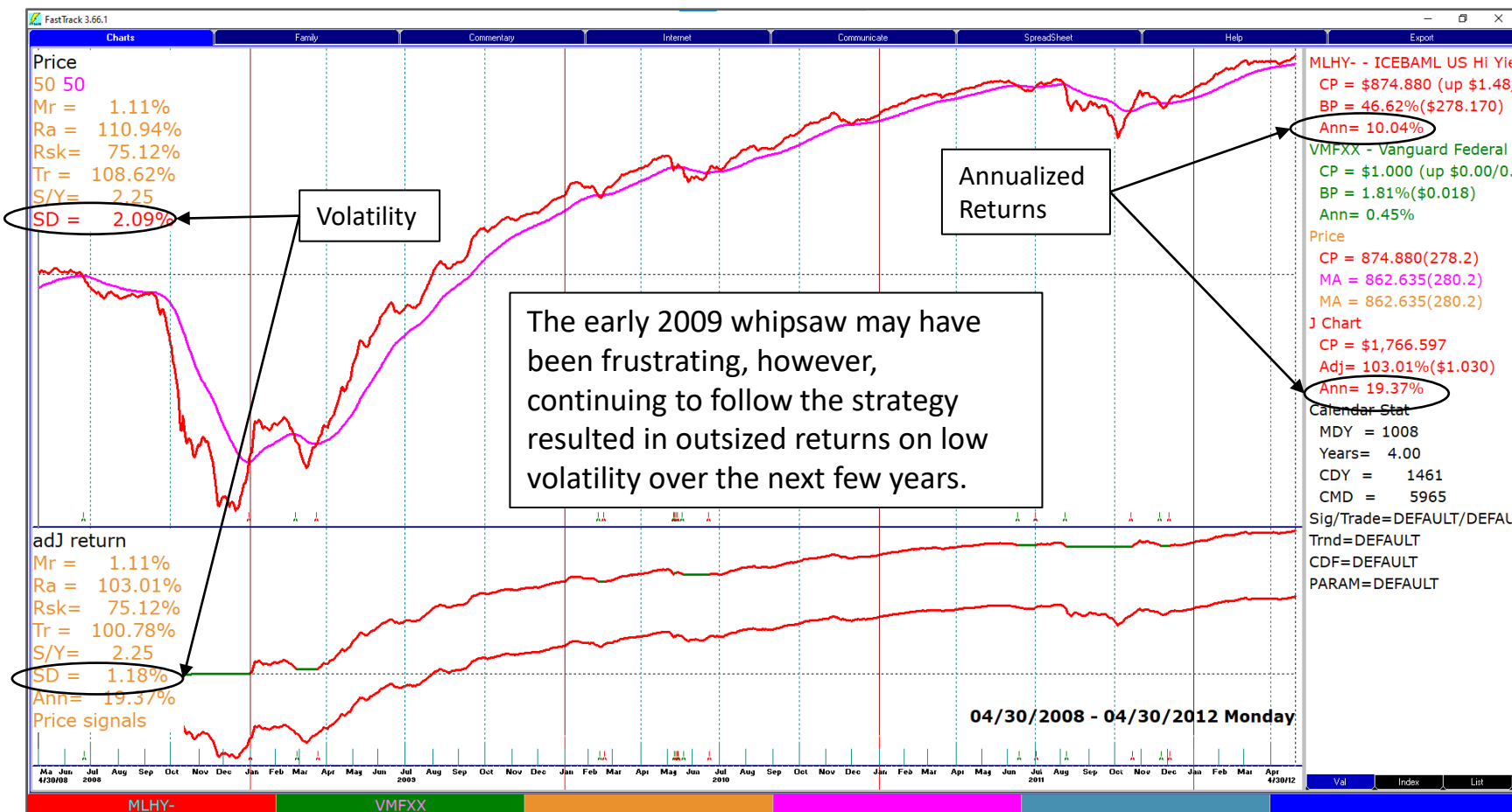
One-Year Chart (9/17/2021 – 9/19/2022)



Historical Perspective Great Financial Crisis

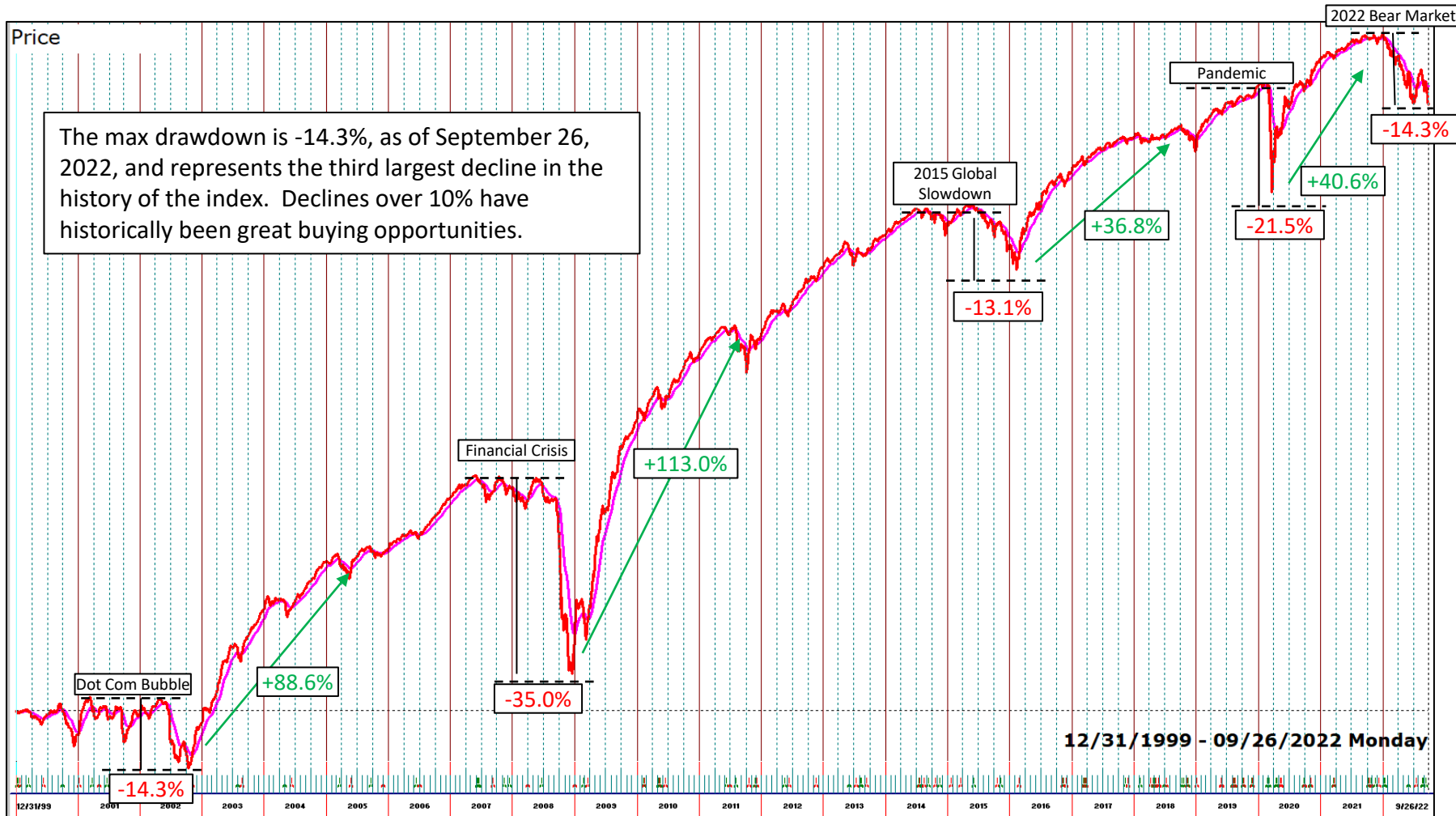


Historical Perspective Great Financial Crisis



Junk Bonds - The Current Market Environment

12/31/1996 – 09/26/2022



Other Low Volatility Asset Classes

An Opportunity in the Making

Symbol	Description	FTCloud Family	MaxDrawDown
RGB01	RGB US Treasury Index	Government	-17.80%
RGB02	RGB Corporate Bond Index	Corporate	-18.20%
RGB03	RGB Floating Rate Index	Bank Loan	-5.90%
RGB04	RGB Junk Bond Index	High Yield	-14.20%
RGB05	RGB Muni Bond Index	Muni National	-12.70%
RGB06	RGB High-Yield Muni Index	High Yield Muni	-16.30%
RGB07	RGB Securitized Credit Index	N/A	-8.80%
RGB08	RGB Emerging Market Debt Index	Emerging Markets	-24.20%
RGB09	RGB Inflation Protected Bond Index	Inflation-Protected	-12.60%
RGB10	RGB Preferred Securities Index	Preferred Stock	-13.10%

- The RGB indices are available in FastTrack (both FT4Web and FTCloud). A Fasttrack subscription is required to access the data. RGB is not affiliated with FastTrack and does not benefit from your subscription.
- FTCloud Family is the predefined group available in FTCloud that contains the funds (mutual funds and ETFs) that represent this index.
- MaxDrawDown is the largest decline during the period from 12/31/2020 to 9/26/2022.