September 2015

EquityCompass

Equity Risk Management Strategy

Timeless Principles.

- Stay invested
- Avoid large loss
- Disciplined, unemotional decision-making

Timely Opportunities.

- Monthly monitoring of fundamental and technical market conditions
- Automatically reduces equity exposure when conditions for large loss are indicated

EquityCompass Strategies

Why the Equity Risk Management Strategy (ERMS)?

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Is it necessary to incorporate a risk management strategy in an equity portfolio? The answer is yes, if you agree with the following.

1. **Downside volatility is a serious threat to achieving investment goals.**

   Stock markets, as represented by the S&P 500 index, have fluctuated more than 10% in approximately 70% of the years since 1901. In other words, volatility outside +/- 10% is more likely than not. While gains of this magnitude are great, investors should really be wary of large losses — as they can undermine their ability to stay invested. According to prospect theory, *"equal-magnitude gains and losses do not have symmetric impacts on the decision. Losses hurt more than gains satisfy; in fact, most empirical estimates conclude that losses are about twice as painful as gains are pleasurable."*[1] Large losses thus make investors vulnerable to ill-timed investment decisions that can in turn undermine the achievement of financial goals. It may not be rational, but it is human nature.

2. **Avoiding large losses is a key element to pursuing investment objectives.**

   An investment of $1 in the S&P 500 in 1928 would have grown to $71 by 2010. If the 10 best days during this period were missed, that same $1 investment would be worth only $24. However, missing the 10 worst days during this period would have increased the value of the investment to $229![2]

   The ERMS is a prepositioned strategy that seeks to reduce downside volatility. Where it differentiates from market timing is the presumption that the strategy is a source of excess return. The benefit of the ERMS is lower volatility, thus encouraging an investor to stay invested during the inevitable periods of market turbulence.

   We believe that drawdown, or peak-to-trough decline in monthly value, is the biggest deterrent to an investor's willingness to stay invested. **Table 1** shows the annual returns and volatility of the S&P 500 from 1958 to 2014 under three scenarios. The Buy-and-Hold scenario is the most volatile (as measured by standard deviation) and has the greatest drawdown. The second scenario assumes investors miss the 5% best and worst months during the study period — a more realistic assumption when implementing a risk management strategy. While the overall return is higher than Buy-and-Hold, more importantly an investor would experience one-third less volatility, and a drawdown of about

Buy-and-Hold Versus Missing Best and Worst Months — Table 1

1958 - 2014 | Source: EquityCompass Strategies, Ned Davis Research

S&P 500 (12/31/57 - 12/31/14)	Compounded Annual Total Return	Annual Volatility (Standard Deviation)	Return/Risk Sharpe Ratio	Maximum Drawdown
Buy-and-Hold S&P 500 Total Return Index	10.43%	14.67%	0.71	-51.01%
Missing the best and worst 5% of months overall	12.04%	10.60%	1.14	-26.51%
Missing the best and worst 10% of months overall	12.99%	8.64%	1.50	-15.34%

Past performance is not indicative of future results.

(1) Reid Hastie and Robyn Dawes, (2001, p. 216) on prospect theory developed by Daniel Kahneman and Amos Tversky (1979). http://prospect-theory.behaviouralfinance.net/

(2) "Five Popular Investment Myths," January 31, 2012. www.registeredrep.com

one-half that of Buy-and-Hold. Volatility is even lower in the third scenario, which assumes that 10% of the best and worst months are missed. Our point to this analysis is to view the equity risk management strategy not as a means to enhance returns, but to help reduce risk so that investors are more likely to stay invested to participate in the long-term returns the market provides.

3. **There is a difference between magnitude and frequency of loss.**

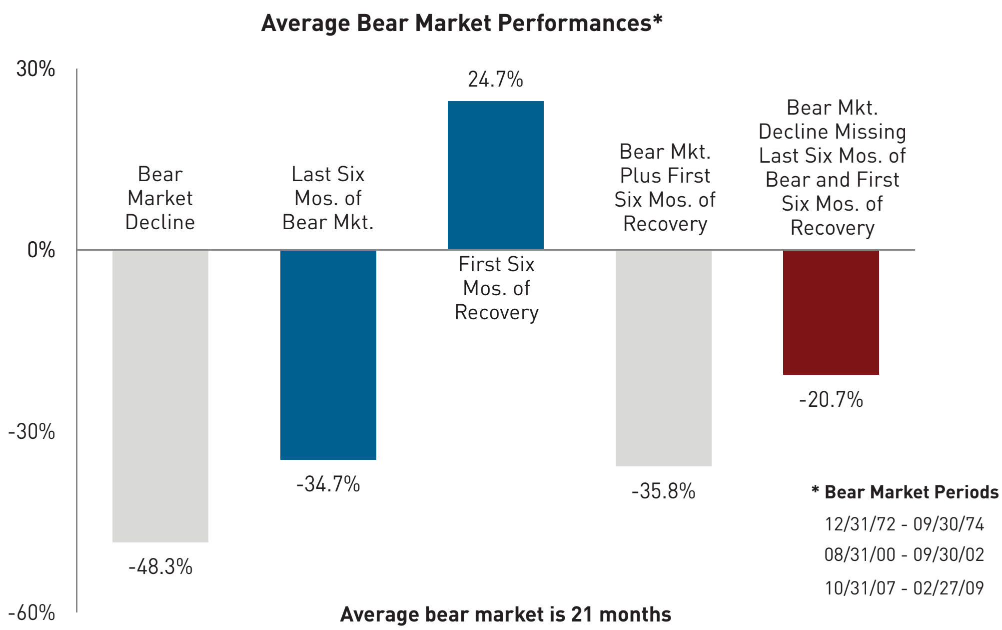
   Incorporating the ERMS can be compared to the premise of buying a homeowner's casualty policy — you buy it, even though the probability of loss is low, because the significance (magnitude) of the loss could be devastating. The equity markets posted gains during 61 of the past 85 years (71%). Nevertheless, the magnitude of a large loss can overwhelm the frequency of gains. Leading up to 2008, the market had risen in seven of the prior 10 years (70%). However, the magnitude of the 2008 decline wiped out the gains of the previous five years. The objective of the ERMS is to help mitigate the magnitude of a large loss.

4. **The benefits of missing the major declines, outweighs the cost of missing the rebound.**

   In the last three major bear markets, the greatest damage occurred in the final six months or when the bear market was well underway (**Chart 1**). Having the equity risk management strategy in place can potentially help to mitigate these losses. But what about the cost associated when the market bottoms and has a sharp recovery? The average gain in the first six months after the bear market bottom was a robust 24.7%. However, these gains did not overcome the losses that occurred in the last six months of the bear markets. If investors were able to miss both the last six months of losses, and first six months of gains, they would still be ahead of Buy-and-Hold and have experienced far less volatility. The lower volatility may help investors stay in the market through this trying, but inevitable, period thus allowing them to benefit from the ensuing upside.

The Cost / Benefit of Avoiding Bear Market Bottoms **Chart 1**

Cumulative Performances | Dividends excluded | Source: EquityCompass Strategies



Past performance is not indicative of future results.

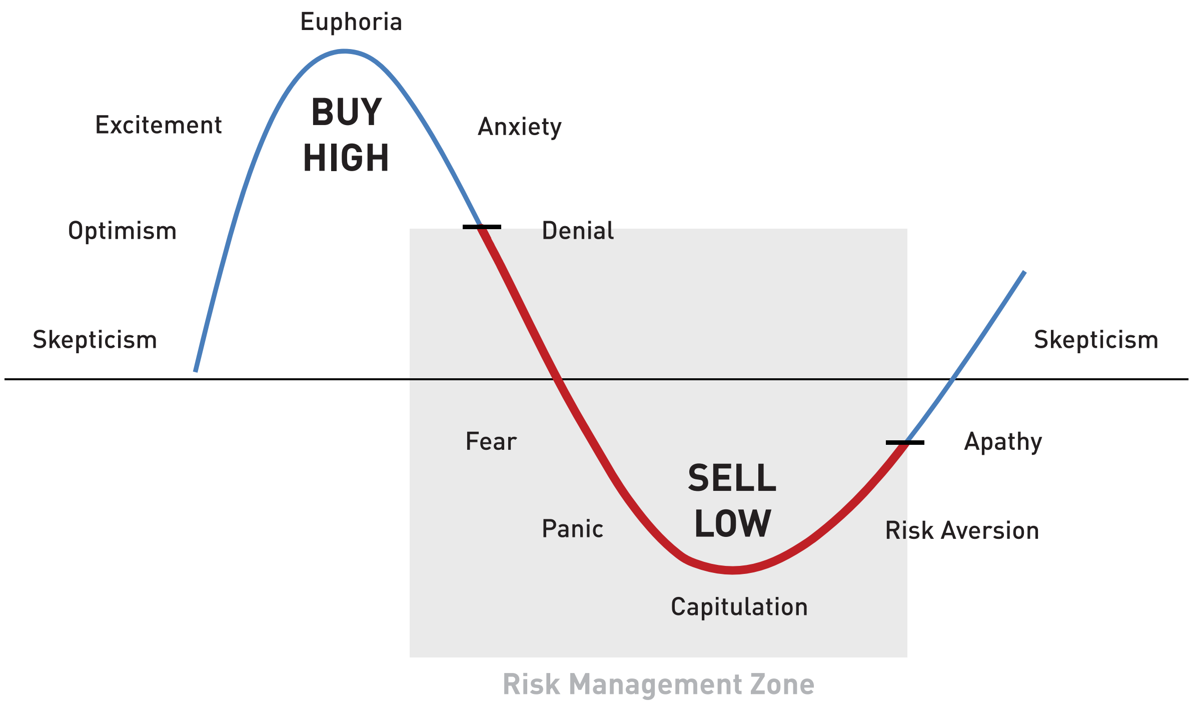
5. **Avoiding the "Emotional Roller Coaster" can help prevent ill-timed investment decisions.**

   While long-term stock market returns are primarily driven by fundamentals, short-to intermediate-term stock market volatility is driven by the collective emotions of investors. The natural human reaction to our emotions — buy high, sell low — is counterintuitive to successful investment results. Bull markets often fool investors into accepting increased risk, believing excess returns will continue indefinitely. In contrast, bear markets accentuate risk aversion, keeping investors out of the market for too long. These behavioral errors are well documented. Dalbar's study of investor returns shows from 1994 to 2014, the S&P 500 gained 9.9%, while the average stock fund investor only gained 5.2%. A disciplined risk management strategy removes the emotional decision-making that is destructive to building long-term wealth, reducing equity exposure when investors are paralyzed by fear and overriding despondency and skepticism to get them back into the market.

The equity risk management strategy should be a part of a coordinated investment strategy, and not a replacement for an equity strategy. The ERMS responds to deteriorating fundamental and technical conditions by reducing equity exposure. This can help reduce downside participation during times when stock price movements are volatile. When fundamental and technical conditions improve, ERMS restores exposure to stocks. For investors seeking a strategy to reduce volatility, this systematic approach to managing stock exposure can help investors stay invested over the long term.

Emotional Roller Coaster **Figure 1**

Source: EquityCompass Strategies

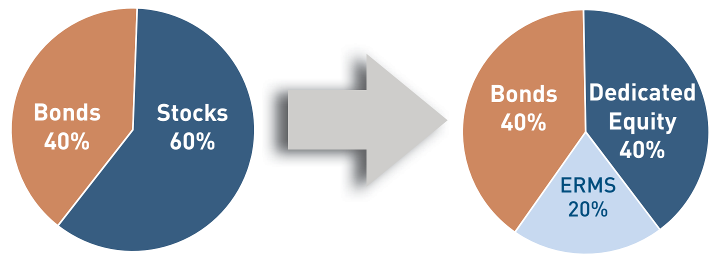


Equity Risk Management Strategy (ERMS)

Alternative Strategies

Tactical allocation strategy that seeks to adjust a portfolio's equity exposure to potentially provide downside protection and volatility control

- Incorporating the Risk Management Strategy involves carving out a portion of an equity portfolio for tactical allocation (could range from one-third to a maximum of 50% of the portfolio)
- The Risk Management Strategy would be fully invested to track the S&P 500 when market conditions are favorable
- When conditions are deemed unfavorable, the Risk Management Strategy is shifted to cash or inverse (short)



This example assumes a 60% stock / 40% bond allocation with 33% of the equity allocation invested in the Equity Risk Management Strategy.

How It Works

The Equity Risk Management Strategy analyzes technical and fundamental indicators to determine the current market condition and recommends the appropriate tactical allocation.

- The fundamental indicator tracks the trend in changes of expected earnings for the S&P 500. Two or more consecutive months of declining expectations increases the risk of large market losses and is considered unfavorable, while two or more consecutive months of increasing expectations is considered favorable.
- The technical indicator determines the market favorability based on the current level of the Dow Jones Industrial Average (Dow).
- The strategy may invest in inverse ETFs.

Status of Fundamental and Technical Indicators	Market Condition	ERMS Action	Equity Allocation
• Fundamental (earnings expectations) indicators positive • Technical conditions positive	Favorable	Fully Invested	95% - 100% S&P 500
Either Fundamental **OR** Technical indicators are negative	Caution	Reduce Equity Exposure	5% - 100% Cash 0% - 95% S&P 500
Both Fundamental **AND** Technical indicators are negative	Unfavorable	Hedge Equity Exposure	55% - 90% Inverse S&P 500 45% - 10% Cash

Current Allocation (as of September 1, 2015)

Fundamental Indicator: POSITIVE

S&P 500 forward earnings estimate edged 0.2% higher to $126.66 in August. This is the seventh consecutive monthly increase. The fundamental indicator remains positive.

Technical Indicator: NEGATIVE

The Dow declined 6.6% in August to 16,528, and the 5-day average price finished the month 10.7% below the all-time closing high. This moves the technical indicator to an unfavorable reading. With earnings estimates positive and the technical indicator fully negative, ERMS moves to 60% S&P 500, 40% Cash.

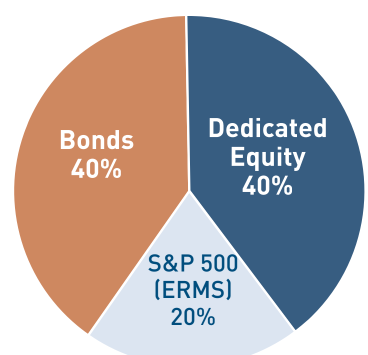
Risk Management Strategy Allocation

60% S&P 500

40% Cash

(Reduced Equity Exposure)

Effective Portfolio Allocation



EquityCompass Strategies have been available on the Stifel platform since 2006

Strategies are based on fundamental, technical, and behavioral insights evolving from the empirical research conducted by EquityCompass professionals since 2001.

We follow a rules-based investment process for portfolio construction and risk control overseen by the Chief Investment Officer while Senior Portfolio Managers focus on quantitative and qualitative research for stock selection appropriate to the various investment strategies.

EquityCompass is committed to providing full transparency on investment decision-making so that financial advisors and investors can assess risk and return potential.

For updated performance and portfolio statistics, contact a Stifel Financial Advisor.

Portfolios & Products

- **Tactical Total Core**
- **Tactical Total Core-Municipal**
- **Tactical Core Equity**
- **Global Leaders**
- **Quality Dividend**
- **Research Opportunity**
- **Select Quality**
- **Socially Responsible Select Quality**
- **Equity Risk Management Strategy**
- **Share Buyback**

Investment Portfolios & Products	Inception	Description
Global Asset Allocation		
Tactical Total Core (TTC)	June 2009	Stock/bond strategy that seeks to effectively capture market returns while minimizing volatility. With MTTC, the fixed income component is allocated to municipal bond ETFs and closed-end funds.
Tactical Total Core - Municipal (MTTC)	December 2009	
Global Equity		
Tactical Core Equity (TCE)	May 2011	Equity portfolio that utilizes risk management strategies and seeks to pursue returns in excess of the stock market returns while minimizing volatility.
Global Leaders Portfolio (GLP)	July 2014	Focused portfolio of leading global companies positioned to benefit from the unprecedented growth in worldwide consumer demand.
U.S. Equity		
Quality Dividend (QDIV)	January 2006	Diversified strategy of 25 high-quality, high-yielding stocks that integrates quantitative and qualitative approaches.
Research Opportunity (ROPP)	January 2006	Integrates insights from Stifel and KBW's nationally recognized equity research and EquityCompass' quantitative investment process.
Select Quality Growth & Income (SQLT)	January 2006	Sector balanced strategy investing in high quality, underpriced stocks with favorable value and price momentum characteristics.
Socially Responsible Select Quality (SRS)	June 2007	Sector balanced strategy investing in high quality, underpriced stocks with favorable value and price momentum characteristics. Stock selection is constrained by social criteria developed and monitored by RiskMetrics Group.
Alternative Strategies		
Equity Risk Management Strategy (ERMS)	June 2009	Rules-based tactical asset allocation strategy designed to help reduce portfolio risk without curtailing the upside.
Share Buyback	November 2011	Seeks to systematically capture the investment returns associated with share buyback announcements.

Important Disclosures

EquityCompass Overview: The information contained herein has been prepared from sources believed to be reliable but is not guaranteed and is not a complete summary or statement of all available data nor is it considered an offer to buy or sell any securities referred to herein. EquityCompass Strategies is a research and investment advisory unit of Choice Financial Partners, Inc., a wholly owned subsidiary and affiliated SEC registered investment advisor of Stifel Financial Corp. Choice Financial Partners does not manage actual client portfolios; rather, portfolios based on EquityCompass Strategies are available primarily through Stifel, Nicolaus & Company, Incorporated. Affiliates of EquityCompass Strategies may, at times, release written or oral commentary, technical analysis, or trading strategies that differ from the opinions expressed within. Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation, or needs of individual investors.

Strategy Specific Risks: Any investment involves risks, including the risk of a loss of principal. The Equity Risk Management Strategy invests primarily in ETFs, which are subject to the risk that the values will fluctuate with the value of the underlying investments or indices the ETFs are tracking. ***Exchange Traded Funds (ETFs) represent a share of all stocks in a respective index. ETFs trade like stocks and are subject to market risk, including the potential for loss of principal, and may trade for less than their net asset value. The value of ETFs will fluctuate with the value of the underlying securities. Inverse ETFs are considered risky and are not suitable for all investors. Typically, these products have one-day investment objectives, and investors should monitor such funds on a daily basis. Inverse ETFs are constructed by using various derivatives for the purpose of profiting from a decline in the value of an underlying benchmark. Investing in inverse ETFs is similar to holding various short positions, or using a combination of advanced investment strategies to profit from falling prices. Investors should review the prospectus and consider the ETF's investment objectives, risks, charges, and expenses carefully before investing. Prospectuses are available through your Financial Advisor and include this and other important information.*** Short selling incurs significant risk. Theoretically, securities sold short have unlimited risk.

Description of Benchmark(s): The Equity Risk Management Strategy performance and/or characteristics are compared to the S&P 500. The S&P 500 index is a broad market index that tracks the performance of 500 stocks from major industries of the U.S. economy. The S&P 500 Total Return Index tracks both the capital gains of the stocks in the S&P 500 Index over time, and assumes that any cash distributions, such as dividends, are reinvested back into the index. Looking at an index's total return displays a more accurate representation of the index's performance. By assuming dividends are reinvested, you effectively have accounted for stocks in an index that do not issue dividends and instead, reinvest their earnings within the underlying company. The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq. Indices are unmanaged, and it is not possible to invest directly in an index.

There is no guarantee that the figures or opinions forecasted in this report will be realized or achieved. Past performance is no guarantee of future results.

Additional Information Available Upon Request

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