

# Equity Risk Management Strategy (ERMS)

## Strategy Overview

January 2019



### Current Allocation (as of January 1, 2019)

#### Fundamental Indicator: **NEGATIVE**

S&P 500 forward 12-month EPS estimates decreased 1.1% to \$170.99 in December. This is the second consecutive monthly decline, moving the Fundamental Indicator to a negative reading. This is the first unfavorable reading for the fundamental indicator since February 2016. There will need to be two consecutive monthly increases to shift the indicator back to positive.

#### Technical Indicator: **NEGATIVE**

The Dow Jones Industrial Average fell 8.7% in December, with the 5-day average price for the index 14.9% below its all-time high. This moves the technical indicator to its most negative reading. With both the technical and fundamental indicators negative, the Equity Risk Management Strategy will move to its most defensive position as 2019 begins.

#### INVERSE VERSION

**90% Inverse /  
10% Cash**  
(changed from  
100% Equities)

#### CASH VERSION

**90% Cash /  
10% Equities**  
(changed from  
100% Equities)

### Objective

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

### Highlights

#### Seeks to avoid large market losses

- The tactically allocated portion helps manage the portfolio's exposure to equity markets. The tactical allocation would be fully invested in equities when market conditions are favorable. When conditions are deemed unfavorable, tactical allocation is shifted to cash or inverse.
- Large losses make investors vulnerable to ill-timed investment decisions that can, in turn, undermine the pursuit of financial goals.
- ERMS seeks to reduce portfolio volatility and provide risk mitigation from extended market declines, helping investors to stay invested during periods of market turbulence.

#### Addresses the Shortfalls of Traditional Risk Management Techniques

ERMS seeks to provide risk control during periods of enormous market stress when the performance of various asset classes becomes highly synchronized, and the traditional risk management approach of asset class diversification alone is not sufficient.

#### Rules-Driven Decision Making

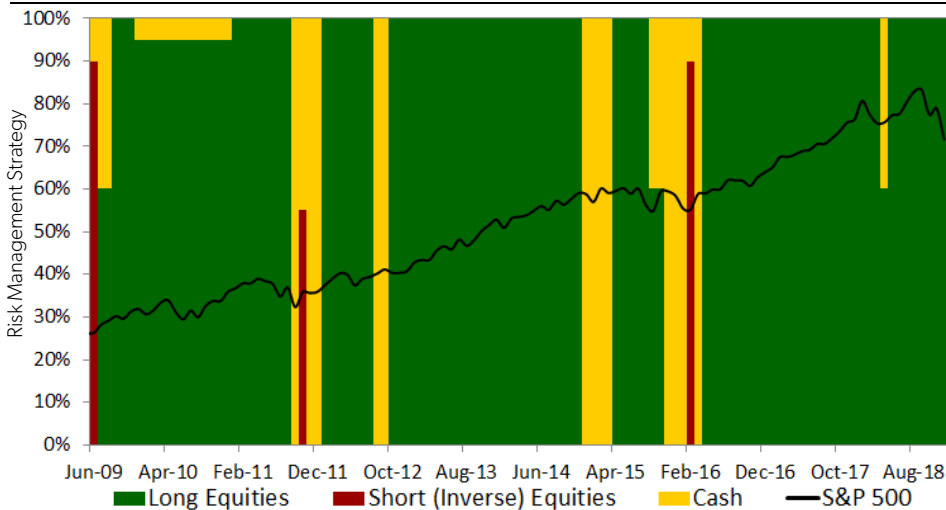
Tactical allocation decisions are based on a predetermined rule-set. This approach helps minimize the subjective biases and imposes discipline and consistency to investment decisions.

The inverse version may invest in inverse ETFs; the cash version will not.

### ERMS Tactical Allocation History

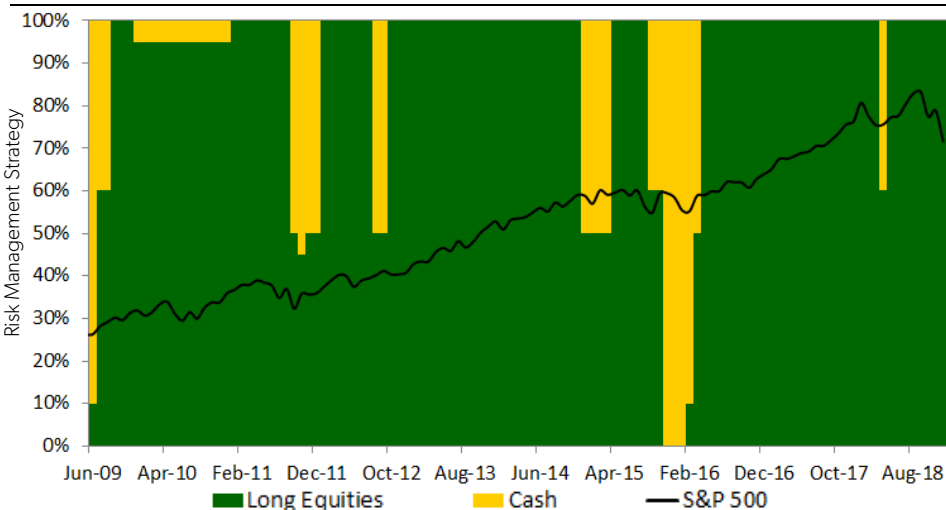
#### Inverse Version

June 1, 2009 – December 31, 2018



#### Cash Version

June 1, 2009 – December 31, 2018



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### How It Works

- Incorporating the Equity 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 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).

Status of Technical and Fundamental Indicators	Market Condition	ERMS Action	Portfolio Allocation
<ul style="list-style-type: none"> <li>■ Earnings expectations (fundamentals) rising</li> <li>■ Technical conditions positive</li> </ul>	Favorable	Fully Invested	 <b>Tactical Allocation:</b> Invested in Equities
Either fundamental <u>OR</u> technical conditions are negative	Caution	Reduce Equity Exposure	 <b>Tactical Allocation:</b> Partially or Fully Cash
Both fundamental <u>AND</u> technical conditions are negative	Unfavorable	Hedge Equity Exposure	 <b>Tactical Allocation:</b> Mostly Cash or Short (Inverse) Equities

### Portfolio Management Team



**Bernard J. Kavanagh III, CMT<sup>®</sup>**  
Senior Portfolio Manager



**Timothy M. McCann**  
Senior Portfolio Manager

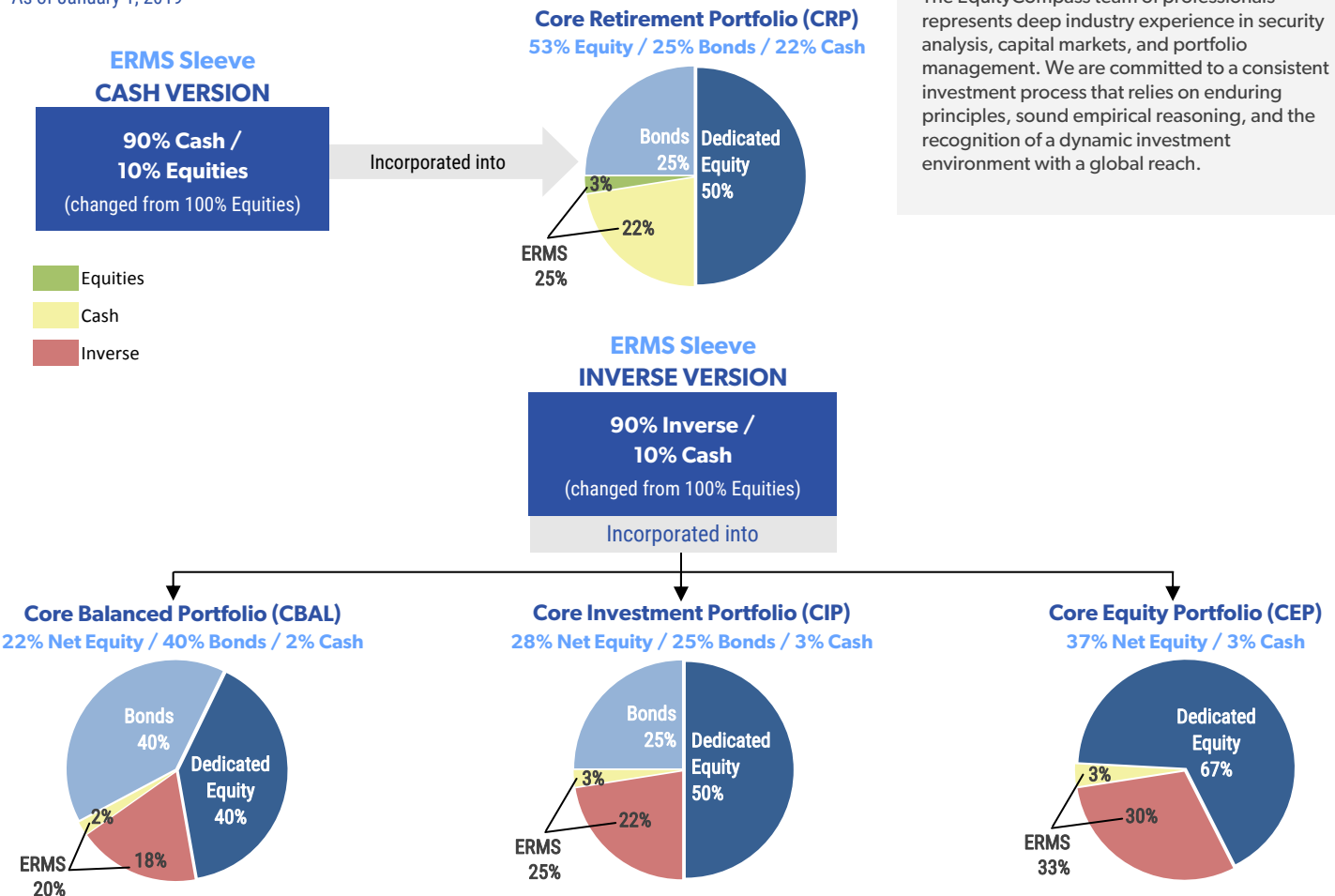
### About EquityCompass

EquityCompass is a Baltimore-based SEC registered investment adviser offering a broad range of portfolio strategies and custom plans for individuals, financial intermediaries, and institutional clients in the U.S. and Europe. Formally organized in 2008, EquityCompass provides portfolio strategies with respect to total assets over \$3.8 billion as of December 31, 2018.\*

The EquityCompass team of professionals represents deep industry experience in security analysis, capital markets, and portfolio management. We are committed to a consistent investment process that relies on enduring principles, sound empirical reasoning, and the recognition of a dynamic investment environment with a global reach.

### Effective Target Portfolio Allocations (based on current ERMS allocation)

As of January 1, 2019



## About EquityCompass

EquityCompass Investment Management, LLC is a registered investment adviser and wholly owned subsidiary of Stifel Financial Corp. EquityCompass offers a broad range of portfolio strategies based on its research-driven, rules-based investment process, which merges traditional investment theory with quantitative techniques. As of December 31, 2018, EquityCompass provided portfolio strategies with respect to total assets (Assets Under Management and Assets Under Advisement) over \$3.8 billion.

### Important Disclosures

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**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 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 Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques, strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. Indices are unmanaged, do not reflect fees and expenses, and it is not possible to invest directly in an index. Diversification (or asset allocation) does not ensure a profit or protect against loss.

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