Leverage & Inverse Trading Strategies
Inside ETFs Trading

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Using Leverage as Part of A Strategy

**Process**

The Good Harbor U.S. Tactical Strategy

- A repeatable process
- Model driven
- Fully vetted, precise process inputs
- Consistently applied
- Closely monitored

A well-constructed, data-driven model that produces results through consistent execution.

1. **Analyse** market, credit and economic conditions
   - **Inputs:**
     - Momentum measures
     - Yield curve dynamics
     - Economic conditions

2. **Model outputs** asset classes expected to
   - Outperform
   - Underperform

3. **Investment Universe:**
   - SP500 Large Cap
   - SP400 Mid Cap
   - Russell 2000 Small Cap
   - US Treasury Bonds

4. **Determine asset allocation and leverage targets**
   - Monthly execution and trading

**Value added trading:**
- Continuous
- Monitored

**Active monitoring and risk management**
Leverage does not need to mean “conviction”...

**Choices: Don’t need to be “bullish” to use equity leverage**

<table>
<thead>
<tr>
<th>1/2/1981-12/31/2009</th>
<th>Good Harbor (Net-of-Fees)</th>
<th>S&amp;P 500</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Best Month</strong></td>
<td>14.13%</td>
<td>13.18%</td>
</tr>
<tr>
<td><strong>Worst Month</strong></td>
<td>-12.32%</td>
<td>-21.76%</td>
</tr>
<tr>
<td><strong>Best 12 Months</strong></td>
<td>56.61%</td>
<td>52.94%</td>
</tr>
<tr>
<td><strong>Worst 12 Months</strong></td>
<td>-13.21%</td>
<td>-44.76%</td>
</tr>
<tr>
<td><strong>Worst Drawdown</strong></td>
<td>-20.61%</td>
<td>-56.78%</td>
</tr>
<tr>
<td><strong>Effective APR</strong></td>
<td>12.71%</td>
<td>7.52%</td>
</tr>
<tr>
<td><strong>Average Annual Return</strong></td>
<td>13.03%</td>
<td>9.18%</td>
</tr>
<tr>
<td><strong>Standard Deviation</strong></td>
<td>11.83%</td>
<td>15.37%</td>
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<tr>
<td><strong>Sharpe Ratio (1% Rf)</strong></td>
<td>1.01</td>
<td>0.47</td>
</tr>
<tr>
<td><strong>Information Ratio</strong></td>
<td>0.36</td>
<td>*</td>
</tr>
<tr>
<td><strong>Beta</strong></td>
<td>0.53</td>
<td>*</td>
</tr>
<tr>
<td><strong>Upside Capture</strong></td>
<td>80%</td>
<td>*</td>
</tr>
<tr>
<td><strong>Downside Capture</strong></td>
<td>43%</td>
<td>*</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Best Month</strong></td>
<td>18.45%</td>
<td>13.18%</td>
</tr>
<tr>
<td><strong>Worst Month</strong></td>
<td>-15.13%</td>
<td>-21.76%</td>
</tr>
<tr>
<td><strong>Best 12 Months</strong></td>
<td>81.29%</td>
<td>52.94%</td>
</tr>
<tr>
<td><strong>Worst 12 Months</strong></td>
<td>-16.69%</td>
<td>-44.76%</td>
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<tr>
<td><strong>Worst Drawdown</strong></td>
<td>-25.17%</td>
<td>-56.78%</td>
</tr>
<tr>
<td><strong>Effective APR</strong></td>
<td>17.57%</td>
<td>7.52%</td>
</tr>
<tr>
<td><strong>Average Annual Return</strong></td>
<td>18.31%</td>
<td>9.18%</td>
</tr>
<tr>
<td><strong>Standard Deviation</strong></td>
<td>15.53%</td>
<td>15.37%</td>
</tr>
<tr>
<td><strong>Sharpe Ratio (1% Rf)</strong></td>
<td>1.06</td>
<td>0.47</td>
</tr>
<tr>
<td><strong>Information Ratio</strong></td>
<td>0.72</td>
<td>*</td>
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<tr>
<td><strong>Beta</strong></td>
<td>0.69</td>
<td>*</td>
</tr>
<tr>
<td><strong>Upside Capture</strong></td>
<td>106%</td>
<td>*</td>
</tr>
<tr>
<td><strong>Downside Capture</strong></td>
<td>54%</td>
<td>*</td>
</tr>
</tbody>
</table>

Source: Internal

Use leverage to:

- Approximately bring “risk” to levels consistent with benchmark
- Use that leverage in an attempt to raise the APR
- In a case such as this, leverage is not a decision about whether markets are more or less “attractive” at any given time
- Here, looking for about 1.3x (15.53/11.83 = 1.3). Can achieve by using 70/30 blend of 1x and 2x ETFs.
Not all leveraged vehicles are the same

Expectations: Know what can happen

It’s not just the end that matters

Depending on how leverage is deployed, it is possible to get results that at first glance may seem unexpected.

If leverage is adjusted more frequently than the hold period path dependence produces some interesting scenarios. This is most obvious when using daily reset vehicles while holding longer than a day:

- Leveraged mutual funds
- Leveraged exchange traded funds

KNOW WHAT TO EXPECT…
...(or use managers who do)

Example of 2x long levered ETF vs. Underlying Index for 2011

Source: Bloomberg
So what is true “tracking error”?

*Expectations: Know what can happen*

Index flat does not mean no loss

Depending on how leverage is deployed, it is possible to get results that at first glance may seem unexpected.

Here:

- Financials index down approximately 3.3% over the period
- 3x ETF down over 43% well beyond three times 3.3%
- Is ETF broken?

![Graph showing financials compared to underlying index](source: Bloomberg)
So what is true “tracking error”? 

**Expectations: Know what can happen**

**Must Understand Leverage Effects**

Even though ETF is nowhere near 3x the index, the problem is not the ETF, it is the simple use of leverage with daily reset.

- Due to erratic path of underlying index, theoretically due simply to leverage, ETF should be down 46%. It was down 44%.
- Not meant to exonerate leveraged ETFs, but know what you own!
- Whether leverage reset daily (through ETF or mutual fund) is appropriate depends on the application and is a matter of opinion

*Source: Bloomberg*
So what is true “tracking error”? 

**Expectations: Know what can happen**

**Taking a closer look…**

Even though ETF is nowhere near 3x the index, the problem is not the ETF, it is the simple use of leverage with daily reset.

- Tracking error should be judged relative to a theoretical leveraged index performance

![Chart showing the comparison between Index, ETF, and Theoretical performance](chart.png)

*This is not “tracking error”*

*This should be the focus*

Source: Bloomberg
Disclosure

Mutual funds and exchange traded funds (ETFs) are offered by prospectus only. Investors should consider a fund’s investment objective, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other important information, is available from your Financial Advisor and should be read carefully before investing. The investment return and principal value of an investment will fluctuate, so that an investor’s shares, when redeemed, may be worth more or less than their original cost. ETFs trade like stocks and may trade for less than their net asset value. There will be brokerage commissions associated with buying and selling ETFs unless trading occurs in a fee-based account.

The S&P500 Total Return Index is the total return version of the S&P 500 Index which includes the effects of reinvested dividends. The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The S&P 400 Index is a capitalization-weighted index of 400 stocks designed to measure performance of the U.S. mid-cap sector. The Russell 2000 Index is a measure of the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 Index serves as a benchmark for small cap stocks in the United States. The Russell 1000 Financial Services Index is the Russell US Large Cap Financial Services Sector index that is part of the Russell Global Index classification. The Russell 1000 Index is a stock market index that represents the highest-ranking 1,000 stocks in the Russell 3000 Index.
Using Leverage in the MCS Portfolio

- Strive for Double Digit Returns in low risk market environments
- Goal is to never have a losing year in the portfolio – to date MCS has met this goal
- Access to all asset classes globally through ETFs
- Leverage, inverse, sectors, bonds, currency, etc.

**Tactical Growth Portfolio**
September 2005 to September 2012

- MCS Tactical Growth +109%
- S&P 500 +36%
- MSCI World Index +29%
Brief Education of Inverse ETFs

Source: Bigcharts.com Dec. 4, 2012
Inverse ETFs – Long FAS

Source: Bigcharts.com Dec. 4, 2012
### Inverse ETFs – Short FAZ

<table>
<thead>
<tr>
<th>Last:</th>
<th>17.23</th>
</tr>
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<tbody>
<tr>
<td>Change:</td>
<td>🟡 -0.0999</td>
</tr>
<tr>
<td>Percent Change:</td>
<td>-0.58%</td>
</tr>
<tr>
<td>Open:</td>
<td>17.31</td>
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<tr>
<td>High:</td>
<td>17.38</td>
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<tr>
<td>Low:</td>
<td>17.20</td>
</tr>
<tr>
<td>Volume:</td>
<td>1,719,609</td>
</tr>
</tbody>
</table>

Source: Bigcharts.com Dec. 4, 2012
MCS - 2007 Portfolio Holdings

August 2007 to October 2007
Portfolio Return of 11.5% gross

- Mid Cap: 77% of allocation
  - MDY 5.3% IRR
  - IWR 3.7% IRR
  - MVV 2X 18.3% IRR

- S&P 500: 11% of allocation
  - SSO 2X 29.1% IRR

- Bio Tech: 2% of allocation
  - BBH 10.3% IRR
MCS - 2010 Portfolio Holdings

February 2010 to April 2010
Portfolio Return of 25.6% gross

- Emerging Markets: 43% of allocation
  - EDC 3X 52.2% IRR

- Technology: 27% of allocation
  - TYH 3X 57.8% IRR

- S&P 500: 12% of allocation
  - UPRO 3X 51.2% IRR
<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage of Allocation</th>
<th>Fund</th>
<th>Multiplier</th>
<th>IRR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large Cap</td>
<td>26%</td>
<td>BGU</td>
<td>3X</td>
<td>6.0% IRR</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>16%</td>
<td>UPRO</td>
<td>3X</td>
<td>11.6% IRR</td>
</tr>
<tr>
<td>NASDAQ</td>
<td>35%</td>
<td>TQQQ</td>
<td>3X</td>
<td>-1.7% IRR</td>
</tr>
<tr>
<td>Small Cap</td>
<td>9%</td>
<td>TNA</td>
<td>3X</td>
<td>28.2% IRR</td>
</tr>
<tr>
<td>Mid Cap</td>
<td>3%</td>
<td>MWJ</td>
<td>3X</td>
<td>21.3% IRR</td>
</tr>
<tr>
<td>Technology</td>
<td>10%</td>
<td>TYH</td>
<td>3X</td>
<td>-15.8% IRR</td>
</tr>
</tbody>
</table>

March 2011 to April 2011
Portfolio Return of 4.0% gross
Leverage & Inverse ETFs

- In the MCS portfolio leverage and inverse ETFs are used in the way that the products are intended to perform
  - Short term trading vehicles
  - To enhanced returns
  - MCS can achieve a robust return in a shorter amount of time, thus reducing market risk

- Leverage and Inverse ETFs are compliments to the ETF Universe
Disclosure

Past performance is not a guarantee of future results. Investments may lose value. Information has been obtained from sources believed to be reliable, but cannot be guaranteed. Please consult with a tax and/or legal advisor as Metropolitan Capital Strategies does not provide tax and/or legal advice. Metropolitan Capital Strategies, LLC (MCS) is a registered investment adviser established in 2007. MCS claims compliance with the Global Investment Performance Standards (GIPS®). GIPS® compliance has been independently verified for the periods May 1, 2007 through May 31, 2008 by Cohen Fund Audit Services and for periods June 1, 2008 through December 30, 2011 by Ashland Partners & Co. LLP. The Tactical Growth Strategy primarily involves purchasing and selling Exchange Traded Funds (ETFs) and writing uncovered put and call options. There are special risks associated with uncovered option writing which exposes the investor to potentially significant loss. This type of strategy may not be suitable for all investors. Options may be employed continually throughout the year. The Tactical Moderate Strategy primarily involves purchasing and selling ETFs. The composites include discretionary accounts consistent with the investment strategy noted above. Composite returns are calculated in US dollars and are presented net and gross of investment management fees and wrap fees. Gross returns are pure gross and considered supplemental to net returns because they are not reduced by the transaction costs. Returns include reinvestment of dividends and other earnings. The composites were created on May 1, 2007. Returns prior to composite creation are those from a previous firm and have been linked to the current firm performance. Prior firm returns have been reduced by transaction costs only. MCS measures its composite performance to the MSCI World (gross) Index (“MSCI World”). The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed markets. For periods prior to December 31, 2009, the S&P 500 Index was used for comparison purposes. The S&P 500 Index consists of 500 US stocks chosen for market size, liquidity and industry group representation. The benchmark was changed to more accurately reflect the strategy of the composite. To receive a list of composite descriptions and and/or a presentation that adheres to GIPS® standards, email info@mcsmgr.com or call 703-251-4535. Tactical Growth Composite net annual returns compared to the MSCI World Index are as follows: as of 09/2012: -1.9% vs 13.6%, 2011: 0.4% vs -5.0%, 2010: 23.7% vs 12.3%, 2009: -2.9% vs 30.8%, 2008: -0.2% vs -40.3%, 2007: 21.7% vs 9.6%, 2006: 17.2% vs 20.7%, 9/30/05-12/31/05: 6.9% vs 3.2%. Tactical Moderate Composite net annual returns compared to the MSCI World Index are as follows: as of 09/2012: -1.8% vs 13.6%, 2011: -0.4% vs -5.0%, 2010: 20.3% vs 12.3%, 2009: -2.8% vs 30.8%, 2008: 0.8% vs -40.3%, 2007: 18.8% vs 9.6%, 2006: 10.8% vs 20.7%, 9/30/05-12/31/05: 2.1% vs 3.2.
Stephen Blumenthal
Founder and CEO
Capital Management Group, Inc.
CMG Scotia Partners Growth S&P Plus Program

Strategy Inception: 2004
CMG Platform Introduction: 2008
Investment Category: Tactical Long/Short

Strategy Summary:
- Based on the alignment of signals across multiple time frames, Scotia will invest long or short the S&P 500.
- Strategy also utilizes an overbought/oversold overlay that is meant to capitalize on mean reversion trades.
CMG Scotia Partners Growth S&P Plus Program

How it Works

- A disciplined trading strategy for both bull & bear markets
- Quantitative and systematic
- Only 3 possible positions: Long S&P 500, Short S&P 500, Cash or Equivalent (60% of the time)
- Average hold time is 1-3 days – seeking targeted high probability trading opportunities
- Trades 2x long or short on every trade
- Roughly 60-65 trades per year/will only trade 1 time on a given day at close
Scotia S&P Plus Since July 2004:

- Profitable every year since 2004
- Cumulative Return: +336%
- Compounded return: Scotia +19.71% vs. S&P +4.76%
- +76% in 2008

- Actual performance since 2004 net of fees. Past performance can not predict or guarantee future performance!

Leveraged ETF’s:

1. SSO – ProShares Ultra S&P 500 (2x long)
2. SDS – ProShares UltraShort S&P 500 (2x short)
3. Trade end of day via a large ETF market maker
CMG Opportunistic All Asset Strategy

Strategy Inception: 1995 using Mutual Funds
CMG Platform Introduction: 2012 ETF’s
Investment Category: Tactical Equity

Strategy Summary:

- **Quantitative/Systematic** strategy that analyzes a diverse universe of ETF’s to determine an optimal portfolio allocation comprised of up to 11 ETF positions.
- The **ETF selection process** utilizes proprietary mathematical and technical indicators to identify ETF’s with emerging price trends across various asset classes and market sectors.
Hedge and/or directional trade

- **TBF** – ProShares Short 20+ Year Treasury Bond Index 1x
- **TBT** – ProShares UltraShort 20+ Year Treasury Bond 2x
- **TTT** – ProShares UltraPro Short 20+ Year Treasury Bd 3x

### 10 Year Treasury Bond assuming a 2% Coupon with a 1.63% yield to maturity

<table>
<thead>
<tr>
<th>Yield to maturity</th>
<th>1.00%</th>
<th>1.63%</th>
<th>2.63%</th>
<th>3.63%</th>
<th>4.63%</th>
<th>5.63%</th>
<th>6.63%</th>
<th>7.63%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price</td>
<td>109.494</td>
<td>103.401</td>
<td>94.492</td>
<td>86.433</td>
<td>79.137</td>
<td>72.530</td>
<td>66.541</td>
<td>61.109</td>
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<tr>
<td>Change in Price</td>
<td><strong>5.89%</strong></td>
<td>-8.62%</td>
<td>-16.41%</td>
<td>-23.47%</td>
<td>-29.86%</td>
<td>-35.65%</td>
<td>-40.90%</td>
<td></td>
</tr>
</tbody>
</table>

### 30 Year Treasury Bond assuming a 3% Coupon with a 2.82% yield to maturity

<table>
<thead>
<tr>
<th>Yield to maturity</th>
<th>2.00%</th>
<th>2.82%</th>
<th>3.82%</th>
<th>4.82%</th>
<th>5.82%</th>
<th>6.82%</th>
<th>7.82%</th>
<th>8.82%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price</td>
<td>122.478</td>
<td>103.628</td>
<td>85.432</td>
<td>71.287</td>
<td>60.213</td>
<td>51.479</td>
<td>44.535</td>
<td>38.967</td>
</tr>
<tr>
<td>Change in Price</td>
<td><strong>18.19%</strong></td>
<td>-17.56%</td>
<td>-31.21%</td>
<td>-41.89%</td>
<td>-50.32%</td>
<td>-57.02%</td>
<td>-62.40%</td>
<td></td>
</tr>
</tbody>
</table>

Current 10-yr yield 1.63%
Current 30-yr yield 2.82%
11/7/2012

Source: CMG Investment Research
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The CMG Opportunistic All Asset Strategy and the Tactical Portfolio performance results reflect hypothetical results that were achieved by means of the retroactive application of a back-tested model and, as such, the corresponding results have inherent limitations, including: (1) the model results do not reflect the results of actual trading using client assets, but were achieved by means of the retroactive application of each of the above referenced models, certain aspects of which may have been designed with the benefit of hindsight; (2) back-tested performance may not reflect the impact that any material market or economic factors might have had on the advisor’s use of the model if the model had been used during the period to actually manage client assets; (3) for various reasons (including the reasons indicated above), CMG’s clients may have experienced investment results during the corresponding time periods that were materially different from those portrayed in the model; and please note: the hypothetical performance results reflect the deduction of the maximum investment management fee, 2.50%, which would have been charged by CMG during the corresponding time periods for CMG strategies. Indices used in the Tactical Portfolio illustration do not reflect the deduction of management fees. The portfolio reflects annual rebalancing of positions.

Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that future performance will be profitable, or equal to any corresponding historical index. The composition/percentage weighting of each corresponding CMG index (i.e. S&P 500 Total Return or Dow Jones Wilshire U.S. 5000 Total Market Index) is also disclosed. For example, the S&P 500 Composite Total Return Index (the "S&P") is a market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market. Standard & Poor's chooses the member companies for the S&P based on market size, liquidity, and industry group representation. Included are the common stocks of industrial, financial, utility, and transportation companies. The historical performance results of the S&P (and those of or all indices) do not reflect the deduction of transaction and custodial charges, nor the deduction of an investment management fee, the incurrence of which would have the effect of decreasing indicated historical performance results. The S&P is not an index into which an investor can directly invest. The historical S&P performance results (and those of all other indices) are provided exclusively for comparison purposes only, so as to provide general comparative information to assist an individual client or prospective client in determining whether the performance of CMG’s portfolio meets, or continues to meet, his/her investment objective(s). A corresponding description of the other comparative indices, are available from CMG upon request. It should not be assumed that any CMG holdings will correspond directly to any such comparable index. The CMG performance results do not reflect the impact of taxes.

PAST PERFORMANCE MAY NOT BE INDICATIVE OF FUTURE RESULTS
Thank You.
Let’s Open for Q&A.