

## Sector vs. Style: Tactical Equity ETF Strategies

**Paul Baiocchi**, *Moderator*  
ETF Specialist, IndexUniverse

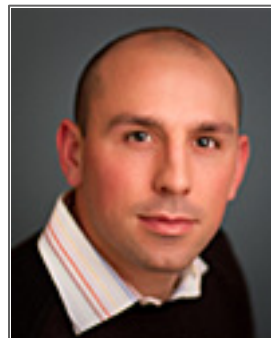
**Kim Arthur**, *Panelist*  
CEO & Founding Partner,  
Main Management

**Sam Stovall**, *Panelist*  
Chief Equity Strategist,  
S&P Capital IQ Equity Research

**Howard Present**, *Panelist*  
Co-Founder, President and CEO,  
F-Squared Investments

**James McDonald**, *Panelist*  
CEO & Chief Investment Officer  
Index Strategy Advisors

## Moderator



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ETF Specialist  
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## Panelists



**MAIN**  
MANAGEMENT, LLC

## Sector vs. Style

## Why Sector & Industry Investing Makes Sense

# Main Management Sector Rotation Strategy

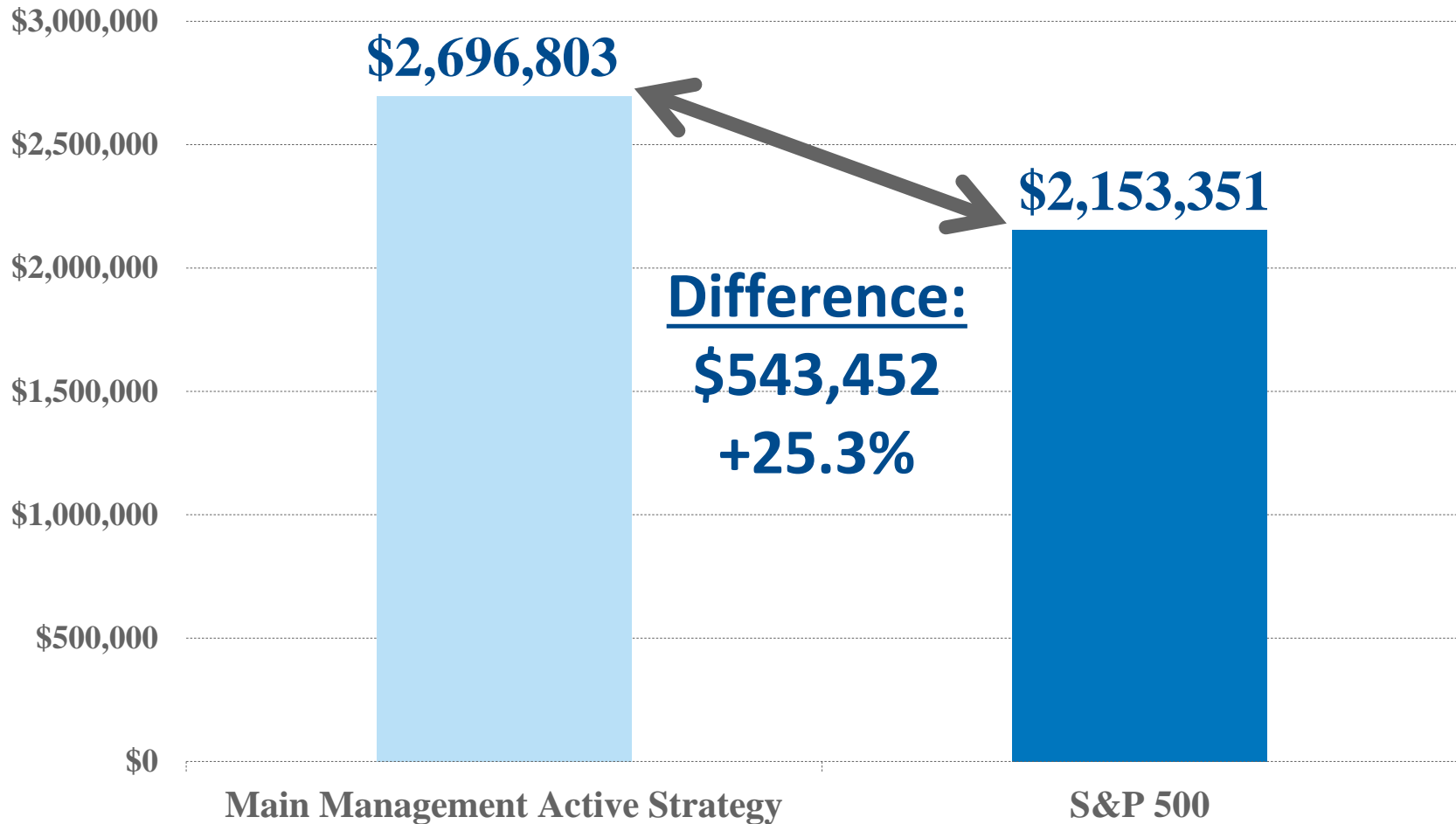
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- Over 10 Years Managing Money Exclusively Using Exchange Traded Funds (ETFs)
- Fundamental, Long Only Money Manager
- Approximately \$0.5 Billion Under Management
- Low Fees; Low Turnover; Low Costs; Low Taxes
- Outperformed the S&P 500 by 239 Basis Points Per Year over the past 10+ Years
- 5 Star Morningstar Rating for the firm's GIPS Verified Live Track Record



# Main Management vs. S&P 500\*

(\$1MM Invested Over 10 Years)

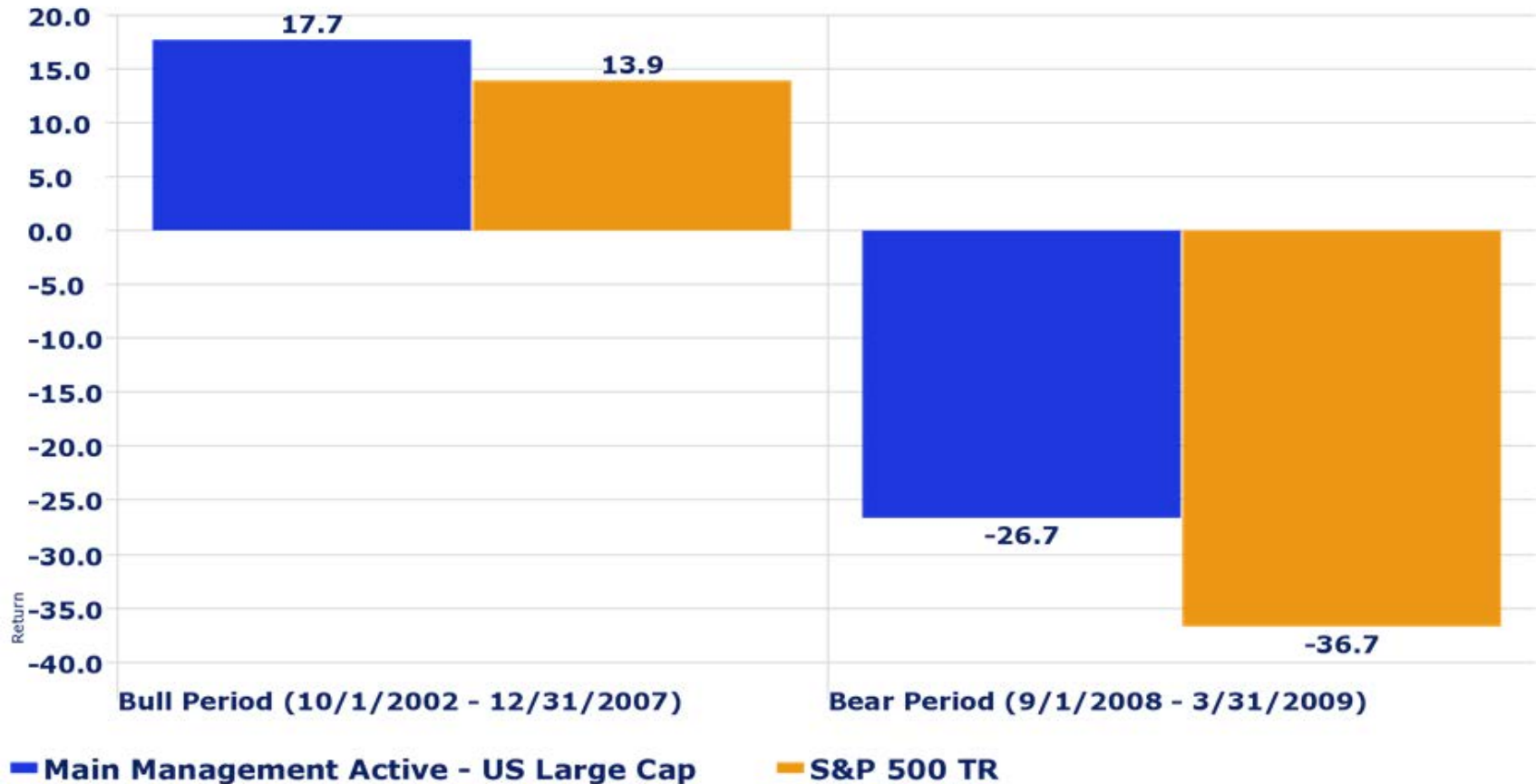


\* Total Return from 10/1/2002 through 12/31/2012

# Fundamentals Provide Embedded Downside Protection

## Bull/ Bear Period Returns

Source Data: Total Return



Source: Morningstar Direct



# Actual Sector to Industry Trade – Executed 8/22/12

## Fundamentals of Homebuilders Versus Broader Discretionary Sector

Portfolio Date: 7/31/2012

	XLY	XHB
<b>Average Market Cap (mil)</b>	<b>30,579.69</b>	<b>2,872.62</b>
<b>Market Cap Large %</b>	<b>47.88</b>	<b>5.69</b>
<b>P/E Ratio (TTM)</b>	<b>14.53</b>	<b>15.86</b>
<b>P/B Ratio (TTM)</b>	<b>3.01</b>	<b>2.19</b>
<b>P/S Ratio (TTM)</b>	<b>1.14</b>	<b>0.93</b>
<b>P/FCF Ratio (TTM) (Long)</b>	<b>0.06</b>	<b>0.03</b>

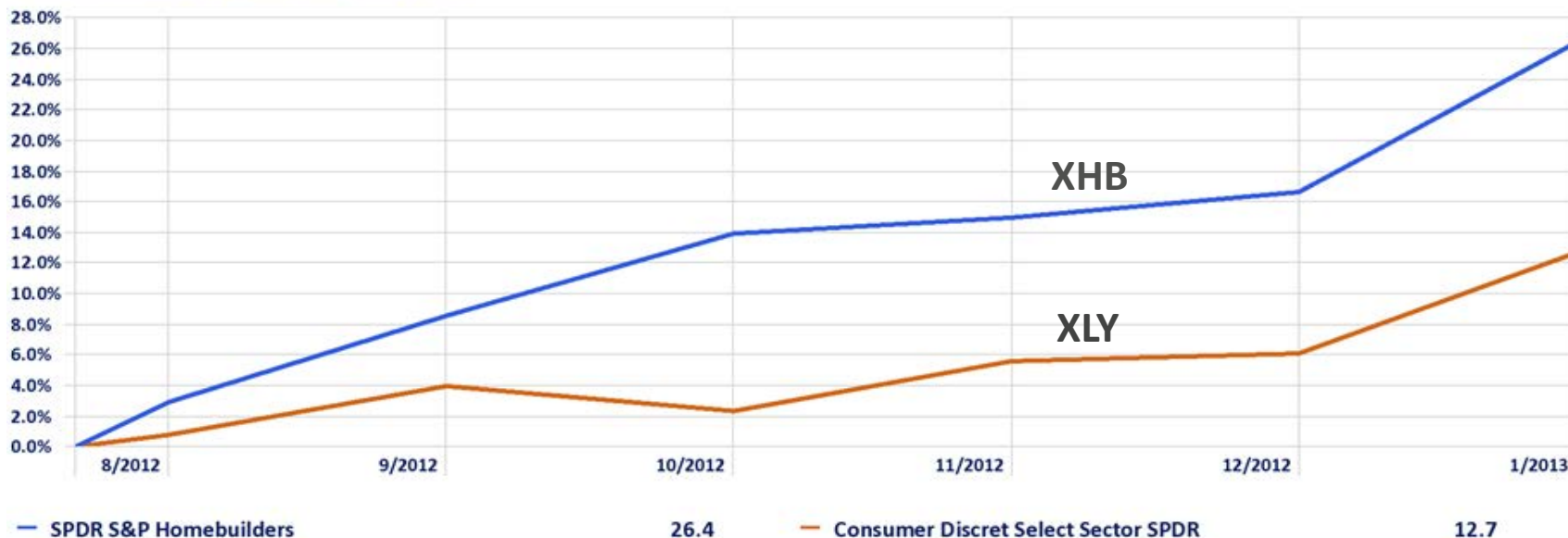
- Fundamentals suggested superior valuations for the Homebuilding Industry versus the broader Consumer Discretionary sector
- Industry has higher beta than broader sector but risk/reward was appealing



# Outcome of XLY to XHB Trade

## Investment Growth

Time Period: 8/22/2012 to 1/30/2013



## Trailing Returns

As of Date: 1/30/2013 Source Data: Total Return

	Trailing 1-month	Trailing 3-month	Since 8/22/2012
SPDR S&P Homebuilders	11.25	13.37	26.42
Consumer Discret Select Sector SPDR	8.34	10.49	12.68



Source: Morningstar Direct

# Contact Us

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## Rules-Based Sector Rotation Strategies

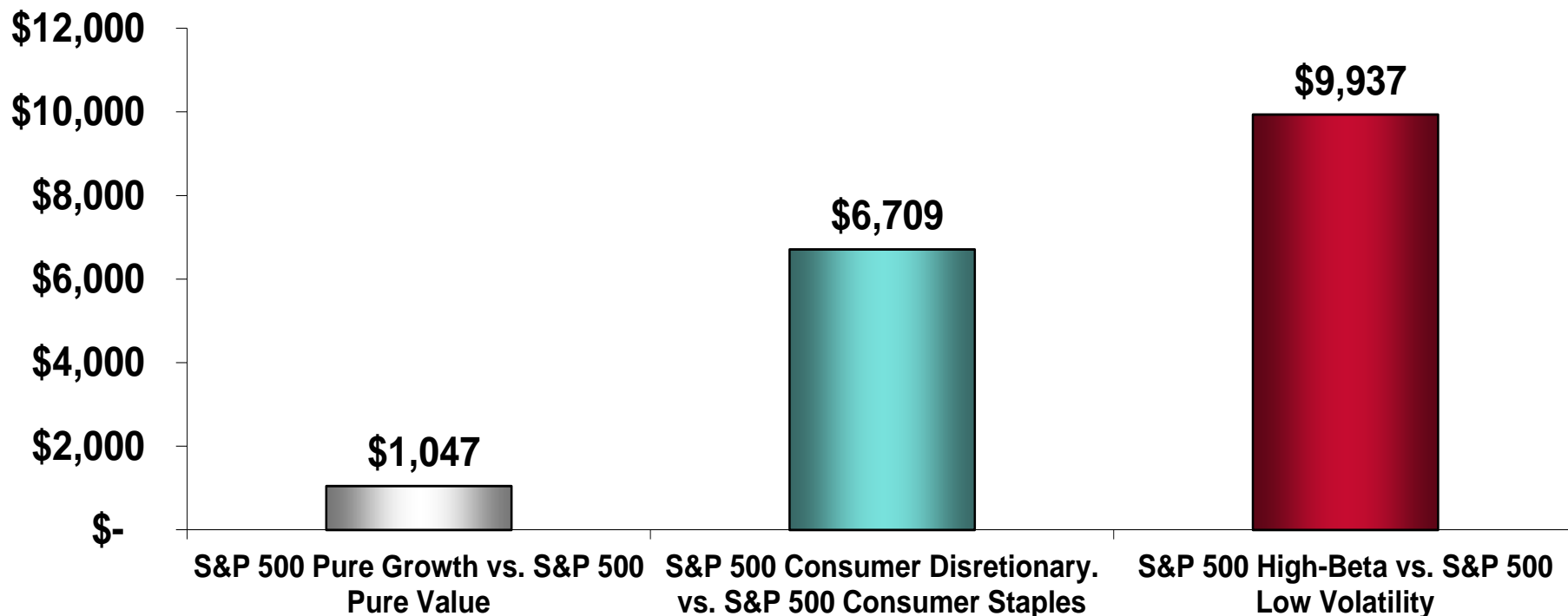


**Sam Stovall**  
Chief Equity Strategist  
S&P Capital IQ Equity Research

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# Growth of \$1000 Based on Hypothetical Monthly "Risk On"/"Risk Off" Signals

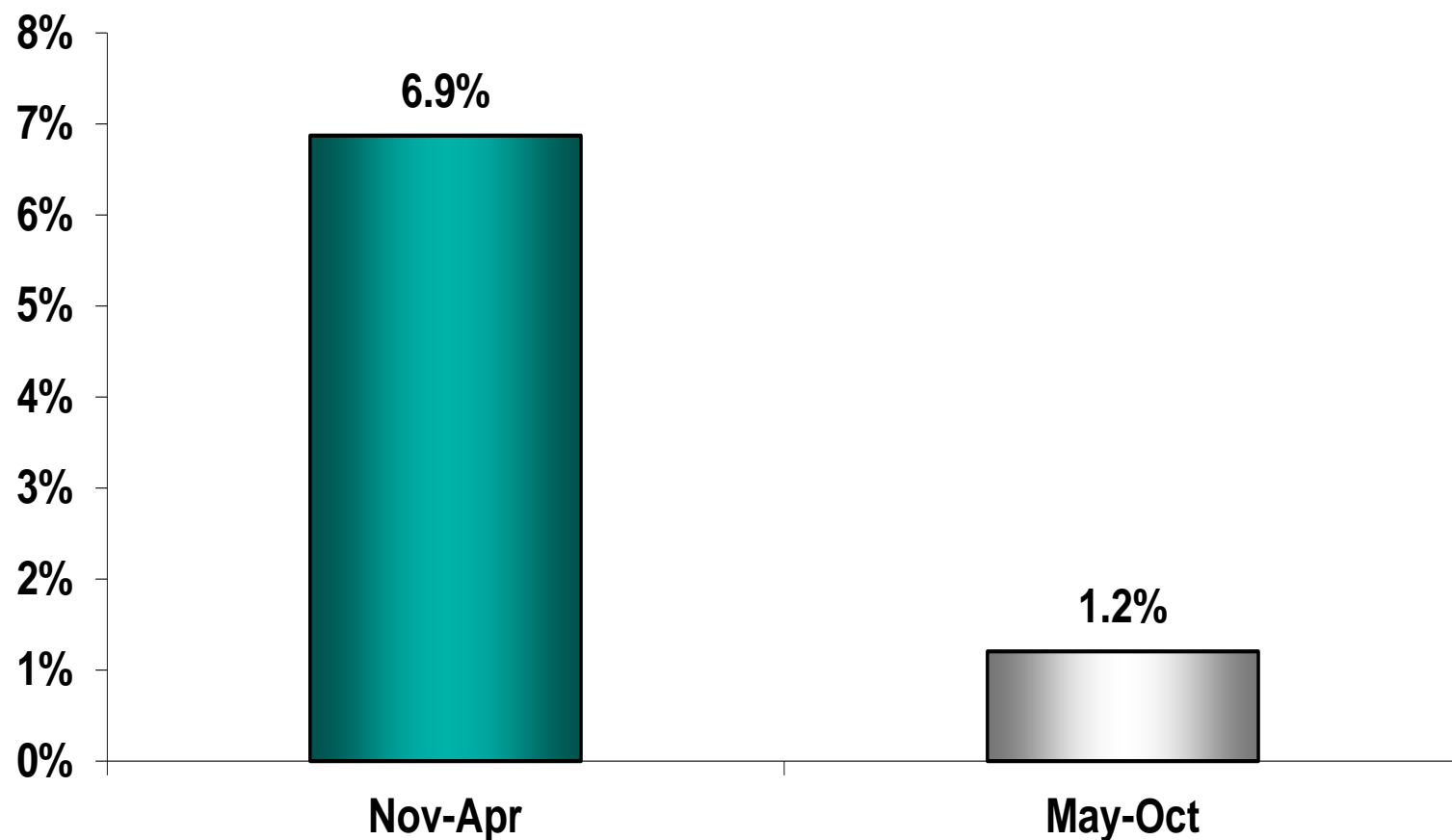
(Long the S&P 500 in the months that Pure Growth Beat Pure Value, Consumer Discretionary Beat Consumer Staples, or High Beta Beat Low Volatility; otherwise in cash: 12/31/99-12/31/12)



Source: S&P Capital IQ. Indexes are unmanaged, statistical composites and it is not possible to invest directly in an index. These results are inherently limited because they do not represent the results of actual trading and were constructed with the benefit of hindsight. The returns shown do not reflect payment of any sales charges or fees an investor would pay to purchase the securities they represent. The imposition of these fees and charges would cause actual and back tested performance to be lower than the performance shown. Returns exclude dividends. S&P Indices and its affiliates do not sponsor, endorse, sell, promote or manage any investment fund or other vehicle that is offered by third parties and that seeks to provide an investment return based on the returns of any S&P Indices index. Past performance is no indication of future results.

# SEASONALITY: The Cyclical and Defensive Months

Average Semi-Annual S&P 500 Price Changes: 04/30/45-1/18/13



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# SEASONALITY: Semi-Annual Sector Rotation Strategy

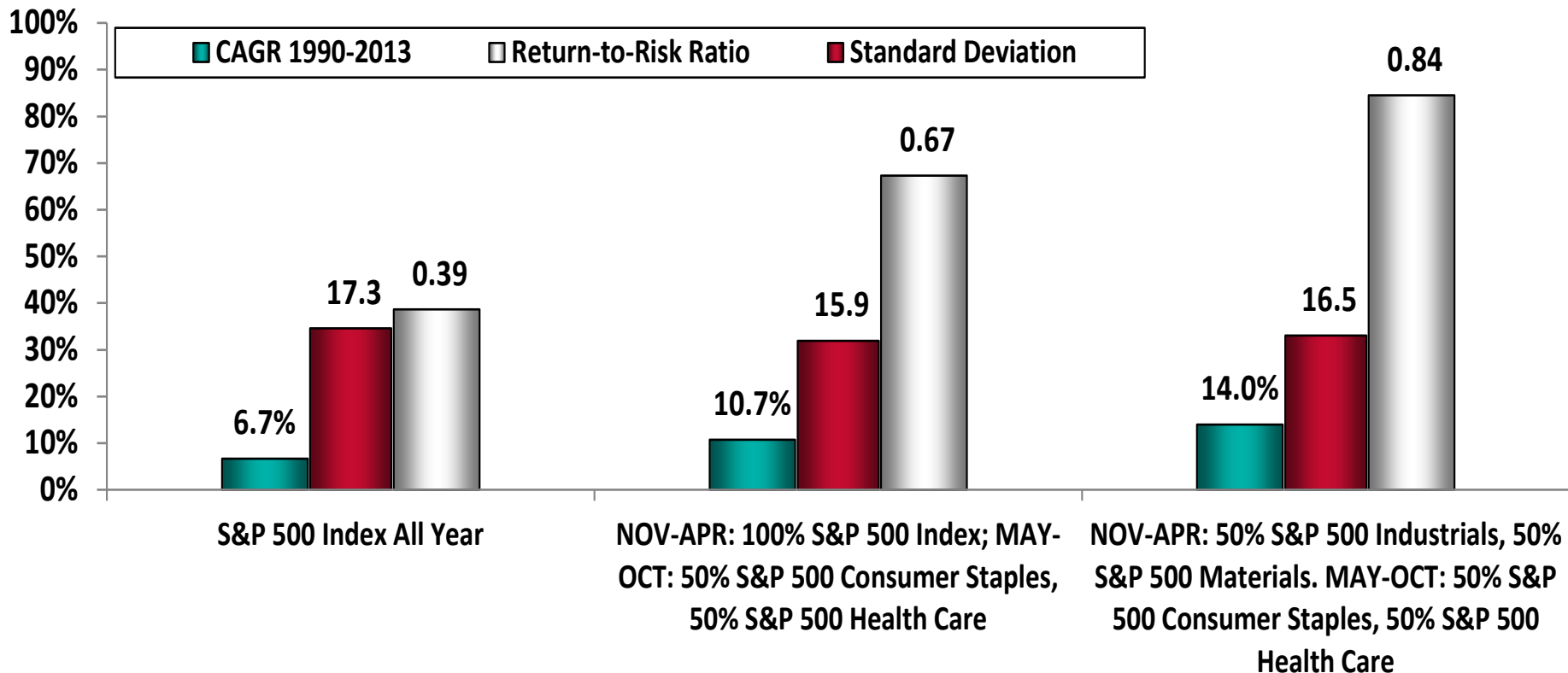
Average Semi-Annual S&P 500 Sector Price Changes: 4/30/90-1/18/13

Sector	May-Oct.		Nov.-April	
	% Chg.	F.O.	% Chg.	F.O.
Cons. Discretionary	(1.1)	43%	10.6	61%
Consumer Staples	4.6	70%	4.4	43%
Energy	1.4	39%	8.3	43%
Financials	0.7	52%	7.8	65%
Health Care	4.4	65%	5.4	43%
Industrials	(1.1)	17%	9.4	74%
Info Tech	2.7	61%	8.9	57%
Materials	(2.8)	30%	10.1	74%
Telecom Services	1.2	61%	2.7	30%
Utilities	1.9	52%	2.6	30%
<b>S&amp;P 500</b>	<b>1.0</b>	<b>NA</b>	<b>6.8</b>	<b>NA</b>

Source: S&P Capital IQ. Indexes are unmanaged, statistical composites and it is not possible to invest directly in an index. The returns shown do not reflect payment of any sales charges or fees an investor would pay to purchase the securities they represent. The imposition of these fees and charges would cause actual and back tested performance to be lower than the performance shown. Returns exclude dividends. Past performance is no indication of future results.

# SEASONALITY: Semi-Annual Sector Rotation Strategy

Hypothetical Compound Annual Growth Rates (Price Only): 4/30/90-1/18/13



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A+	Highest	B-	Lower
A	High	C	Lowest
A-	Above Average	D	In Reorganization
B+	Average	NR	Not Ranked
B	Below Average		

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CAGR- Compound Annual Growth Rate

CAPEX- Capital Expenditures

CY- Calendar Year

DCF- Discounted Cash Flow

EBIT- Earnings Before Interest and Taxes

EBITDA- Earnings Before Interest, Taxes, Depreciation and Amortization

EPS- Earnings Per Share

EV- Enterprise Value

FCF- Free Cash Flow

FFO- Funds From Operations

FY- Fiscal Year

P/E- Price/Earnings

PEG Ratio- P/E-to-Growth Ratio

PV- Present Value

R&D- Research & Development

ROE- Return on Equity

ROI- Return on Investment

ROIC- Return on Invested Capital

ROA- Return on Assets

SG&A- Selling, General & Administrative Expenses

WACC- Weighted Average Cost of Capital

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**F-Squared Investments**<sup>®</sup>

*Rethink Investing*<sup>™</sup>

**AlphaSector**<sup>™</sup>

An F-Squared<sup>®</sup> Solution

## The Changing Face of Risk Management



**Howard Present**  
Co-Founder,  
President & CEO  
F-Squared Investments



# About F-Squared Investments

- **SEC-registered investment adviser**
  - Over \$10 billion in assets under management or under model manager agreements (as of 1/4/2013)
  - Offices in Newton, MA (headquarters) and Princeton, NJ
  
- **New thinking for today's markets**
  - Seek to align investment results with the real needs of investors
  - Solutions designed to consistently and repeatedly deliver on clearly-defined investor expectations

## Legacy Model

Bull Market

Benchmark-Centric

Offensive Bias

Buy & Hold

vs

vs

vs

vs

## F-Squared Investments

Full Market

Client-Centric

Defensive Bias

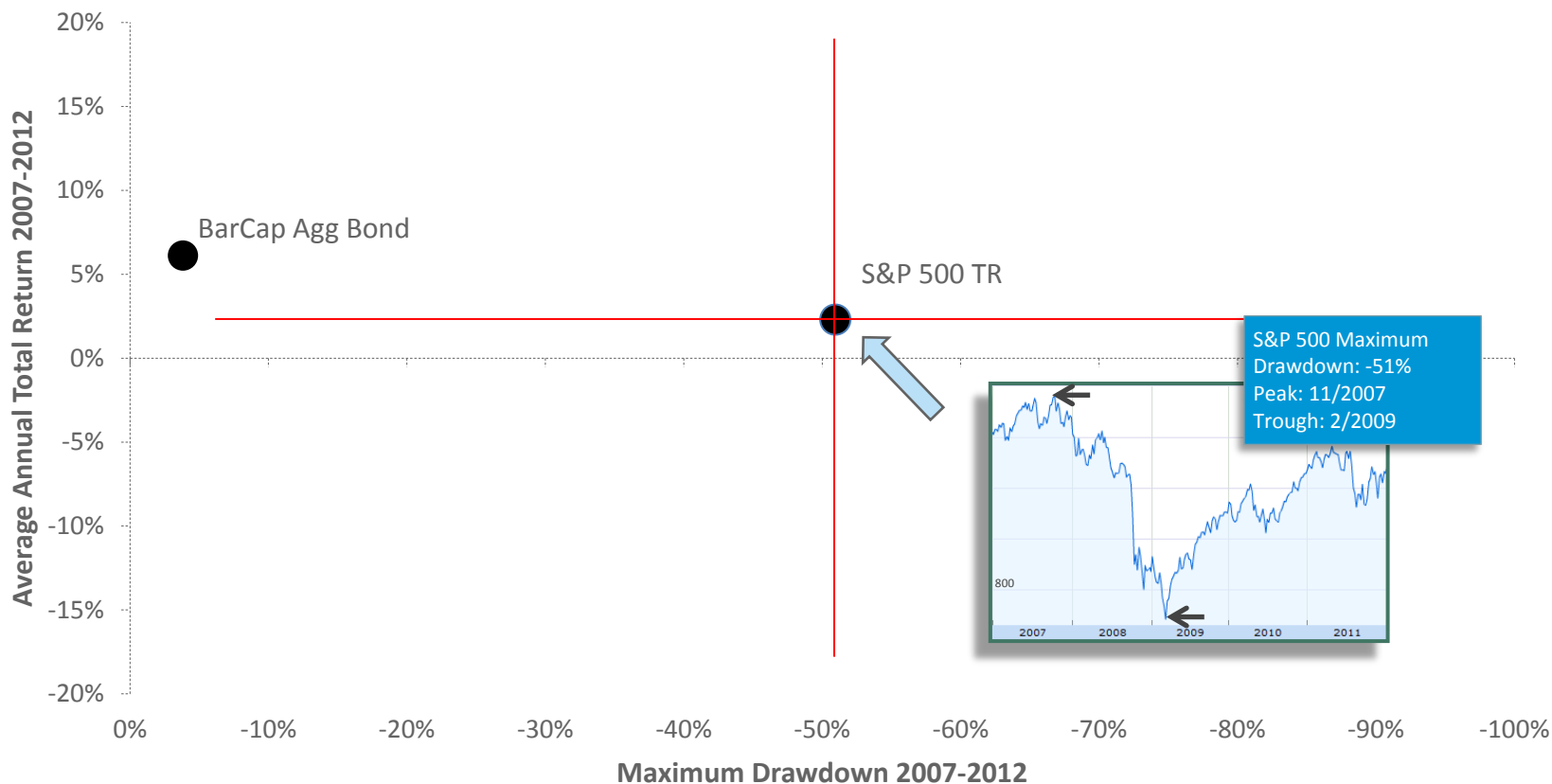
De-Risk / Re-Risk

# Defining Risk Management from the client's perspective: Impact of Maximum Drawdown

**Risk:** “How much can I lose in a short period of time?”

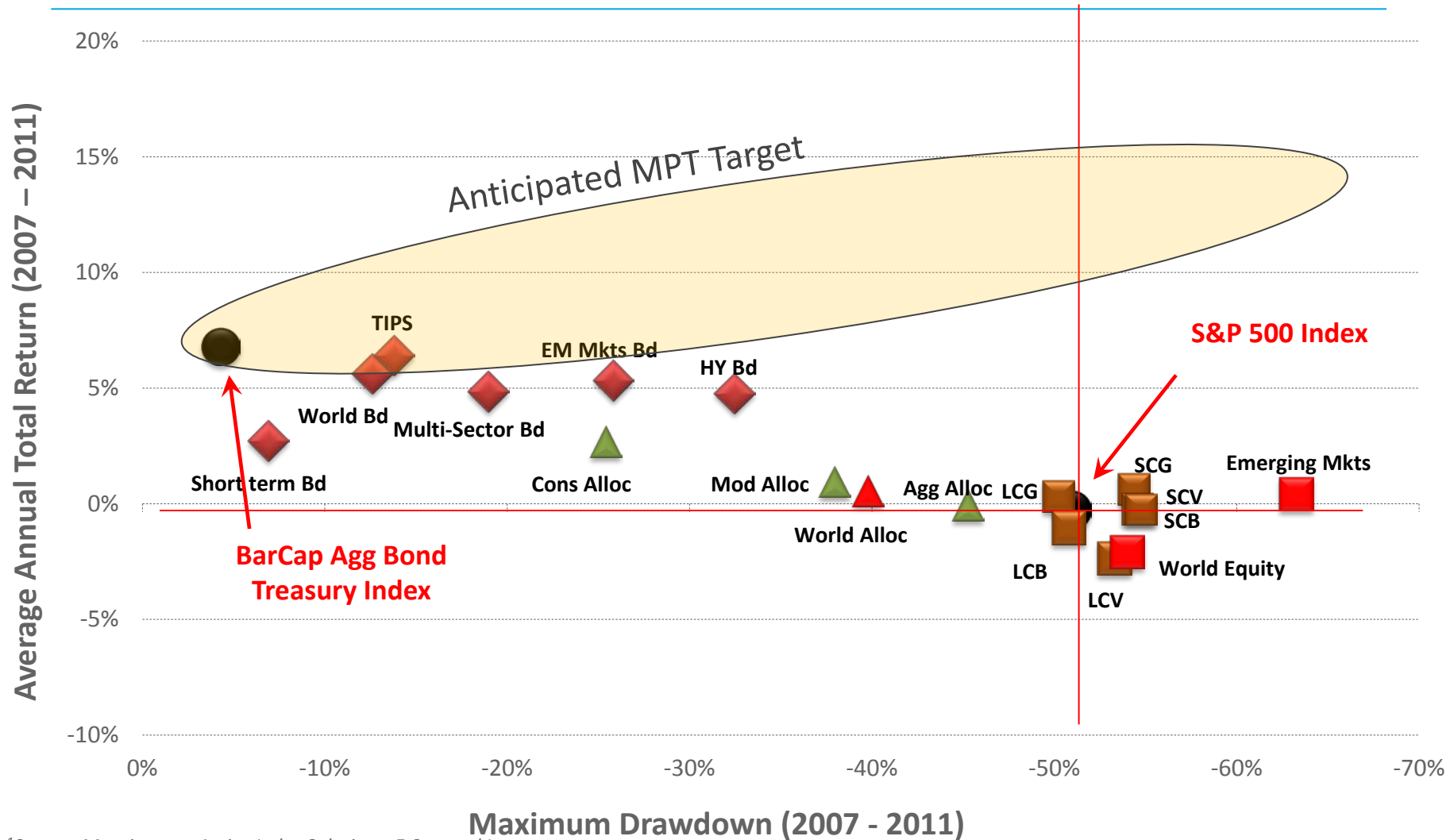
**Statistic:** Maximum drawdown

**Definition:** The maximum decline from a performance peak to a performance trough



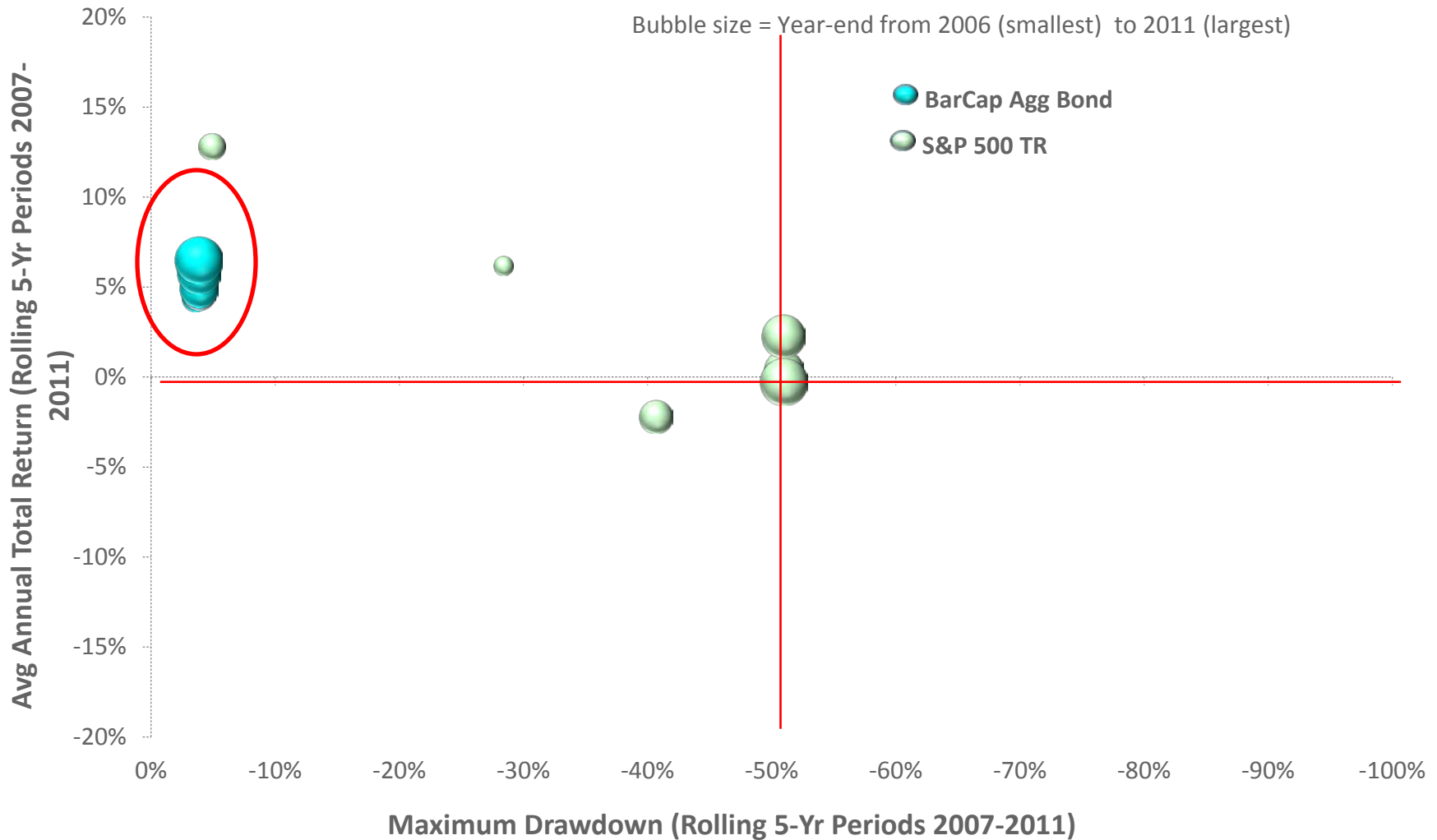
Source: Morningstar

# MPT is based on average volatility -- broken for downside risk metrics



<sup>1</sup>Source: Morningstar, Active Index Solutions; F-Squared Investments

# The changing face of risk management, driven by the changing risk of owning bonds<sup>1</sup>

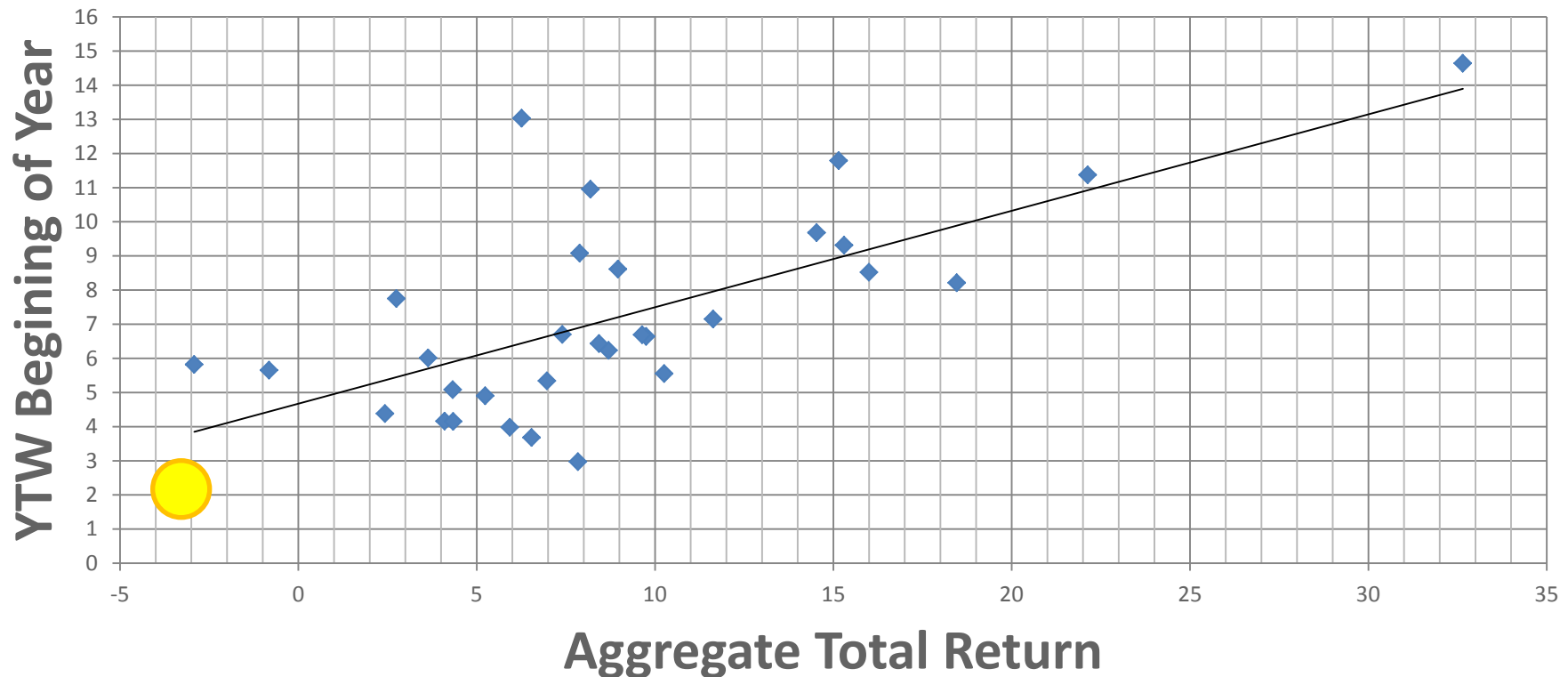


<sup>1</sup>Source: Morningstar, F-Squared Investments

# Current yield levels mark the end of the “free lunch” in managing portfolio risk

- BarCap Aggregate Yield and Total Return from 1981-2011

## BarCap Agg Yield vs. Return<sup>1</sup>



<sup>1</sup>Source: Morningstar, F-Squared Investments

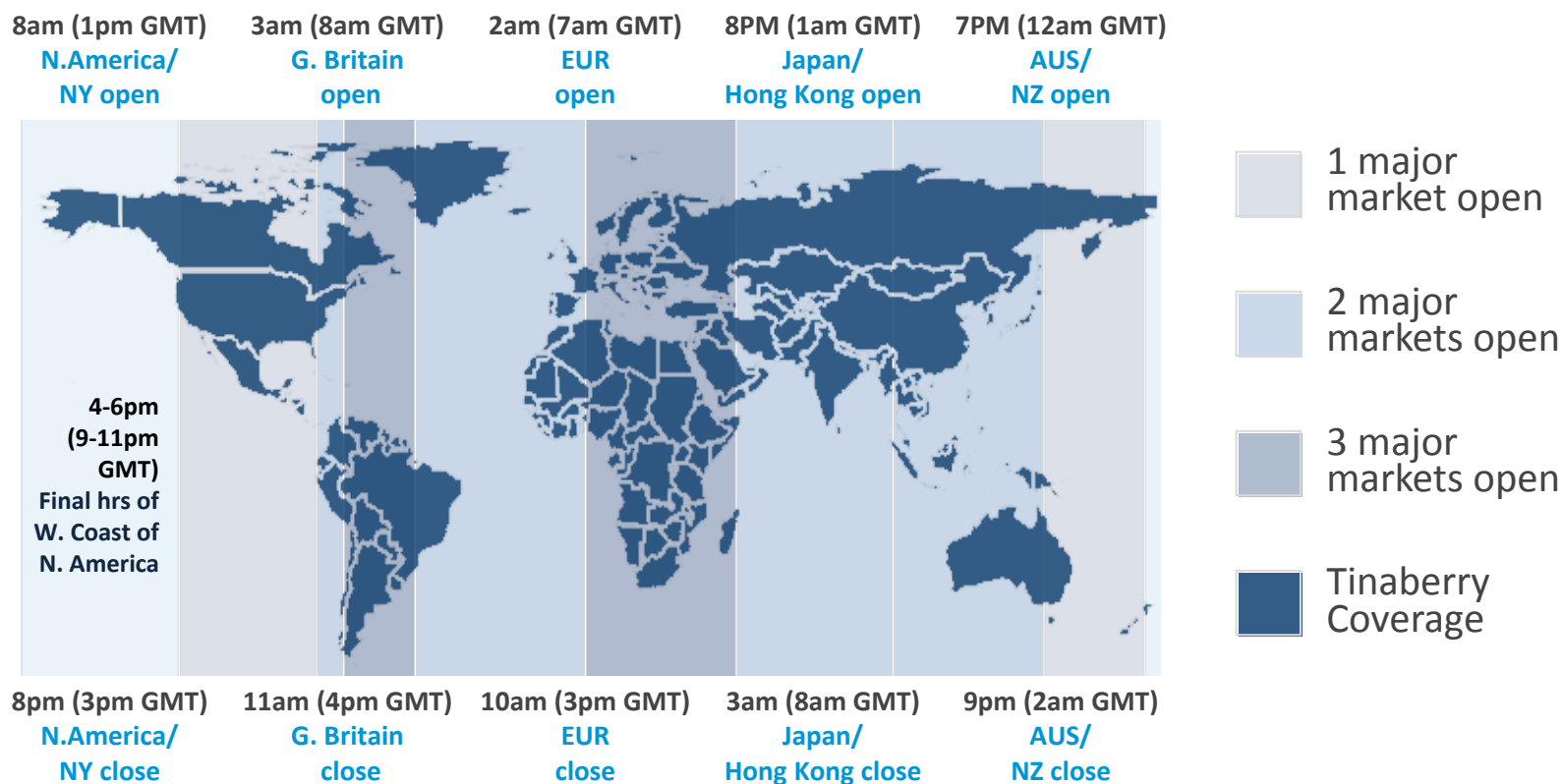
## Tactical Trigger Approaches: When Should You Buy or Sell?



**James McDonald**  
CEO & Chief Investment Officer  
Index Strategy Advisors

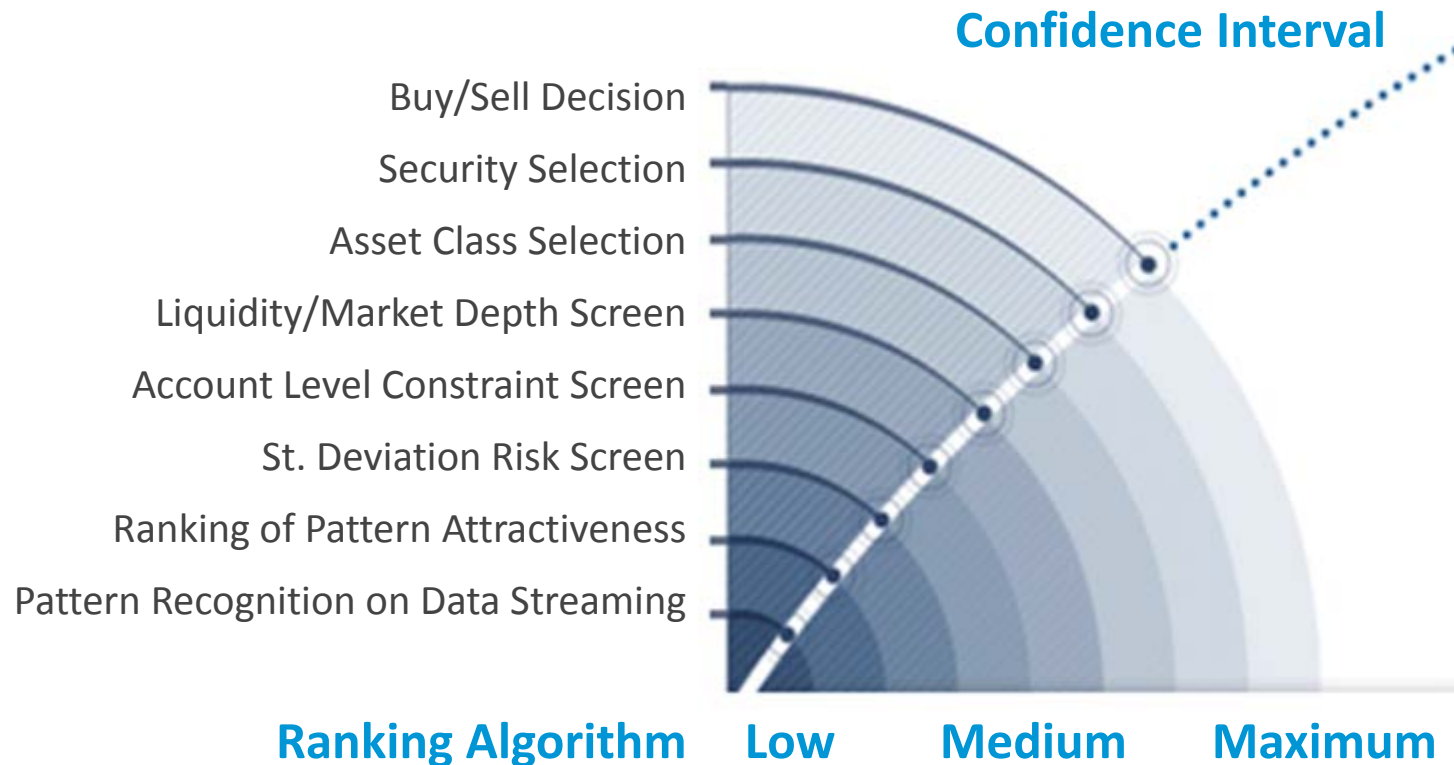
# “Tinaberry” Algorithm

- Tracks data footprint of human emotions



# Buy/Sell Decision Process

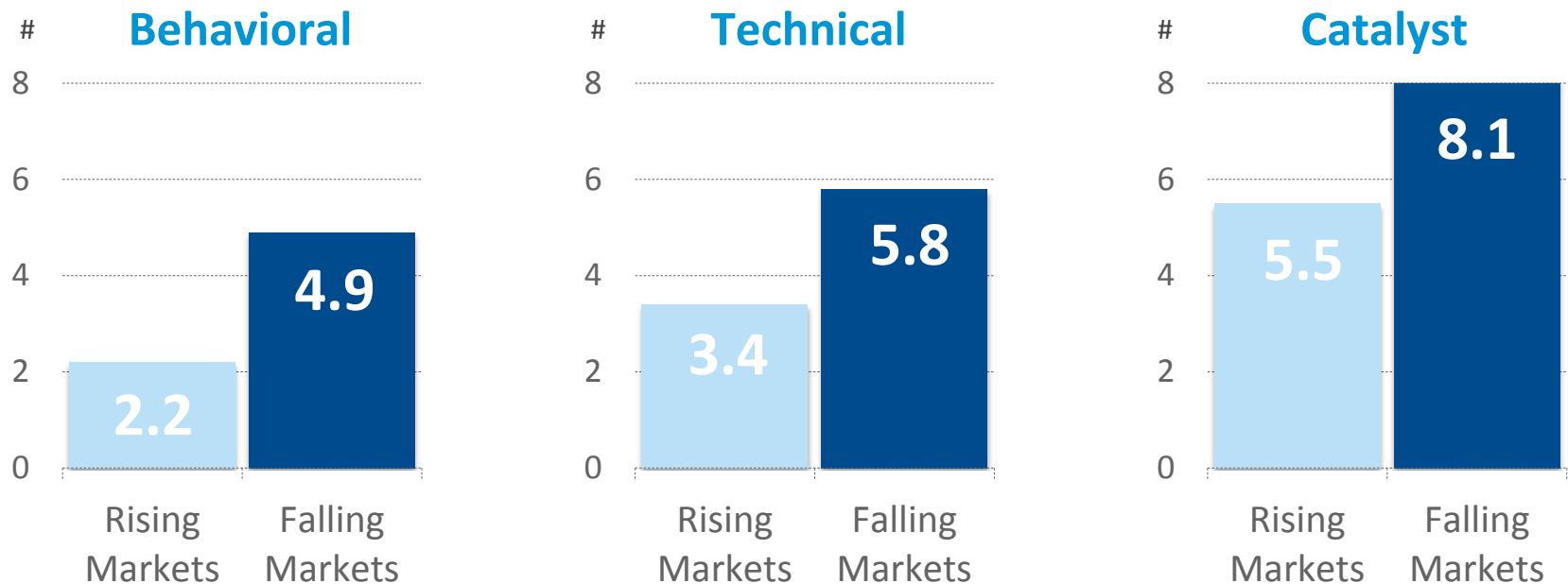
- Can be predictive or reactive





# Multifactor Data Input

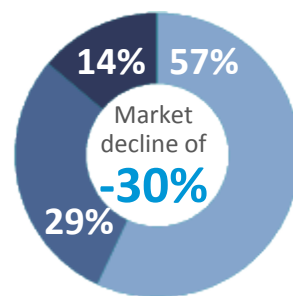
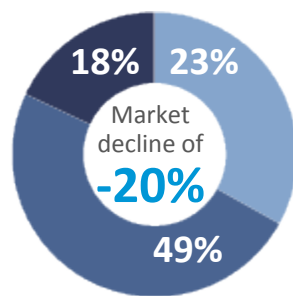
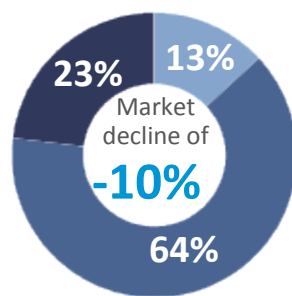
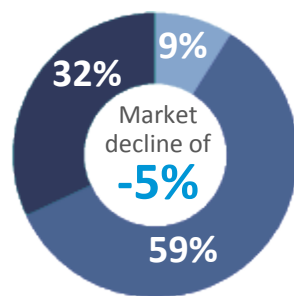
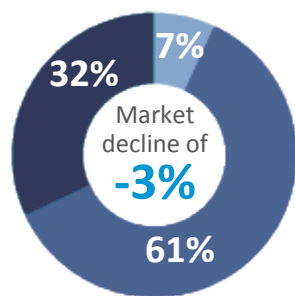
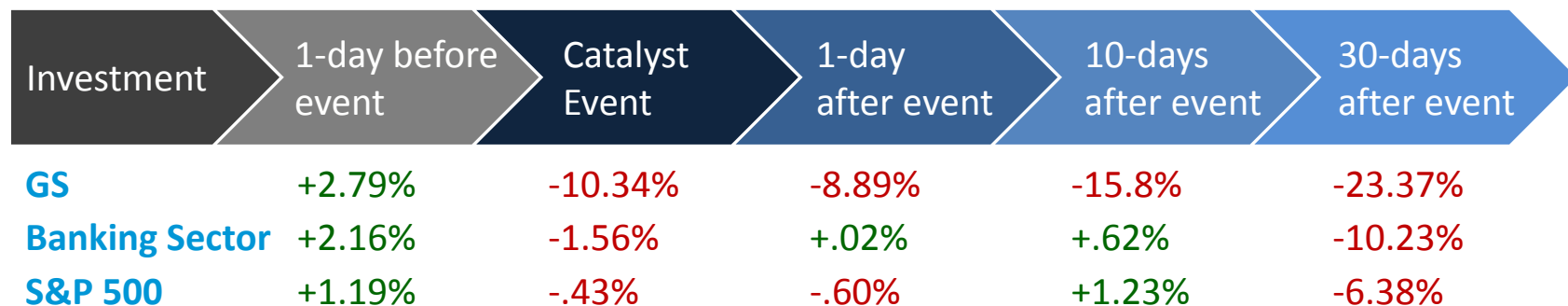
- Buy/sell timing driven by prevalence of risk factors.



Average annual frequency of index trend reversal risk factors for NDX, SPX, RUT  
(Reflects data from January 2, 1985 – December 31, 2012 on all 3% reversals)

# Risk Factor Causal Relationships

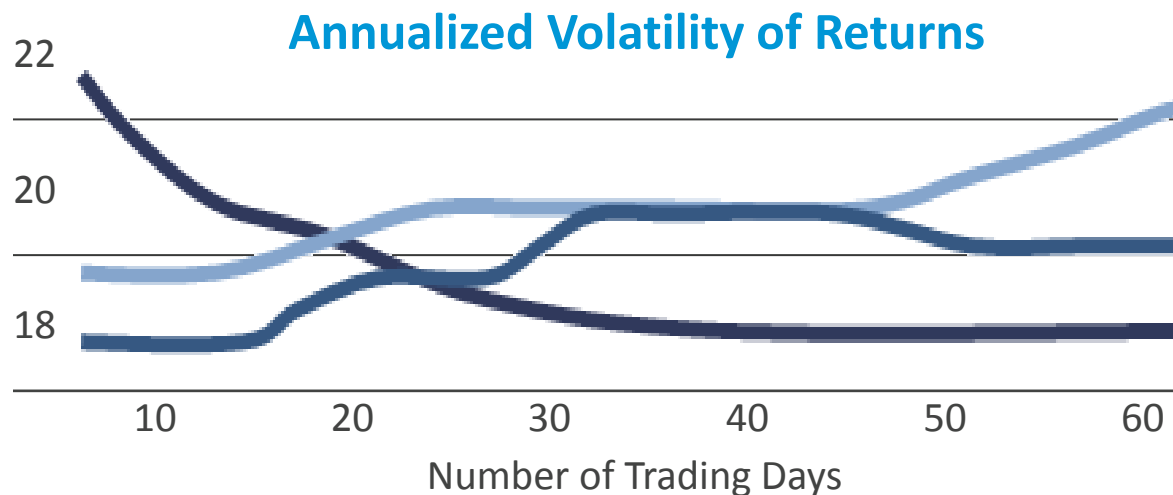
- 4/6/10 - SEC charges GS with fraud in structuring and marketing of CDOs tied to subprime mortgages.



1/2/85 -12/ 28/10: The average factor - to - factor causal relationship change for the SPX during measured "peak to valley" declines. These data illustrate the exponentially increasing influence of behavioral risk factors as the severity of market corrections increases.

# Situational Logic/Trade Execution

- Selecting the maximum risk factor levels a portfolio is exposed to requires a thorough understanding of each variable's time varying relevance.



The weights of risk factors change dramatically with the time horizon, pointing to differences across scenarios of portfolio vulnerability and potential impact for rebalancing purposes.

Behavioral

Technical

Catalyst

\*1/2/85 -12/ 31/10: Impact on volatility of risk factors in a hypothetical 40/60 bond/equity portfolio. Assumes average annual portfolio volatility of 20% and correlation between risk factors of 0.6.

Thank You.  
Questions?

