RPg asset management
Defending Capital. Redefining Risk.

August 2015 Expanded Commentary

Given the escalation and sustained levels of volatility in the markets that begun mid-August, RPg Asset Management wanted to outline the shifts made in our strategies beyond our normal monthly update to help provide what we believe is valuable insight into our tactical methodology.

The adjustments made to the sector exposures within our strategies reflect the priorities of our disciplined approach of #1 avoid a bear market, and #2 materially participate in upwardly trending bull markets. Volatility and corrections are not a bear market, but of course they can evolve into a bear market. No one knows where the bottom will be and corrections by their very nature can be challenging.

When designing the sensitivity of our quantitative methodology, we made an allowance for a range of volatility to minimize exposure in a bear market with a recognition that the stock market goes up more often than it goes down. It is our desire to keep the portfolios in a position of compounding as frequently as possible. We were also sensitive to an investment approach that would incur an unreasonable amount of transactions and did not seek a trading strategy but a long-term investment discipline. This set of priorities makes us an active manager, and as active managers we are dependent on the willingness to embrace change, and more importantly to capitalize on it.

Profitable ideas, approaches and techniques will make an active manager different from an index. RPg will be different from an index due to our portfolio construct of equally weighting the sector exposure and the flexibility to move 100% cash. If this market environment does in fact reflect what may be the beginning of a global bear market, the portfolios have already been de-risking across all of our strategies. This difference should aid clients as a diversifier during a bear market environment and positively contribute to the risk/reward characteristics of a diversified portfolio. If however, a return to upward trending markets materializes, the methodology will capitalize on that and will deploy into the sector exposures to participate.

Adjustments to RPg Tactical US Equity:
July end: The strategy was allocated to: Staples, Discretionary, Tech, Financials & Healthcare; and was out of the Energy sector followed by removing: Industrials, Materials and Utilities.

Early August: The Utilities and Industrial sectors had a healthy enough rebound to be allocated to and were added to the portfolio.

August end: The Technology and Industrial sectors were removed. Sector allocations were to: Consumer Staples, Consumer Discretionary, Financials, Healthcare and Utilities.

With the market close on September 4th leading up to the holiday weekend, the methodology turned off all but one US sector, that exception being Consumer Staples.

Up until mid-August, when the majority of the market volatility took place, the sectors that were allocated to had a pretty sanguine trading range as the charts below reflect. A couple days like the market experienced in mid-August are going to be challenging to our approach as it is a momentum based investment strategy, not a trading strategy. This type of price action will take us by surprise as we are dependent on data that we know to be true. For now, the portfolio sits with significant cash levels (75%), and will let the train of volatility pass while we wait for more sanguine times to return.

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Energy telegraphed to be removed in April, and continued to feel pressure over an extended period. This is exactly where our methodology should shine and did. We exited Energy for the second time in 12 months in July.

Healthcare: Sanguine activity until mid-August where it saw massive volatility over the course of two days. This is not a trend, but rather a violent adjustment that can't be planned for within an investment methodology.

Financials: This position was a good contributor to performance for 2015, until the same day as every other US sector saw an escalated environment in volatility, which caused a rapid correlation convergence that is rare.

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Industrials: Through June, the Industrials sector struggled to stay positive, and kept to a pretty tight trading range. From the end of April, the sector started an extended drawdown which led to being removed. A brief, and not insignificant rebound in July, led to a positive score and for a short time Industrials came back on in the strategy. This represents one of the most challenging environments for a momentum based approach, a trendless whipsaw environment. Industrials was removed by the end of August amid escalated volatility.

Materials: More akin to Energy, Materials trading range saw persistent pressure over the course of months and by the end of July the sector was removed from the portfolio.

Technology: Technology started to see a notable increase in volatility after May which eventually led to a negative score with the August correction. Prior to that, Tech (through XLK) experienced a new high for the year in July and had no reason to be removed through mid-August. Tech saw the same volatility move within August sector correlation rise precipitously.

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Consumer Staples: Consumer Staples reached a new high for the year in July and had been enjoying a stable trading range trending higher. The mid-August correction was a trading event that spared no sector as sector correlations escalated over the course of a few days. Consumer staples has weathered the August correction as well as any sector and is the sole sector in the portfolio as of September 10th.

Consumer Cyclicals: Quite a sanguine trading range that will give any momentum based methodology reason to be long the sector. The theme of the mid-August correction is one of escalating correlations, and RPg asserts that with most of the sectors, Consumer Cyclicals especially, inclusion in the portfolio was warranted. What would be cautionary is if we removed sectors like Consumer Cyclicals given the data, as we are not market forecasters trying to pick the high.

Utilities: The greatest contributor to portfolio performance in 2014 has become one of the most challenging sectors in 2015. Utilities reach the high for the year in January after a fantastic 2014, and experienced significant levels of volatility in Q115 which dramatically lowered the score output in the methodology. By the end of Q1, Utilities was removed. Hovering around the 0.00 mark, Utilities entered and exited the portfolio a number of times throughout the year. As the Utilities chart reflects, until the correction of mid-August, Utilities was trending up over the course of July and part of August. With the trend in place, a couple day event like the one in mid-August, will create short-term havoc for a momentum based approach.

Commentary Disclosure

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References to Indexes
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