RPg asset management

Defending Capital. Redefining Risk.

July 2016 Commentary

Solutions based upon the RPg ActiveParadigm Methodology

Risk Paradigm Group seeks to defend capital through our ETF strategies based upon the RPg ActiveParadigm methodology. The below monthly commentary is related to the RPg Tactical ETF managed portfolios available as separately managed accounts.

Overview

In July, global equity markets dismissed worries related to the surprising results of June's Brexit referendum, and U.S. equities posted healthy gains. The S&P 500® increased over 3% on a total return basis. Not surprisingly, volatility declined substantially.

Today, we have a very strange arrangement in the bond market. With much of the fixed income market trading at negative interest rates, borrowers are actually paid to borrow. It may seem obvious that if the borrower is paid to borrow then the lender (bond investor) is paying to lend; however just saying that is precarious. In this environment bond investors aren't getting a "fixed-income", they are merely hoping that bond prices rise so they can generate capital gains that outweigh the loss in yields. This is uncharted territory as historically most bond investors have been seeking coupon payments that were paid by borrowers and then getting their principal back upon maturity. This is no longer the case in much of the worlds fixed income markets.

Economic fundamentals improved in July and point to accelerating economic growth in the U.S. At the July Fed meeting, Esther George, the Kansas City Fed Bank President shifted to being in favor of hiking rates 25 basis points at the July 27 meeting. As a body the Fed tilted toward tightening pointing to three areas. First they stated that labor markets strengthened. Second they noted that "economic activity has been expanding at a moderate rate". Third, the Fed added extra text stating that "near-term risks to the economic outlook have diminished", which is a turn-around from prior minutes where the Fed was worried about outside forces effecting economic growth in the U.S. (think Brexit).

RPg Tactical US Equity

The portfolio came into July in a bullish posture, fully invested in seven (7) sectors, and ended the month invested in seven (7) sectors having made no changes. July saw the continued recovery of the mild "Brexit" turbulence in June and saw Equities rally and the VIX index plunge. This drove capital to offensive sectors and while yield generative sectors like Utilities which, due to our natural overweight to Utilities, underperformed, Tactical US Equity was able to materially participate in the upwardly trending US equity markets.

RPg Tactical US Equity FT

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RPg Tactical Global Balanced

RPg Tactical Global Balanced portfolio has targeted allocations to four asset classes: US Equity (33%), Global Fixed Income (28%), International Equity (28%), and Alternatives (11%). Below are highlights of the activity for each asset class within the portfolio for the month of May.

US Equity: The portfolio came into July in a bullish posture, fully invested in seven (7) sectors, and ended the month invested in seven (7) sectors having made no changes. July saw the continued recovery of the mild "Brexit" turbulence in June and saw Equities rally and the VIX index plunge. This drove capital to offensive sectors and while yield generative sectors like Utilities which, due to our natural overweight to Utilities, underperformed, the RPg Tactical models were able to materially participate in the upwardly trending US equity markets.

Global Fixed Income: The sleeve came into July fully invested in ten (10) of the ten (10) Fixed Income sectors, and ended the month with no changes. The "Brexit" referendum in June led to a flight to safety in fixed income and even with bond yields at very low levels (negative in much of the world), capital came into the safe havens of fixed income in June. July saw a preference for risk as yields rose and equity markets caught a tailwind of risk appetite. Even with the rally in yields, roughly 75% of the entire Japanese and German bond market is now trading at negative yields.

International Equity: The International Equity sleeve entered the month of July invested in only two (2), ETFs, just Canada, Japan and 50% cash and made no changes. There is no doubt a bias to high quality markets with the sluggish global growth and the uncertainty that "Brexit" and negative interest rates introduced. These recent developments have led Tactical Global Balanced to an overweight in US stocks relative to other equity markets.

Alternatives: The sleeve started July invested in the Gold ETF, REITs sector ETFs and MLPs ETF and remained with that allocation as there were no changes during the month.

Outlook

As a quantitative rules-based asset manager who relies on data to drive the investment decisions, we do not make market forecasts. However, the portfolio allocation does offer useful intelligence to how the methodology is interpreting current market activity. Some specific observations:

- While the cyclical sectors of Financials and Consumer Cyclicals were not included in the allocation in July, the model has a deliberate overweight to U.S. stocks relative to other equity markets.
- TIPS, Gold and U.S. stocks were positive again in July as their correlation remains significant. With the S&P 500 P/E over 20, 75% of Japan and German debt with negative yields, and the uncertainty presented by the political cycle in the U.S., investors seem to be diversifying their holdings so much that every asset class is correlating and has been for a few months.
- With negative rates in much of the developed international world, the US fixed income market looks comparatively like high yield. With international capital seeking yield in the US fixed income markets, the lower rate reaction the market experiences every time data stumbles may also be providing a bid for stocks.
- Investors who are long stocks and US fixed income could be using gold as a hedge if one of those markets crack and either rates start going up, or the S&P 500 breaks the 1800 level. We don't know which will break and when, but correlation convergence usually doesn't last forever.

Commentary Disclosure

Risk Paradigm Group, LLC a/k/a RPg Asset Management is a registered investment advisor with the U.S. Securities and Exchange Commission ("SEC"). Additional information regarding Risk Paradigm Group, LLC can be found on our website at www.rpgassetmanagement.com.

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"ActiveParadigm" is a quantitative methodology that is proprietary to RPg. The RPg tactical strategies ("RPg Tactical US Equity", "RPg Tactical US Equity FT", "RPg Tactical US Long-Short Equity", and "RPg Tactical Global Balanced") are managed account strategies managed by RPg. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. All investments include a risk of loss that clients should be prepared to bear. The principal risks of the quantitative methodology and strategies are disclosed in Risk Paradigm Group's publicly available Form ADV Part 2A.

RPg may change the exposures and compositions reflected herein at any time and in any manner in response to market conditions or other factors without prior notice to investors.

References to Indexes
The S&P 500 Index is an unmanaged index of 500 stocks that is generally representative of the equity performance of larger companies in the U.S. Please note that an investor cannot invest directly into an index.

Risk Disclosures
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Sources: Bloomberg.

For more information including risks of investing in our strategies, visit our website at www.rpgassetmanagement.com