RPg asset management

Defending Capital, Redefining Risk.

October 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

Donald Trump is bad for the stock market and Hillary Clinton is good for the stock market. October's market influences would lead an investor to believe that is what the market believed. We're referring to the news that the FBI was taking a second look at Hillary Clinton's emails, apparently due to messages uncovered in its investigation of Anthony Weiner. In the two hours after the FBI news hit, the S&P 500 dropped a grand total of 1%, finishing the day down just 0.3% compared to its close on Thursday October 27th.

The market continues to be all about rates, but given the time of the year, the market is also about the election and differentiating the two potential policy tracks. U.S. equities ended October in negative territory. The S&P 500 lost 1.8% with more pronounced losses in small and mid-cap equities. The doldrums spilled over to most sectors as only Financials and Utilities posted gains at the sector level. We will need to look for clues from incoming officials about direction and priorities in several areas of U.S. policy including fiscal, monetary, trade, immigration, regulation and security.

From where we sit at present, this business cycle is shaping up to be on the longer side of historical experience, and with that, our models are maintaining a modestly pro-risk tilt, with overweights to equities and credits vs. government bonds and cash. We continue to pore over the data in an effort to discern late-cycle deceleration dynamics from what has been a low-growth expansion. The flat mid-cycle dynamic in the US makes the global economy more reliant on emerging markets as a driver of growth which may make EM equities and debt a driver of performance as emerging market economies recover.

RPg Tactical US Equity

The portfolio came into October in a bullish posture, fully invested in nine (9) sectors, and ended the month invested in seven (7) sectors within in our investment universe having exited Utilities and Health Care. Financials and Utilities were the only sectors to post gains in October. As well, October saw a return of volatility driven by pre-election jitters and a slew of mixed data from economic data to mixed earnings. As well questions of pricing power within the healthcare sector adversely affected all segments of healthcare.

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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 October.

<u>US Equity:</u> The portfolio came into October in a bullish posture, fully invested in nine (9) sectors, and ended the month invested in seven (7) sectors within in our investment universe having exited Utilities and Health Care. Financials and Utilities were the only sectors to post gains in October. As well, October saw a return of volatility driven by pre-election jitters and a slew of mixed data from economic data to mixed earnings. As well questions of pricing power within the healthcare sector adversely effected all segments of healthcare.

<u>Global Fixed Income:</u> The sleeve came into October fully invested in eight (8) of the ten (10) Fixed Income sectors, and ended the month invested in six (6) of the ten (10) fixed income sectors. With much of the Developed Global bond market trading at negative yields coming into October, the German BUND had a massive move towards the end of the month. A move on the 10-year BUND from -0.09% to close at 0.08 added to the volatility within global fixed income. As we approach the next Fed meeting in December, we will have a new president-elect and the beginning of new positioning based on potentially different policy direction. Data has been supportive for a rate hike and general Fed “speak” has been supportive of a likely hike in rates at the December meeting.

<u>International Equity:</u> The International Equity sleeve entered the month of October fully invested in six (6) of the possible six (6) ETF exposures and remained there through the month. In early August, the model turned on Emerging Markets, Developed Markets ex-US, Asia ex-Japan, and Europe bringing the portfolio to a fully invested posture and every position in the International sleeve ON and that is how it ended in October with no changes. While the flat mid-cycle in the US makes the global economy incrementally more reliant on Emerging Markets (EM) as a driver of growth, the whipsaw environment of the U.S. presidential election is adding to the current level of volatility.

<u>Alternatives:</u> The sleeve started October invested in the Gold ETF, REITs sector ETF and MLPs ETF, and sold all three ETFs leaving the Alternatives sleeve in cash at the close of October.

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:

- October volatility was driven largely by pre-election uncertainty, earnings, economic data, and concerns about the trajectory of monetary policy. In the end, we are still positioned in a fully invested posture given the risk/return dynamics in the equity markets with a tilt towards cyclical sectors.
- The thirst for yield continues to favor spread related fixed income sectors which our model is positioned for that to continue.
- With the very low rate environment 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.

Important Disclosures:
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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.

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