Defending Capital. Redefining Risk.

# May 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

U.S. equity markets posted another positive month as the S&P 500 ended May up 1.79% on a total return basis despite growing expectations that the Fed will raise interest rates sooner than previously anticipated. After a disappointing April, Technology was the strongest sector in May, while the Energy sector struggled after the price of oil climbed to a seven month high near $50 a barrel, as U.S. daily crude production slipped to the lowest level since 2014.

Economic data in May generally rebounded, as estimates for April retail sales, industrial production, and business orders all increased sharply. Additionally, data consistent with a more favorable trajectory for U.S. industrial production came in with growth of 1.7% in April – the largest monthly increase in 17 months. As we noted last month, "while (April) month end volatility may remind us of the January – mid-February angst, there are a number of differences that suggest this may simply be a breather in a tape that ran up fast in a global economy that is experiencing tepid growth", May data are consistent with a stabilizing U.S. economy and continued growth in consumer durables and construction materials.

With oil stabilizing, the U.S. consumer and housing sectors continuing to show signs of strength, and growth stabilizing, one can see why the Fed may raise rates sooner rather than later. In addition to the fact that the Central Bank is clearly guiding the market there, the U.S. economy appears to either be on track to accelerate from here, or at least not decline dramatically, rather than turn down into a recession as many market participants thought in February. As well, there is little element of surprise like we had in May of 2013 with the "taper tantrum".

## RPg Tactical US Equity

The portfolio came into May fully invested in nine (9) sectors, and ended the month fully invested in nine (9) sectors with no changes. The story of May centered on improved economic data and the resurgence of the Technology sector. With only Materials, Industrials and Energy mildly negative in May, the strength of Tech, Health Care and Financials led the way to a solid month.

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## RPg Tactical US Long/Short Equity

The portfolio came into May invested long in nine (9) sectors, and ended the month invested long in nine (9) sectors with no changes. The story of May centered on improved economic data and the resurgence of the Technology sector. With only Materials, Industrials and Energy mildly negative in May, the strength of Tech, Health Care and Financials led the way to a solid month.

**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 sleeve came into May fully invested in nine (9) sectors, and ended the month fully invested in nine (9) sectors with no changes. The story of May centered on improved economic data and the resurgence of the Technology sector. With only Materials, Industrials and Energy mildly negative in May, the strength of Tech, Health Care and Financials led the way to a solid month.

*Global Fixed Income:* The sleeve came into May fully invested in ten (10) of the ten (10) Fixed Income sectors, and ended the month with no changes. The ECB's bond-buying plan has increased the appeal of US corporate bonds. To put more perspective to that thought, roughly 75% of the entire Japanese and German bond market is now trading at negative yields. US corporate bonds are offering yields above 3% and benefit from a stronger economic backdrop than credit markets in Europe and Japan.

*International Equity:* The International Equity sleeve entered the month of May fully invested in six (6) of the possible six (6) sector ETFs, and ended the month with no changes. Aggressive monetary stimulus measures from the ECB and BoJ continues to focus on direct and unconventional means of qualitative easing with the BoJ entering the stock market and the ECB making major asset purchases in corporate bonds.

*Alternatives:* The sleeve started May 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:

- Every sector ETF we evaluate is currently ON which is a display of correlation convergence. Correlation in-and-of itself is a complex system. Our observation is that outside forces are contributing to all sector ETFs being on.
- It is rare to see TIPS and Gold have such a high correlation. But with the S&P 500 struggling to push 2100 for any sustained period of time, 75% of Japan and German debt with negative yields, investors seem to be diversifying their holdings so much that every asset class is correlating and has been for a couple 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.

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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.

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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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Sources: Bloomberg. 

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