Beaumont
CAPITAL MANAGEMENT

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# What is Global, Tactical Asset Allocation (GTAA)?

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GTAA is **"anti-style box"** investing. Instead of focusing on company size, a country/region or even on an asset class, GTAA is designed to be a top-down approach that migrates to where the best opportunities await, wherever they might be. GTAA picks desired exposures or themes to invest in. Each exposure has different risks and rewards. Successful GTAA strategies produce returns with a low correlation to traditional static asset allocations and, ideally, provide enticing risk-adjusted returns. In other words, instead of hiring multiple single-discipline managers under a fixed asset allocation, GTAA decides when, where and how much to invest in promising themes. These investment decisions are based on the opportunities present, not a pre-conceived set of assumptions—most often based on the past—that may have little bearing on the future.

Some investment opportunities come and go in weeks, some in months, and others last for years. Real opportunities are often lost simply due to a timing mismatch. **"Set it and forget it" often doesn't work** because people, our lives, and circumstances change. If the one great constant in our lives is change, then why construct investment portfolios that have limited, if any, ability to adapt? Just think what has changed in the last ten years. The Great Financial Crisis. Brexit. Terrorism. Interest rates. Covid-19. Did static allocation adjust for all this? No. Investors were forced to endure quite a bumpy ride and many failed to stick with their plans. More importantly, what will strategic models fail to adjust for in the future?

Unlike the humans that create these opportunities, BCM's GTAA system, Decathlon, doesn't panic or get greedy. The system is void of emotion and is agnostic as to what type of investments it is choosing. The discipline comes from following rules, not the potentially irrelevant past. Decathlon is predictive and uses many concepts such as momentum, reversion to the mean, and the speed of greed when evaluating investor behavior. It also looks for any structural, fundamental, or informational asymmetries.

Whether it is time, the type of investment, or the ever-changing market conditions, GTAA uses flexibility as a strength. Why not add a type of strategy to your portfolio mix that is engineered to provide the smoother ride that most investors covet most of all? Humans, and human investors, all are subject to their emotions and biases. In the aggregate, these emotions and biases drive investment decisions and create patterns in security prices. At BCM, our Decathlon system marries machine learning and behavioral finance to create models that hunt for these attractive investment patterns. These patterns identify where other investors are likely to go next and Decathlon is formulated to exploit them before others do the same.

The goal? Build a portfolio of 10 ETFs that maximizes the return given a defined risk budget. **If a strategy stays within an investor's risk budget, then does anyone care what asset class or geography the returns are coming from?**

## Why Use GTAA?

Typical portfolio construction follows an assessment of the investor's risk budget, goals, income, assets, liabilities, and timeframes. An advisor will then build a strategic asset allocation based on capital market assumptions, reasonably designed to meet the investor's needs. But there can be significant problems with this process:

- Past performance is not indicative of future results.
- Recognizing the impact of human emotions.
- Investors are not risk adverse; they are loss adverse.
- Diversification can become "diworsification".

In a static portfolio, **what is indicative of future results?** Most capital market and other assumptions are based on the past, have too short of a viewpoint, and are subject to home country bias. For example, in the last decade, U.S. large cap equities were the best performing major equity market . Yet during the 2000's, U.S. large cap equities had 10-year periods with negative realized return. Which period is appropriate to use for future assumed returns? Is the long-term average return really the most appropriate estimate for the next 10 years?

Today, we have an enormous compounding problem: The traditional lower-risk asset class, bonds, are at the end of a 40-year run. Interest rates have been falling since the early 1980's and appear to have bottomed near zero. During this mega-cycle, bonds have not only contributed their coupons to returns but also a good amount of capital appreciation in most years. Will these or any long-term trends continue indefinitely? No!

Yet many 60/40, 50/50, etc. portfolios assume, whether explicitly or implicitly, that U.S. large cap equity will maintain its leadership and that bonds will continue to provide a robust contribution to returns, as well as help dampen any stock bears. These are massive assumptions. What if yields rise or even stay flat at the current low levels? What if rising yields cause a bear market in stocks? These strategic portfolios have been built by looking only in the rear-view mirror. Like driving a car, it can help you see where you have been, but it will eventually lead to disaster going forward.

Now enter **human emotion.** Fear/panic and greed/FOMO drive markets to extremes. They cause valuations to over-shoot in both directions. These price anomalies can be measured in hours and days out to years and decades. How is a static allocation supposed to cope with, let alone take advantage of these opportunities?

**Investors are not risk adverse; they are loss adverse.** Investors love risk… when markets are doing well. While investors can stomach some losses, every investor has their breaking point… when their fear of a significant lifestyle change overwhelms rational thought and they sell out, typically at or near the bottom. That's why the last phase of a bear is called the capitulation stage. Even the best laid strategic portfolio and plans can be laid waste when a bear market hits. There is too little flexibility and no mechanism for adaptability. GTAA is specifically designed to give portfolios this adaptability.

**Diworsification.** There are two inherent weaknesses to diversification: In bull markets you are almost always underweight the best performing asset class(es) and, more importantly, when equity markets falter, all risk assets tend to follow equities down. Strategic portfolios are designed to give fixed allocations to various asset classes, including riskier investments to provide growth. If these risk assets are all doing well, then your portfolio is doing well. But what if only some are doing well, and others are languishing or worse? Your best returns are diluted by the lesser performers and your portfolio will wallow in mediocrity.

Show me a bear market where U.S. stocks of all market caps, international stocks of all types/regions, commodities, junk bonds and any other risk asset of import did not have a significant drawdown. Yes, there are a few exceptions, but during most bear markets after WW II, each major risk asset class has experienced a major drawdown nevertheless. Spreading out your risk assets in a bear market does not provide significant portfolio protection. The markets are just too highly correlated.

In bull markets, diversification provides mediocrity as returns are diluted across multiple asset classes, and in bear markets all risk assets tend to correlate together and provide little to no protection. Today, even bonds may fail to provide an anchor to windward.

**So, what to do?** Diversification in a strategic portfolio does have its benefits, it is just not complete by itself. What helps bring true value is diversification of management style. Where is it written that that an entire portfolio must be all strategic and never change? Why restrict your portfolios to such a narrow focus when, over time, the market's focus will shift as various economic, political, societal and market forces all influence the competition for capital and returns? Adding flexibility and the ability to seek opportunities as they present themselves may be the answer to the pitfalls of a static portfolio built on the results of the past.

GTAA is designed to give investors what they want: robust returns in good times with the potential to avoid unwanted volatility and even large losses when markets falter. Instead of just a "diworse" portfolio, why not provide diversity that can make a real difference?

***Need some guidance making the switch and implementing GTAA solutions into your portfolios? Reach out to our regional consultants.***

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The BCM Decathlon strategies are predictive, algorithm driven and use pattern recognition technology (PRT) to rank a population of ~130 handpicked ETFs in which it will "invest" in the 10 most promising based on upward price movement and defined volatility levels. The algorithm re-evaluates the population of ETFs and 'rebalances' once a sufficient number of securities have fallen far enough in the rankings to justify the resulting trades. The portfolio manager maintains full investment discretion.

Diversification does not ensure a profit or guarantee against a loss. Past performance is no guarantee of future results.

As with all investments, there are associated inherent risks including loss of principal. Stock markets, especially foreign markets, are volatile and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. Sector and factor investments concentrate in a particular industry or investment attribute, and the investments' performance could depend heavily on the performance of that industry or attribute and be more volatile than the performance of less concentrated investment options. Foreign securities are subject to interest rate, currency exchange rate, economic, and political risks, all of which are magnified in emerging markets. The risks are particularly significant for ETFs that focus on a single country or region. The ETF may have additional volatility because it may be comprised significantly of assets in securities of a small number of individual issuers. Fixed Income investments are subject to inflationary, credit, market and interest rate risks.

An Exchange Traded Fund (ETF) is a security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange. ETFs typically are not actively managed. They trade like stocks and are subject to investment volatility and the potential for loss. The principal amounts invested in ETFs are not protected, guaranteed or insured. ETFs experience price changes throughout the day as they are bought and sold.

The BCM investment strategies may not be appropriate for everyone. Due to the periodic rebalancing nature of our strategies, they may not be appropriate for those investors who desire regular withdrawal or frequent deposits.

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