11.15.23 | INVESTMENT MANAGEMENT

# Framing Tactical and Indexing

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If this blog seems very familiar to you, it is. I took the framework of a blog written last week ("Framing the Big Picture") and used the format for this application.

In Chart 1 below, which security would you rather have invested in?

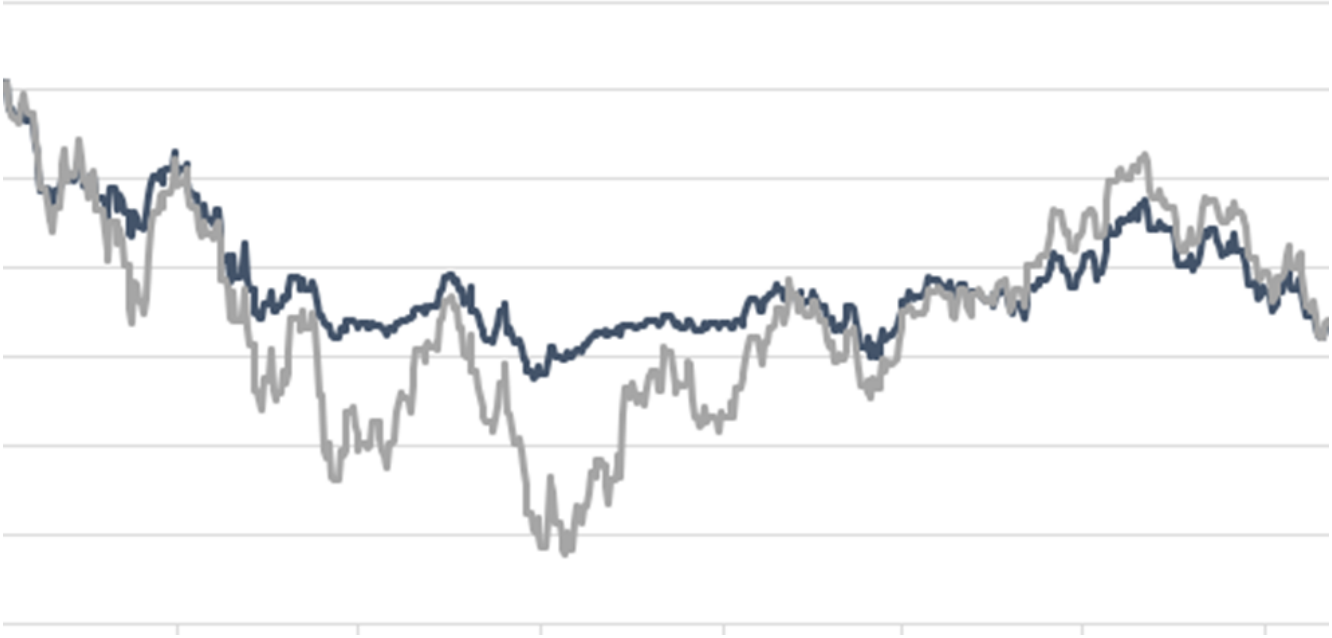

Chart 1

I cannot speak for you, but I would have chosen the dark blue investment. It had far less volatility and drawdown than the other choice – about half the risk.

Chart 2 tells a very different story, and this time the gray investment is the clear choice, with strong returns relative to the slightly negative results for the dark blue investment. Why would anyone be satisfied with the dark blue investment?

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Well, what if I told you that you were looking at the same thing?

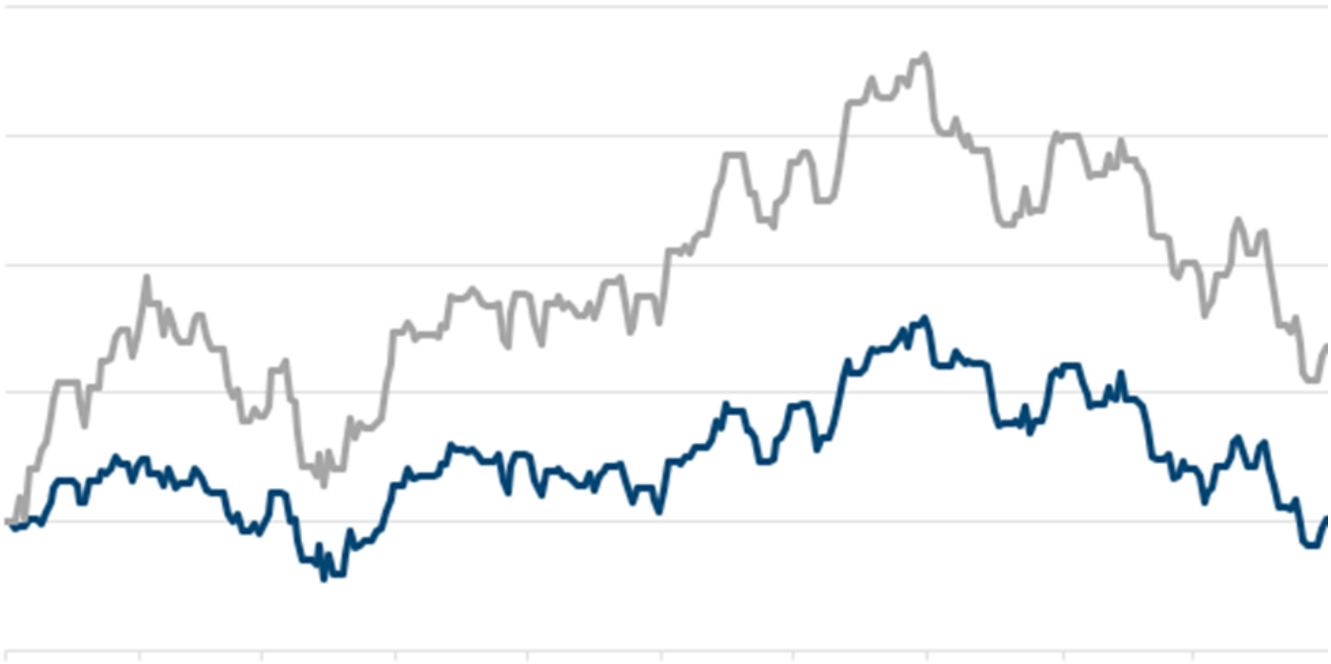

Chart 2

Time for the unveiling: the dark blue line is a global tactical investment strategy – in this case it is the model for the Sector*Select* Plus strategy managed by our firm. The gray line is the return of an Exchange Traded Fund (ETF) tracking the MSCI All-Country World Index, the most widely followed global stock index. The difference is that Chart 1 is from the beginning of 2022 to present, and Chart 2 is year-to-date 2023. Chart 2 is essentially the second half of Chart 1, but with a new even starting point. So, which one is the better investment?

Spoiler alert – both are very good long-term investments. Indexing is inexpensive and will provide 100% of the upside in positive markets (like 2023) and 100% of the downside exposure in bad years (like 2022). Tactical investing means that there is flexible exposure to risk. In the case of our tactical strategies, like Sector*Select* Plus depicted here, we will reduce risk and carry cash and other low risk investments during times of trouble. The downside is that we will miss parts of the recovery, which can make some time frame comparisons unattractive (like 2023), especially in the short run.

Which approach is "best" for an investor will depend on the investor's risk tolerance and the overall allocation to risky assets, not on which strategy the investor wishes they had in hindsight for the last year. Tactical risk management can allow for an investor to have more overall stock exposure for the same expected risk than a fully invested approach. Also, risk managed strategies may make it easier to "stay the course" during the scary market periods, since the strategy reduces risk for investors so they are not temped to do so at the worst possible points (which happens in every market cycle).

For many investors the best answer may be to blend a mix of different strategy types and styles, perhaps including various bond and alternative investment approaches, together to provide the best experience for that particular investor.

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The big loser is the investor that hops on the prior year's big winner, only to be disappointed and frustrated – again. It is very important to assess performance over various time frames, not relying only on the most recent.

IMPORTANT DISCLOSURES:

Sources include eSignal.com, Bureau of Economic Analysis, Bureau of Labor Statistics and FactSet.

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