The Active Manager

Quarterly Journal of the National Association of Active Investment Managers

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Index

THERE'S LOTS TO LOOK FORWARD TO AT Outlook 2024, including headliners Shahira Knight, Managing Principal, Policy & Government Relations for Deloitte and Technical Analyst John Roque with 22V Research.

Shahira promises to take NAAIM members on a wild ride through the 2024 US congressional and presidential elections and possible policy implications of different election scenarios, as well as examine the legislative agenda in 2025. John takes a completely different tack, explaining why Technical Analysis makes markets fun and how to find the message in the charts.

Then there's a look at AI and investing, compliance hot spots, marketing and lots of member exchanges on everything from broken strategies to marketing tidbits and

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President's Letter

Barry Arnold

IT IS AN HONOR TO BE THE NEW president of NAAIM. Ryan Redfern, NAAIM's president over the past two years, did an exemplary job putting the pieces in place to turbo charge NAAIM in the years ahead. As an organization, we owe a world of gratitude to Ryan and the Board for their efforts. There's also a ton of committee members who are volunteering their valuable time and input and putting rocket fuel into our organization. My role is simple … to keep that momentum in place and continue building awareness of NAAIM throughout the active manager universe and Wall Street.

To give you an idea of my background, I joined the investment business in the late 1980s, managing money for a value-oriented shop. The firm sold in the mid-2010s, and I took a hiatus to see what my next step would be. When I found Global View Capital Management and met with the firm's president and chief investment strategist, Dina Fliss, it was like a second home. I am a data junkie ... I love technical analysis. Tactical management is part of Global View's DNA. Objective, systematic investing driven by tactical signals with no emotional interference makes sense to me. And it's very calming during times of chaos. Now as Chief Investment Officer for Global View, my passion for the markets is fueled every day.

I was born and bred in Wisconsin, and never left. My three adult sons chose not to follow in my footsteps; two are CPAs and one has started his residency as a surgeon in Detroit. Beyond spending time with my boys, I love to golf … but as most of my golfing partners know, golf does not love me. But thanks to my handicap, my team was able to win the NAAIM Golf Classic (sorry, Paul).

When Dina and Dave Morton, director of research at Global View, introduced me to NAAIM in 2017, I was stunned at the collaboration, camaraderie, and intellectual capital of the members. Volunteering on committees and the board, and then serving as the association's treasurer expanded my closeness to the organization even more, which is why I am glad to be part of NAAIM's ongoing growth. I look forward to getting more members actively involved with NAAIM. This is a unique organization and the payoff is tremendous for members.

At April's Uncommon Knowledge conference, NAAIM unveiled a revamped website featuring a much-needed overhaul. Our site is now more user friendly and appealing, and has the ability to capture metrics to see where we are succeeding in outreach to the industry, and more importantly, where we are failing. A major part of our ongoing objective to grow the NAAIM membership is increasing our social media

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ideas on analyzing strategies. It adds up to two information-filled days and incredible networking opportunities. Check the agenda on page 3 for more details on the conference and keep up with the latest information on the conference at https://naaim.org/outlook-lp/. To register, just click on the QR code!

NAAIM's 2024 Officers and Board

Chairman	Ryan Redfern, Shadowridge Asset Management, LLC
President	Barry Arnold, Global View Capital Management
Vice President	Jacob Deschenes, Era Capital Management
Treasurer	Paul Schatz, Heritage Capital, LLC
Secretary	Robert Bernstein, RGB Capital Group LLC
Director	Sam Bills, Jr., Bills Asset Management
Director	Gregory Corneille, Choice Wealth Management
Director	Joshua Kneller, Atlas Capital Management
Director	Jim Lee, StratFI
Director	Whitney Ribbens, Chicago Wealth Management Inc.
Director	Asher Rogovy, Magnifina
Director	Ron Rough, Financial Services Advisory (FSA)
Director	Matt Spangler, Signal Research Group, LLC
Director	Craig Thompson, Asset Solutions
Strategic Advisor to the Board	
	David Bush, ALPHATATIVE LLC.

New NAAIM Website Introduced at Uncommon Knowledge 2024

NAAIM'S WEBSITE HAS A NEW LOOK AND increased functionality. If you have not yet had an opportunity to explore the new site, make time to do so today!

Thank you, OUTLOOK 2024 Sponsors!

GUGGENHEIM

ProShares

Direxion ETFs | Funds

MassMutual Investments

Rob Hanna Takes Home the 2024 Founders Award

CONGRATULATIONS TO Rob Hanna of Capital Advisors 360 as the 2024 winner of NAAIM's annual white paper competition, the Founders' Award. Rob's paper is titled *"Chicken and Egg: Should you use the VIX to time the SPX? Or use the SPX to time the VIX?"* In it, he challenges the prevailing market wisdom by maintaining that S&P 500 Index (SPX) action offers a more reliable basis for forecasting the CBOE Volatility Index (VIX) movement than VIX action does in forecasting SPX movement.

"I believe most traders have been getting it wrong for years. Rather than using the VIX to predict SPX movement, more substantial edges lie in using SPX to predict movement of VIX-based products," Rob explains.

The chicken and egg reference in the paper's title refers to not the question of whether the chicken or the egg came first but whether egg weight influences the size of the chicken and whether heavier chickens produce larger eggs. Hanna concludes that overbought/oversold SPX readings produce a more sizable edge in anticipating VIX futures movement than overbought/oversold VIX readings produce an edge in anticipating SPX moves.

Rob is a Registered Investment Adviser Representative of Eastsound Capital Advisors, LLC d.b.a. Capital Advisors 360, where he manages numerous short-term quantitative stock and bond models, as well as VIX-based models and VIX option overlay strategies. Rob also runs QuantifiableEdges.com, providing research for individuals and institutions via a website and subscriber letter, published five nights a week, and hosts courses on VIX trading, market timing, and short-term trading.

AGENDA
OUTLOOK 2024 | October 28-29

Sunday, October 27

4:00 – 6:00 PM	Board Meeting
8:00 PM	Meet in Hotel Lounge - for a night cap and your first drink is on NAAIM!

Monday, October 28

7:30 AM	**Registration** – Breakfast in the Sponsor Hall
8:30 AM	Welcome – Barry Arnold, NAAIM President
8:45 AM	**Technical Analysis – You Make Markets Fun and The Message in the Charts -** John Roque, Sr. Managing Director, Head of Technical Strategy, 22V Research
9:45 AM	**AI in your Practice -** Ben Olsen, Founder and CEO, Beemo Automation, AI
10:45 AM	Refreshment Break
11:00 AM	**Financial Planning – NAAIM Member Panel**
12:00 PM	Lunch - Sponsor Introductions
1:00 PM	TBA
2:00 PM	**Constructing and Back Testing Multi-Strategy Portfolios** - Marsten Parker, Founder, RealTest (monitoring System performance)
3:00 PM	Refreshment Break
3:30 PM	**Analyzing Strategies NAAIM Member Panel**
4:30 PM	**NAAIM Member Round Tables:** Informal concurrent discussions. 40 minutes: **Session #1 Topics:** Marketing Trading; Software; and Back Office **Session #2 Topics:** Marketing; Crypto; and AI in your practice:
6:15 – 9:00 PM	**NAAIM Evening Event** – TBA

Tuesday, October 29

7:30 AM	Breakfast in the Sponsor Hall
8:30 AM	**2024 Election and Policy Outlook - Shahira Knight**, Managing Principal, Policy & Government Relations, Deloitte
9:30 AM	**Communicate 2 Succeed** - Dallas Amsden, Communication Expert, Communicate2Succeed.com
10:30	Refreshment Break
11:00 AM	**Vance Harwood, President, Six Figure Investing (VIX)**
12:00 PM	Lunch – Roundtable Summaries
1:00 PM	**NAAIM Member Panel – Crypto / Marketing**
2:00 PM	**Compliance: Stephen Galleto and Joe Antonakakis, Stark & Stark (flexible)**
3:00 PM	Refreshment Break
3:15 PM	**Strategies – NAAIM Member Panel**
4:00 PM	Conference Adjourns

What makes a conference great? At NAAIM it's the value of information sharing from great speakers and topics to our new members who bring new perspectives and ideas. There's the opportunity to form personal relationships through activities such as pickleball, the NAAIM Golf Classic and member events. Every NAAIM conference also gives us an opportunity to recognize the outstanding contributions of our members, sponsors and speakers. Thank you to everyone who made Uncommon Knowledge 2024 a wonderful conference.

Complimentary Access to AAII's Education Class: "The Case for Active Management"

NAAIM IS EXCITED TO ANNOUNCE A COLLABORATION with the American Association of Individual Investors (AAII) and their inclusion of the NAAIM "The Case for Active Management" class in their newly launched online "AAII Essential Investing Course" (EI).

The EI Course is a studio-grade collection of 12 plus hours of investment classes housed in a professional learning management system. The EI Course includes individual class tests, credits, access to AAII's Active Investing Workstation, AAII certification and a host of benefits for those passing the EI Course final exam. Classes are taught by industry leaders like Ken Fisher, Morningstar, Fidelity Investments and NAAIM member and past president, David Moenning.

As part of our collaboration, AAII is offering NAAIM associates and friends complimentary access to the NAAIM Class. To take the NAAIM Class at no cost, go to AAII's dedicated webpage for NAAIM members at aaii.com/eicourse-naaim-professional, select the NAAIM class on the page, and use the code (NAAIM100) at checkout.

"The Case for Active Management" was created by NAAIM members Robert Bernstein, RGB Capital Group, LLC; David Moenning, Heritage Capital Research; Matt Spangler, Signal Research Group, LLC; and Ryan Redfern, Shadowridge Asset Management, LLC. It offers an in-depth look at key aspects of active management. Course participants will gain a better understanding of alpha generation, risk management, and the critical factors to consider when selecting an active manager who can better meet their unique financial objectives.

In appreciation of NAAIM's contribution to the EI Course, AAII is also offering NAAIM members a professional discount for the entire EI Course. This offer *is for active NAAIM members only*. To register for the EI Course at the professional discount price of $199 (the listed price is $399), contact Susan Truesdale at info@naaim.org.

NAAIM member Raymond A. Rondeau, who serves as an Investment Strategist and Senior Technical Analyst with AAII, emphasizes the unique value of the EI program. "This EI Course is comprised of two separate courses, and both are included with a single registration. The EI Structured Course is a comprehensive course designed to provide retail investors with a basic understanding of the essential investing elements, terms, and concepts so they can work more effectively with their investment advisors. The EI FlexiLearn Course is geared towards professional investors with advanced topics, actual evidence-backed strategies, and real-world investing tools to test and apply those strategies." Ray's endorsement underscores the course's focus on providing all types and levels of investors with the skills, knowledge, strategies, and tools to control risk and succeed as investors.

Are You Aware of the Following NAAIM Programs?

New Member Benefit - NAAIM Financial Planning Masterminds Online

AMONG THE IDEAS RESULTING FROM Uncommon Knowledge 2024 was giving NAAIM members an opportunity to learn more about incorporating Financial Planning in their business models. In response, NAAIM launched a new online meet-up in June. This August marked our third session.

NAAIM Financial Planning Mastermind
Date: Monthly on the second Thursday of each month
Start Time: 15 minutes after market close (4:15PM Eastern Time).
Next Meeting: Sept. 12, 2024

The online meet-up starts with a moderator-led discussion on a designated topic, then opens up for a roundtable-style conversation. Live sessions are open to members and non-members, however, recordings and materials will be available exclusively to NAAIM members.

To join the conversation, look for an invite in your email box. Sign up on Info Hub or from a link in the invitation, and then login. Reviews of the first two sessions were all positive, so don't miss out on this new opportunity to enhance your management practice.

Boost Your Reputation as a Financial Leader

ARE YOU READY TO ENHANCE YOUR REPUTATION as a financial leader and become a thought leader in the industry?

NAAIM members have valuable insights to share, and we've created a platform just for you to do so!

Introducing NAAIM Confidential!

Join us every Friday at 4:30PM ET for a 30-minute LIVE stream where NAAIM members take the stage to discuss the markets, share their favorite financial quotes, offer insights on the NAAIM Exposure Index, and much more!

Your live stream will be recorded, and NAAIM will create snippets of your interview to share on our social media platforms.

Our interviewers include Branden DuCharme, Ryan Redfern, Asher Rogovy, and Ben Fox.

To become a featured guest, complete the NAAIM Confidential Guest Form (https://members.naaim.org/ap/Form/Fill/pBVE8Cyp) and we'll call you to schedule an interview date!

NAAIM Confidential is an informal discussion, not meant for advertising, but as a platform to showcase the insights of our membership as they share their thoughts on investing and the financial markets.

Your Blog Should Be on "NAAIM Speaks"

NAAIM IS SEEKING NEW VOICES FOR OUR NAAIM Speaks monthly compilation of NAAIM Member Insights.

NAAIM Speaks is a monthly email newsletter containing market insights and analysis from NAAIM member firms. "Speaks" is designed to provide a plethora of market indicators, market analysis, some occasional humor, as well as a summary of NAAIM's proprietary Dynamic Asset Allocation Model and Exposure Index. The report is for informational use only and is not to be construed as investment advice.

Each NAAIM Speaks newsletter includes introductory paragraphs to members' blog postings with a link to the full blog on the member's website. It's a good way to increase your firm's visibility and bring new readers to your website. To add your regular blog publication to NAAIM Speaks, contact NAAIM's administrator, Susan Truesdale at info@naaim.org.

NAAIM
NATIONAL ASSOCIATION OF ACTIVE INVESTMENT MANAGERS

SPEAKS

A Monthly Compilation of NAAIM Member Insights

Volatility Reduction in Focus: Optimize Portfolio and Concentrated Positions with Option Strategies

BY JOHN R. BELDY

INTRODUCTION: FOR MOST INVESTORS, IT'S NOT just the destination that matters …but the journey. Equities are essential for growth, but the sharp, periodic losses that inevitably come with the asset class can have severe consequences for clients at any stage of the investment continuum. For these reasons, investors need strategies that offer equity market participation, but whose value-add centers on volatility reduction.

The following primer explores the philosophy and approach underpinning the use of a dynamic Covered Call strategy on Exchange Traded Funds (ETFs). A strategy that uses passive ETFs to achieve market-like returns and relies on liquid options – without leverage – to limit downside capture. By taking a less complicated approach to equity market participation and options markets, we believe the strategy can serve as an essential component of most investor portfolios.

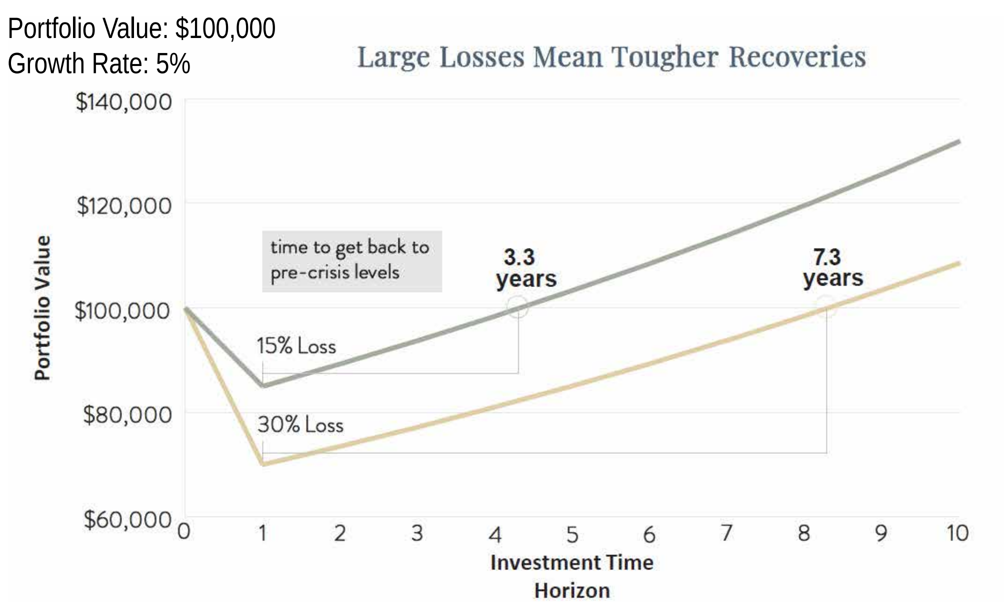
I: Volatility Reduction: The Key to Meeting Long-term Investment Objectives

An 11-year bull market made it easy to forget, but early 2020 and early 2022 served a reminder that volatility, can – and does – strike at any time. By dampening drawdowns in those painful periods, a portfolio has a smaller hole to climb out of after an equity market downturn, helping that strategy outperform broader equity markets over full market cycles.

Volatility reduction has other, more profound implications for helping investors achieve their long-term objectives. For investors with long- to mid- range time horizons, reducing the volatile swings in equity markets can keep them off the sidelines, remaining fully invested through a downturn, so they get the full benefit of compounding over a lifetime of equity investing. Meanwhile, investors at or near retirement can ill-afford to suffer a significant drawdown to their nest egg right when they need to draw from it.

Large drawdowns have long-term consequences. Limiting a big loss can dramatically speed up the time it takes to bring the portfolio back to its original, pre-crisis level, and can lead to significantly better results over a longer time horizon.

For these reasons, covered call strategies that achieve equity-like returns with less volatility can be a valuable complement to any investor's portfolio. But investors must be mindful of how the strategy achieves equity-like returns and how it uses options to manage volatility. We explore those topics in the next two sections.



II. Equity Exposure: Inexpensive and Holistic

The most vital aspect of a dynamic covered call strategy is how it dampens volatility using options while maintaining equity market exposure. Utilized ETFs to obtain broad equity exposure as economically efficient as possible.

To achieve greater market breadth, investing in ETFs replicating the S&P 500, the NASDAQ and the Russell 2000 indices. By selecting these three indices' investors get exposure to large and small-cap markets, and the growth of the technology sector. Its objective is not to add value by making over- or under- weight allocations to a given index, but instead ensuring clients maintain the broadest exposure possible.

III. The Options Overlay: A Responsible Approach to Dampening Volatility

ETFs allow investors to participate in equity markets' long-term upside potential cost effectively and efficiently. But dampening the volatility inherent in achieving those long-term returns cannot be realized as effectively with a mechanical, passive approach. The strategy relies on ETFs for equity market participation, but actively manages options to achieve two outcomes:

- Offset losses in down markets.
- Provide additional yield in flat markets.

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Volatility Reduction in Focus: Optimize Portfolio and Concentrated Positions with Option Strategies

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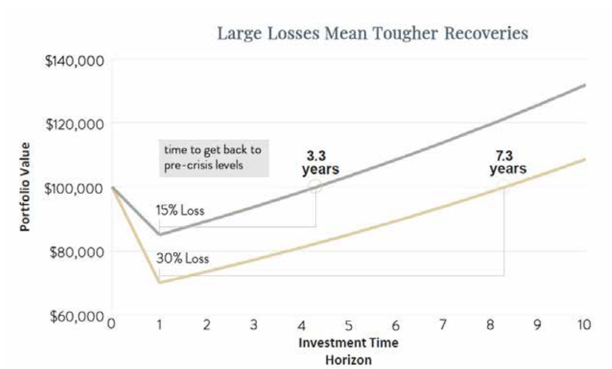
Achieving those outcomes is limited with a passive approach. Options markets provide a wide range of potential opportunities for portfolio managers based on the option's strike price and expiration. Active options managers can also capitalize on volatility in options markets to select the best position that provides the best potential yield or hedge.

Passive approaches such as the CBOE S&P 500 Buy Write Index are hamstrung from capitalizing on these opportunities. The mechanical nature of such strategies dictates that they consistently sell the closest strike price to the value of the S&P 500 Index on a pre-determined time and date. They lack the flexibility and nimbleness to find the best opportunity option markets present. As the charts below show, the missed opportunities can be considerable, particularly in flat and down markets.

The first chart shows the performance of both the strategy and its benchmark in 2020, a period that includes the most significant market drawdown in more than a decade. The ability to actively use options to limit losses helped it outperform when markets were down, leading to outperformance for the year-to- date period. The second table shows how dynamically managing the options portfolio has contributed to outperformance – and lower standard deviation. In short, actively managing the options overlay has provided a considerable advantage relative to a passive covered call approach.



	Covered Call	BXM Index
Annualized Return	8.9%	6.3%
Standard Deviation	11.7%	9.5%
Sharpe Ratio	0.65	0.52
Risk-Adjusted Return	7.8%	5.6%

* Results are annualized from 01/2013 thru 05/2023.

Risk Controls for Options Investing

A Covered Call Strategy takes a back-to-basics approach to options trading, using the instruments for one of their most intended solutions: PROTECTION.

Options trading draws negative connotations with some investors, due to the speculative nature in which some hedge funds use them. These funds will employ leverage to take on speculative bets in options markets, a risky endeavor that has sometimes backfired.

This is not the intent of the Covered Call Strategy. The strategy does not employ leverage or use options trading to make a speculative bet, rather, the portfolio holds the required number of underlying ETF shares to cover each option it writes.

The strategy takes a few other measures to reduce risk within the options overlay:

First, the portfolio owns options against broad-based index ETF's (Exchange Traded Funds), which are some of the most liquid options markets in the world. This approach is different from other options strategies, which may use options for specific stocks or sectors. The latter approach has a higher risk element and can be more volatile.

Second, the strategy only sells options expiring within the next three months, avoiding longer-duration trades to maintain flexibility.

Finally, positions are actively monitored daily to continually manage risk. The lack of leverage and other controls ensure the options overlay is carrying out its original intent: enhancing yield and reducing risk.

IV. Conclusion:

Equity market participation is essential for the goals of nearly every investor. Passive investment structures allow for that participation inexpensively and efficiently. The key for advisors and allocators is to help dampen volatility so that clients stay invested through the market cycle.

A dynamically managed strategy takes advantage of passive equity market participation but uses options – without leverage – to minimize the volatility that is inevitable through an entire equity market cycle.

Importantly, managing volatility requires an active approach. By actively monitoring the opportunity set among different strike prices and expirations dates – and capitalizing on volatility within options markets – a portfolio manager can produce better outcomes that go further in dampening volatility than a mechanical, covered call writing approach. The dampened volatility creates better long-term results for investors.

John R. Beldy is Founder and Chief Investment Officer of Sentry Capital Management. To find out more about Sentry Capital Management visit www.sentrycapital.com.

Welcome New Members!

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President's Letter

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presence through Facebook, YouTube, X (twitter), and other emerging platforms.

Among NAAIM's crown jewels is the NAAIM Exposure Index where members are polled weekly and asked "where are you exposed in the market." The Index is published every Thursday, utilized by institutional and retail investors and technicians throughout the industry and featured on NAAIM's social media channels. We know the Index has lots of hits and views, now we need to reel them in and get them more involved in NAAIM.

NAAIM's newest endeavor in 2024 is NAAIM Confidential, a weekly, live, one-on-one interview with NAAIM members held every Friday after market close at 4:30 p.m. Eastern. The interview can be viewed live or watched later on NAAIM's YouTube channel. We now have 29 episodes in the can. Starting out, we were pretty shaky on the process, but recent episodes are really nailing it down on who to interview, what to talk about and how to keep it interesting. Four NAAIM members alternate as moderators. So far, interviewees have been NAAIM members, but we are starting to look at branching out to non-member guests.

The last Thursday of the month at 4:30 p.m. Eastern features NAAIM Exchange, where members gather via an open ZOOM session to share charts and discuss individual stocks, technical indicators, software packages to track the market and the hot topics of the day. The discussion is not recorded; there's no replay, so you need to be there to be a part of the collaboration.

And of course, we have the NAAIM Webinars mid-month featuring industry experts covering a wide range of topics from the market to specifics in market, strategies, tools, trends, indicators and much more.

Coming up in September is the 4th monthly NAAIM Financial Planning Masterminds. This is our newest program, born out of a panel presentation on financial planning at Uncommon Knowledge 2024 in Orlando. The meet-up session talks about financial planning from soup to nuts and takes place the 2nd Thursday of each month at 4:15 p.m. Eastern. Topics might include debt elimination, estate planning, account disbursements, risk diversification, income strategies and more. Members and non-members are welcome to participate, but the video playback is only available to NAAIM members. If non-members need a reason to become members, this is one more. I'm on because I love to learn, and the discussions have been very good.

We are also continuing to promote our staple programs – the NAAIM Founders Award white paper competition, NAAIM's Indicator Wall, and the Active Investing Strategy Competition.

There really is no replacement, however, for the live interaction that comes from joining fellow members at NAAIM conferences, which is why I am hoping you will be at the NAAIM 2024 OUTLOOK Conference coming up in Dallas, Texas, October 28-29. Among our featured speakers is Shahira Knight, Managing Principal, Policy & Government Relations with Deloitte, based in Washington D.C. She promises to update us on the status of the 2024 U.S. congressional and presidential elections and possible policy implications of different election scenarios. Shahira will also examine the legislative agenda in 2025, including expiration of portions of the Tax Cuts and Jobs Act of 2019.

With that, this letter is getting much too long. I hope the remainder of your summer is fun and prosperous. Take some time out to participate in the NAAIM monthly events and let me know how we can make NAAIM better in the year ahead!

Sincerely,

Barry Arnold
NAAIM President

The Deception of Average

BY GREG MORRIS

I published this the first time in November 2017 and think it is just as appropriate now as then.

$$\bar{x} = \frac{1}{n}\sum_{i=1}^{n} x_i$$

THE "WORLD OF FINANCE" IS FRAUGHT WITH misleading information. The use of average is one that needs a discussion. Chart A is a chart showing the compounded rates of return for a variety of asset classes. If I were selling you a buy and hold strategy, or an index fund, I would love this chart. From this chart, showing 85 years of data, I could say that if you had invested in small cap stocks you would have averaged 11.93% a year, and if you had invested in large cap stocks you would have averaged 9.85% a year. And I would be correct.

I think that most investors have about 20 years, maybe 25 years, in which to accumulate their retirement wealth. In their 20s and 30s, it is difficult to put much money away for many reasons such as: low incomes, children, materialism, college, etc. Therefore, with that information, what is wrong with this chart? **It is for an 85-year investment and people do not have 85 years to invest.** As said earlier, most have about 20 years to acquire their retirement wealth, and there are many 20-year periods in this chart where the returns were horrible. The bear market that began in 1929 did not fully recover until 1954, a full 25 years later. 1966 took 16 years to recover and 1973 took 10 years.

Table A shows the performance numbers for the asset classes shown in Chart A (LT – Long Term, IT – Intermediate Term). The cumulative numbers in Table A begin at 1 on December 31, 1925.

Hint: Be careful when someone uses inappropriate averages; or more accurately, uses averages inappropriately.

Recall in Chart A that the small cap and large cap compounded returns were about 12% and 10% respectively? Chart B shows rolling 10 year returns by range since 1900. A rolling return means it shows the period from 1900-1909, 1901-1910, 1902-1911, etc. You can clearly see that the small stock and large stock returns depicted in Chart A fall within the middle range (8%-12%) in Chart B, yet of all the 10 year rolling periods, only 22% of them were in that range. <u>Often average is not very average.</u> **It reminds me of the story of the six-foot-tall Texan that drowned while wading across a stream that averaged only three feet deep**.

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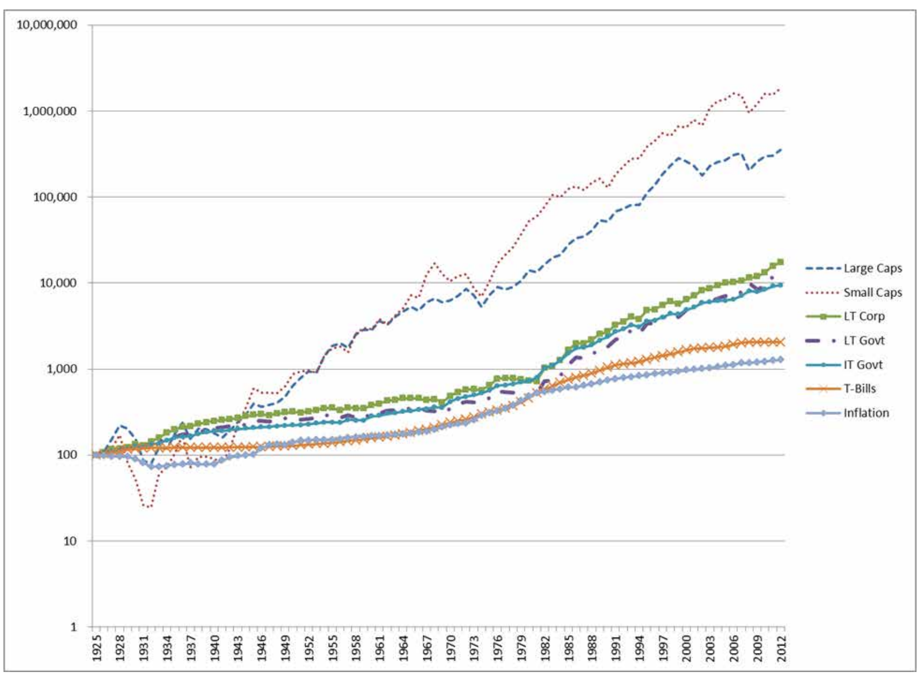

Chart A - Year Returns of Various Assets

	Small Caps	Large Caps	LT Corp. Bonds	LT Govt. Bonds	LTGovt. Bonds	T-Bills	Inflation
Cumulative	18,366.93	3,531.23	173.08	122.13	93.00	19.58	11.81
Annualized	11.95%	9.85%	6.11%	5.69%	5.36	3.54%	2.97%
Mean	16.5	11.8	6.4	6.1	5.5	3.6	3.1
Sigma	32.2	20.2	8.3	9.7	5.6	3.1	4.1

Table A - Long Term Performance of Asset Classes
Data Source: Morningstar Ibbotson SBBI Yearbook

The Deception of Average

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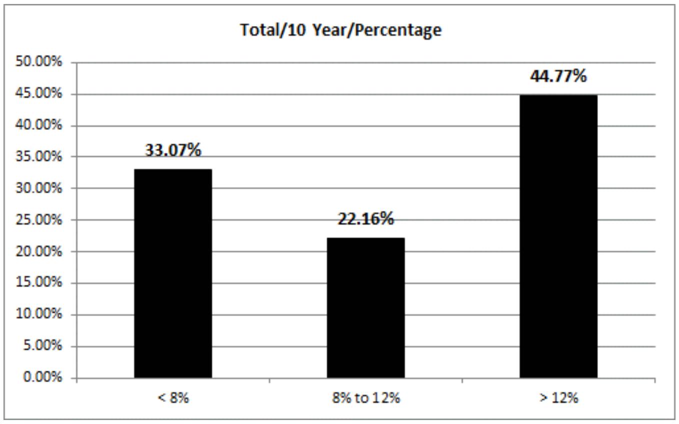

Chart B Distribution of Returns based upon Percentage

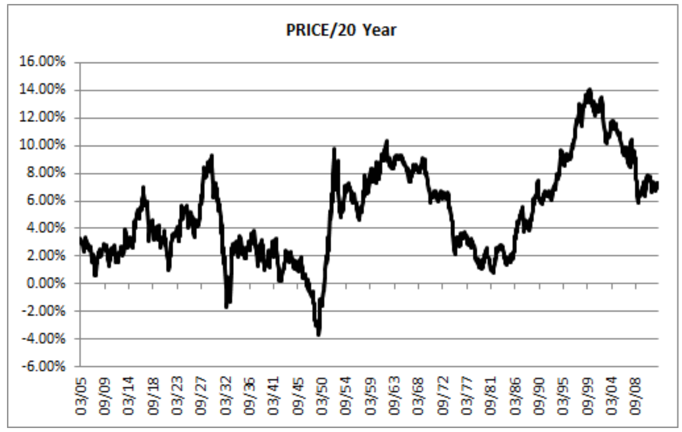

Chart C - Dow Industrial Average 20 Year Rolling Returns (1885 – 2012)

Chart C shows the 20-year rolling price returns for the Dow Industrials. The range of returns in this 127-year sample (1885 – 2012) is from a low on 08/31/1949 of -3.71% to a high on 3/31/2000 of 14.06% which is a 17.77% range. To help clarify rolling returns, on 8/31/1949 (the low point on the chart), if an investor was in the Dow Industrials from 9/30/1929 until 8/31/1949, they had a return of -3.71%. Complementary, if one invested on 4/30/1980, then on 3/31/2000, they had a return of 14.06%.

The mean return is 5.2% and the median return 4.8%. **When median is less than mean, it simply means more returns were less average.** If you recall the long-term assumptions that are often used in the first part of this article (Chart A), you can see there is a problem. The magnitude of errors in assumptions of long-term returns cannot be overstated and certainly cannot be ignored. This variability of returns can mean totally different retirement environments for investors who use these long-term assumptions for future returns. It can be the difference between living like a king or living on government assistance. Institutional investors have the same problems if using these long-term averages.

This is important! One of the primary beliefs developed by Markowitz in the 1950s as the architect of Modern Portfolio Theory; was the details on the inputs for the efficient investment portfolio. In fact, his focus was hardly on the inputs at all. The inputs that are needed are expected future returns, volatility, and correlations. The industry as a whole took the easy approach to solving this by utilizing long-term averages for the inputs. In other words, one full swing through all the data that was available; and the average is the one used for the inputs into an otherwise fairly good theory. **Those long-term inputs are totally inappropriate for the investing horizon of most investors;** in fact, I think they are inappropriate for all human beings. While delving into this deeper is not the subject of this article, it once again brings to light the horrible misuse of average. These inputs should use averages appropriate for the investor's accumulation time frame.

Everything with Four Legs is a Pig

While this is unrelated to investments and finance, it is a story about averages which offers additional support to this topic. Doctors use growth charts (height and weight tables) for a guide on the growth of a child. What folks do not realize is that they were created by actuaries for insurance companies and not doctors. As doctors began to use them the terms overweight, underweight, obese, etc. were created based upon average. So, if your doctor says you are overweight and you need to lose weight, he is also saying you need to lose weight to be average. And from a Wall Street Journal article by Melinda Beck on July 24, 2012... "The wide variations are due in part to rising obesity rates, an increase in premature infants who survive, and a population that is growing more diverse. Yet the official growth charts from the Centers for Disease Control and Prevention still reflect the size distribution of U.S. children in the 1960s, '70s and '80s. The CDC says it doesn't plan to adjust its charts because it doesn't want the ever-more-obese population to become the new norm." And now you know.

During my last physical examination, I told my doctor about how these charts on height and weight were just large averages created by actuaries for insurance companies and that I did not mind being above average.

Try not to be Average.

About the author: Greg Morris *has a 50-year investing career as a technical analyst, a developer of indicators and trading systems. He is also an accomplished author of books on trend analysis, breadth, and candlesticks. Morris worked with N-Squared Computing from 1982 to 1993. During his time there he produced over 15 technical analysis and charting software titles.*