Perspective: A Bit Choppy, Top 10 Portfolio, TipTop Portfolio

Apr 04, 2015

Dear Scott,

The Market's a Bit Choppy — What's a Bit?
Since the market is still within spitting distance of its all time high last month, my neighbor Ralph says he'll continue to sit on his cash and wait for a worthy pull-back before buying in again. Clearly he doesn't feel the 4% dips in the current market chop constitute a worthy pull-back.

Ralph is among many traders still waiting for that elusive 10% pull-back, now long overdue. Meanwhile, the market continues to steadily melt upward. A trend follower believes a steady ride upward is the most one could hope for and embraces it knowing that it is world events that trigger markets, and market action that drives charts. Thus, there will neither be a 10% pull-back, nor a 60% market crash just because a chart pattern says one is overdue.

Although the market crash of 2008-2009 provided a strong rebound opportunity for the broader market through 2013, since then momentum in most sectors has measurably waned. With the forward earnings outlook indicating near zero year-over-year growth, a flat year ahead is indicated. But, it's worth repeating that the market's P/E ratio has a habit of only passing through fair value on the way to being either overbought or oversold, and notably the market continues heading higher.

Sectors on the Move: Healthcare, Homebuilders, Treasuries.
Anything in healthcare, particularly biotechnology, continues to rule the roost of outperforming sectors. While the transportation sector seems to have lost its leadership, homebuilders are on the move, perhaps buoyed by a belief that low interest rates will continue to be available for prospective buyers for quite some time. While long-term treasuries sold off aggressively during February, they have had a significant rebound in the last three weeks of March. Apparently the selloff was just a short-term technical correction, not the start of a downward trend based on a fundamental market shift.

"Top 10 of Top Fund" Portfolio - Concept by Gary Millhollen
Fellow surfer Gary Millhollen clearly had his thinking cap on straight when he developed this excellent Portfolio-of-Strategies concept. Recently he suggested that instead of buying a few trend leading Fidelity sector funds, perhaps it would be better to put the top 10 stocks (selected by allocation weight) of each Fidelity sector fund into a SectorSurfer Strategy and have the algorithm pick the trend leader from among them as the one stock to own from the Fidelity

3-Months

9-Years

Portfolio: Top 10 of Top Fund

Top 10 Portfolio: Underlying Strategies

sector fund. I encouraged him to try it because the methodology would avoid the problem of selecting stocks in hindsight (the curve-fitting selection bias problem) and because it would offer the possibility of producing greater performance than can be produced by the inherent diversification of stocks within the Fidelity sector fund. Click the Portfolio and Strategy thumbnail images to the right to for details.

In addition to the 10 sector stocks in each Strategy, Gary also put SPY (the SPDR S&P 500 market index ETF), and TLT (the iShares 20+ Year Treasury Bond ETF) into each Strategy as backstop funds, meaning that if none of the stocks do as well as one of the backstops, then the backstop fund is selected to ensure a reasonable minimum performance. After creating the three Strategies, Gary further combined them into a single Portfolio to create a Portfolio-of-Strategies, a step we call Post-Surfing Diversification to further reduce short term volatility.

The results speak for themselves and handily beat the performance of simply putting the three Fidelity sector funds in a portfolio. If you are driven to invest in stocks, please take the time to consider the importance of what this methodology accomplishes for both investment performance and modeling legitimacy. Hopefully Gary will pursue this further and share a more refined update with us next month.

"TipTop of the Market" Portfolio - 5% Q.R.Max Drawdown. As the number of ETFs offered continues to mushroom, investors are now faced with a dozen or more ETF choices in each sector, begging the question as to which of them should be selected for use in a Strategy. Further complicating matters is that if you make that selection today with hindsight, you may be creating Strategies showing past performance that could not have been executed in real time because you would likely not have known to choose those same funds.

The perfect solution for this problem is to use a SectorSurfer Strategy to select the one best performing ETF from among many similar ETFs designed to model a particular sector. In this way, the ETF selection is done in a walk-forward manner and both provides best-in-class performance during each period of time and avoids the hindsight problem. Accordingly, I created a family of 11 TipTop Strategies, one for each of various market sectors and asset classes (see listing on right). Each TipTop Strategy selects the best ETF from among 10 alternatives representing the same sector or asset class. Each of the Strategies additionally contains MDY (the SPDR S&P Midcap 400 market index ETF) as a backstop fund so that if none of the ETFs do as well as MDY, then MDY is selected to ensure a reasonable minimum performance.

The **TipTop of the Market Portfolio** utilizes eight of the TipTop Strategies plus UBT, a long term treasury fund to produce a compound annualize return of over 20%, a Sharpe Ratio over 1.5, a Sortino Ratio over 8 and a Quarterly Realized Max Drawdown of 5%.

Click to Enlarge

Portfolio: TipTop of the Market
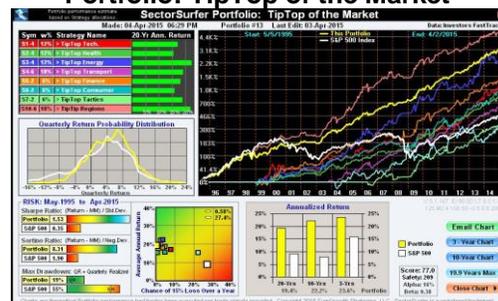
Portfolio Specification

Click Name to See Chart — StrategyID

S1 - TipTop Tech.
635636758904173750-152-1-125009

S2 - TipTop Health
635636758904173750-152-2-125013

S3 - TipTop Energy
635636758904173750-152-3-125028

S4 - TipTop Transport
635636758904173750-152-4-125030

S5 - TipTop Finance
635636758904173750-152-5-125032

Although UBT, the long term treasury fund, somewhat reduces the Portfolio's return, it has a very significant effect on reducing remnant shorter term risk as it is strongly inversely correlated to the S&P 500 market index. Not all of the TipTop Strategies were included, as the objective of the Portfolio was not to simply include all of the TipTop Strategies I could make, but rather to create a high performance Portfolio with primary focus on risk reduction while maintaining reasonably good returns. The allocation weights of the Strategies were adjusted to maximize the Safety rating without terribly compromising the return. Certainly other combinations and allocation weightings of these Strategies may offer better performance, but the TipTop Strategies and the TipTop Portfolio have been pretty well optimized already.

The TipTop Strategies and Portfolio will soon have a web page of their own, but for a while, this newsletter will serve as their initial description and documentation.

S6 - TipTop Consumer
635636758904173750-152-6-125033

S7 - TipTop Tactics
635636758904173750-152-7-125035

S8 - TipTop Bond
635636758904173750-152-8-125068

S9 - TipTop Materials
635636758904173750-152-9-125086

S10 - TipTop Regions 635636758904173750-152-10-125088

S11 - TipTop Industrials
635636758904173750-152-11-125070

Speaking Engagement Calendar
Please come and see one of these seminar presentations if you are in the neighborhood. Alternatively, ask your AAII Chapter or Investment Group leader to schedule a presentation. Webex presentations for smaller investment clubs and groups are also possible.

Seminar Title: True Sector Rotation: Breaking Through the Efficient Frontier.
This is a fast paced detailed seminar that will cover SectorSurfer basics, Forward Walk Progressive Tuning, Strategy-of-Strategies, and how to make Low Drawdown Portfolios.

• Dallas, TX: MTS Group - Saturday, April 11, 9:00 AM (advanced forum)
• Dallas, TX: AAII Chapter - Wednesday, April 15, 9:00 AM
• San Antonio, TX: AAII Chapter - Friday, April 17, 5:30 PM
• Austin, TX: AAII Chapter - Monday, April 20, 7:00 PM
• Baltimore, MD: AAII Chapter - Saturday, May 9, 10:00 AM
• Pittsburgh, PA: AAII Chapter - Tuesday, May 12, 7:00 PM
• Cleveland, OH: AAII Chapter - Wednesday, May 13, 7:00 PM
• Twin Cities, MN: AAII Chapter - Friday, Oct 23, 7:00 PM + Sat. 9:00 AM
• Las Vegas, NV: AAII National Conference - Saturday Nov 7 - Nov 10
• Houston, TX: Houston Investors Association - Sat., Nov14, 9:00 AM
• Houston, TX: AAII Chapter - Saturday, Nov 21, 9:00 AM

Surf Well and Prosper,

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SectorSurfer ®
Change the Game

Additional Resources

Sector Surfer University — Learn to Change the Game

Investment professional Richard Erkes created SectorSurfer University to provide everyone the opportunity to learn how to use SectorSurfer to improve investment portfolio performance while simultaneously reducing investment costs. **Click HERE**

Sector Surfer Users Group — Join the Conversation

The SectorSurfer Users Group is an online Google Groups Forum created by Joe Gruender of San Jose, CA to provide a platform for exchanging strategies, ideas and learning from the experience of other SectorSurfers. **Click HERE**

ALPHAGEN STRATEGIES — Professional Help - Change the Game

Bryan Sullivan founded AlphaGen Strategies to empower financial advisors with SectorSurfer's True Sector Rotation technology in a framework that helps advisors manage high performance portfolios for their clients. **Click HERE**

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