

Perspective: Rebound, SectorSurfer University, Managed Volatility?

Sep 03, 2014

Dear Scott,

Market Dip Rebounds Again

You may recall that when the market took quite a dip at the end of July, [I listed six very concerning world events](#) which likely participated in triggering the dip. But none of them (so far) has risen to the level of causing measurable disruption of our economy. And so any shock value of the news soon dissipates and investors again bravely "buy the dip" — and the market rebounds and continues its march higher.

It's worth repeating that while there are many market moving events that are unpredictable, statistically it can be shown that it is better to ignore events in the short term to avoid selling low only to watch the market rebound, thus locking in whipsaw losses. For more discussion on this, see: [The "Faster Response" False Dilemma](#).



Introducing SectorSurfer University

Richard Erkes, a seasoned financial professional with expertise in portfolio planning, securities analysis, and risk management has announced the founding of SectorSurfer University.

Mr. Erkes is an active member of the AAI LA Chapter, founder of [MalibuInvests](#), founder of the Erkes Trading Group, was a member of the Chicago Board of Trade and Chicago Board Options Exchange, was appointed Chairman of the State of Illinois Retirement System and has consulted for corporations and individuals on structuring financial plans. He holds a B.A. from the University of Illinois, and attended the Graduate School of Business, University of Chicago.

Mr. Erkes has long made a practice of helping new investors get started on the right foot. He has now launched SectorSurfer University to provide personal training for individuals who really want to employ SectorSurfer, but find it a bit overwhelming. His mission is to help investors proficiently understand and skillfully use SectorSurfer to confidently manage their own retirement accounts. Sessions may be in-person, or via a personal web conference.

Sector Surfer®
University
Learn to Change the Game



Richard Erkes: Financial Specialist

Please contact Richard directly at rerkes1@gmail.com

Managed Volatility? What's that Mean?

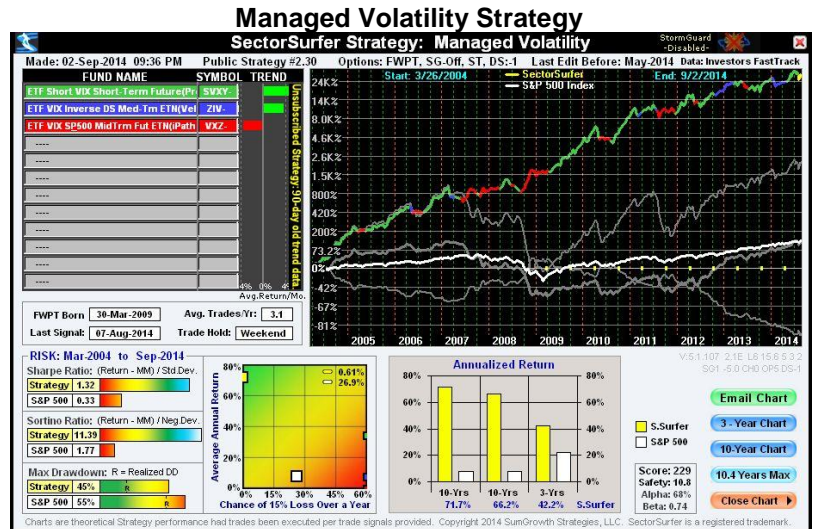
Over the years I have been asked several times whether I had any success incorporating the VIX (volatility index) as a means of improving Strategy returns. The answer is that I could never figure out how to get the VIX to do anything but degrade SectorSurfer performance. So I abandon thinking about it until Power Surfer Bob Toombs sent me an email regarding some fairly new ETFs based on VIX futures contracts.

Now mind you that one can wax philosophical about whether SectorSurfers can legitimately call themselves investors, as opposed to being gamblers. Even when there are real shares of company underlying a fund it seems to me that if we don't really study the company's business and purely make decisions based on price movement, then we probably are more like gamblers using a fancy tool to tilt the odds in our favor. Nobody I say this to ever feels ashamed of their apparent manipulative greed. Instead they almost always say "but it's my turn." No gambling guilt? Consider the VIX.

The VIX estimates the implied volatility of the S&P500 over the next 30 days, but is ambiguous as to whether it will be to the upside or down side. The VIX futures contracts represent bets as to whether the implied volatility will increase or decrease. Volatility is a derivative measure of the S&P500, and the ETFs are a measure of the psychic proficiency of traders predicting the future implied volatility of the S&P500. Wow!

One saving grace that makes it interesting for SectorSurfers is that the price movements of these ETFs actually have significant trend characteristics. Market data reactions are really only about human reactions to new information ... how long to believe, to buy in, to be afraid, to take action. As a population, this character is baked in our genes and thus trending characteristics should be expected. A second possible saving grace is the common belief that they express some amount of negative correlation to the market.

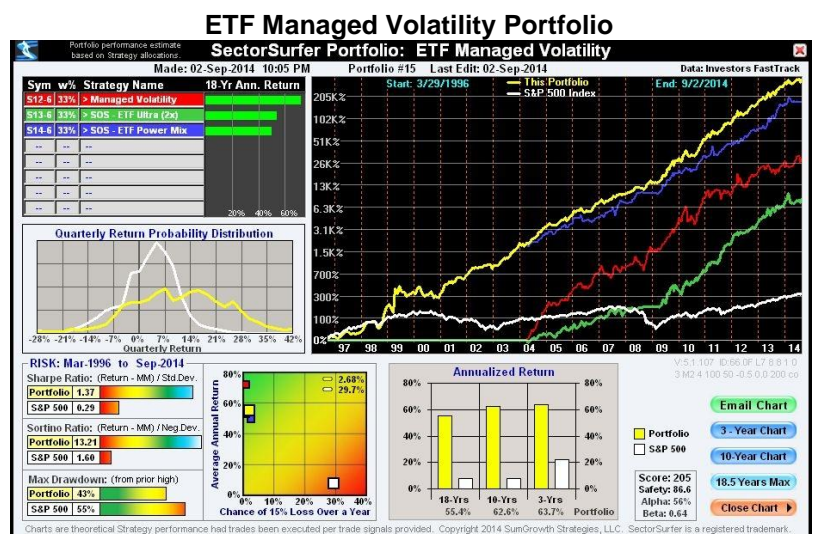
Now back to Bob Toombs. As he engaged me in discussion about a Strategy using four of these new ETF (ZIV, VXZ, SVXY, and VIXY) I moaned about how the data only went back to 2011



[Click To Enlarge Chart](#)

Portfolio Construction

12	Name: Managed Volatility	VXZ- SVXY- ZIV-
PAID	Notes:	
13*	Name: S&S - ETF Ultra (2x)	M.SSS1 M.SSS2 M.SSS3 M.SSS4 M
PAID 2X	Notes:	
14*	Name: S&S - ETF Power Mix	M.SSS23 M.SSS24 M.SSS25 M.SSS26 M
PAID 2X	Notes:	
15	Name: P: ETF Managed Volatility	512-3 513-5 514-5
FREE	Notes:	



[Click To Enlarge Chart](#)

and did not include a prior market crash. But Bob knew of a data source for extending the data for these ETFs back to 2004 because they are based on calculations of futures contracts which have trading records back to 2004. After sufficient scrutiny of the calculated values versus the actual market values in more recent years, we became satisfied that the calculated values back to 2004 were quite satisfactory, and we integrated the extended data into symbols ZIV-, VXZ-, SVXY-, and VIXY- respectively. The Managed Volatility Strategy (above right) uses these extended symbols.

	Managed Volatility Allocation Weight				
	0%	14%	25%	33%	40%
Score	198	202	204	205	205
Safety	49	81	91	87	72
Sharpe	1.22	1.32	1.36	1.37	1.37
Sortino	11.5	12.5	13	13.2	13.2

To test whether the Managed Volatility Strategy could actually provide risk reduction properties if included in a Portfolio, the ETF Managed Volatility Portfolio was created using the Master SOS ETF Ultra (2x) and the Master ETF Ultra (3x) in equal weights, and the Managed Volatility Strategy with a variety of weights, as shown in the final table. Indeed, risk was measurably lower with about a 33% weighting of the Managed Volatility Strategy. I must say that I have been impressed on multiple fronts.

I would close by noting that in other Portfolios the improvement will likely peak at a different allocation weighting if the other Portfolio Strategies are not similarly leveraged as are these 2x and 3x Strategies. Stay tuned for next month when we will take Volatility Strategies to yet another level.

Speaking Engagement Calendar

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

Seminar Title: True Sector Rotation, and How to Own the Bubble: New Tools Simplify Everything.

- Dallas MTS Group - Saturday Sept 13th at 9:30 CST - (remote by Webex)
- Denver, CO AAI Chapter - Monday Oct 20th 7:00 PM - (local - web streamed)
- Boulder, CO AAI Subgroup - Monday Oct 20th 1:00 PM
- Colorado Springs AAI Subgroup - Tuesday Oct 21st 7:00 PM

Surf Well and Prosper,



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