Perspective: Merlyn.AI Bull-Rider Bear-Fighter Portfolio

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Markets Calm and Cautiously Head Higher
Following a set of diminishing corrections in response to US-China trade war skirmishes over the past year, the market appears to be calming itself and heading higher. Perhaps the trade negotiation parties are truly getting closer to agreement, or perhaps the market has grown numb to predictions of severe economic damage. In any case, market volatility is roughly half what it was a year ago. StormGuard-Armor has been stuck on probation (at +.02) during the market's recent uncertainty. However, the laggard of its three components, Momentum, has recently turned decisively upward and will likely go positive and release StormGuard-Armor from probation by month-end if the market's bullish trend continues. For a discussion of StormGuard-Armor's performance during this volatile year, please review the recent September Newsletter.

MAI Bull-Rider Bear-Fighter Index Fully Deployed
The Bull-Rider_Bear-Fighter_Index is now fully deployed on SectorSurfer and AlphaDroid for subscribers. Per the announcement letter you received, and its associated press release regarding a new ETF listed on the NYSE, the Bull-Rider Bear-Fighter Index used as its basis is the same one available to SectorSurfer and AlphaDroid subscribers.

The Bull-Rider Bear-Fighter Index seeks to do the three things investors want most: (1) select equity momentum leaders during bull markets; (2) select fixed-income momentum leaders during bear markets; and (3) employ AI to automate the process and
adapt to changing markets. The Index’s Bull market portfolio will generally reflect a classic growth portfolio having approximately an 80/20 stocks/bonds allocation weighting, whereas during a Bear market the portfolio will generally reflect a classic defensive portfolio having four or more ETFs selected by a set of integrated Bear Market Strategies.

The construction, operation, and character of the Index can perhaps best be understood by clicking the Bull-Rider Bear-Fighter chart (above-right). The current holdings of the Index, which may change monthly, are listed in the box (above-right). To learn more about the investment options click the Bull-Rider Bear-Fighter graphic (right).

The ETF Liquidity Myth

Many investors erroneously believe that the liquidity of an ETF is determined by its AUM (assets under management) or its average daily trading volume. However, ETF liquidity is actually determined by the liquidity of its underlying securities. As explained in the article Clearing Up an ETF Liquidity Myth, market makers competitively and efficiently create and redeem shares to satisfy demand. In the process, they arbitrage premiums or discounts toward the true underlying net asset value (NAV). I have appended information to the article showing how to find the bid/ask spread information for ETFs. Keep in mind that an astute trader will statistically be on the premium side of the trade half of the time and on the discount side for the other half.

The IPAY ETF chart (right) demonstrates the liquidity truth quite well. On June 10th, Merlyn.AI signaled a return to IPAY, which only had an average daily volume of 111,547 shares. On June 10th, our subscribers traded 25 times that amount. It was about $110M more than average and was 25% of the fund’s AUM. Particularly noteworthy is the $30M trade just before noon. Plotted with IPAY, the Nasdaq 100 index moves quite similarly. A close comparison of them reveals no visible impact on the price of IPAY due to the size of the trade.
ETF Tax Efficiency? An Exchange In-Kind

A provision of the federal tax code enacted in 1969 allows an investor to exchange shares of a fund “in-kind” for shares of its underlying stocks (rather than cash) without incurring capital gains tax liabilities. The law was designed to remove the otherwise taxable event from impeding the transfer of an investor’s mutual fund account to another brokerage. The creators of the first ETF saw this law as an opportunity to increase the appeal of their new ETF product category.

Importantly, this means that ETFs designed to trade internally in order to adapt to changing markets are well matched to taxable investment accounts. Such ETFs are inherently designed to be held long term and thus can take advantage of the additional benefits of long term capital gains tax rates with its associated deferred payment.

The ETF Exchange In-Kind diagram (right) illustrates how such exchanges are achieved by an ETF broker (called an Authorized Participant, or AP) so that investor transactions involve only cash and ETF shares. This is an incredible gift from congress!

(Flexible + Control) vs. (Simple + Tax Efficient + Succession)

There are two ways to invest, with very different sets of benefits:
– More (Flexible + Control) is associated with a subscription-based Bull-Rider Bear-Fighter implementation where more aggressive or more conservative portfolios can be created to better suit personal needs.
– More (Simple + Tax Efficient + Succession) is associated with an ETF-based Bull-Rider Bear-Fighter implementation that automates trading, can provide long-term capital gains tax benefits, and includes built-in succession planning (because it keeps working whether it is you or I that gets hit by the proverbial bus). It enables investors to escape from their trading screens to attend to life’s more enjoyable priorities.
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