Beaumont
CAPITAL MANAGEMENT

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Glossary of Financial Terms

By David Haviland

April is Financial Literacy Month and for good reason. A lack of financial preparedness has huge individual and societal costs, especially as our country ages into retirement. Regardless if it is April or not, we at BCM know how valuable your financial well-being is and the importance of "starting early" to attain it. If you have not felt secure with your personal situation and hope to achieve financial literacy and understanding for yourself or your clients, look out for our dedicated Financial Literacy series posts throughout the next four weeks.

Now start with us on step one: understanding common terms and financial concepts in our industry. Below, see what we deem to be most commonly used terms you may come across today. While there may be overlap from our 2017 Glossary of Terms, we received feedback that both individual investors and financial advisors found it to be a very useful tool. So we thought we would kick this year off with a refresher of these terms! You also can refresh yourself and view our Financial Literacy posts from last year.

Glossary of Financial Terms:

- **Active Management** can be thought of as any strategy that uses human discretion to decide what the portfolio should own. The manager(s) generally employs some combination of fundamental, quantitative, or technical research in conjunction with their experience, knowledge and judgement to try to find opportunities greater than the market. The fees are typically higher than passive as you are paying the managers for their work

- **Passive Management** is often synonymous with index investing. By simply investing in the holdings of the index the strategy follows, the buy and sell decisions are not discretionary but rather based on the rules of the index. If an index fund that you invest in enters a period of failure, then your portfolio will also succumb to the market failure. Costs are typically low as there is little management of the portfolio.

- **Tactical Management** is a type of active portfolio strategy that shifts the percentage of assets held in various asset classes, sectors or individual investments to take advantage of opportunities as they present themselves. Tactical is also unique in that in times of market duress, Tactical managers seek to protect the assets by raising cash, shifting into other asset classes or geographies, or using other types of defensive mechanisms to avoid large losses.

- **Closet Indexing** is a strategy used to describe funds that claim to actively purchase investments, but wind up with a portfolio not much different from the benchmark. By doing this, portfolio managers are able to achieve returns similar to an underlying benchmark, like the S&P 500®, without exactly replicating the index.

- **Drawdown** is the measurement of an investment's total decline from its previous peak for a particular period of time. Drawdown is a useful tool to help determine an individual's risk tolerance. This statistic can help investors gauge their risk appetite as previous large drawdowns, or peak to trough declines, may repeat in the future. Since most investors' primary worry is how much they can lose in a bear market, this is often a good measure of an investment's appropriateness to each investor. How large of a drawdown can your client handle before they begin to panic or react with emotion?

- **Alpha** is a measure of excess return, usually expressed as a percentage. A positive excess return means that for the risk taken, the reward received was greater than expected. In the industry, it is commonly accepted that a manager with positive Alpha has added value beyond what was available to a passive investor.

- **Beta** is used to determine the risk-reward profile of an investment relative to the market as a whole. If the beta is greater than one, then the investment is deemed riskier than the market as a whole as and if less than 1 than it is less risky than the market. A beta of 1.2 implies that if the index goes up or down 10%, the investment in question can be expected to go up or down 12%.

- **Standard Deviation** (Volatility) is a measure of the dispersion of a set of data from its mean. It is calculated as the square root of variance by determining the variation between each data point relative to the mean. If the data points are further from the mean, there is higher deviation within the data set.

- **Sectors** (Sector Investing) sectors are areas of the economy in which businesses share the same or a related product or service. There are eleven sectors of the stock market which include areas such as Financials, Utilities, Healthcare, and Energy. Sector investing is a strategy based on moving investments across these sectors to take advantage of cyclical trends in the overall economy.

- **Smart Beta** is often synonymous with Factor Investing. Smart Beta funds typically follow a passive index yet the index is built to own securities with certain investment attributes or factors. Factors generally seek to do one of two things: exploit market inefficiencies to create alpha, or harvest a risk premia to realize higher returns through the targeted beta in one or more factors. In short, these factors have the ability to add alpha to portfolio returns.

  By itself, may not be so smart. While the factor exposure can lend 1-3% of excess returns over time, unfortunately smart beta funds act too similar to the broad markets when they falter. The 6 most common factor ETFs (Dividend, Momentum, Quality, Size, Volatility and value), if held in equal weights, declined the same amount as the S&P 500 in the 2007-2009 drawdown.

- **Single Factor** investing includes funds that focus on a single factor, like value or momentum, when creating an index.

- **Multi-Factor** investing includes funds focus on multiple different factors when organizing the weights of a given index.

- **Rules-Based** is a term often used to describe a Tactical Manager's ongoing process. Most Tactical processes have been created using quantitative and/or technical research. This research is then used to derive rules for managing money. The rules and process of the various strategies will vary, sometime wildly, but the point is that rules have been created as part of system to manage assets in a non-emotional, methodical manner.

- **Quantitative Research** uses mathematical and statistical methods, often aided by computers, to objectively analyze data for the purpose of making quantifiable favorable investments. If the research is not directly actionable, it may be further refined into rules and models for implementation. The advantage of quantitative research, if completed without bias, is that the system should be devoid of emotion and not subject to human interpretation.

- **Fundamental Research** is a research method of evaluating an investment in an attempt to measure its intrinsic value, by examining related economic, financial and other qualitative and quantitative factors. The end goal is to use real, public data including macro and micro economic factors, like the overall economy and company management, respectively to decide if the investment is over or undervalued.

Beaumont Capital Management
(844) 401-7699
salessupport@investbcm.com
investbcm.com

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Written by: David Haviland, Managing Partner and Portfolio Manager

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Beaumont Financial Partners, LLC DBA Beaumont Capital Management, 250 1st Avenue, Suite 101, Needham, MA 02494, (844) 401-7699
salessupport@investbcm.com

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