SECTOR ROTATION: TAKING EMOTION OUT OF INVESTING

Beaumont Capital Management's Use of Sector Rotation

MEET THE PORTFOLIO MANAGER

David Haviland is Managing Partner and Lead Portfolio Manager of Beaumont Capital Management's (BCM's) US-based sector rotation strategies. David helps oversee the $4.0 billion that BCM manages in ETF-based growth strategies designed around BCM's motto, "Making Bears More Bearable®."[1] BCM's quantitative, rules-based portfolios incorporate defensive capabilities, and are offered to advisors, institutions and retirement plans.

"The mutual fund industry is always saying 'stay invested,' because if you miss the 10 best days your performance will stink. What they never do is show you the opposite of that, which is if you miss the 10 worst days of the market, how much better your portfolio would be."

David Haviland

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The amount of US stock market returns the average investor misses out on over time.[2]

THE CHALLENGE: SAVING INVESTORS FROM THEMSELVES

There's one particularly detrimental client behavior that David has witnessed time and again during his 30 years in the industry: When markets go off a cliff, investors inevitably engage in panic selling at the worst possible times. Then they wait years to re-invest, missing the next upturn. "We need to embrace the fact that we're all human, and that we have emotions that get the best of us," David says, "BCM seeks to design strategies that overcome this human element by making both the buying and selling decisions on behalf of clients."

Key Features

- US large-cap exposure
- Quantitative strategy
- Buys only sectors with positive momentum
- Equal weight sectors owned
- Fully invested except during significant downturns, when it may go to cash

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THE APPROACH: QUANT-BASED SECTOR ROTATION

David explains that BCM's sector rotation philosophy takes the emotion out of investing by using quantitative, rules-based inputs to make buy and sell decisions — with the goal of delivering growth during good or sideways markets and attempting to mitigate losses when markets are falling.

"The average investor expects us not only to grow their money during the good times, but they also expect us to protect their nest eggs when markets decline," he says.

They seek to achieve this through their US-based sector rotation approach which uses sector ETFs to invest in 10 sectors of the S&P 500®. Their goal is to be fully invested during good or sideways markets by equally weighting sectors with positive momentum, while rotating out of sectors with sustained negative momentum.

For example, if only four sectors are exhibiting positive momentum in the market at any given time, BCM would look to gain exposure to those four sectors by equally weighting each of them. The result? Each sector would comprise 25% of the portfolio. In a strong upward market, BCM's approach may seek to equal weight all 10 sectors. When fewer than four sectors show positive momentum, the portfolio management process may begin to raise cash – which they have done three times since the firm's inception.

Conversely, when there is no positive momentum in the market, BCM's investment framework may signal a move to all cash.

"Our philosophy is to be fully invested during good or neutral markets, but only in sectors that have positive momentum. With sector ETFs, you can take advantage of the fact that different sectors perform differently within different phases of the market cycles."

David Haviland
Managing Partner and
Lead Portfolio Manager,
Beaumont Capital Management

WHY SECTORS?

Dividing the S&P into sector ETFs is the key to BCM's approach, and the liquidity of sector ETFs allows BCM to be nimble executing its sector rotation. David notes, "With sector ETFs, we can take advantage of the fact that different sectors perform differently within different phases of the market cycles, and we can stay fully invested and seek growth in most market environments." If energy is falling and dragging down the broad S&P, for example, the portfolio can sell that sector but stay fully invested in sectors still showing a positive trend. In contrast with a broad market indexing strategy, this sector rotation approach offers efficient access to attractive sectors, a rules-based method of identifying and avoiding less attractive sectors, and the potential to mitigate the downturns that threaten many investors and chase them out of the market.

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[1] Assets under management as of 9/30/2017

[2] Quantitative Analysis of Investor Behavior (QAIB), 2016, DALBAR, Inc. www.dalbar.com. Returns are for the period January 1, 1986 through December 31, 2015. The QAIB uses data from the Investment Company Institute (ICI), Standard & Poor's, Barclays Capital Index Products and proprietary sources to compare mutual fund investor returns to an appropriate set of benchmarks. Investor returns are represented by the change in total mutual fund assets after excluding sales charges and costs, but do captures realized and unrealized capital gains, dividends, interest, trading costs, sales charges, fees, expenses and any other costs. After calculating investor returns in dollar terms, two percentages are calculated for the period examined: Total investor return rate and annualized investor return rate. Total return rate is determined by calculating the investor return dollars as a percentage of the net of the sales, redemptions and exchanges for each period.

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State Street Global Advisors One Lincoln Street, Boston, MA 02111-2900.

T: +1 866 787 2257.

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