

Tactical Asset Allocation in Bull/Bear Markets

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What is Tactical?

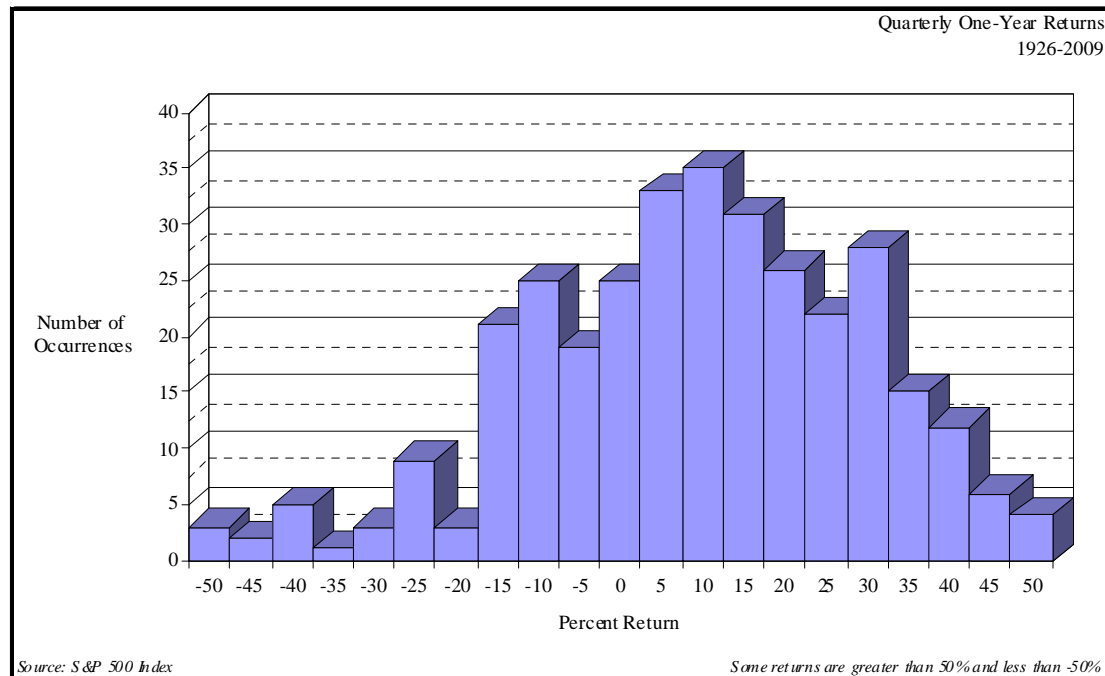
Webster's:

- “Small-scale action to serving a larger purpose”
In Investment Management:
- Method of modifying asset allocation based upon valuation estimates and judgments of the future return of markets or sectors
 - ✓ 1970s – 90s
 - ✓ Current (GTAA, Hedge Funds, Lifecycle)

Review of Conventional Approach

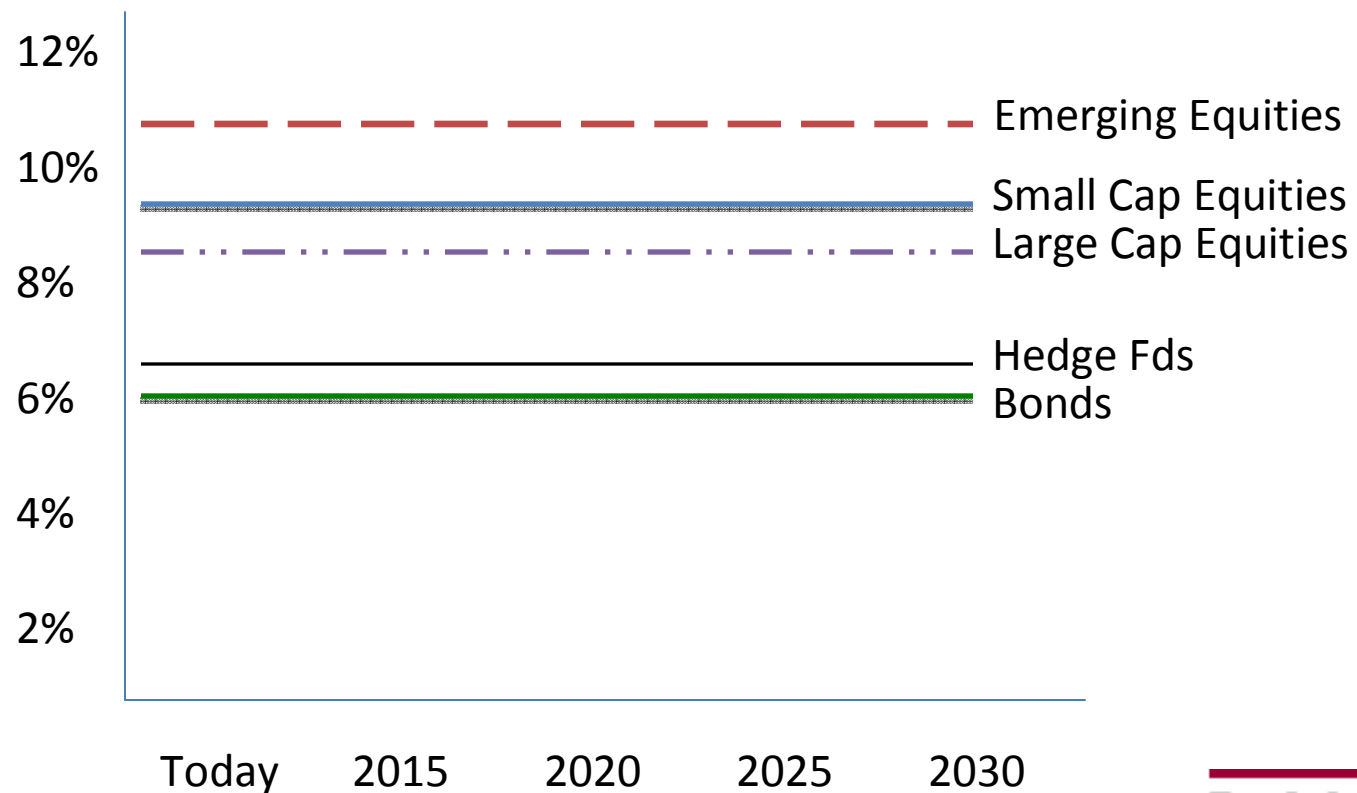
- Inputs based upon history
- Typical models assume “average” future outcomes

Large Capitalization Stocks
Distribution of Returns



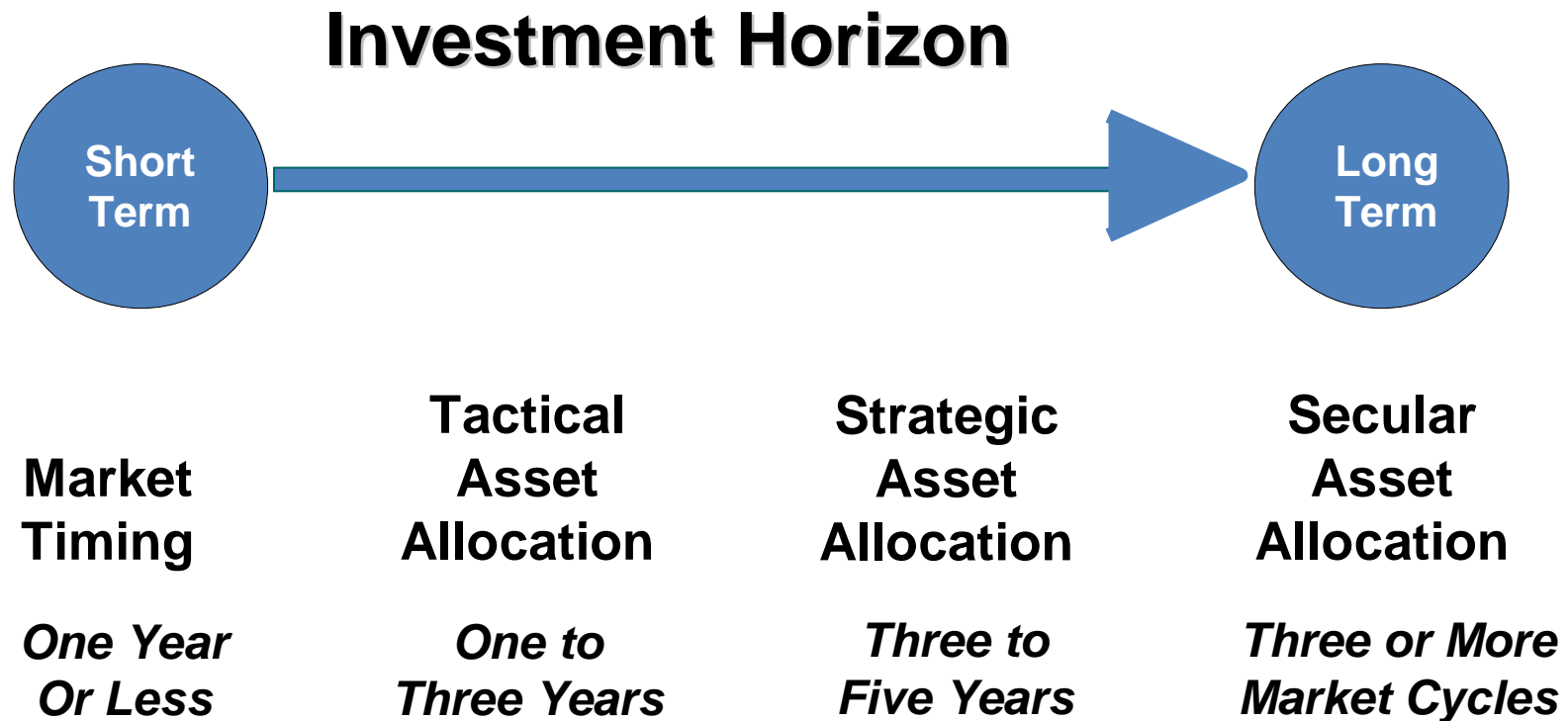
Review of Conventional Approach

- Typical models assume “average” future outcomes (sample chart below)



Time Horizon for Investment Objectives

Asset Allocation Study has a Long Term (Secular) Perspective



Markets Change

Markets change over long periods of time

- As markets change, relative value between asset classes changes
- DeMarche research has acknowledged and identified these long wave markets as “Supercycles”
- Multiple bull and bear markets exist within each “Supercycle”

DeMarche Supercycle Study

Supercycle	Years	Bank Panics/ Recessions	Market Cycles (Bull/Bear Cycles)
A. High Growth	1900 – 1929	8	8
B. Moderate Growth	1929 – 1942	3	5
C. High Growth	1942 – 1966	5	8
D. Moderate Growth	1966 – 1980	3	6
E. High Growth	1980 – 2000	2	5
F. Moderate Growth	2000 - Present	2	3

DeMarche Supercycle Study

Supercycle	Beginning	End	Avg. Quarterly GDP Growth*
A	1900	1929	N/A
B	1929	1942	N/A
C	1942	1966	+4.2%
D	1966	1980	+3.1%
E	1980	2000	+3.4%
F	2000	Present*	+1.7%

*As of 12/31/2010. N/A – GDP data not available until 1947.

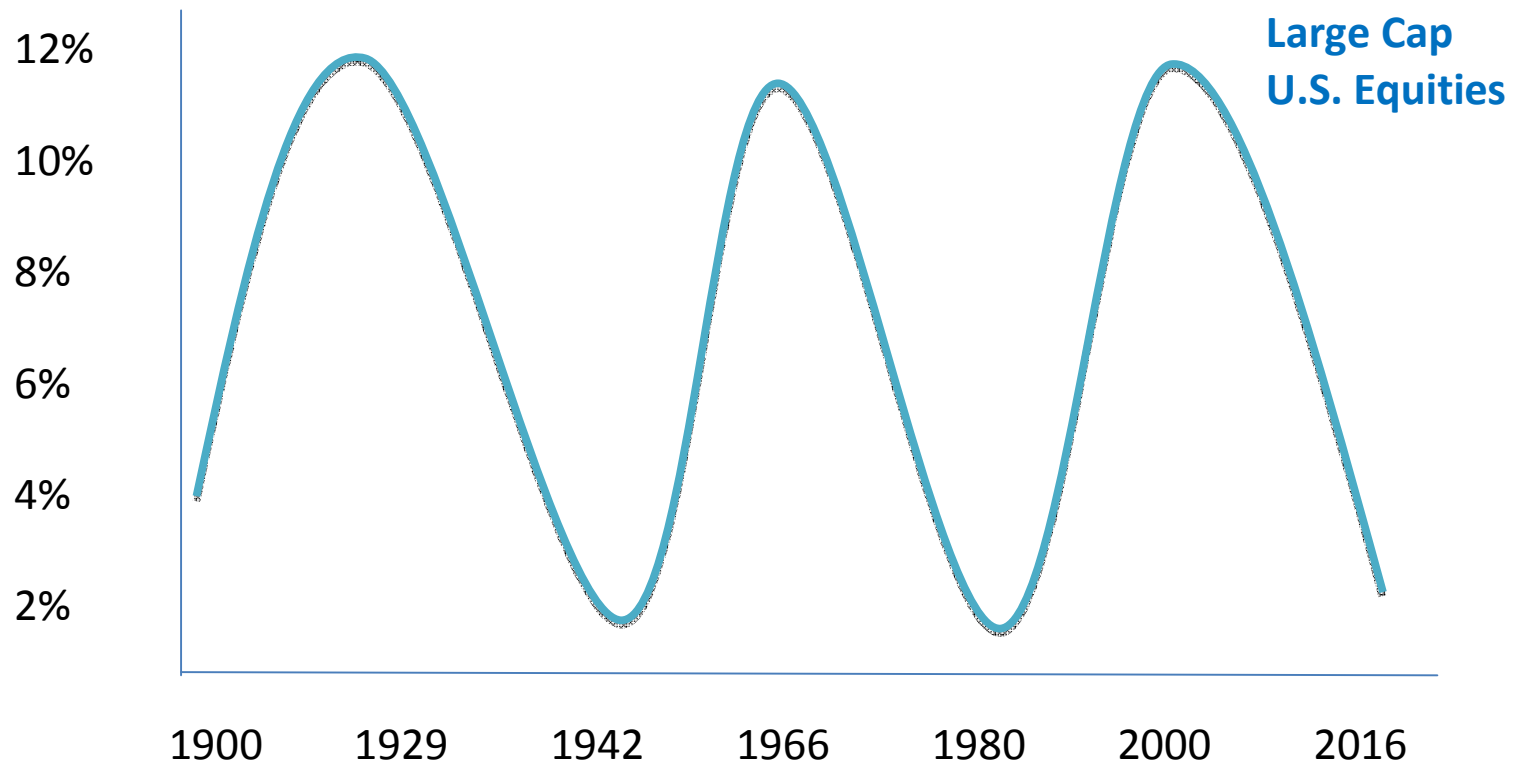
DeMarche Supercycle Study

Supercycle	Beginning	End	DJIA Price Return*
A	1900	1929	+882%
B	1929	1942	-75
C	1942	1966	+701
D	1966	1980	+2
E	1980	2000	+1,444
F	2000	Present*	-5

*As of 3/31/2011. Cumulative returns are shown for each cycle (non-annualized).

Past Supercycles

- Smoothed representation: peak-to-trough (sample chart below)



The Consumer in Supercycles

Supercycles		Environment
A	1900 – 1929	High population growth
B	1929 – 1942	High unemployment
C	1942 – 1966	Baby boom / income growth
D	1966 – 1980	Inflation
E	1980 – 2000	Expansion of consumer credit
F	2000 – ?	Demographics & debt

New Normal

Macroeconomic Environment

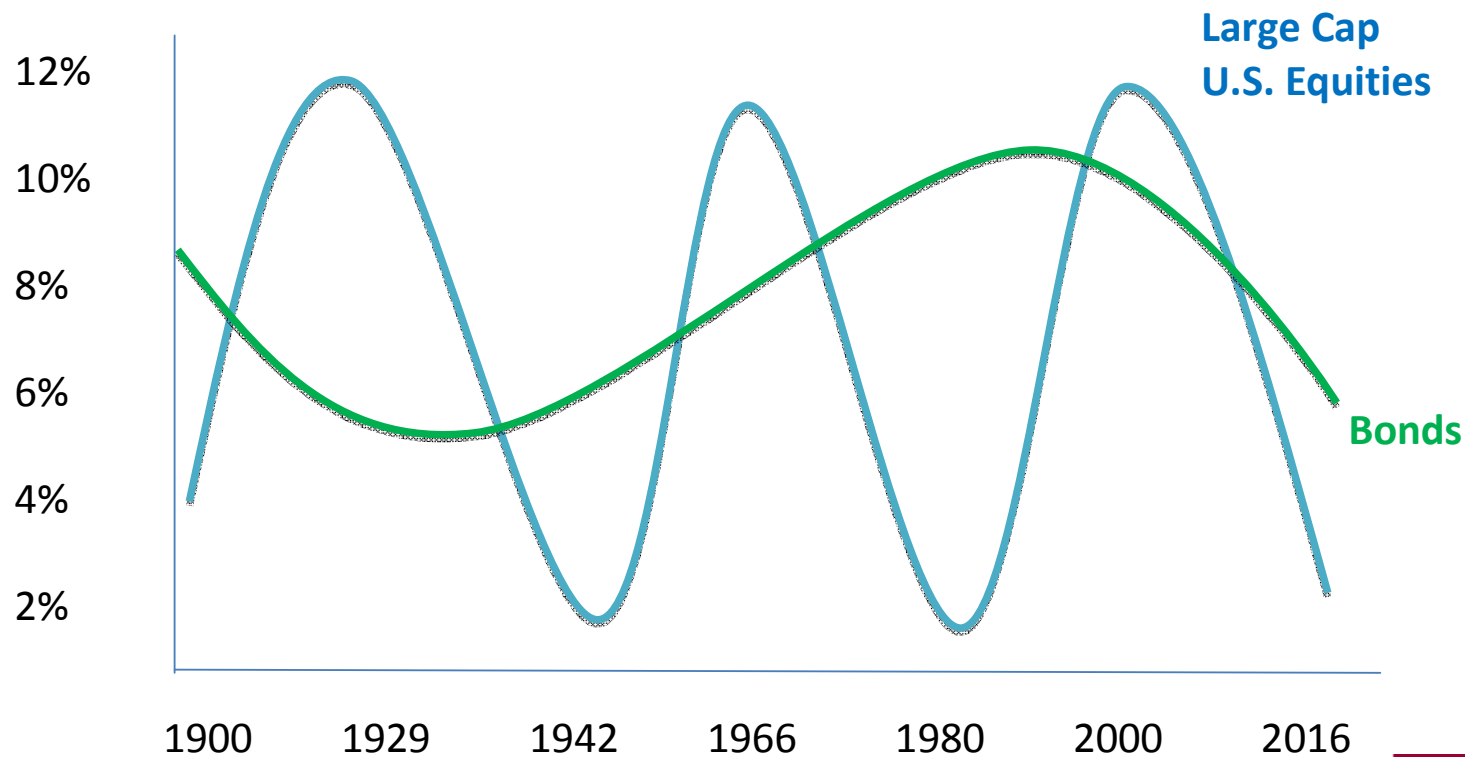
- Demographics
 - ✓ “Boomers” retire or shift emphasis from consumption to saving
 - ✓ Immigration slowing?
- Consumers gradually improve their finances
 - ✓ Paying down debt / increase savings
 - ✓ Foreclosures

New Normal Macroeconomic Environment (cont'd)

- Unemployment
- Wage growth remains slow
- Less help from asset gains (wealth effect)
- Higher taxes

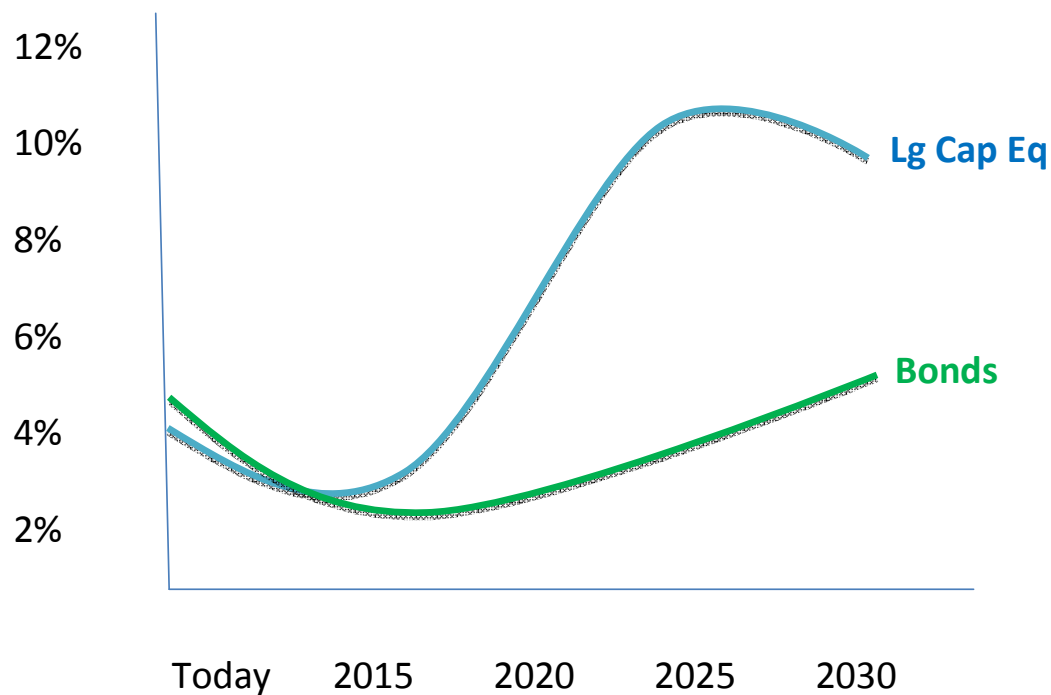
Past Supercycles

- Smoothed representation: peak-to-trough (sample chart below)



Strategic Supercycle Outlook

- Stocks in Moderate Growth Stage
- Bonds enter Rising Inflation Cycle (sample chart below)



Strategic Implications of Current Supercycles

- Stock returns likely to underperform mean
- Bond returns likely to underperform mean
- Policies need other strategies to improve expected risk/return outcomes

Strategic Implications of Current Supercycles (cont'd)

- Volatility of risky asset classes likely higher
- Correlations of risky assets may be higher
- Illiquid asset classes more likely to see crisis

Correlations in High-Growth Supercycles

- Higher returns drive investors to seek risk
- Correlation falls between certain assets*
 - ✓ Stock - Bond
 - ✓ Large Cap – Small Cap

*Preliminary results – DeMarche Study

Correlations in Moderate-Growth Supercycles

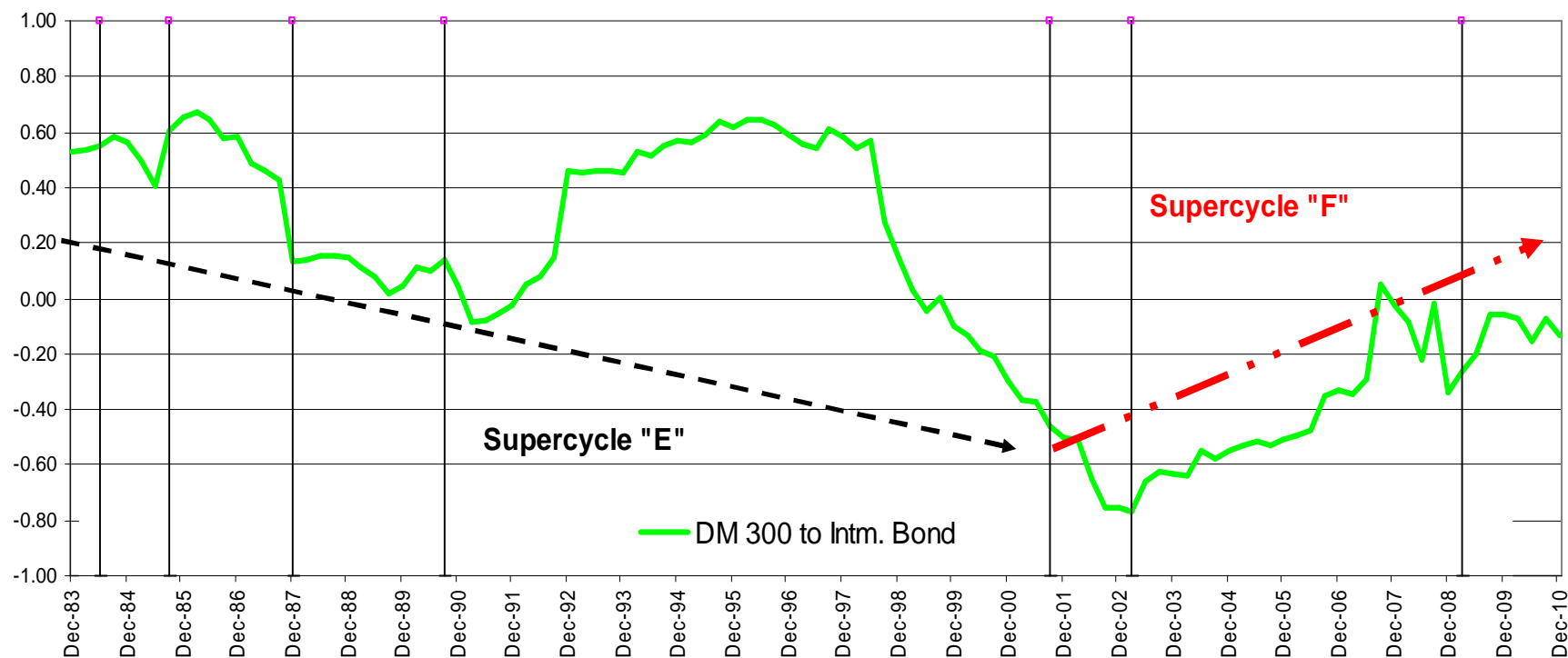
- Higher volatility and losses drive investors to reduce risk
- Correlation rises between certain assets
 - ✓ Stock - Bond
 - ✓ Large Cap – Small Cap

*Preliminary results – DeMarche Study

Correlations in Last 3 Decades

Stocks-to-Bonds

20 Qtr Moving Correlation Stock to Bond



Recommendations

- Adjust asset allocation more frequently
- Incorporate supercycles
- Emphasize liquidity
- Diversify
- Increase allocation to dynamic strategies
 - ✓ Hedge Funds
 - ✓ GTAA

Thank you!