

One California Street, Suite 2800 San Francisco, CA 94111 (415) 249-6337 www.deltaim.com

How to Earn Double-Digit Returns While Avoiding Major Down Markets in a Safety-First Approach

AAII Chapter Meeting

May, 2014



- Registered Investment Advisory firm San Francisco
- > Offer disciplined and proven tactical strategies
- Delta Tactical strategies provide strong downside protection in bearish markets and participation in up markets by making up to 100% allocation changes based on nonemotional, systematic model driven investment methodologies

MANAGEMENT

Partners





GUGGENHEIM INVESTMENTS

> DELTA INVESTMENT MANAGEMENT

* Partial list

Market Laboratory • Indicators

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DELTA MARKET SENTIMENT INDICATOR

The Delta MSI measures the position of ~3,600 stocks relative to an intermediate-term moving average crossover (MAC) point. When greater than 50% of the stocks followed are above this MAC point, the market is bullish and equities are attractive. When the indicator is below 50%, risk is clevated and stock exposures should be reduced. Manager uses discretion on asset allocation when MSI is 50% +/- 3%. 2 Weeks 3 Weeks Last. 10 A 10

Current Sentiment	week	Ago	NSO
BULLISH	52.1%	67.4%	65.2%
Current Market Exposure:	100% Equities	,0% Bonds	, 0% Cash
Sou	irce: Delta Inves	stment Mar	agement
	www.deltaim	.com, (415)	249-6337

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ADJUSTABLE MORTGAGE BASE RATES

				727
	Jan 33	Aug 24	Tudge.	16.000
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Trees Notes	1.65	1.85	9.79	138.36
r Treas Notes	2,82	2.88	1.90	根板
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CROE PUT/CALL BATIO vs S&P 100

Readings in the CEOE equity pat-call ratio of 68:100 and in the SAIP 100 of 125:100 are considered builts). for instance, Beachth signals flash when the opekr pot-call lenel reaches (lie vicinity of 20,000 and the index ratio hits Tic100.



INVESTOR SENTIMENT READINGS

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TIM Group Market Sentiment Indicater (Formerly First Coverage) 54.5% 22.7% 54.3%

Source Title Group 101 Arch 51, Sale 1265 loston, MAGET 18 (#17/183-8168, Swappong) Singroup com

MONEY SUPPLY

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FOREIGN EXCHANGE

Printag, January 37, 2014

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AAII Special: \$20

Books Available Today While Supply Lasts HARNESS THE POWER OF WINNING STREAKS

AND AVOID LOSING STREAKS

WIN BY NOT LOSING

A DISCIPLINED APPROACH TO BUILDING AND PROTECTING YOUR WEALTH IN THE STOCK MARKET BY MANAGING YOUR RISK

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SPECIAL OFFER

DETAILS INSIDE

NICHOLAS ATKESON

FOUNDING PARTNERS OF DELTA INVESTMENT MANAGEMENT, LLC





My solution, Delta. Delta's Tactical

strategies win by not losing and protect my capital by staying out of major down markets. In a bullish market, Tactical invests in strong stocks and ETFs to capture upside.



www.deltaim.com

ANAGEMENT

DELTA WEALTH ACCELERATOR WEEKLY NEWSLETTER www.deltawealthaccelerator.com

The Bond and Interest Rate Investment Challenge



The 30 Year Bond Bull Market...

Nominal and Real 10-year Treasury Yields



Source: Federal Reserve, BLS, J.P. Morgan Asset Management.

MANAGEMENT

Warren Buffett – May 6, 2013, USA Today

> Doesn't like owning bonds right now, and he doesn't think average investors should either.

➤ "Bonds are a terrible investment at the moment" and "owners of long-term bonds may see big losses."



Interest Rates Bernanke Speech – March 1, 2013



Note: The term structure model forecast assumes that the expected real rate and term premium components of the 10-year nominal yield as shown in chart 2 revert to their respective pre-crisis means over a 5-year period while the expected inflation component remains constant at the level at the end of 2012.

Source: For December BCFF consensus, Blue Chip Financial Forecasts (BCFF) survey, December 2012; for Congressional Budget Office, Congressional Budget Office (2013), The Budget and Economic Outlook: Fiscal Years 2013 to 2023 (Washington: CBO), February 5; for Survey of Professional Forecasters, Survey of Professional Forecasters for 2013;Q1.

The Stock Investment Challenge



Volatility without Overall Market Appreciation



Source: Standard & Poor's, First Call, Compustat, FactSet, J.P. Morgan Asset Management.

Problem 1: Stock Investment Not Growing As Expected



Uncertain Future



Source: Standard & Poor's, First Call, Compustat, FactSet, J.P. Morgan Asset Management.

<u>Problem 2</u>: Protecting Investment From Major Loss

DELTA INVESTMENT MANAGEMENT

117 Year History of the Market: 1896 – 2013



Dow Jones Industrial Average from December 1896 through December 2011 Graph created by Guggenheim Investments using data from <u>www.dowjones.com</u>

DELTA INVESTMENT MANAGEMENT

S&P 500 Sector Returns – Extreme Gains and Equivalent Declines



Source: Morningstar, F-Squared Investments. Weekly returns in each of 10 S&P Sector Indexes were analyzed for the 21-year period from 1/92-12/12.

Extreme Bull/Bear Weeks

Bear (Red) Weeks: 63% Bull (Green) Weeks: 37%

Recent History of Bear Markets

Over the past 30 years, the U.S. stock market has suffered a **Bear Period** (greater than 20% decline) about once **every 6 years** or **17%** of the time.

Bear Market	Duration (Months)	Decline	New Market High	Recovery (Months)
Nov. 1980-Aug.1982	22	-28.0%	Nov. 1982	3
Aug. 1987-Oct.1987	3	-35.9%	Jul. 1989	21
Jul. 1990-Oct.1990	4	-20.3%	Feb.1991	4
Jul 1998-Oct. 1998	4	-22.4%	Nov. 1998	1
Mar. 2000-Oct. 2002	32	-50.5%	Jul. 2007	57
Oct. 2007-Mar. 2009	17	-57.7%	Apr. 2013	49

Making Back What Was Lost Takes Time Especially During Red Periods

DELTA INVESTMENT MANAGEMENT

Difficulties with Diversification

Negative Market Events Happen More Frequently than a Normal Distribution Suggests

negatively skewed distribution

Correlations
 Migrate Towards
 1 During a Crisis

0 V	c 1		
One-Year	Correl	ation of H	Returns
(usin	g Vanguar calculated	d Equity Fund	ds)
Asset	Mutual	Correlation	Alternative
Category	Fund	to VFINX	ETF
S&P 500	VFINX	1.000	SPY
Total US	VTSMX	0.999	VTI
World Ex US	VFWIX	0.940	VEU
EAFE	VDMIX	0.935	VEA
Europe	VEURX	0.925	VGK
Pacific	VPACX	0.910	VPL
Emerging	VEIEX	0.854	VWO

www.QVMgroup.com

THE IMPACT OF LOSSES

Why The First Rule Of Investing Is Also The Second Rule ...

Copyright 2009, Crestmont Research (www.CrestmontResearch.com)

Avoiding the Downs is More Important Than Catching the Ups

The market's worst days have had a large effect on returns

Growth of \$1 in the S&P 500 Index from Dec. 31, 1927 to Dec. 31, 2011

Days	Growth of \$1	Cumulative Return (%)
Capture 10 best and worst	71.21	7,021.18
Miss 10 best	23.62	2,262.10
Miss 10 worst	226.14	22,514.32
Miss 10 best and worst	75.01	7,401.19
Cash	19.32	1,831.52

Sources: Bloomberg L.P., Invesco, Morningstar. ©2012 Morningstar, Inc. All rights reserved. The information contained herein: is proprietary to Morningstar and/or its content providers; may not be copied or distributed; and is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance cannot guarantee comparable future results. Cash results are based on the Ibbotson U.S. 30-Day T-Bill Index.

What Happens When Interest Rates Rise?

Correlations Between Weekly Stock Returns and Interest Rate Movements Weekly S&P 500 returns, 10-year Treasury yield, rolling 2-year correlation, 1963-2013

Source: Standard & Poor's, US Treasury, FactSet, J.P. Morgan Asset Management.

Returns are based on price index only and do not include dividends. Grey bars in the right chart represent the historic range in correlations for each sector.

Data are as of 6/30/13.

How Do you Protect and Grow Your Portfolio?

- Over the past 30 years, severe equity losses have occurred 17% of the time or about once every six years.
- Diversification is not providing the portfolio
 protection it is expected to because correlations
 are not static.
- Bonds may have entered a secular bear market.
- Your personal investment horizon may not allow time for you to make back what was lost

Average Investor Returns – Past 20 Years

Source: J.P. Morgan Asset Management

DELTA INVESTMENT MANAGEMENT

BAD Timing

		Fund Flows															
Billions, USD	AUM	YTD 2014	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999
Domestic Equity	5,860	17	18	(159)	(133)	(81)	(28)	(149)	(69)	(3)	17	100	120	(25)	57	258	176
World Equity	2,074	27	142	6	4	57	26	(80)	142	151	107	72	24	(4)	(23)	58	11
Taxable Bond	2,820	7	(22)	252	127	219	301	22	100	45	21	0	39	125	76	(36)	8
Tax-exempt Bond	514	2	(58)	50	(12)	11	70	8	11	15	5	(15)	(7)	17	12	(14)	(12)
Hybrid	1,301	8	73	47	40	35	20	(26)	40	20	43	53	39	8	7	(37)	(14)
Money Market	2,661	(56)	15	(0)	(124)	(525)	(539)	637	654	245	62	(157)	(263)	(46)	375	159	194

Source: J.P. Morgan Asset Management

- Steady Outflows from Domestic Equity Since Market Low Peaking in 2012
- Steady Inflows into Taxable Bond Funds Near Peak Inflow 2012
- Peak Equity Inflow 2000

Stock Buybacks

Solution:

A Tactical Approach

Tactical, Disciplined, Systematic Investing

- > Avoid major bearish moves
- > Participate in bullish equity moves

The Case for Systematic Decision-Making by Wesley R. Gray, Ph.D.

- Human Expertise is required to design models, but computers should be in charge of implementing models
- Humans perform worse than models because of behavioral biases, including overconfidence and the desire for explanations

Jim Simonds, founder of Renaissance Technologies (1998):

"If you do fundamental trading one morning you feel like a genius, the next day you fell like an idiot...by 1998 I decided we would go 100% models...we slavishly follow the model... no matter how smart or dumb you think it is."

Tactical Investing

- Adjusting investment exposure based on market risks
 Tactical investing is active management, not buy-and-hold
- Avoid bearish markets and participate in bullish markets Delta's allocation changes are based on non-emotional, systematic model driven investment methodologies.
- Tactical investing is like having insurance Insurance policies are not perfect but they go a long way towards mitigating loss.

Delta Tactical Good Harbor

Important Disclosure: Past performance does not guarantee future results. Consider the investment objectives, risks, charges, expenses, and instruments used to implement a strategy before investing.. See full disclosures on website.

Delta Tactical Good Harbor Returns, May 2003 – Sep. 2013 Quintile Review

S&P Average Quarterly Returns

DELTA INVESTMENT MANAGEMENT

The Tactical Investment Process

DELTA INVESTMENT MANAGEMENT

When To Buy

Earnings Is Not the Only Factor Driving Stock Prices Over Time In Fact, It May Not Be Even the Most Important Driver of Price

When To Buy

Earnings Is Not the Only Factor Driving Stock Prices Over Time In Fact, It May Not Be Even the Most Important Driver of Price

Its All About Risk Perceptions Not Earnings

Prices driven by cash flows and discount rates

$$PRICE = \sum_{t} \left(\frac{CashFlows_{t}}{1 + DiscountRate_{t}} \right)$$

Discount rate reflects risk premium

 $DiscountRate = R_f + Risk$ Premium

Risk Premium - more to the story

Classical View:

- Markets are efficient
- Risk premium is **constant** (a.k.a. Random Walk hypothesis)
- Focus on cash flow analysis

Delta View:

- Markets are efficient
- Investors' risk premiums are **time-varying**, even when cash flow
- expectations are stable.
- Focus on risk-premium

The Important Driver of Stocks in the Intermediate-Term Is:

Changes in Investors' Equity Risk Premiums Rather than Changes in Expected Cash Flows

Fear and Greed

Moving Average Crossover (MAC) Model

"Moving Average: Holy Grail or Fairy Tale"

June 2009 study published in Advisor Perspectives Theodore Wong – BSEE and MSEE degrees from MIT

The moving average crossover (MAC) is the simplest and probably the oldest trading system.

You buy when the price rises above its moving average, and you sell when it drops below.

Moving Average Crossover (MAC) Model

	CAGR	Terminal Equity Value	Risk- Adjusted Return	Average Drawdown	Maximum Drawdown
Buy-and-Hold	8.6%	\$84,660	23.8%	-25.9%	-84.8%
6-Month MAC (Best of Class)	9.6%	\$319,000	37.4%	-2.0%	-13.8%

"Based on aggregate performance over the entire 138-year period, the MAC system beats buy-and-hold in both absolute performance and risk-adjusted return."

Theodore Wong – BSEE and MSEE degrees from MIT



Best Measure of Downside Risk: Equity Drawdown





75-Day MAC Buy/Sell Signals

vs. S&P 500 (SPX) 2008-2010





75-Day MAC Buy/Sell Signals

vs.

S&P 500 (SPX)

September 2010-September 2012





75-Day MAC Buy/Sell Signals

vs.

S&P 500 (SPX)

September 2012-April 2014



The Cost of False Signals



Of the total of 60 bullish signals since December of 1971, 38 have been "correct" for an average gain of 16.7%.

The 22 "incorrect" signals produced an average loss of 2.5%



The Tactical Investment Process



High Relative Strength Stocks

Dorsey Wright & Associates "Real-World" Testing of Relative Strength

In all 100 trials, high relative strength stocks outperformed the market. High RS stocks average return 227.1% vs. S&P 500 81.0%.

Table 1: Summary Data (Cumulative Returns)						
12/29/95—12/31/09						
# of Trials	100					
Average Return	227.1%					
Median Return	214.8%					
Max Return	446.4%					
Top Quartile	263.4%					
Bottom Quartile	181.0%					
Min Return	94.2%					
S&P 500 Return	81.0%					
% Trials Outperform	100%					

High Relative Strength Stocks

IBD 85-85 Index vs. the S&P 500 11/13/2000 – 4/17/2014



"Our research shows that in every market over the last 50 years, the best Stocks have had EPS and Relative Strength ratings of 85 or better BEFORE they made their biggest gains.

The consistently superior performance of the IBD 85-85 Index reinforcesthis fact."Investors.com – Investor's Business Daily (IBD)

High Relative Strength Stocks

Or

Use levered ETFs to increase beta Example: 70% S&P 500 (IVV) 30% 2x S&P 500 (SSO) Beta 1.3x

The point is, in bullish markets Get Long









When To Sell

When Not in Equities?



Delta Tactical Sanctuary



U.S. Treasury Bonds, 1 to 10 year duration

Delta Tactical Good Harbor



Delta Tactical Capital Appreciation Delta Tactical Treasury Bond



U.S. 5 and 10-Year Treasuries Show Average Positive Performance During Recessions

Market Environment	Average Monthly Return					
(1981-2008)	Large	Mid	Small	10-Yr Bond	5-Yr Bond	
	cap	Cap	Cap	DONU	DONU	
Recessions	-0.83%	-0.42%	-0.52%	1.55%	1.31%	
Front Half of Recession	-1.56%	-1.04%	-2.08%	0.71%	0.82%	
Back Half of Recession	0.03%	0.31%	1.32%	2.54%	1.88%	

RESULTS

The Tactical Investment Process



Delta Tactical Capital Appreciation



Important Disclosure: Past performance does not guarantee future results. Consider the investment objectives, risks, charges, expenses, and instruments used to implement a strategy before investing. See full disclosures on website.

Delta Tactical Good Harbor

4



Good Harbor: Audited Results: 2003 to Today

Important disclosures at www.deltaim.com





2010

2011

2012

Capital Appreciation: **Audited Results** 2013 to Today Hypothetical Returns 2007 to 2013

Important disclosures at www.deltaim.com

Important Disclosure: Past performance does not guarantee future results. Consider the investment objectives, risks, charges, expenses, and instruments used to implement a strategy before investing.. See full disclosures at www.deltaim.com.

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2007

2008

2009

Delta Tactical Capital Appreciation

2013

Delta Tactical Dividend

- 50 High Dividend Paying Stocks
- Equally weighted across 10 S&P 500 Sectors
- Current yield 4.18%
- MAC Model for Risk Mitigation
- When Defensive, in 90-day t-bills

Important Disclosure: Past performance does not guarantee future results. Consider the investment objectives, risks, charges, expenses, and instruments used to implement a strategy before investing.. See full disclosures at <u>www.donoghue.com</u>. Performance is based on the Power Dividend Total Return Index (Ticker: PWRDXTR) with an inception date of 12/31/1999.

Date	Power Dividend TR Index (Net 2.00% Fee)	S&P 500 TR Index	+/- vs S&P 500 TR Index	
12/29/2000	6.50%	-9.10%	15.61%	
12/31/2001	12.10%	-11.89%	23.98%	
12/31/2002	-6.83%	-22.10%	15.27%	
12/31/2003	30.28%	28.68%	1.60%	
12/31/2004	15.26%	10.88%	4.38%	
12/30/2005	3.40%	4.91%	-1.51%	
12/29/2006	18.38%	15.79%	2.59%	
12/31/2007	-0.73%	5.49%	-6.22%	
12/31/2008	-0.51%	-37.00%	36.49%	
12/31/2009	39.13%	26.46%	12.66%	
12/31/2010	17.98%	15.06%	2.92%	
12/30/2011	0.79%	2.11%	-1.32%	
12/31/2012	9.08%	16.00%	-6.92%	
12/31/2013	32.36%	32.39%	-0.03%	

Delta Tactical Multi-Fund Fund Highlights:

- Optimized across eleven investment sleeves
- Each equally weighted sleeve uses a mutual fund security to gain investment exposure
- Dynamically managed exposures to participate in growth opportunities and mitigate risk
- No transaction/commission costs on trades
- Portfolio construction to meet your objectives and risk tolerance
- Non-emotional, computer model driven based on 25 years of experience

Portfolio Construction

100% Tax Deferred Money
e.g., IRA, Roth IRA
401k Rollover, etc.

Take Full Advantage of the Tax Advantage Offered by the Tax Code



Portfolio Construction

Traditional 40% / 60% Asset Allocation



Replace half of the bond and a third of the Equity Allocations with Tactical – Total Portfolio Tactical Allocation Equals 40%





Impact of Equity/Bond Tactical Strategy on the Portfolio



Delta MSI

Important Moments in History



1987 Market Crash

October 19, 1987 – Black Monday, 21% Decline

Bearish Signal: October 5, 1987

Bullish Signal: January 25, 1988



Bear Market	Duration (Months)	Decline	New Market High	Recovery (Months)	
Aug. 1987-Oct.1987	3	-35.9%	Jul. 1989	21	

1998 Asian Financial Crisis Bearish July 27, 1998 Bullish October 19, 1998



Bear Market	Duration (Months)	Decline	New Market High	Recovery (Months)	DELTA
Jul 1998-Oct. 1998	4	-22.4%	Nov. 1998	1	INVESTMENT

2000 – 2003 Technology Bubble Burst Multiple Signals



Bear Market	Duration (Months)	Decline	New Market High	Recovery (Months)
Mar. 2000-Oct. 2002	32	-50.5%	Jul. 2007	57

September 11, 2001 Bearish July 12, 2001 Bullish November 5, 2001



2007 – 2009 Financial Crisis Bearish November 8, 2007 – Bullish April 7, 2008 Bearish June 19, 2008 – Bullish April 9, 2009



Bear Market	Duration (Months)	Decline	New Market High	Recovery (Months)	O DE
Oct. 2007-Mar. 2009	17	-57.7%	Apr. 2013	49	

D E L T A I N V E S T M E N T M A N A G E M E N T

2010 – Flash Crash May 6, 2010 Sold May 14, 2010 Bought August 4, 2010



2011 – Debt Ceiling Negotiation Sold July 27, 2011



Delta MSI Captures Bullish Trends



December 1988 – October 1989



January 1995 – April 1996



April 2009 – November 2009


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