



# PremiumPoints

## Timeless Truths. New Perspectives.

### Welcome Back...to the third quarterly edition of the new PremiumPoints.

Another quarter is in the books and our 6th birthday as a firm was June 30th. As quarters go, it was pretty good, at least for our *structur*ALPHA® strategies. A word about alpha: officially alpha is a portfolio analysis statistic that measures risk-adjusted return. Increasingly however, alpha is often mis-used to mean benchmark outperformance. And as we receive reams of investment marketing material daily, alpha (outperformance) is often the carrot held out by product marketers to attract attention and interest, and perhaps assets.

Alpha (risk-adjusted return) does exist. But as all things in the world of portfolio management, if alpha relies on the numerous and continual decisions of active portfolio management, it is going to be fleeting, unreliable and expensive. At Clothier Springs Capital Management, we believe that portfolio structure is the most prudent and effective way to capture market returns, and allocate assets. And with our methodically implemented hedging strategy—delivering a superior return and risk profile—all of our strategies deliver very healthy alpha (risk-adjusted return).

It is important to point out that our superior portfolio alpha is a function not of active portfolio management, but of portfolio structure. Enter *structur*ALPHA®.

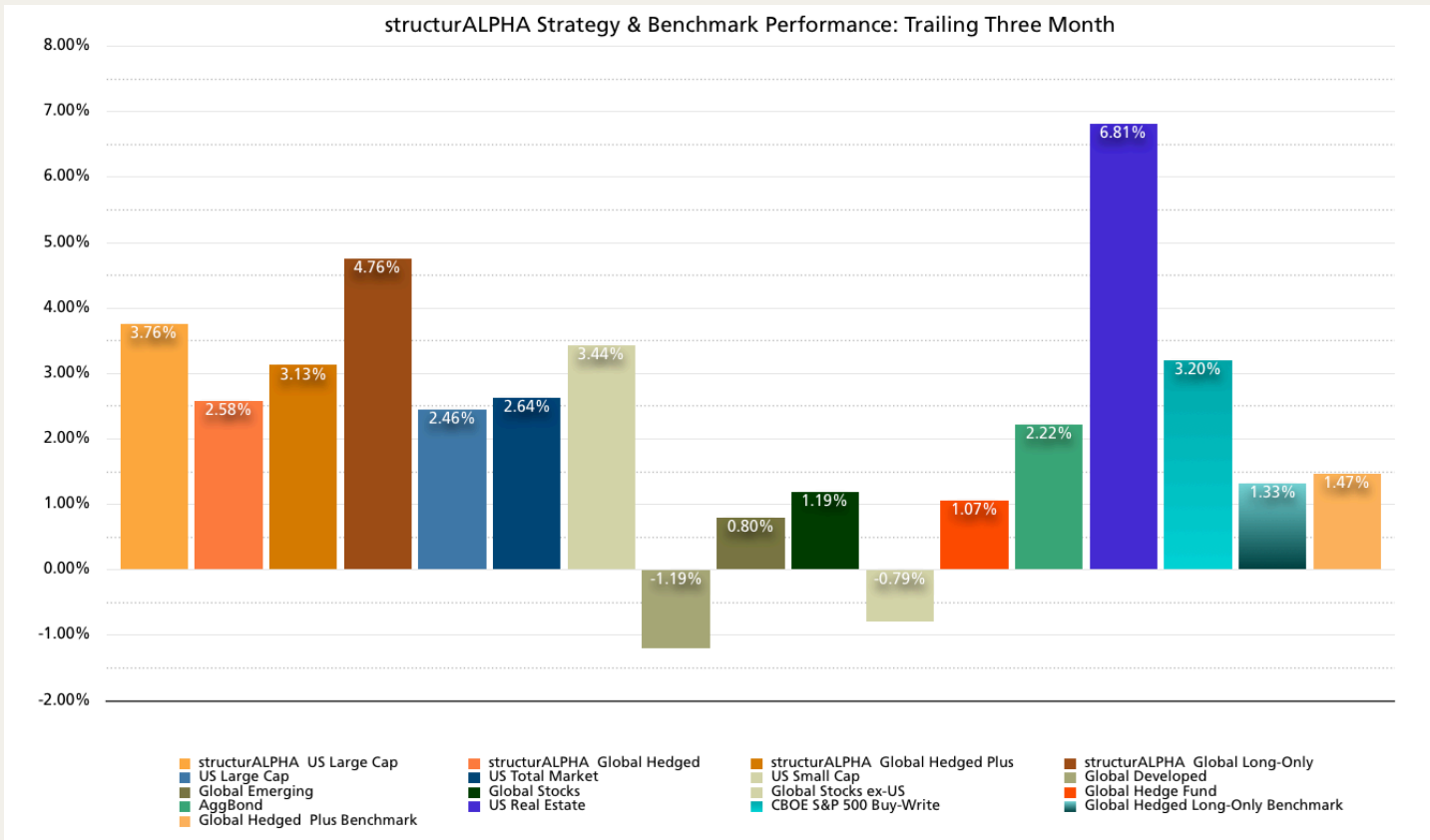
In our effort to differentiate ourselves and grow our business, we thought that branding our portfolio strategies with a memorable name would be useful. Alpha is indeed a desirable portfolio characteristic but as we believe it is best achieved through structure, combining the two words: structural & ALPHA turned into *structur*ALPHA®.

We applied for a trademark through the U.S. Patent and Trademark office and during the second quarter, we were granted the trademark of *structur*ALPHA®.

All investors want more of the good stuff, positive asymmetry and yes, alpha. Now you know where the *structur*ALPHA® name comes from and where to get it.

#### About Clothier Springs Capital Management, LLC

We help investors improve outcomes and meet their objectives with greater certainty and less risk with *structur*ALPHA®—our suite of Managed ETF strategies that combine the well-known cost and market capture advantages of passive investing with the superior return and risk profiles of a structurally implemented, rules-based hedge.



“Our newest, the *structurALPHA*® Global Long-Only is a strategy that is globally allocated and balanced, but does not include the hedging component... Interestingly, that strategy was our best performer for 2Q-2016, gaining 4.76%.”

All of the Clothier Springs Capital Management *structurALPHA*® strategies had a solid quarterly performance result, with returns ranging from a low of 2.58% for the *structurALPHA*® Global Buy-Write to 4.76% for the *structurALPHA*® Global Long-Only portfolio. Our flagship *structurALPHA*® Global Hedged Plus—a globally diversified, balanced and hedged portfolio—returned a healthy 3.76% for the quarter, ahead of U.S. equity markets, global equity markets and the global hedge fund benchmark.

Down from a high of thirteen individual strategies, we now manage and market only four strategies:

- *structurALPHA*® U.S. Large Cap Buy-Write
- *structurALPHA*® Global Hedged (Buy-Write)
- *structurALPHA*® Global Hedged PLUS
- *structurALPHA*® Global Long-Only

Our newest, the *structurALPHA*® Global Long-Only is a strategy that is globally allocated and balanced, but does not include the hedging component. That is simply because one option covers 100 shares of the underlying investment. If an account is not large enough to own 100 shares of one of the ETFs we use in our hedged strategies, the account will be fully diversified and globally allocated, just not hedged. Interestingly, that strategy was our best performer for 2Q-2016, gaining 4.76%.

We reduced our strategy count in response to our growing and evolving client base and because thirteen was just too many, with not enough differentiation.

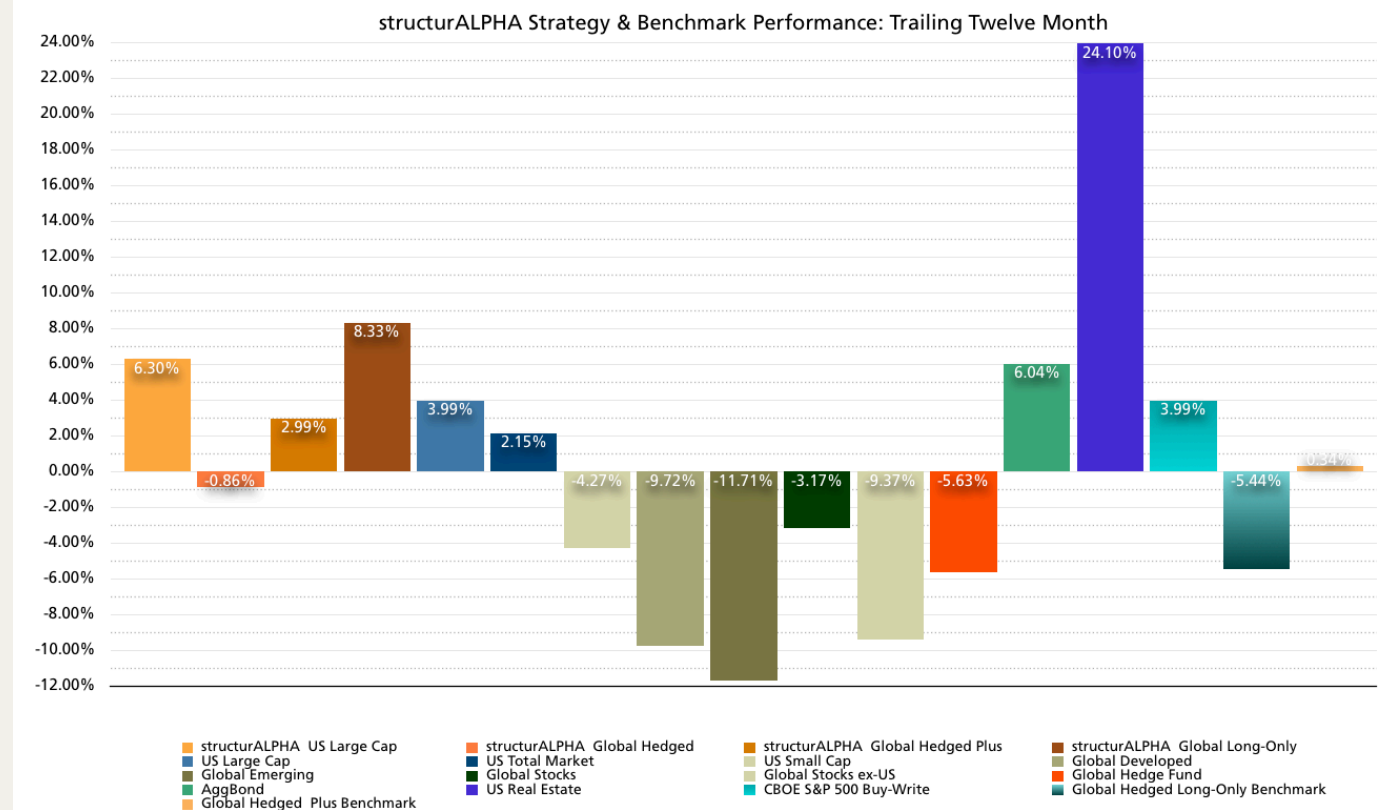
### Review & Outlook

Despite some end of the quarter turmoil precipitated by the surprise outcome of the BREXIT referendum, U.S. equity markets had a generally constructive quarter. The Broad US Equity market gained slightly more than 2.5%. Global equities did not fare so well with global developed equity markets falling a little over 1.0%

We continue to believe that after more than six years of gains, U.S. equity markets will underperform historical averages, perhaps for several years. Foreign markets will probably fare somewhat better as they have been under pressure for several years, and the emerging markets especially has favorable valuations relative to the U.S. and a better long-term economic growth rate. Better growth at better prices tends to be a better investment opportunity.

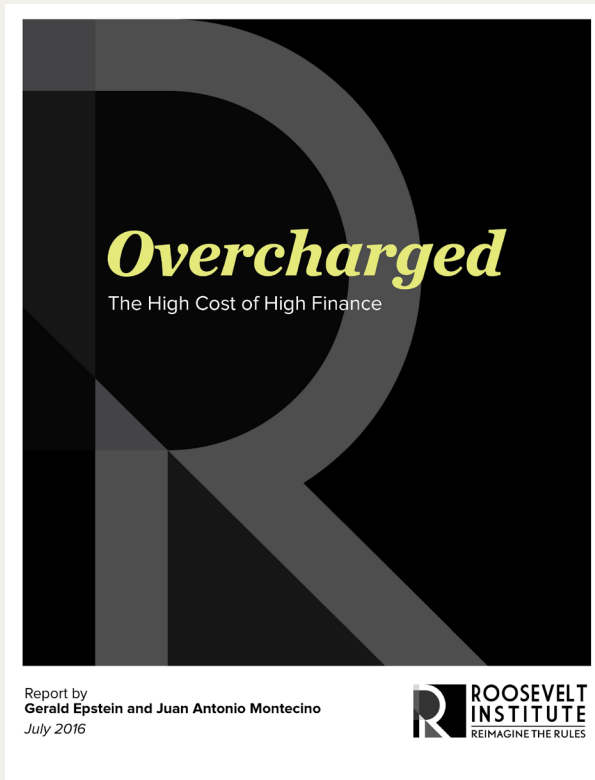
Still, in our *structurALPHA*® Global Hedged Plus strategy, we have tilted the portfolio towards greater current income: dividend income, bond income, real estate income. The certainty of income from these sources is a large component of total portfolio return. With return expectations in the low-normal range, income from the above-mentioned asset classes can deliver more than half of expected portfolio returns.

All of our *structurALPHA*® strategies collect option premium income from the methodical, rules-based hedge we implement. This additional component of portfolio income and return is a unique technique we employ and adds significantly to the superior return and risk profiles (alpha) of our strategy portfolios.



## The Culture of Extraction

*Dissatisfaction with hedge funds has been in the financial news lately. Several recent papers also point to the excessive rent-seeking pervasive on Wall Street. Are investors finally wising up?*



*“Astonished, Bogle replied, “don’t you get it? The money belongs to people.... investors, pensioners, etc. It is a means to an end...a better retirement, a better college education, a better research budget, etc. That who we are investing for.”*

My friend David Freudberg—producer of *Humankind-Voices of Hope and Humanity*—a radio program distributed worldwide by National Public Radio recently sent me a podcast of an interview he did with Vanguard founder Jack Bogle in 2014. We have a high regard for Bogle and Vanguard, and have been absorbing the Bogle/Vanguard truths and worldview for quite some time. The podcast was titled “The Culture of Distraction.” We think the title should have been “The Culture of Extraction.”

In the podcast, Bogle relates a story about a lecture he had recently given at the Harvard Business School—arguably where many of America’s best and brightest go to prepare for a career in business. After the lecture, a student—obviously impressed with his own “insight”—asked Bogle why he would have a chapter about “people” in his book about investing. Astonished, Bogle replied, “don’t you get it? The money belongs to people....investors, pensioners, etc. It is a means to an end...a better retirement, a better college education, a better research budget, etc. That who we are investing for.”

The student’s question was also an insight into the prevailing mindset at one of America’s top business schools: that these great pools of assets are nothing more than a resource to be exploited, a faceless, nameless asset base to extract fees and revenues from, and in the true, mercenary business sense, the more the better. That mindset clearly pervades much of Wall Street.

## Beating the Market vs. Beating the Competitors

There is an old joke that still draws a laugh and is a direct analog to the investment world. It goes like this:

*There are two photographers hiking in the woods. They come upon a mother bear, obviously angered and preparing to attack. One photographer sits down to take off his hiking boots and put on his running shoes. The other hiker says “are you crazy, you can’t out run that bear.” Hiker 1 replies “I only have to outrun you.”*

An oldie but goodie.

Jack Bogle was derided for launching the index fund because the objective was to deliver market returns, instead of “beating” the market. But Bogle had done his homework. He knew from reams of market data that active managers do not beat their benchmark, on average. In fact they underperform by roughly the expense ratio of their mutual fund. In effect, Bogle was saying “I don’t have to beat the market, I only have to be you Mr. Average Active Manager.” And without the need for the expenses of research, distribution through commissioned brokers and a profit margin, Vanguard could deliver their index funds at a (very-low) cost. The average expense ratio across the \$3 trillion managed at Vanguard is 0.13%. Compare that to the hedge fund complex, managing a roughly similar \$3 trillion and charging a confiscatory average fee of 1.8%, not counting performance incentive fees.<sup>1</sup>

1. Source: Bloomberg Brief – ETFs, May 31, 2016

### Overcharged: The High Cost of High Finance

The Roosevelt Institute just published a lengthy report on how the financial industry has mutated from an industry that used to channel finance to productive investment to one that has extraction and rent-seeking as its main objective. It is well worth reading. It tackles many of the issues surrounding finance, but our hobbyhorse is hedge funds. From the report:

*Simon Lack, an analyst and hedge fund operator offers this stark assessment: “In my research, I found that if all the money that has ever been put in hedge funds had been put in Treasury bills instead, the results for investors would have been twice as good as they have been in reality.”*

Ouch...the objective truth hurts. And T-bill returns can be had for a far lower fee than the typical hedge fund. Download the report here: **Overcharged**.

We see more research and commentary, and more questioning of the confiscatory and woefully underproductive (for investors) hedge fund business model all the time. Truth be told, the hedge fund Emperor has no clothes. It seems that investors are finally realizing that. Our mission at Clothier Springs Capital Management remains the same: to help investors meet their objectives with greater certainty and less risk with *structur*ALPHA®—our suite of Managed ETF strategies that combine the well-known cost and market capture advantages of passive investing with the superior return and risk (ALPHA) profiles of a structurally implemented, rules-based hedge.

Mr. Bogle, we’ve been paying attention.

## The *structur*ALPHA® Strategies

<i>structur</i> ALPHA® Single Market Hedged Strategies	Hedge Cycle	<i>structur</i> ALPHA® Global Multi-Asset Hedged Strategies	Hedge Cycle
US Large Cap Buy-Write	monthly	Global Hedged	monthly
		Global Hedged PLUS	monthly

### Why Clothier Springs Capital Management

#### Methodical, Reliable, Durable

Investors clearly need and desire risk-limited and modified strategies in the asset mix to optimize their portfolios and outcomes. Our mission at Clothier Springs Capital Management is to provide those risk-limited returns through *structur*ALPHA®—Managed ETF strategies that incorporate a methodically implemented, structural hedge within a low-cost, liquid and transparent separate account wrapper.

For More: [www.clothiersprings.com](http://www.clothiersprings.com)

**Thomas F. McKeon, CFA** is founder, principal and Chief Investment officer of Clothier Springs Capital Management, LLC. He began his career in the capital markets in 1980 as an equity and foreign currency options market maker on the floor of the Philadelphia Stock Exchange. In 1994 he co-founded West Chester Capital Advisors—a registered investment advisor—where he managed equity portfolios for both institutional and private clients. He founded Clothier Springs Capital Management in 2010 to manage portfolios that combine the cost and market capture advantages of passive investing with the superior return and risk profiles of rules-based hedged investing.