Market Commentary

A Portfolio Manager's Resolution for Investors: Trailing-Stops

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SIERRA MUTUAL FUNDS

OCEAN PARK ASSET MANAGEMENT

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Terri Spath serves as the leading member for market and economic analysis, portfolio allocation and investment strategy for Sierra, while providing reasoned analysis through portfolio management and market commentary.

A new year brings with it the elation of a renewed start. We proclaim resolutions about how we will make this year better than the one that just concluded. After the volatile close to 2018, investors should now be doing the same. Fortunately, there is the trailing-stop.

As we have been reminded, the market usually drops faster than it rises. The cliché is that the market "takes the escalator up and the elevator down," and while not always true, the stats do seem to bear this out. Daily percentage equity gains are on average smaller than daily percentage equity losses[1], and even asset classes considered "safe" or "risk off" can have astonishingly quick drawdowns. Long government bonds, for example, can and have tanked over 5% in 3 short days!

Look Out Below!

MAXIMUM 3 DAY DRAWDOWN BY ASSET CLASS

Asset Class		Max Drawdown	Date of Max Drawdown
U.S. Stocks	**SPY**	-13.36%	Nov. 20, 2008
MLPs	**AMLP**	-12.95%	Feb. 9, 2016
Oil	**USO**	-12.60%	Nov. 6, 2008
International Stocks	**VXUS**	-12.26%	Oct. 22, 2008
Emerging Markets Debt	**JEMDX**	-10.55%	Aug. 27, 1998
Long Government	**PGOVX**	-5.26%	Nov. 10, 2016
Junk Bonds	**FHISX**	-5.22%	Oct. 10, 2008
U.S. Dollar	**UUP**	-4.75%	Dec. 16, 2008
Floating Rate Loans	**OOSIX**	-3.67%	Nov. 21, 2008
Municipal Bonds	**SNTIX**	-3.18%	Oct. 10, 2008
Intermediate Government	**IEF**	-2.94%	Sep. 9, 2018

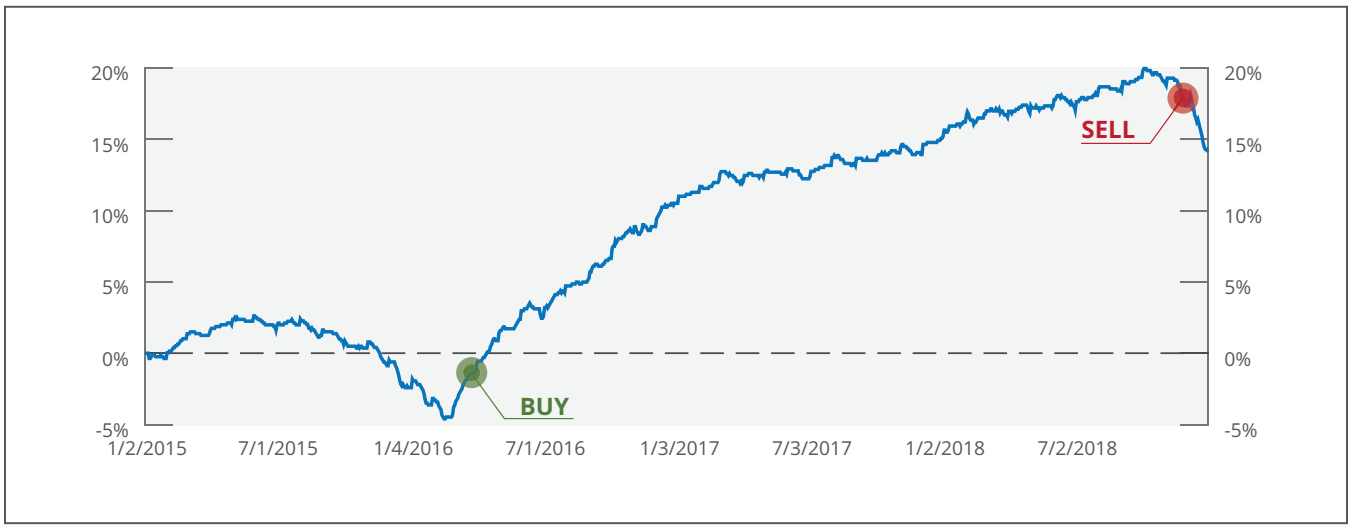
Source: yCharts, Reuters, Sierra Investment Management. December 7, 1984 to August 27, 2018

[1] In 2018, for example, on days when the S&P 500 was up, the gain averaged 0.65%, but on days when that benchmark fell, the loss averaged -0.78%.

Armed with the knowledge that corrections can be swift and merciless, we have often spoken of the importance of discipline within any investment approach and how a tactical, rules-based approach can significantly outperform. This is where a simple yet effective tool like the trailing-stop comes into play.

A trailing-stop is a rules-based sell level that moves up as a given security trends upward and is executed when the trend reverses downward. In this manner, investors may benefit from productive rising trends and step aside in an effort to avoid significant declines. Using a rules-based, trend-following strategy offers the opportunity to participate in the vast majority of an upside move while also managing downside exposure. Below is a visual representation of the lifespan of a position in a particular asset class with our entry and exit points illustrated.

A Sample Bond Mutual Fund Holding Period



For illustrative purposes only. There is no guarantee that any investment strategy will achieve its objectives, generate profits or avoid losses.

Sometimes we are asked, why we don't sell at the top price? Most can't do that consistently. However, you can see that utilizing a trailing-stop seeks to reduce downside impact and any gains left on the table are de minimus compared to gains realized and losses avoided. At the end of the day, the trailing-stop is a tool that helps investors like us stick to a disciplined process and sell discipline. While not perfect, rules-based selling can help investors limit both the effect of rapid drawdowns and the possibility of permanent destruction of capital.

Portfolio Positioning

Recently, we have often been asked "what is driving this volatility"? While we can't point to any one factor, it's clear that markets are vulnerable, and they could be reacting to any number of things: headlines about trade, or tweets about tariffs, or the Federal Reserve's latest news conference, as examples. Our approach is to react with discipline to what the market is telling us.

Using trailing-stops gives an early warning signal for when to sell. In the last few months of 2018, our stop-losses gave many early-warning signals and we exited positions, avoiding further losses. It's also important to seek out how to make money in falling markets and our rules-based approach also led to significant position in intermediate and long-dated Treasuries where prices were rising in the flight-to-quality environment.

Our trailing stops prompted us to bid adieu to many holdings last year. We also say good-bye to 2018. As we turn the page and enter 2019, our portfolios and strategies began with high cash positions and opportunity to participate in new rallies. The New Year brings elation of a renewed start, but just as last year and all the years before that, we resolve to always stick with our trailing-stops. We wish everyone a prosperous New Year.

Definitions

Drawdown, calculated at month end, is an indicator of the risk of a portfolio chosen based on a certain strategy. It measures the largest single drop from peak to bottom in the value of a portfolio (before a new peak is achieved).

The SPDR® S&P 500® ETF Trust (SPY) seeks to provide investment results that, before expenses, correspond generally to the price and yield performance of the S&P 500® Index (the "Index").

The Alerian MLP ETF (AMLP) seeks investment results that correspond (before fees and expenses) generally to the price and yield performance of its underlying index, the Alerian MLP Infrastructure Index (the "Index").

The United States Oil Fund® LP (USO) is an exchange-traded security designed to track the daily price movements of West Texas Intermediate ("WTI") light, sweet crude oil. USO issues shares that may be purchased and sold on the NYSE Arca.

The Vanguard Total International Stock ETF (VXUS) seeks to track the performance of the FTSE Global All Cap ex US Index, which measures the investment return of stocks issued by companies located outside the United States.

The JPMorgan Emerging Markets Debt Fund (JEMDX) seeks individual fixed income investments that should perform well over market cycles.

The PIMCO Long-Term U.S. Government Fund (PGOVX) seeks maximum total return, consistent with preservation of capital and prudent investment management.

The Federated High Income Bond Fund (FHISX) invests in below-investment-grade securities, providing exposure to the higher-yielding, lower-rated, corporate bond market.

The Invesco DB US Dollar Index Bullish Fund (UUP) seeks to track changes, whether positive or negative, in the level of the Deutsche Bank Long USD Currency Portfolio Index - Excess Return™ (DB Long USD Currency Portfolio Index ER) plus the interest income from the Fund's holdings of primarily US Treasury securities and money market income less the Fund's expenses.

The Oppenheimer Senior Floating Rate Fund (OOSIX) seeks to invest in the most attractively valued opportunities across the credit spectrum commensurate with underlying risks and other factors. While portfolio managers establish the overall strategy and continuously monitor portfolio level risk exposures, credit analysts are charged with conducting bottom-up, fundamental analysis across the credit spectrum that drives industry allocation and security selection decisions. The result is an actively managed, diversified portfolio of attractively valued senior loans.

The Sit Tax-Free Income Fund (SNTIX) objective is high current income that is exempt from federal income tax consistent with preservation of capital. The Fund seeks to achieve its objective by investing primarily in municipal securities that generate interest income that is exempt from both federal regular income tax and federal alternative minimum tax. In selecting securities for the Fund, the Adviser seeks securities providing high tax-exempt income. The Adviser attempts to maintain an average effective duration for the portfolio of approximately 3 to 8 years.

The iShares 7-10 Year Treasury Bond ETF (IEF) seeks to track the investment results of an index composed of U.S. Treasury bonds with remaining maturities between seven and ten years.

Important Risks

When the Fund invests in Underlying Funds that invest in fixed-income securities, the value of your investment in the Fund will fluctuate with changes in interest rates, as well as other factors. The Adviser's dependence on multi-asset diversification and judgments about the attractiveness, value and potential appreciation of particular Asset Classes in which the Fund invests will in some cases prove to be incorrect and have negative impacts on performance. As to the portion of the portfolio invested in ETFs and closed-end investment companies, turnover may result in higher brokerage commissions, dealer mark-ups and other transaction costs. The Fund's investment style will result in most capital gains within the portfolio being realized as short-term capital gains. It is possible that the U.S. Government would not provide financial support to its agencies or instrumentalities if it is not required to do so by law. The Fund engages in hedging or declining-market strategies by investing in inverse Underlying Funds. Any strategy that includes inverse securities could cause the Fund to suffer significant losses.

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