A PRACTICAL GUIDE TO TACTICAL INVESTING

Optimus
Advisory Group

WHAT IS TACTICAL INVESTING?

By definition, **tactical investing** means actively managing a portfolio with the goal of improving that portfolio's risk-reward characteristics.

WHY BE TACTICAL?

For many advisors, tactical investing seems like the ideal solution for delivering solid performance and lower volatility to their clients.

That being said, tactical investing with all of its various investment styles and techniques can sometimes be difficult to understand let alone explain to a client. Questions we often get from advisors include:

- **What are the key drivers of the portfolio's return?**
- **What are the portfolio's inherent risks?**
- **How do I determine which type of portfolio is right for my client?**

To answer these questions, it helps to understand tactical portfolio construction and the numerous management styles used.

PORTFOLIO CONSTRUCTION

Most tactical managers are systematic in their approach and their portfolio's performance is a reflection of that system. However, the broader investment mandate and portfolio construction which guides the manager and the manager's system, is more often than not a key driver behind the portfolio's risk/return profile.

Here are three broad categories of tactical strategies as defined by their portfolio construction:

#1 - CORE Tactical

To many institutional managers, being tactical means shifting a portion of the portfolio from healthcare stocks to consumer staples stocks. In other words, the manager's strict mandate requires the portfolio to remain entirely invested in equities, so there is no consideration for tactically moving to bonds or cash. We refer to this style of investing as "Core" tactical where the portfolio stays true to its asset class (equities for example) and the manager attempts to achieve superior risk-adjusted returns by tactically shifting within that asset class.

For advisors, the benefit of using core tactical strategies is that you always know the portion of the portfolio allocated to core tactical will be invested entirely in equities or entirely in fixed income, enabling you to allocate a minimum percentage of your client's account to that asset class. Because of their strict mandate, core tactical strategies generally have a higher correlation to the market when compared to other types of tactical strategies.

#2 - SATELLITE Tactical

When a tactical strategy dramatically shifts from equities to cash or bonds, whether in a single-step or multi-step process, we consider that strategy to be a "Satellite" tactical strategy.

For advisors, the benefit of using satellite tactical strategies is that the manager can change your client's portfolio from risk-on to risk-off, or vice versa, in a short period of time. Because of their broader mandate, satellite tactical strategies generally have a low correlation to the market and can quickly change the portfolio's risk/reward profile raising or reducing exposure to risky assets.

#3 - ALTERNATIVE Tactical

When a tactical strategy utilizes non-traditional assets such as inverse funds or options as a means of obtaining their objective, we refer to that as "Alternative" tactical. The manager of an alternative tactical strategy may use these non-traditional assets by themselves to create a tactical short strategy, for example, or may use these non-traditional assets in combination with equities to create a long/short or hedged portfolio.

For advisors, the benefit of using alternative tactical strategies is adding real diversification to their client's portfolio. Most alternative tactical strategies have no correlation or a negative correlation to the market so these strategies can really help to dampen portfolio volatility.

MANAGEMENT STYLE

Within these three broad categories, tactical managers use a variety of techniques including, but not limited to, trend following, mean reversion, rotation, and seasonality to achieve their portfolio's objective. The manager's style is another key driver behind the portfolio's risk/return profile.

Let's take a quick look at each style to better understand what the manager is doing.

TREND FOLLOWING is a method by which managers seek to identify trends in the assets they invest in. Spotting a new sustainable uptrend in an asset class and identifying when that trend ends is vital to the success of trend following systems.

MEAN REVERSION is a technique whereby managers seek to identify assets whose prices have moved well above or below their historical average with the belief that prices will eventually move back to that historical average.

ROTATION is a process in which managers make changes to the portfolio based upon periodically ranking their list of investment choices. The ranking may occur weekly, monthly, bi- monthly, quarterly, etc. and the ranking criteria may be one or more factors such as momentum, volatility, value, etc.

SEASONALITY (CALENDAR EFFECTS) is a means by which managers make changes to portfolios based on historical calendar (or seasonality) market trends for certain assets.

OTHER FACTORS

While portfolio construction and management style are critical factors in determining the behavior of your tactical portfolio, there are other factors that impact that behavior as well.

FREQUENCY (daily, weekly, monthly, etc.) refers to how often your portfolio is monitored. A portfolio that is monitored daily may be quicker to react to changes in the market, but may also be subject to higher turnover.

CONCENTRATION refers to the percentage of the portfolio that can be invested into a single asset or asset class. A portfolio that owns one or only a few securities may provide greater growth potential, but also greater potential for loss.

LEVERAGE refers to the portfolios ability to have market exposure that is greater than 100% by using leveraged ETFs, leveraged mutual funds, options, etc. Leverage may provide greater growth potential, but also greater potential for loss.

HOW CAN OPTIMUS HELP?

As Tactical Portfolio Management Experts, we provide:

TACTICAL PORTFOLIO MANAGEMENT – a diverse strategy lineup including core, satellite, and alternative tactical strategies

STRATEGY INTEGRATION – provide detailed analysis combining Optimus strategies with your existing client portfolios

ASSET ALLOCATION MODELING – create multi-strategy asset allocation models for your firm

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CONTACT US

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