
# UPSIDE/DOWNSIDE CAPTURE RATIOS

Win More by Losing Less During Market Decline

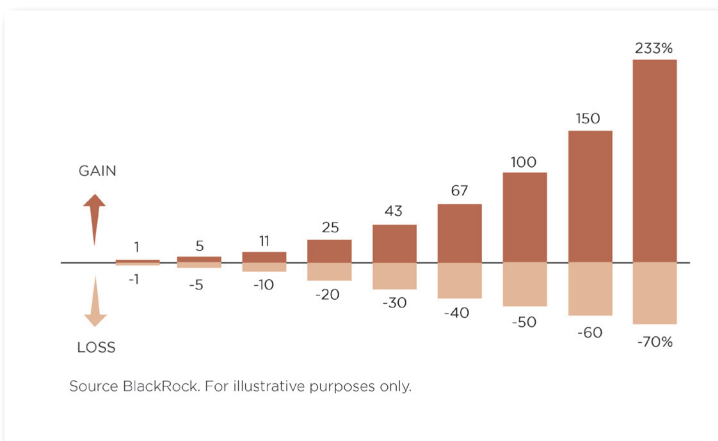
MAY 2017 WHITE PAPERS

WEALTHMANAGEMENT

This month's white paper will discuss the slow-and-steady road to investment success, particularly when the terrain gets bumpy. I hope it's not a secret, but the farther you fall, the harder it is to climb back up. This universal truth is painfully apparent in the investing world, as illustrated here: We call it 'win more by losing less.'

**THE SIMPLE (AND PAINFUL) MATH OF INVESTMENT LOSSES**

The chart to your right, is one reason why at WT Wealth Management we much prefer a "steady-as-she-goes" path to investment returns. This chart illustrates that a 10% loss in your portfolio, while may be uncomfortable to endure, it only takes a 11% gain to recover from that 10% drawdown. In many cases, based on past recoveries, that could be done in 6-12 months or even as few as several months. In late 2015 and early 2016 we witnessed just that. From November 2, 2015 to February 8, 2016 the S&P 500 declined just over 11% and by May 23rd we had recaptured that entire loss. By early July we had set an new all-time on the S&P 500. From that low pint in February of 2016 we have added on nearly 30% to the S&P 500 as of May 5, 2017.




Source BlackRock. For illustrative purposes only.

On the other hand, a 30% loss requires a 43% gain which obviously would take a substantially longer duration to recover from. While our approach might mean giving up some blockbuster numbers during equity market booms, it can also mean a potentially less treacherous fall on downturns. In the long run, that patient, steady (and studied) approach can be more successful for our clients.



Jackson Hole, Wyoming
Scottsdale, Arizona
Las Vegas, Nevada
WWW.WTWEALTHMANAGEMENT.COM

## WE CALL IT 'WIN MORE BY LOSING LESS.'

Drawdown protection is a particularly important dynamic when markets are volatile, which is what we expect for the remainder of this year. A portfolio built with some "buffers" is better equipped to weather those drawdowns and deliver superior results over full-market cycles, which typically take 5-7 years to be fully realized.

According to a recent study by Isaac Braley, president of BTS Asset Management of Lexington, Mass., 75 percent of a group of surveyed advisors emphasized capital preservation as a primary concern among investor clients. In addition, 45 percent said clients were mainly concerned about losses on equity investments, and 30 percent said clients were worried that their investments would not yield them sufficient returns to last them the rest of their lives. Furthermore, 99 percent said clients tended to buy an exchange-traded fund (ETF) based on its track record rather than its brand name.

If that were only true.

If we had the opportunity to do so, we would challenge other advisors on their stated criteria for purchasing ETFs. We commit to looking at industry asset flows every week, and we always find most fund flows channeling into the most prominent fund names, who are not necessarily the highest performers. Clearly the advisors in that survey want fund managers to reprise the actions they took in other strategies that apparently account for the success of those big brand names.

At WT Wealth Management, we believe those advisors are mistaking brand for track record. As a research-driven firm, we do not care about names. For we can best serve you, our clients, by not even looking at the names of the firms that sponsor our investment products. We crunch the numbers alone, and from only those numbers we determine where we believe the best upside participation may be coming from while protecting our downside participation.

We have understood the importance of consistent and hair-like returns for over a decade. During the financial crisis of 2008–2009, many investors had just broken even from the tech bubble of 2000–2001, when the financial disaster first struck. Our mantra has always been:

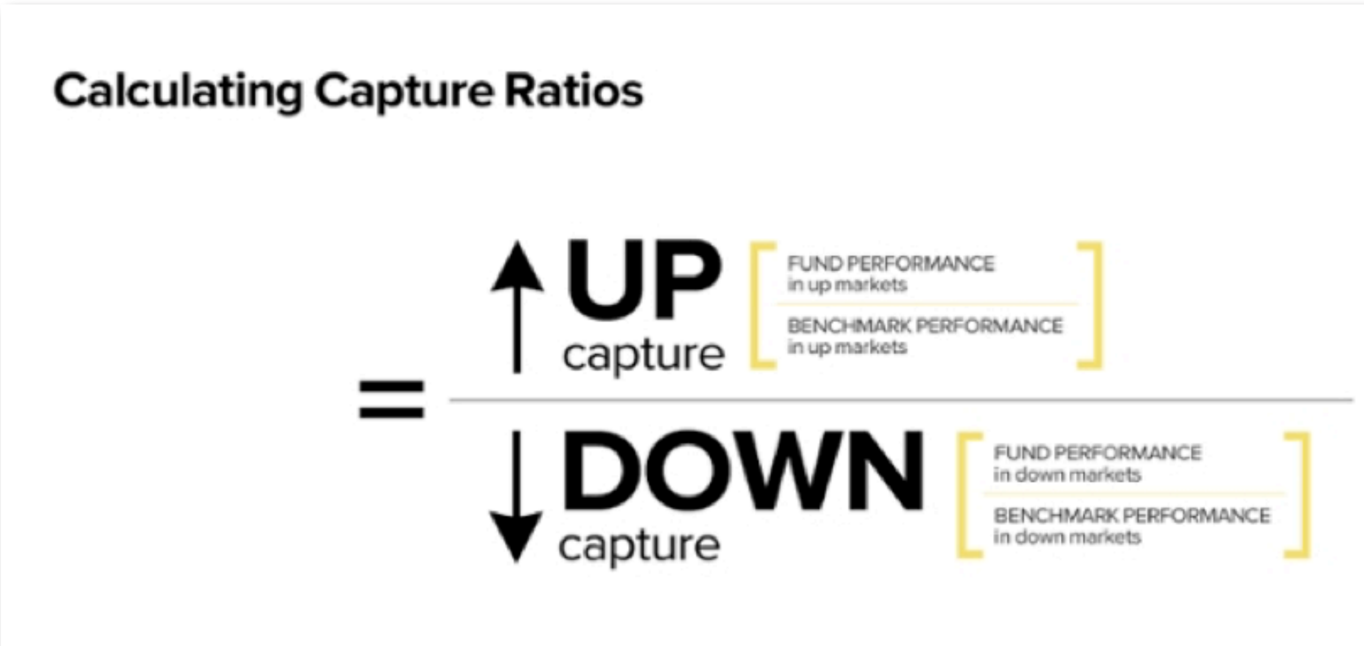
**PARTICIPATION IN RISING MARKETS**
**OUT-PERFORMANCE IN DECLINING MARKETS**
**PRESERVE CAPITAL**

How do we accomplish that? For years we have observed that a key statistic in selecting an investment is upside/downside capture ratio, which measures the degree to which a fund has underperformed or outperformed a market benchmark based on monthly returns during periods of market highs and lows.

If a fund's increase parallels that of the benchmark, the fund's upside capture is 100 percent. If the upside capture is 120 percent, then the fund rose 20 percent above the benchmark. An 80 percent ratio means the fund captured only 80 percent of the positive returns the benchmark enjoyed. Downside capture, however, compares the returns of a fund to the proper benchmark's negative returns in a particular fiscal period. A 2 percent decrease in a fund's returns while the benchmark has lowered 2 percent yields a 100 percent downside capture. If the downside capture were 80 percent, then the fund would fall 8 percent were the market to drop 10 percent. A 120 percent downside capture denotes that a 10 percent benchmark decline would give the fund a 12 percent loss, or a 20 percent greater loss than that of the benchmark.



WIN MORE CONTINUED ON P3




When we head out on the road, we learn more and more about our client's misconceptions. We take considerable time to explain to clients what it means for us at WT Wealth Management to take a measured approach to investing and to implement strategies to protect principal but still grow capital. We love it when lightbulbs go off and clients see our proven, measured approach to long-term wealth accumulation.

At WT Wealth Management, we had always believed that this approach was the best way to grow account values by limiting drawdowns. Then something exciting happened. This past February we attended the TD Ameritrade conference in San Diego and participated in a session with BlackRock Investments, the world's largest asset manager with $5.1 trillion —yes, that's trillion—under management.

A leader in creating low-volatility ETFs, BlackRock recently completed a study examining upside/downside capture ratios. They found that, since 2000, if you captured only 73% of every upside move and participated in 73% of every downside move, then you would have outperformed the S&P 500, and that 73/73 was the ultimate, perfect sweet-spot after looking at every combination from 1/1 to 100/100.

To us at WT Wealth Management, this reconfirmed that we had been on the right path for the past several years. It was an exciting turn of events for us.

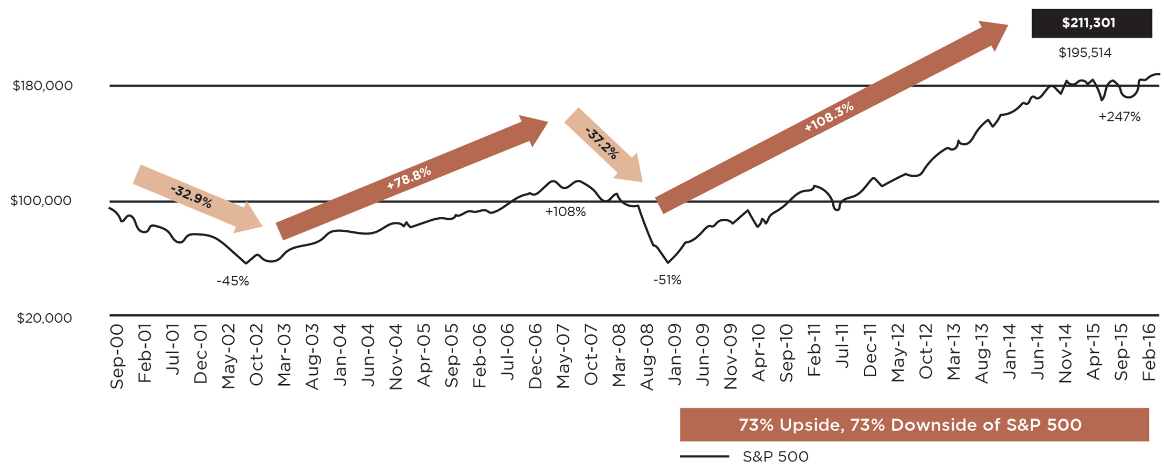


WIN MORE CONTINUED ON P4

## WE CALL IT 'WIN MORE BY LOSING LESS.' CONTINUED

Why Limiting Volatility (Downside Risk) is so Important
Optimal Upside/Downside Capture 73%

**S&P 500 versus 73% Upside / 73% Downside Capture (8/31/00-9/30/16)**




Source: Crestmont and Morningstar as of 9/30/16. Past performance does not guarantee or indicate or future results.

## CONCLUSION

Upside/downside capture ratio, in our opinion, is the most important but most overlooked statistic in mutual fund or ETF selection, for building a strong foundation and a stable base is fundamental to what we do.

At WT Wealth Management, we screen hundreds of ETFs to identify those with exceptional upside/downside capture ratios, exposure to sectors and industries we find most attractive, and low internal expenses. Every investor—large or small, aggressive or conservative, old or young—starts with these exceptional ETFs as a base, and then we branch outward to personalize your portfolio and deliver returns in accordance with your personal risk profile, time horizon and investment objectives.

When I show clients an ETF that has captured 110% or 120% of the upside and 65% or 70% of the downside of each S&P 500 move over the last three years, they think I have found the "holy grail." The truth is, I have—but only for a fleeting moment. I've seen the trailing one-year capture ratios flip-flop from super-good (150/50) to super-bad (50/150) in only three or four months. Nothing lasts forever, and the markets will become growth-biased, value-biased, momentum-biased, or defensive-biased in just a few short weeks. An ETF that seemed like easy pickings one year will be a thorny bush the next year.

So the moral of the story is: Don't expect every dollar of every upside move—but don't worry, you won't get every dollar of every downside move either. As the BlackRock study showed, if we can deliver a total capture ration on your portfolio in the 75% range, then we can outperform the S&P 500. The truth of the matter is, our



CONCLUSION CONTINUED ON P5

## CONCLUSION CONTINUED

expectations are higher, and we strive to obtain 80-85% of every upside move and 60-65% of every downside move, thus to generate return that surpasses even the 73/73 that Blackrock determined to have been the upside/downside sweet-spot since 2000.

**WIN MORE BY LOSING LESS.**

## DISCLOSURE

WT Wealth Management is a manager of Separately Managed Accounts (SMA). Past performance is no indication of future performance. With SMA's, performance can vary widely from investor to investor as each portfolio is individually constructed and allocation weightings are determined based on economic and market conditions the day the funds are invested. In a SMA you own individual ETFs and as managers we have the freedom and flexibility to tailor the portfolio to address your personal risk tolerance and investment objectives – thus making your account "separate" and distinct from all others we potentially managed.

An investment in the strategy is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

Any opinions expressed are the opinions of WT Wealth Management and its associates only. Information is neither an offer to buy or sell securities nor should it be interpreted as personal financial advice. You should always seek out the advice of a qualified investment professional before deciding to invest. Investing in stocks, bonds, mutual funds and ETFs carry certain specific risks and part or all of your account value can be lost.

In addition to the normal risks associated with investing, narrowly focused investments, investments in smaller companies, sector ETF's and investments in single countries typically exhibit higher volatility. International, Emerging Market and Frontier Market ETFs investments may involve risk of capital loss from unfavorable fluctuations in currency values, from differences in generally accepted accounting principles or from economic or political instability that other nation's experience. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Bonds, bond funds and bond ETFs will decrease in value as interest rates rise. A portion of a municipal bond fund's income may be subject to federal or state income taxes or the alternative minimum tax. Capital gains (short and long-term), if any, are subject to capital gains tax.

Diversification and asset allocation may not protect against market risk or a loss in your investment.

At WT Wealth Management we strongly suggest having a personal financial plan in place before making any investment decisions including understanding your personal risk tolerance and having clearly outlined investment objectives.

WT Wealth Management is a registered investment adviser in Arizona, California, Nevada, New York and Washington with offices in Scottsdale, AZ Jackson, WY and Las Vegas, NV. WT Wealth Management may only transact business in those states in which it is registered, or qualifies for an exemption or exclusion from registration requirements. Individualized responses to persons that involve either the effecting of transaction in securities, or the rendering of personalized investment advice for compensation, will not be made without registration or exemption. WT Wealth Managements web site is limited to the dissemination of general information pertaining to its advisory services, together with access to additional investment-related information, publications, and links.



DISCLOSURE CONTINUED ON P6

## DISCLOSURE

Accordingly, the publication of WT Wealth Management web site on the Internet should not be construed by any consumer and/or prospective client as WT Wealth Management solicitation to effect, or attempt to effect transactions in securities, or the rendering of personalized investment advice for compensation, over the Internet. Any subsequent, direct communication by WT Wealth Management with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information pertaining to the registration status of WT Wealth Management, please contact the state securities regulators for those states in which WT Wealth Management maintains a registration filing. A copy of WT Wealth Management's current written disclosure statement discussing WT Wealth Management's business operations, services, and fees is available at the SEC's investment adviser public information website – www.adviserinfo.sec.gov or from WT Wealth Management upon written request. WT Wealth Management does not make any representations or warranties as to the accuracy, timeliness, suitability, completeness, or relevance of any information prepared by any unaffiliated third party, whether linked to WT Wealth Management's web site or incorporated herein, and takes no responsibility therefor. All such information is provided solely for convenience purposes only and all users thereof should be guided accordingly.